

1998

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

CORPORATE LAW ECONOMIC REFORM PROGRAM BILL

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
the Hon Peter Costello, MP)

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Outline

1.1 This Bill will legislatively implement key elements of the Government's Corporate Law Economic Reform Program (CLERP) in the areas of Fundraising, Directors' Duties and Corporate Governance, Accounting Standards and Takeovers.

1.2 The Bill implements proposals to improve the operation of the Corporations Law (the Law) contained in CLERP Paper No. 1 (Accounting Standards — Building international opportunities for Australian business), CLERP Paper No. 2 (Fundraising — Capital raising initiatives to build enterprise and employment), CLERP Paper No. 3 (Directors' Duties and Corporate Governance — Facilitating innovation and protecting investors) and CLERP Paper No. 4 (Takeovers — Corporate control: a better environment for productive investment). Some proposals have been slightly modified in the light of public comment on draft provisions released for public exposure.

1.3 In relation to Directors' Duties and Corporate Governance, the Bill contains reforms designed to promote optimal corporate governance structures without compromising flexibility and innovation. A statutory form of business judgment rule is intended to protect the authority of directors in the exercise of their duties and to clarify their liability. The introduction of a statutory derivative action provides a new avenue of enforcement and action by shareholders where previously there has been a gap. It is not intended to impose a new form of liability on directors. Other measures, for example, clarification of the director's duty of care and diligence, and of the ability of directors to delegate functions and to rely on the advice of experts when making decisions, will give directors the confidence to engage in entrepreneurial or informed decision making.

1.4 The Takeover reforms contained in the Bill are designed to improve the efficiency of the market for corporate control while encouraging better management and enhancing investor protection. Takeovers, or the prospect of takeovers, provide benefits for shareholders, the corporate sector and the economy since they provide incentives for improved corporate efficiency and enhanced management discipline, leading ultimately to greater wealth creation. The reforms are aimed at ensuring that these incentives operate effectively.

1.5 In relation to Fundraising, the Bill contains reforms designed to minimise the costs of fundraising while improving investor protection. The purpose of the fundraising provisions is to promote the disclosure of information that investors reasonably require in order to make informed investment decisions. The reforms will promote the operation of informed markets and, by removing unnecessary impediments to fundraising, facilitate investment which is vital to Australia's economic performance. The reforms also seek to ensure that the fundraising rules provide an appropriate cost effective framework for capital raising by small, medium and large companies.

1.6 The Accounting Standards provisions in the Bill provide for the establishment of new institutional arrangements for the Australian accounting standard setting process and for the adoption of new procedures that must be followed by the standard setter when it is making or formulating accounting standards.

1.7 Other reforms arising from the proposals in CLERP Paper No.5 (Electronic Commerce — Cutting cybertape — building business) have been implemented in the *Payment Systems and Netting Act 1998* and the *Company Law Review Act 1998*. In relation to CLERP Paper No. 6 (Financial Markets and Investment Products — Promoting competition, financial innovation and investment), consultation papers regarding reforms relating to financial markets, financial intermediaries and investment products are expected to be released by the end of 1998.

Regulation impact statement

Background to proposed amendments

2.1 The Corporate Law Economic Reform Program has reviewed existing policy over the past 15 months of key areas of business regulation. The purpose of the program is to ensure that current regulation is consistent with the Government's economic objectives. In particular, it seeks to improve the efficiency of corporate regulation and reduce regulatory burdens on business. The reforms are aimed at facilitating a more efficient and competitive business environment.

Consultation

2.2 Under this program, the Government released policy papers containing detailed proposals and draft legislative provisions as a means of consulting widely. The Treasurer and the former Parliamentary Secretary to the Treasurer have consulted extensively with business and peak organisations, including through forums conducted in Adelaide, Brisbane, Hobart, Melbourne, Perth and Sydney.

2.3 So that the CLERP proposals could be developed in close consultation with business and community groups, the Government established the Business Regulation Advisory Group which represents key stakeholder organisations. This group was involved in the development of the policy proposals and reviewed all public submissions on the proposals. As well as key interest groups responding to the proposals, the Companies and Securities Advisory Committee and its Legal Committee which represent the business and professional communities have provided detailed comments on all the proposals. As noted above there has been strong support from the business community for the CLERP program as it is seen as addressing those issues that are of particular concern to business.

Problem identification and regulatory objectives

2.4 The current regulatory environment has failed to keep pace with changes occurring in financial markets and commercial practices. Liberalisation of world capital markets in combination with technological developments in information and telecommunication industries have fundamentally altered the way business operates. Australian firms are being exposed to greater international competition. In light of that, the regulatory framework needs to adapt to respond to challenges posed by changes in the way business is conducted. In addition, changes in investor behaviour which are reflected in growing financial sophistication require a reassessment of the regulatory framework.

2.5 The purpose of the review has been to develop a regulatory framework that is consistent, flexible, adaptable and cost effective. The objective of the CLERP program is to streamline the operation of regulation in order to improve the efficiency of the regulatory environment and to reduce costs on business and market participants. It seeks to reduce the transaction costs, remove barriers to entry for service providers and improve harmonisation of Australia's laws with those applying in major world financial markets.

2.6 To address these issues the CLERP reviewed the Law relating to the making of accounting standards and the regulation of directors' duties, fundraising and takeovers.

2.7 The following identifies problems with existing regulation, the key drivers for changes in these areas and the proposed solutions to meet these problems. Where applicable the options that were available to the Government are discussed. However, given that each of these areas are covered by existing regulation the recommended option in each of the areas is to amend the operation of existing regulation through making amendments to the Law.

Directors' duties

Problems/options

2.8 Directors are subject to both the general common law and a range of statutory duties (eg approving company financial statements, signing a prospectus). Directors have a contractual relationship with the company and a fiduciary relationship with shareholders. The Law codifies common law duties of loyalty and care. It also requires directors to exercise their powers in good faith and in the best interests of the company. A breach of requirements imposed under the Law may result in civil and/or criminal liability for directors.

2.9 Director uncertainty as to liability for decisions made in good faith is operating as an inhibitor of business activity and is leading to risk averse behaviour by directors. The option for the Government is to take no action and allow the courts to clarify this area of the Law. However, the courts have failed to provide clear guidance to directors on the level of skill and care expected of them, particularly in relation to the responsibilities and liability of executive and non-executive directors. The incremental approach of the courts has not clarified uncertainty in the operation of the Law.

2.10 At the same time shareholders are demanding greater accountability from directors. However, the Law does not provide an adequate remedy for shareholders who wish to take action on behalf of the company where directors have failed to do so.

Cost benefits

2.1 A clarification of directors' duties will lead to improved corporate governance practices and market confidence. Clarification of directors' duties will also lead to a reduction in agency costs by addressing the uncertainty of directors in decision making and thereby freeing them up to take calculated business risks to maximise company profits. Allowing directors to delegate and rely on judgments of employees of the company or other experts will give recognition to the complexity of management of large corporations and remove impediments to decision making and the efficient management of a corporation's business.

2.2 Providing an enhanced remedy for shareholders will increase incentives for management to conduct their affairs in the appropriate fashion. It may also lead to shareholders being more vigilant of the operations of management.

Feedback from public exposure

2.3 There is strong support from the business community for removal of uncertainty in relation to directors' duties and for the recognition of the changing role of directors in corporations. Investor groups strongly support the introduction of a statutory derivative action which is seen as remedying a key defect in shareholders rights at the present time.

Conclusion

2.4 The CLERP proposals recommend the introduction of a statutory business judgment rule to provide directors with the confidence that if they make informed business decisions in good faith they will meet their duty of care and diligence. This will remove the uncertainty for directors and should lead to better management processes within companies for the taking of decisions.

2.5 It is proposed to introduce a new action for shareholders, a statutory derivative action, to enable shareholders in a company to take action on behalf of the company where directors fail to do so. The Law will prescribe tight constraints on the availability of this action to ensure that it is not used by vexatious shareholders to usurp the appropriate management of the board.

Takeovers

Problems/options

2.6 The Law regulates the market for corporate control through prescriptive procedures to be followed in the launch and acceptance of a takeover bid. The Law imposes obligations on bidders and target companies for the purpose of ensuring that acquisitions of substantial parcels of shares are conducted in a transparent and equitable manner. As well as the black letter law, the Eggleston principles — rules to ensure sufficient information and fairness in takeovers — give jurisdiction to the Corporations and Securities Panel (the Panel) to declare conduct as unacceptable even if it does not involve a breach of the Law.

2.7 The current regulatory regime overly constrains takeover conduct. Too often litigation is used to as a defensive tactic and bidders are inhibited by having to enter into an auction for corporate control. The CLERP proposals assessed whether the code should be replaced or liberalised to facilitate changes in control. They also considered whether responsibility for adjudicating on takeover disputes should be taken away from the courts and given to a Panel which could reduce costs, speed up resolution of disputes and bring to bear greater market expertise in the adjudicative process.

2.8 The CLERP review concludes that takeovers are an essential element of a competitive business environment in that they allocate capital to its most productive uses by providing incentives for management to optimise performance. The concept of the equal opportunity principle whereby the premium for control is shared equally with all shareholders is to be retained as it contributes to investor confidence and market integrity.

Cost benefits

2.9 The retention of the equal opportunity rule encourages market integrity in Australian securities markets through providing certainty and confidence to investors. The introduction of a mandatory bid rule would remove an impediment to changes in corporate control by providing greater certainty to bidders. This would reduce the costs of making a takeover bid. Investors would benefit from being offered the best price paid in the past 4 months for the shares. Changes to the compulsory acquisition rules would reduce costs for companies by making it easier to rationalise corporate groups. Removing tactical litigation and disputes from the courts would lead to a more timely resolution of those matters reducing costs for the parties involved.

Feedback from public exposure

2.10 Market participants support the retention of the equal opportunity rule. There is strong support for the introduction of a mandatory bid procedure so long as the safeguards which are proposed for shareholders are included. There is strong support for a greater role for the Panel in the resolution of takeover disputes.

Conclusion

2.11 To improve the operation of the takeovers code, two key changes are proposed. The concept of a mandatory bid would be introduced whereby acquisitions above a statutory threshold would be permitted if the acquisition preceded the immediate announcement of a full takeover bid. This approach is intended to facilitate the making of takeover bids by reducing uncertainty as to the outcome of the bid. All shareholders will be required to be offered the highest price paid during the last 4 months.

2.12 The Panel will be given an enhanced role replacing the courts as the venue for dispute resolution during the period of the bid. Parties' rights to seek injunctive relief from the courts for contraventions of the black-letter takeover law will be removed. This will have the benefit of enabling takeover disputes to be resolved on a final basis within the period of the bid. As well, disputes will be reduced through the Panel being able to initiate changes to takeover documents and negotiate with parties to minimise areas of dispute.

Fundraising

Problems/options

2.13 A prospectus is required where funds are sought through the issue of securities. A prospectus is generally required to disclose information that investors and advisers reasonably require and reasonably expect to find in the prospectus to make an informed decision about the financial position and prospects of the corporation and the rights attaching to the securities.

2.14 Current regulation results in long and complicated prospectuses with high costs of preparation and distribution to fundraisers. In particular, uncertainty about the liability regime leads to excessive due diligence procedures. The current rules are a clear barrier to fundraising by small and medium sized enterprises (SMEs).

2.15 The CLERP proposals canvassed whether the general disclosure test should be retained or whether Australia should revert back to a checklist approach for disclosures.

Cost benefits

2.16 CLERP concluded that the advantage of the general disclosure test is that the quality of information available to the marketplace has improved since the introduction of the test. The check-list approach was easily circumvented by fundraisers and led to less meaningful disclosures to investors. Additionally, the onus was placed on the regulator to ensure that the check-list was fulfilled. In contrast, the general disclosure test places the onus on the fundraiser to provide such information as is necessary for investors to make an informed investment decision. Given this position, attention has been focussed on improving the operation of the fundraising rules by addressing the source of the high costs of prospectuses.

2.17 The use of short form prospectuses will lead to reductions in costs for fundraisers while at the same time improving disclosures to retail investors. As well distribution costs for fundraisers would be reduced. Allowing certain industries, eg the funds management industry, to use profile statements, which contain key information, will benefit investors by allowing them to compare similar investments.

2.18 Costs of fundraising will also be reduced by removing uncertainty as to liability for parties involved in the preparation of prospectus. Measures addressing small business fundraising would have a significant impact on attracting SMEs to undertake fundraising and reduce the transaction costs for those companies.

Feedback from public exposure

2.1 There is very strong support from the business community for the general disclosure test, removal of the uncertainty relating to liability for professionals involved in fundraising and for specific measures to facilitate SME fundraising.

Conclusion

2.2 The CLERP proposals provide a range of measures to improve the fundraising rules to facilitate the raising of investment capital by Australian companies. A fundraiser will be able to prepare a 2-part prospectus with a short form document being provided to retail investors with further additional information available on request.

2.3 The potential strict liability under the Trade Practices Act will be removed. The due diligence regime under the Law will provide a defence for mandatory disclosures where appropriate inquiries are made.

2.4 Issuers will be able to raise up to \$5 million through the issue of Offer Information Statements (OIS). The disclosure required by an OIS will be limited to certain specific matters. A warning will be provided to investors that the OIS only discloses material information already within the knowledge of the corporation, its directors or promoters.

2.5 The OIS is a specific measure aimed at facilitating SME fundraising. The limitations imposed with OISs are intended to ensure that the general disclosure rule would remain the paramount rule for fundraising. As well a corporation will be able to raise \$2 million each year from up to 20 persons. This should assist business angels making investments in SMEs. A corporation will also be able to more easily raise funds from sophisticated investors as high worth individuals will be able to invest amounts of less than \$500,000 in a corporation without the need for the corporation to prepare an OIS or a prospectus.

Accounting standards

Problems/options

2.6 Australian accounting standards have been found to be too prescriptive and overly technical, imposing excessive costs on business. Business considers that the standard setting process is captured by the accounting profession and that there is no real accountability to users. Australian accounting standards are not widely understood in international capital markets resulting in high capital costs for business. There is a strong push from some parts of business for Australia to embrace the greater use of standards set by the International Accounting Standards Committee (the IASC).

2.7 The options for the Government in this area are to either improve the existing process for the making of accounting standards and have a policy of moving towards adoption of international standards or, alternatively, as soon as possible, adopt without modification the standards set by the IASC.

Cost benefits

2.8 Companies and financial markets will derive significant benefits from improvements in the development of accounting standards. Greater involvement by business and stakeholders in the development of accounting standards will improve financial reporting. Compliance costs will be reduced for companies as accounting standards will become more easier to prepare. The move towards adoption of international accounting standards should reduce costs for companies operating in international capital markets.

Feedback from public exposure

2.9 The CLERP proposals have received strong support from the business community. However, some interest groups suggest that Australia should move more quickly to adopt international standards. It is proposed that the Government would take advice from the Financial Reporting Council (the FRC) and other interest groups before taking decision on when Australia should seek to move to adopt international standards. The FRC will report on the extent to which international accounting standards have been adopted in the world's major capital markets and whether it would be in Australia's best interests to adopt such standards.

Conclusion

2.10 It is proposed that a clear mandate be given to the standard setting body in relation to the objectives of standards, their development and interpretation. In the immediate future, Australia should continue to harmonise with IASC standards as far as possible. In the longer term, depending on the acceptance of international standards in overseas capital markets, Australia should adopt international standards as a basis for financial reporting by foreign and domestic companies.

2.11 The FRC, an advisory body representing key interest groups, will be established to oversee the accounting standard setting process. The FRC would approve the agenda/priorities and the business plan of the accounting setting body. The benefits of this proposal are that it would lead to greater stakeholder involvement in accounting standard setting and should lead to financial reporting which is more informative and useful to business and investors.

Implementation and review

2.12 The reforms are being implemented through changes to the Corporations Law. In addition, a plain English rewrite is being undertaken of the relevant areas of the Corporations Law. This will make the law more user friendly and reduce compliance costs for corporations and market participants.

2.13 The reforms in relation to SME fundraising, the mandatory bid for takeovers and enhanced role of the Takeovers Panel will be reviewed after 2 years.

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Financial impact statement

3.1 The Bill will reduce compliance costs for business by removing unnecessary regulation, reducing the complexity of the rules and simplifying their expression.

3.2 The Bill will remove the current immunity of the Federal Government from the fundraising provisions, except in relation to offers of government guaranteed debt securities. It is anticipated that this will not have any impact on government expenditure because the Federal Government currently undertakes privatisations as if the fundraising provisions applied.

3.3 The Bill will also remove the current immunity of the Federal Government from the takeover provisions. It is anticipated that this will not have any impact on government expenditure because there is limited Government activity in this area.

3.4 Any impact on government expenditure would be outweighed by competitive neutrality benefits, ensuring that government activity in these areas is subject to the same legal requirements as private sector activity.

4

Summary of key amendments proposed by the Bill

4.1 The key features of the new regulatory arrangements proposed by the Bill are in four main areas of the Law.

Directors' duties and corporate governance

4.2 The key features of the new regulatory arrangements proposed by the Bill are:

- **Introducing a business judgment rule**, which would offer directors a *safe harbour* from personal liability for breaches of the duty of care and diligence in relation to honest, informed and rational business judgments.
- **Introducing a statutory derivative action**, to enable shareholders or directors of a company to bring an action on behalf of the company, for a wrong done to the company where the company is unwilling or unable to do so.
- **Rewriting the existing duty to exercise care and diligence** in subsection 232(4) to clarify that the standard of care required by the duty must be assessed by reference to the particular circumstances of the officer concerned. A breach of the duty of care and diligence will give rise to civil consequences only, and will no longer provide a basis for an offence under the Law. Criminal liability will continue to apply to breaches of the duty to act honestly.
- **Delegation** — express legislative authority will be given to the board of directors to delegate their powers, subject to any restrictions in the constitution of the company.
- **Reliance** — directors will be expressly allowed to rely on the advice or information provided by experts when making decisions, as long as the director believes on reasonable grounds that the person relied upon is reliable and competent in relation to the matters concerned.
- **Reformulating the existing duty to act honestly** in subsection 232(2) to capture the fiduciary principles that a director or other officer of a corporation must exercise their powers and discharge their duties in good faith in what they believe to be in the best interests of the corporation and for a proper purpose. Breach of this will continue to attract both criminal and civil consequences.
- **Clarifying the duty of directors in situations of conflict of interest** to permit directors who serve on wholly owned subsidiaries to take into account the interest raised

by the nominating company in certain circumstances. It is to be noted that the provisions are not intended to codify the common law. The common law obligation to disclose conflicts of interest remains.

- **Recasting section 241 dealing with indemnification for legal expenses** to confine the matters for which a company or related body corporate may not give an indemnity for legal expenses to legal expenses incurred:
 - in defending or resisting a proceeding in which the person is found to have a liability for which the company may not indemnify the person; or
 - in defending or resisting criminal proceedings in which the person is found guilty; or
 - in defending or resisting proceedings brought by ASIC or a liquidator for a Court order if the grounds for making the order are found by the Court to have been established; or
 - in connection with proceedings for relief to the person under this Law in which the Court denies the relief.

4.3 The Bill will also rewrite without substantial change the remaining provisions in Parts 3.2 (Officers), 3.2A (Related Party Transactions), 3.4 (Oppression) and 9.4B (Civil Penalty Provisions) of the Law.

Takeovers

4.4 The key features of the new regulatory arrangements proposed by the Bill are to:

- **Promote a more competitive market for corporate control** by:
 - allowing a bidder to exceed the statutory threshold of 20 per cent of total voting rights to gain control of a target provided that the announcement of a full takeover bid — the mandatory bid — immediately follows the acquisition that takes the bidder through the threshold. The bid price must be the same as, or higher than, the best price paid by the bidder for shares in the target in the previous 4 months.
 - modifying the compulsory acquisition rules to:
 - : allow all types of securities (not just shares) to be compulsorily acquired;
 - : allow compulsory acquisitions to take place at any time (not just following a takeover bid);
 - : facilitate the acquisition of the outstanding securities in a class by any person who already holds 90 per cent of the class; and
 - : make it easier for majority shareholders to obtain the benefits of 100 per cent ownership by providing for the acquisition of all the securities, in all classes, of a target, where overwhelming ownership of the target by the majority shareholder can be demonstrated.
- **Improve resolution of takeover disputes** by reforming the Corporations and Securities Panel (Panel) so that it, rather than the courts or the Administrative Appeals

Tribunal (AAT), is the primary forum for resolving takeover matters. This will be achieved by:

- opening up access to the Panel to any interested party (rather than being limited to ASIC as at present);
 - except on the application of ASIC or another public authority of the Commonwealth or a State, ensuring that the courts will not grant injunctions during the bid period; and
 - having the Panel, rather than the AAT, deal with appeals against ASIC exemption and modification decisions relating to takeovers.
- **Extend the takeover provisions to listed managed investment schemes**, so that members of these schemes will have the same rights to share in a control premium as shareholders, while responsible entities of these schemes will face the same competitive pressure to perform as company directors.
 - **Streamline the rules for off-market and market bids**, including bringing together disclosure requirements into a bidder's statement (replacing the current Part A and Part C statements) and a target's statement (replacing the current Part B and Part D statements). These statements will facilitate better disclosure by replacing the checklist of content rules with a general disclosure requirement for all information material to a shareholder's decision whether or not to accept an offer.
 - **Rationalise liability provisions** by ensuring that the liability regime for the contents of takeover disclosure documents is generally consistent with that applying to the proposed new fundraising rules.

4.1 In addition, provisions in the Bill will have the effect of removing the overlapping application of section 52 of the Trade Practices Act to takeover activity, and removing governmental immunity of Federal government business enterprises from the takeover provisions.

Fundraising

4.2 The key features of the new regulatory arrangements proposed by the Bill are:

- **Small business fundraising** will be facilitated by:
 - allowing issuers to raise up to \$2 million each year from up to 20 persons without issuing a prospectus or other disclosure document;
 - allowing issuers to raise up to \$5 million under an offer information statement rather than a full prospectus. The statement will be required to disclose material information known to the issuer but it will not be necessary for the issuer to undertake the due diligence investigations required for prospectuses; and
 - extending the class of 'sophisticated investors' from whom an issuer can raise capital without issuing a prospectus or other disclosure document.
- **Facilitating shorter prospectuses** by reducing the volume of material provided to retail investors and providing retail investors with the information which will assist them, without unnecessary detail. Information which may be of interest primarily to professional

analysts and advisers can be mentioned in the prospectus and made available on request. In addition, ASIC will be empowered to allow the use of short profile statements in suitable industries. The full prospectus will be available on request.

- **Rationalising liability provisions** by removing the overlapping application of the Australian Securities and Investments Commission Act and corresponding provisions in the Fair Trading Acts of the States and Territories. In addition, changes proposed to the fundraising liability regime and associated defences will provide both issuers and investors with greater certainty about their rights and obligations under the Law. A uniform defence will be available to all persons acting with reasonable care. Professional advisers and experts will only be liable to investors for statements attributed to them with their consent. The rule reversing the onus of proof for forward-looking statements will be removed.
- **Reforming advertising restrictions** to enable information to be provided to the market about a proposed offer. Advertising of securities which are already traded on the Australian Stock Exchange (ASX) will be liberalised. Advertising of securities which are not already traded on the ASX will be restricted to basic information until a disclosure document has been issued.
- **Electronic commerce** will be facilitated by enabling fundraisers to issue disclosure documents in electronic form and distribute them via any medium, including the Internet.
- **Prospectus registration** will be replaced with a 7 day 'free look' period during which ASIC, market participants, financial journalists and others will be able to examine a prospectus before fundraising is permitted.
- **Removing governmental immunity** from the fundraising provisions of Federal government business enterprises and encouraging the States and Territories to follow suit.

4.3 The Bill will also complete the reform of fundraising provisions by rewriting the debenture provisions in Division 4 of Part 7.12 of the Law.

Accounting standards

4.4 The key features of the new regulatory arrangements proposed by the Bill are:

- **Establishing the Financial Reporting Council** as an advisory body with responsibility for the broad oversight of the Australian accounting standard setting process and for giving the Minister reports and advice on that process.
 - Members of the FRC would be appointed by the Minister on the basis of nominations made by peak professional, business and government organisations having an interest in the standard setting process.
 - Specific functions of the FRC would include:
 - : appointing the members of the standard setter (the Chairman of the standard setter would be appointed by the Minister);
 - : approving and monitoring the standard setter's priorities, business plan, budget and staffing arrangements;

- : monitoring the development of international accounting standards and furthering the harmonisation of Australian standards with international standards; and
- : promoting a greater role for international accounting standards in the Australian accounting standard setting process.
- **Reconstituting the standard setter, the Australian Accounting Standards Board (AASB)** as a body corporate, thus enabling it to employ staff and acquire property in its own right.
 - Functions of the AASB would include making accounting standards for the purposes of national scheme laws, formulating accounting standards for entities not established under national scheme laws and participating in the formulation of international accounting standards.
 - The AASB’s powers include engaging the staff and consultants needed to undertake its technical research and providing administrative support.
- **Facilitating interpretation of accounting standards** by setting out the objectives of the accounting standard setting provisions in the legislation and providing that accounting standards are to be interpreted in accordance with those objectives. In addition, each accounting standard would have to be interpreted in accordance with any ‘statement of purpose’ provision in the standard, so long as that statement was not inconsistent with the objectives of the standard setting provisions.
 - A body, based on the existing Urgent Issues Group (UIG), would be established by either the FRC or the AASB to provide guidance on urgent financial reporting issues.
- **Requiring a cost/benefit analysis** of the impact of a proposed accounting standard to be prepared by the AASB before:
 - making or formulating an Australian accounting standard;
 - providing comments on an exposure draft of an international accounting standard; or
 - proposing a standard for adoption as an international accounting standard.
- **Funding** — it is anticipated that funding of the new standard setting arrangements, which will be overseen by the FRC, will be provided by the Government, the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia (jointly) and preparers/users in the public and private sectors in broadly equal proportions.
- **International harmonisation** — the Minister would have the power to give the AASB a direction about the role of international accounting standards in the Australian accounting standard setting system but, before giving such a direction, would be required to consider a report from the FRC about the desirability of giving the direction.

Abbreviations

The following abbreviations are used in this Explanatory Memorandum.

AASB	Australian Accounting Standards Board
ASIC	Australian Securities and Investments Commission
ASX	Australian Stock Exchange
CLERP	Corporate Law Economic Reform Program
FRC	Financial Reporting Council
IASC	International Accounting Standards Committee
Law	Corporations Law
OIS	Offer Information Statements
Panel	Corporations and Securities Panel
SMEs	Small and medium sized enterprises
UIG	Urgent Issues Group

6

Directors' duties and corporate governance

Business Judgment Rule

6.1 In general terms a statutory business judgment rule will offer directors a *safe harbour* from personal liability in relation to honest, informed and rational business judgments.

6.2 The introduction into the Corporations Law (the Law) of a business judgment rule has been considered and recommended by various committees (Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties*, November 1989; Companies and Securities Law Review Committee (CSLRC), *Company Directors and Officers: Indemnification, Relief and Insurance*, 1990; House of Representatives Standing Committee on Legal and Constitutional Affairs, *Corporate Practices and the Rights of Shareholders*, 1991; Companies and Securities Advisory Committee (CASAC), *Directors' Duty of Care and Consequences of Breaches of Directors' Duties*, September 1991).

6.3 The fundamental purpose of the business judgment rule is to protect the authority of directors in the exercise of their duties, not to insulate directors from liability. While it is accepted that directors should be subject to a high level of accountability, a failure to expressly acknowledge that directors should not be liable for decisions made in good faith and with due care, may lead to failure by the company and its directors to take advantage of opportunities that involve responsible risk taking.

6.4 The statutory formulation of the business judgment rule will clarify and confirm the common law position that the Courts will rarely review *bona fide* business decisions. However the statutory formulation will provide a clear presumption in favour of a director's judgment. In particular, while the substantive duties of directors will remain unchanged, absent fraud or bad faith, the business judgment rule will allow directors the benefit of a presumption that, in making business decisions, if they have acted on an informed basis, in good faith, and in the honest belief that the decision was taken in the best interests of the company, they will not be challenged regarding the fulfilment of their duty of care and diligence.

6.5 Under proposed subsection 180(2) a director or other officer of a corporation will therefore be taken to have met the requirements of the duty of care and diligence as set out in proposed subsection 180(1) of the Law and the equivalent duty at common law or in equity in respect of a business judgment made by them if they fulfil all of the following requirements:

- the business judgment was made in good faith for a proper purpose;
- the director or other officer did not have a material personal interest in the subject matter of the business judgment;
- the director or other officer informed themselves about the subject matter of the business judgment to the extent they reasonably believed to be appropriate; and

- the director or other officer rationally believed that the business judgment was in the best interests of the corporation.

6.6 It will be presumed that a director's or officer's belief that a business judgment is in the best interests of the corporation is a rational belief unless no reasonable person in the position of the director or officer could hold that belief.

6.7 It should be noted that proposed subsection 180(2) only operates in respect of duties under proposed subsection 180(1) and the equivalent duty at common law or in equity including common law principles governing liability for negligence. The proposed business judgment rule does not operate in relation to any other provision of the Law or any other Act or any Regulation under which a director or other officer may be liable to make payment in relation to any of their acts or omissions as an officer.

6.8 The proposed provision does not apply, for example, to business judgments made by directors in the context of insolvent trading or in relation to misstatements in a prospectus or takeover document. These are discrete areas that are each regulated by a separate liability regime. The operation of the business judgment rule will be confined to cases involving decision making about the ordinary business operations of the company. For example, the decision to undertake a particular kind of business activity promoted in a prospectus would be the kind of business judgment to which the proposed rule may apply. However, compliance (or otherwise) with the prospectus requirements imposed by the Law would not be a decision to which the proposed rule could apply. In this regard, proposed subsection 180(3) specifically provides that a business judgment means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

6.9 Provided directors or other officers fulfil the requirements of proposed subsection 180(2) paragraphs (a) to (d):

- such directors have an explicit safe harbor, being effectively shielded from liability for any breach of their duty of care and diligence; and
- the merits of directors' business judgments are not subject to review by the Courts.

6.10 Proposed subsection 180(2) acts as a rebuttable presumption in favour of directors which, if rebutted by a plaintiff, would mean the plaintiff would then still have to establish that the officer had breached their duty of care and diligence.

Statutory Derivative Action

Proposed Part 2F.1A — Proceedings on behalf of a company and others

6.11 In recent years, a number of reports have recommended the introduction of a statutory derivative action to enable an individual shareholder to bring an action on behalf of a company for a wrong done against the company, where the company is unwilling or unable to do so.

6.12 The first of these reports was the 1990 report by the CSLRC entitled 'Enforcement of the Duties of Directors and Officers of a Company by means of a Statutory Derivative Action'. The CSLRC recommended that the *Companies Act 1981* be amended to enable the Court to grant a person leave to take derivative proceedings. The report included a draft provision, which formed the basis for consideration in subsequent reports (House of Representatives Standing Committee on Legal and Constitutional Affairs, *Corporate Practices and the Rights of Shareholders*, 1991;

Companies and Securities Law Review Committee (CSLRC), *Enforcement of the Duties of Directors and Officers of a Company by means of a Statutory Derivative Action*, Report No. 12, 1990; Legal Committee of Companies and Securities Advisory Committee (CASAC), *Statutory Derivative Action*, 1993).

6.13 The Corporate Law Economic Reform Program Proposal Paper No. 3, *Directors' Duties and Corporate Governance*, released on 20 October 1997, proposed a statutory derivative action as a measure to reduce the cost to the members and directors of a company of establishing and enforcing their relationship with one another.

Current position

6.14 Shareholder derivative proceedings may currently be pursued at common law under the so-called exceptions to the rule expounded in *Foss v Harbottle* that the company is the proper plaintiff for wrongs done to it. However, a number of practical and legal difficulties regarding the operation of the exception have meant that very few derivative actions have proceeded.

6.15 The main difficulties associated with the common law action centre around:

- the effect of ratification of the impugned conduct by the general meeting of shareholders (if effective, the purported ratification by a majority of shareholders could deny the company as a whole, and hence minority shareholders, any right of action against the directors);
- the lack of access to company funds by shareholders to finance the proceedings (where a shareholder seeks to enforce a right on behalf of a company, they are likely to be disinclined to risk having costs awarded against them in a case which will ultimately benefit the company as a whole, not just individual shareholders); and
- the strict criteria which need to be established before a Court may grant leave.

6.16 Appropriate checks and balances will be provided in the legislation to prevent abuse of the proceedings and to ensure that company managements are not undermined by vexatious litigation and that company funds are not expended unnecessarily.

6.17 In summary, the proposed statutory derivative action will allow an eligible applicant, which will include shareholders and directors, to commence proceedings on behalf of a company where the company is unwilling or unable to do so. Proceedings could be commenced in respect of wrongs done to the company and the company would benefit from successful actions.

Persons who may bring, or intervene in, proceedings on behalf of a company

6.18 To better reflect the nature of the proceedings involved, the term 'proceedings on behalf of a company' will be used rather than the term 'statutory derivative action' in the legislation.

6.19 Under the draft provisions, a person as defined, may commence or intervene on behalf of a company (proposed subsections 236(1) and (2)).

6.20 The proceedings could be in respect of a cause of action, which a company has against either:

- a director of the company for breach of duties owed to the company; or

- a third party for a breach of contract or in respect of a tortious act committed by that third party (it will however be presumed that where proceedings involve a third party, granting leave is not in the best interests of the company unless the contrary is proved (proposed subsection 237(3)).

6.21 The draft provisions will also allow a person to intervene in proceedings to which a company is a party, on behalf of the company, for the purpose of taking responsibility on behalf of the company for those proceedings, or for a particular step in those proceedings. This could include continuing, defending, discontinuing, compromising or settling the proceedings on behalf of the company.

6.22 To be able to commence or intervene in proceedings, in the name of, and on behalf of a company, a person will need to first apply for leave from the Court (proposed paragraph 236(1)(b) and proposed section 237).

No right of action except as provided in this part

6.23 The common (general) law derivative rights under the exceptions to the 'proper plaintiff' rule in *Foss v Harbottle* will be abolished. This is designed to promote certainty regarding the nature of the action and avoid confusion between any diverging principles relating to the statutory action and the common law action (proposed subsection 236(3)).

6.24 However, the common law personal action exception to the rule in *Foss v Harbottle* will remain, since under this action a member is not bringing or intervening in proceedings on behalf of the company (proposed section 236 note 3).

Who can apply for leave

6.25 Pursuant to proposed paragraph 236(1)(a), an application for leave will be able to be made by:

- members of the company (including those with a present entitlement to be registered);
- former members of a company or related body corporate; and
- directors and officers, present and former, of the company.

6.26 Under the common law, only members can institute derivative proceedings on behalf of a company.

6.27 Under the draft provisions, former members will be included because they may have been compelled to leave the company in view of the dispute potentially giving rise to the litigation on behalf of the company. Members and former members of a related body corporate will also be included as they may be adversely affected by the failure of the company to take action and therefore may have a legitimate interest in applying to commence a derivative action.

6.28 The conferral of standing on officers recognises that they are most likely to be the first to become aware of a right of action which is not being pursued by the company.

6.29 The CSLRC and the Standing Committee recommended the inclusion of former members and former directors.

6.30 The Australian Securities and Investments Commission (ASIC) is not included as an eligible applicant, as the basic policy objective of derivative proceedings is to provide an effective remedy for investors and to overcome the difficulties in *Foss v Harbottle* — there is no proper role for ASIC to bring such proceedings. In particular, the statutory action is not intended to be regulatory in nature, but to facilitate private parties to enforce existing rights attaching to the company — effectively, the action is designed to be a self help measure. In this regard, a statutory derivative action has the potential to remove some of the regulatory burden from ASIC by making it easier for investors themselves to protect the interests of a company. (There are other means by which ASIC may commence actions on behalf of investors, for example, under section 50 of the *ASIC Act*).

Criteria for granting leave

6.31 The Court will be required to grant leave if the following five criteria have been satisfied:

- inaction by the company (proposed paragraph 237(2)(a));
- the applicant is acting in good faith (proposed paragraph 237(2)(b));
- the action appears in the best interests of the company (proposed paragraph 237(2)(c));
- there is a serious question to be tried (proposed paragraph 237(2)(d)); and
- the applicant gave written notice to the company of the intention to apply for leave, and of the reasons for applying, at least 14 days before making the application, or circumstances are such that it is appropriate to grant leave in any case (proposed paragraph 237(2)(e)).

6.32 These criteria are aimed at preventing potentially vexatious or unmeritorious actions that would be detrimental to the company on whose behalf the action was taken. The criteria are based on recommendations of the CSLRC and were endorsed by CASAC and the House of Representatives Standing Committee on Legal and Constitutional Affairs.

6.33 The criteria seek to strike a balance between the need to provide a real avenue for applicants to seek redress on behalf of a company where it fails to do so and the need to prevent actions proceeding which have little likelihood of success.

Inaction by the company

6.34 As a practical matter, the company's response to any notice of intention to apply for a grant of leave would provide evidence relevant to this criterion. An applicant might also seek to discharge this criterion by demonstrating that the alleged wrongdoer has a dominant influence on the board of directors.

6.35 Ratification by the general meeting of any wrong committed against the company would be a matter for the Court to take into account under this criterion although it would not necessarily be decisive.

Applicant's good faith

6.36 In assessing whether an applicant is acting in good faith, the Court could be expected to have regard to whether:

- there was any complicity by the applicant in the matters complained of; and
- the application is being made in pursuit of an interest other than that of the company.

6.37 The good faith requirement is designed to prevent proceedings being used to further the purposes of the applicant, rather than the company as a whole.

Best interests of the company

6.38 This criterion would allow the Court to focus on the true nature and purpose of the proceedings. It would recognise that a company might have sound business reasons for not pursuing a cause of action open to it and that its management might legitimately have decided that the best interests of the company would be served by not taking action. For example, a decision may be taken in a case where, although it may be clear that there has been a breach of duty by a director, the loss to the company may only be nominal. In this case, the costs of taking proceedings may outweigh any benefit to the company.

6.39 The inclusion of this criterion would allow the Court to refuse to grant leave in these circumstances because the applicant for leave would not be able to show that to do so would be in the best interests of the company.

Third party actions

6.40 It is proposed that where the proceedings are by the company against a third party or by a third party against the company, it will be presumed that unless the contrary is proved, granting leave is not in the best interests of the company (proposed subsection 237(3)).

6.41 Decisions regarding arms-length transactions by the company are appropriately made by the board of directors, and generally it is not in the interests of a company for other persons to interfere in the smooth decision making processes of the board. The assumption is that such interference is not in the best interests of the company and it must be proven on a balance of probabilities that granting leave will, in fact, be in the best interests of the company.

6.42 It will therefore be presumed (unless the contrary is proven) that granting leave is not in the best interests of the company if:

- the company has decided not to bring or defend proceedings, or has decided to discontinue, settle or compromise the proceedings (proposed paragraph 237(3)(b)); and
- the directors who participated in that decision:
 - were acting in good faith for a proper purpose (proposed paragraph 237(3)(c)(i));
 - did not have a material personal interest in the decision (proposed paragraph 237(3)(c)(ii));

- informed themselves about the subject matter of the decision to the extent they reasonably believed appropriate (proposed paragraph 237(3)(c)(iii)); and
- rationally believed the decision was in the best interests of the company (proposed paragraph 237(3)(c)(iv)).

6.43 It will be assumed that the directors' belief that the decision was in the best interests of the company is rational, unless it is a belief that no reasonable person in their position would hold.

6.44 For the purposes of proposed subsection 237(3), a person will be a third party if:

- the company is a public company and the person is not a related party of the company; or
- the company is a proprietary company and the person would be a related party of the company if the company were a public company.

6.45 A 'related party' is defined in proposed section 228.

Serious question

6.46 The *serious question to be tried* test is familiar and regularly employed by the Courts in the context of interim injunction applications. The *serious question to be tried* test was preferred to the alternative of requiring the applicant to show a *prima facie* case. It is important in this regard that the application for leave to take proceedings is not turned into a trial of the substantive issues, without the applicant having the usual plaintiff's right to pre trial discovery and interrogatories. The applicant is simply required to show that proceedings should be commenced. On the other hand, this criterion would prevent the proceedings being abused by further frivolous or vexatious claims.

6.47 It is considered unnecessary as a precondition for relief for a shareholder to have to bring the matter before a general meeting of the company as the proposed provisions already require the Court to be satisfied that it is probable that the company would not itself bring the proceedings or take responsibility for them. In any case, this criterion would be difficult to establish without the applicant showing that it had in fact tried to gain the support of the company by at least attempting to convene a general meeting. There are also practical obstacles facing an applicant in requisitioning a general meeting. Unless the articles provide otherwise, the Law currently requires five per cent of total voting rights of all members to convene a meeting of the company.

6.48 Similarly, limiting derivative actions to those cases where a dominant shareholder is affecting the interests of the company could exclude from the application of derivative actions cases where directors have acted in breach of their duties to the company, unless those directors were also a dominant shareholder. It would also preclude the situation where several shareholders who held the balance of power acted in concert. In addition, it could be argued that the question of dominance is already addressed in the majority of cases under the oppression remedy, while the statutory derivative action is specifically designed to go beyond instances of strict oppression.

Notice of proceedings

6.49 The requirement on the applicant to set out in a notice the reasons for applying for leave and requiring the applicant to give 14 days notice, allows the company time to address the applicant's concerns prior to the hearing date. Failure by the company to take action would, after notice is

given, support the Court arriving at a conclusion that it is probable the company would not itself take proceedings.

6.50 The applicant does not need to meet the requirement of 14 days notice where it is not practical or expedient, thus allowing for an *ex parte* hearing where there is a need for urgent litigation.

Substitution of another person for the person granted leave

6.1 Proposed section 238 will allow for substitution of another person for the person who has already been granted leave to commence or intervene in the proceedings. Substitution might be required if later events compromise or negate the ability of the person to whom leave has been granted, to take responsibility for the proceedings.

6.2 The class of persons who may apply to be substituted under this provision is the same as that specified under proposed subsection 236(1)(a) in respect of making an application for leave.

Ratification or approval by members

6.3 Proposed section 239 will give the Court flexibility in dealing with the effect of ratification or approval by the members of the company of an alleged breach of a right or duty owed to the company.

6.4 The provision is designed to overcome restrictive rules associated with the common law derivative action, which effectively prevent a shareholder from taking a derivative action in respect of a ratifiable breach of duty. One of the reasons the common law action has been used so infrequently is that a member of a company may be precluded from bringing an action if the conduct about which redress is being sought against directors of the company is capable of being, or has been, ratified by the general meeting of members.

6.5 The approach adopted in the draft provisions is intended to avoid the need to determine what are ratifiable and what are non-ratifiable decisions/actions, and whether a decision/action has been effectively ratified.

6.6 In some circumstances judicial action may be preferable to action by the shareholders and the applicant should be permitted to commence litigation irrespective of shareholder approval.

6.7 To ensure that this can occur, proposed subsection 239(1) will state that the law relating to the effect of ratification or an approval of conduct does not apply to either the application for leave or the proceedings in respect of which leave has been granted.

6.8 Proposed subsection 239(2) will provide that the Court may take into account a ratification or approval of conduct in deciding what order or judgment (including as to damages) to make. However, the provision will make it clear that the Court may only have regard to ratification if it is satisfied that the ratification was effected by the company's fully informed independent members.

Leave to discontinue, compromise or settle derivative proceedings

6.9 An important aspect of the new provisions will be that the person having charge of the conduct of the proceedings will not be permitted to discontinue, compromise or settle the proceedings without the Court being able to consider if that is in the best interests of the company. This has the added benefit of enabling the Court to prevent any collusion between the person

conducting the proceedings and the defendants, which might benefit that person but not the company (proposed section 240).

General powers of the Court

6.10 In addition to the usual orders which a Court may make pursuant to relevant Court rules, the Court will be able to make an order directing the company or an officer of the company to do or refrain from doing any act (proposed paragraph 241(1)(c)).

6.11 Pursuant to proposed paragraph 241(1)(d), the Court will also be able to make an order appointing an independent person to investigate and report to the Court on:

- the financial affairs of the company;
- facts surrounding the circumstances which gave rise to the cause of action; and
- funds expended by both sides during proceedings.

6.12 To enable an investigation to be effectively carried out, the Court appointed investigator will be provided with a right to inspect the books of the company provided the inspection is for a purpose connected with their appointment and reasonable notice is given to the company (proposed subsection 241(2)).

6.13 As the Court appointed investigator will effectively be an officer of the Court, they would be required to protect the confidentiality of any information obtained in the course of their investigation except as provided by the Court.

6.14 The proposed provision is principally designed to ensure that where an action is being funded by the company, the Court will be able to find out independently of the parties whether shareholders' funds are being expended in a reasonable manner and whether a complaint constitutes a good cause of action.

Costs orders

6.15 Under the rules of Court, the Court has power to make orders in respect of the costs of the parties. However, in proceedings brought or intervened in with leave pursuant to proposed section 237, the company will be the party to the proceedings, not the applicant. Accordingly, it is necessary to include a specific provision dealing with costs in relation to proceedings on behalf of a company.

6.16 Proposed subsection 242 gives the Court a broad discretion to make any orders it considers appropriate about the costs of the applicant, the company or any other party to the proceedings or the application.

6.17 Orders can be made in respect of the application for leave or the proceedings, and can include requiring indemnification for costs.

6.18 Where an independent investigator is appointed pursuant to proposed paragraph 241(1)(d), the Court may make or vary an order under proposed paragraph 241(3)(c) stating whom out of the parties to the proceedings, or the company itself, is liable for the remuneration and expenses of the person appointed. Where two or more persons are to be liable for the costs of the investigator, the Court's order may also determine the nature and extent of each of those persons liability (proposed paragraph 241(3)(d)).

6.19 The Court's discretion regarding the allocation of costs is aimed at providing an additional safeguard in respect of use of company funds. In particular, the Court would be able to protect a bona fide shareholder against liability for costs indemnifying them out of company funds while at the same time allowing the Court a further means of discouraging unmeritorious or doubtful action. This reflects the position that the company itself is the beneficiary in a successful derivative action.

6.20 In addition, if a shareholder were successful in an action, the costs would not necessarily fall on the company but on the defendants to the action. If the action was not successful, the applicant may have costs awarded against them, especially if the action was ultimately considered frivolous. The exercise of the Court's decision in this regard would probably depend on the merits of the case.

Duties of Officers and Employees

6.21 The draft provisions rewrite the duties of officers and employees in current section 232 of the Law to make it easier for company officers to know what is expected of them.

6.22 The draft provisions define officer to include a director or secretary as well as certain other persons who may manage the company, but not employees (proposed subsection 179(2)). Where an obligation imposed by the Law applies to employees, as well as officers, the Law will state this.

Care and diligence

6.23 The duty of care and diligence in current section 232(4) will be rewritten to clarify the standard of care and diligence required of an officer (proposed section 180).

6.24 Current section 232(4) was inserted by the *Corporate Law Reform Act 1992* to provide that 'an officer of a corporation must exercise a degree of care and diligence that a reasonable person in a like position in a corporation would exercise in the corporation's circumstances'. The explanatory memorandum indicated that the words 'in a like position' were intended to allow consideration of the special background, qualifications and management responsibilities of a particular officer in evaluating their compliance with the standard of care.

6.25 However, doubt has been expressed about whether current section 232(4) enables the Courts to have regard to the circumstances of the particular officer as well as their position in the corporation. The draft provisions have been rewritten to clarify that whether the officer has breached the standard of care and diligence is determined both by regard to the corporation's circumstances and the officer's position and responsibilities within the corporation (proposed subsection 180(1)).

Civil penalty

6.1 It is proposed that a breach of the duty of care and diligence will only give rise to civil sanctions and will no longer provide a basis for an offence under the Law. Under subsection 1317FA (1) of the Law, a breach of the duty of care and diligence in subsection 232(4) undertaken with a dishonest intent amounts to an offence punishable by a maximum fine of \$200,000 or five years imprisonment, or both. However, the concept of negligence is inconsistent with dishonesty, in that dishonesty suggests an active awareness of wrong doing, rather than a failure to exercise sufficient care and diligence. Criminal liability will continue to apply to breaches of the duty to act honestly.

Good faith

6.2 Current section 232(2) requires officers to act honestly. The draft provisions will rewrite section 232(2) to require officers to exercise their powers and discharge their duties in good faith in what they believe to be in the best interests of the corporation and for a proper purpose (proposed section 181).

6.3 There have been different views about what constitutes a contravention of current section 232(2). One view was that a contravention occurred when a person exercised their powers for a purpose that the law considered improper, regardless of whether the person considered they were acting in the best interests of the corporation: *Southern Resources Ltd v Residues Treatment & Trading Co Ltd* (1990) 3 ACSR 207. The alternative view was that a contravention required knowledge that what was being done was not in the interests of the company, and deliberate conduct in disregard of that knowledge: *Marchesi v Barnes* [1970] VR 434. This was based on the assumption that, as a contravention could have criminal consequences, a person should only be liable if they had a criminal intent.

6.4 The civil penalty provisions were intended to overcome these difficulties by clearly stipulating that a contravention constituted a criminal offence only if accompanied by the fault elements set out in section 1317FA. The civil penalty provisions were also intended to make it clear that for a company to recover compensation or profits from a director as a result of a contravention it is not necessary to establish a fault element.

6.5 The draft provisions will reinforce the distinction between civil obligations and criminal offences, and the intent that each requires, not only in respect of the duty to act in good faith etc, but also other duties in the Law, by clearly distinguishing each in the relevant sections. For instance, the draft provisions divide the duty of honesty into a civil obligation (proposed section 181) and a criminal obligation (proposed section 184). A contravention of the requirements concerning good faith, use of position or information will be criminal offences only if dishonest and committed intentionally or recklessly. The offence relating to an officer's duty of care and diligence will be repealed.

6.6 However, there are other difficulties with the current provisions. In particular, it is difficult to reconcile the use of 'honestly' as an element of the duty in current section 232(2) with the inclusion of 'dishonestly' as one of the fault elements in current section 1317FA. The provisions were described as 'extremely complex and arguably unworkable' by the Model Criminal Code Officers Committee of the Standing Committee of Attorney General's in its June 1996 discussion paper, *Conspiracy to Defraud*.

6.7 The draft provisions overcome these difficulties by rewriting section 232(2) to mirror the fiduciary duty of a director to act in what they believe to be in the best interests of the corporation and for proper purposes.

Restrictions on indemnities and insurance for officers and auditors

6.8 The draft provisions clarify the legal costs exception to the statutory prohibition on a company or related body corporate indemnifying or exempting an officer or auditor of the company, from liability incurred in that capacity.

6.9 It is proposed that the provisions concerning indemnification be rewritten to state all circumstances in which indemnification and exemption of officers or auditors is not permitted. As is currently the case, it is proposed that exemptions in respect of officers or auditors by the

company, for a liability owed to a company, will not be permitted at all. Indemnification will be permitted in circumstances other than those expressly prohibited.

No exemptions

6.10 There are proposed to be no exceptions to the rule that a company or related body corporate must not exempt a person (whether directly or through an interposed entity) from a liability to the company, incurred as an officer or auditor of the company (proposed subsection 199A(1)).

Prohibition on an indemnity for liability (other than for legal costs)

6.11 Proposed subsection 199A(2) sets out the circumstances in which it is proposed to prohibit an indemnity by the company, for a liability owed to the company. The proposed provision does not apply to a liability for legal costs.

6.12 A company or related body corporate will not be able to indemnify a person:

- for any liability owed to the company or a related body corporate, where the liability is incurred as an officer or auditor of the company (proposed paragraph 199A(2)(a)); or
- for a civil penalty order made under proposed section 1317G or a compensation order under proposed section 1317H (proposed paragraph 199A(2)(b)); or
- for any liability owed to someone other than the company or a related body corporate, that did not arise out of conduct in good faith (proposed paragraph 199A(2)(c)).

6.13 An indemnity of this type will be prohibited whether it occurs through an agreement or by making a payment and whether directly or through an interposed entity.

Prohibition on an indemnity for legal costs

6.14 An officer or auditor of a company will not be able to be indemnified by the company or a related body corporate against legal costs incurred in defending an action for a liability to the company if the costs are incurred:

- in defending or resisting proceedings under which the officer or auditor is liable, for a liability for which they cannot be indemnified pursuant to proposed subsection 199A(2) (proposed paragraph 199A(3)(a)); or
- in defending or resisting criminal proceedings in which the person has been found guilty (proposed paragraph 199A(3)(b)); or
- in defending or resisting proceedings brought by the ASIC or a liquidator for a court order, if the grounds for making the order are found to have been established (proposed paragraph 199A(3)(c)); or
- in circumstances where the Court has denied relief sought by the person (proposed paragraph 199A(3)(d)).

6.15 It should be noted however that proposed paragraph 199A(3)(c) does not apply to costs incurred in responding to actions taken by the ASIC, or a liquidator, as part of an investigation, before commencing proceedings for the court order. Legal costs incurred in these circumstances will be able to be indemnified, even if grounds for making orders in proceedings later taken by the ASIC or a liquidator, are found by the Court to have been made out.

6.16 One of the concerns about the operation of the indemnity provisions has been that a person is not entitled to an indemnity until the outcome of the relevant proceedings is known. Substantial liability may be incurred (for example, on-going legal costs) during the course of a proceeding, which are unable to be paid to the indemnified officer, until the outcome of the proceedings is known. To address this, as indicated in Note 2 to proposed section 199A, the company may be able to give a person a loan or advance in respect of legal costs. Once the outcome of the proceedings is known, the person would be either obliged to pay back the loan or advance, if not entitled to an indemnity, or may retain the loan moneys as the indemnity to which the person is now entitled.

Clarification of the liability of directors in situations of conflict of interest

6.17 Proposed section 187 clarifies the issue of conflict of interest faced by directors where they are a director of two or more companies and to permit directors who serve on wholly owned subsidiaries, to take into account the interests raised by the nominating company, in addressing their tasks.

6.18 The proposed new provision is designed to give directors some certainty in the performance of their obligations as the problem of conflict of interest is potentially one that will increase given the growing complexity of corporate groups and the limited pool of people from which directors are drawn in Australia, resulting in many directors of public companies taking on multiple directorships.

6.19 The proposed provision is based on S.131(2) of the *New Zealand Companies Act 1993* and gives legislative expression to the current state of the common law in this area.

6.20 Proposed section 187 provides that a director of a wholly owned subsidiary is taken to act in good faith in the best interests of the subsidiary where the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company, and the director has acted in good faith in the best interests of the holding company.

6.21 The proposed section limits the operation of the provision to where the subsidiary is solvent at the time the director acts and does not become insolvent because of the director's action. The purpose of this limitation is to protect the interests of creditors of the subsidiary.

Reliance on Information Provided by Others and the Delegation of Responsibilities

6.22 Doubts have been expressed about the extent to which it is permissible for directors, non executive directors in particular, to delegate functions to, and rely on, advice and information provided by others. Uncertainty about the circumstances in which it is appropriate for a director to delegate to, or place reliance on the advice of others could lead to an overly conservative approach to management and could impede the decision-making processes within a company. This is a less than optimal outcome and is not conducive to the development of sound corporate governance practices such as putting in place appropriate board committee systems. To remedy this, it is proposed to provide specific legislative authority for delegation and reliance by directors.

Reliance by directors on information and advice provided by others

6.23 Under proposed section 189, in determining whether a director has fulfilled their duties as a director in relying on information, professional or expert advice, provided by others, it will be presumed that reliance by a director is reasonable if the director:

Summary of key amendments proposed by the Bill

- acted in good faith (proposed paragraph 189(b)(i)); and
- made proper inquiry if the circumstances indicated the need for inquiry (proposed paragraph 189(b)(ii)).

6.24 The protection afforded by the proposed provision to a director in relying on information or advice provided by others will be limited to proceedings brought to determine whether a director has performed a duty under the proposed Part, or an equivalent general law duty.

6.25 The presumption that the director's reliance is reasonable, is rebuttable — the director's reliance on the information or advice is taken to be reasonable in the circumstances set out above, unless the contrary is proved.

6.26 Proposed subsection 189(a) will provide that in exercising their powers or performing their duties under the proposed Part, or the equivalent general law duty, a director may rely on information or professional or expert advice supplied by:

- an employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters the subject of the employee's advice (proposed paragraph 189(a)(i)); or
- professional advisers or experts where the director believes on reasonable grounds that the relevant matters are within the person's professional or expert competence advice (proposed paragraph 189(a)(ii)); or
- another director or officer in relation to matters within the director's or officer's designated authority advice (proposed paragraph 189(a)(iii)); or
- a committee of directors on which the director did not serve in relation to matters within the committee's designated authority advice (proposed paragraph 189(a)(iv)).

Delegation

6.1 Proposed section 190 provides specific legislative authority as to the circumstances in which the board of directors may validly exercise their powers or perform their duties by delegating to others.

6.2 Under proposed subsection 190(1) a director will be responsible for the exercise of the power by the delegate as if the power had been exercised by the directors.

6.3 However, under proposed subsection 190(2), a director will not be responsible for the acts of the delegate if the director believed:

- on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on directors of the company by the Law and the company's constitution; and
- that the delegate was reliable and competent in relation to the power delegated. The director's belief must be based on reasonable grounds, arrived at in good faith and after making proper inquiry, if the circumstances indicated the need for inquiry.

6.4 If the delegate acts fraudulently or outside the scope of their delegation, provided a director has fulfilled the above requirements, they will be taken (in so far as they have relied on the delegate) to have fulfilled their duty as a director.

Right of Access to Company Books

6.5 Proposed section 198F is designed to ensure that directors (and former directors) will have sufficient legally enforceable rights of access to company documents.

6.6 At common law, a director has a right of access to all company information necessary to enable the director to discharge his or her fiduciary or statutory obligations (*State of South Australia v Barrett* (1995) 13 ACLC 1369, 1372, 1376; *Kriewaldt v Independent Direction Ltd* (1995) 14 ACLC 73, 75). However, such information may only be used by the director for the purposes of the company (Barrett, *supra*, at 1372, 1376; Kriewaldt, *supra*, at 76). For example, if a director is being sued by the company for an alleged breach of duty owed to the company, it can be difficult for the director to demonstrate that access to documents (perhaps crucial to their defence) would be ‘for the purposes of the company’. This can particularly be a problem for retired directors.

6.7 Proposed section 198F will allow current and retired directors a legally enforceable right of access at all reasonable times to the books of the company in which they are or were a director (proposed subsections 198F(1) and (2)). The right of access is to continue for a period of 7 years after a person ceases to be a director of the company (proposed subsection 198F(2)).

6.8 The right of inspection (other than for financial records) is limited to where the director requires access for the purposes of a legal proceeding to which the director is a party, or proposes in good faith to bring, or has a reasonable belief will be brought against them (proposed subsection 198F(1)).

6.9 A person authorised to inspect the books of the company for the purposes of a legal proceeding may make copies of the books for the purposes of the proceedings (proposed subsection 198F(3)). The company must not refuse access to a person in the exercise of their rights to inspect or take copies of the books (proposed subsection 198F(4)).

Rewrite

6.10 The draft provisions will rewrite without substantial change the existing provisions of the Law about Officers (Part 3.2), Related Party Transactions (Part 3.2A), Oppression (Part 3.4) and Civil Penalties (Part 9.4B). The following paragraphs outline the more significant changes proposed to be made to these provisions in the course of rewriting them.

Material personal interests

6.11 Current section 231 requires a director of a proprietary company to disclose at a director’s meeting interests in contracts and proposed contracts in which the director is either directly or indirectly interested and offices or property held by the director which might give rise to future conflicts of interest. It does not seem appropriate to confine this disclosure obligation to contracts, proposed contracts, offices and property. Other conflicts may be just as prejudicial to the company’s interests. Subject to the exceptions set out below, it is proposed to apply the disclosure obligation to any material personal interest a director has in a matter relating to the affairs of the company.

6.12 Under current section 232A, a director of a public company must not vote on a matter in which the director has a material personal interest, and must not be present when the matter is being considered by the board. The board or ASIC may permit the director to vote or participate in the board’s consideration of the matter. However, the director is not required by the Law to disclose that they have an interest in a matter before the board. It is proposed to remove this

anomaly by requiring that the directors of public companies must always disclose matters in which they have a material personal interest.

6.13 These two changes would bring into line the basic disclosure obligation of directors of public and proprietary companies.

6.14 Proprietary company directors are currently able to fulfil their disclosure obligation in relation to any future contracts between the company and other companies or firms in which they have an interest by giving the other directors a general notice setting out the nature and extent of their interest in those other companies or firms (current section 231). It is proposed to make this procedure available to both public and proprietary company directors and in relation to all matters, not just contracts. The notice will expire if a new director is appointed to the board and the new director is not given the notice. The notice will have effect again as soon as it is given to the new director.

6.15 Current section 231 does not apply to a director's interest in certain contracts. Similarly, under current section 232A, a director is taken to not have a material personal interest in certain insurance contracts. It is proposed to apply each of the current exceptions in sections 231 and 231A to the directors' duty to disclose conflicts of interest and, in the case of public company directors, absent themselves from certain board meetings.

6.16 In recognition of the closely held, often family, nature of many proprietary companies, a director of a proprietary company will not be required to give notice of conflicts of interest where the other directors are aware of the nature and extent of the director's conflict of interest.

Company secretaries

6.1 The *First Corporate Law Simplification Act 1995* allowed the registration of proprietary companies with one director and one member. The requirement for proprietary companies to appoint a company secretary is an unnecessary regulatory burden. It is also inconsistent with the goal of allowing the registration of single-person companies (unless the same person is appointed as both director and secretary). New Zealand and Canada no longer require companies to appoint a secretary. It is therefore proposed to remove the requirement for proprietary companies to appoint a secretary. However, public companies will continue to be required to appoint a secretary in light of the importance of the corporate governance function played by the secretary in these companies.

6.2 It is proposed to amend the rules about when a secretary will be liable for a company's failure to comply with its statutory obligations to:

- maintain a registered office;
- keep its registered office open to the public during certain hours (the Company Law Review Bill will repeal this obligation for proprietary companies);
- lodge an annual return with ASIC; and
- lodge notices about the personal details of its directors and secretaries with ASIC.

6.3 Current subsection 83(2) provides that a secretary is deemed (unless the contrary is proved) to be knowingly concerned in and party to any contravention by the company of these obligations. The secretary will be guilty of an offence unless they can show that they were not knowingly concerned in the company's contravention.

6.4 It is proposed that current subsection 83(2) be replaced by a requirement that the secretary ensure that the company complies with these obligations. The secretary will have a defence if they can show that they took all reasonable steps to ensure that the company complied with the obligation. In the case of a proprietary company that has not appointed a secretary, each director will be guilty of an offence, and have available the same defence, if the company fails to comply with its obligations.

Related-party transactions

6.5 Part 3.2A of the Law regulates related party transactions involving public companies. It is proposed to make minor policy changes in the following areas:

- definition of ‘related party’;
- reasonable remuneration; and
- consequences of contravention.

Definition of ‘related party’

6.1 The definition of ‘related party’ includes entities which ‘control’ the public company. However, ‘control’ is currently defined by reference to the accounting standards. It is therefore necessary for users of the Law to refer to external material to understand their obligations under the Law. It is proposed to overcome this by inserting into the Law a test for control based on the accounting standards.

Reasonable remuneration

6.2 The Law currently exempts reasonable remuneration given to an officer from the related-party provisions.

6.3 The reasonable remuneration that may currently be given to an officer includes an indemnity or insurance premium in respect of a liability incurred as an officer. In the light of suggestions that it is not appropriate to count these indemnities and insurance premiums as remuneration, it is proposed to include a separate section exempting from the requirement for shareholder approval a reasonable indemnity or insurance premium given to an officer who is a related party. The reasonableness of the indemnity or premium would also be assessed as at the time the company agrees to make the payment, not when the payment is actually made under the indemnity or insurance contract.

Consequences of contravention

6.4 Currently, a related party who is given a financial benefit in contravention of the prohibition contravenes the Law even though they may not have sought the benefit. It is proposed to provide instead that a related party contravenes the Law only if they are involved in the contravention of the related-party provisions.

Civil penalty provisions

6.5 The draft provisions contain a rewrite of the civil penalty provisions in Part 9.4B of the Law. The civil penalty provisions apply to contraventions of certain specified sections (such as the duty on directors to prevent insolvent trading). If a person has contravened these provisions, the Court can make the following orders:

- a declaration that the person has contravened the provision;
- an order disqualifying the person from being a director or officer of a company for such period as it thinks fit; and
- if the contravention is serious, a pecuniary penalty payable to the Commonwealth of an amount up to \$200,000.

6.6 A contravention of a civil penalty provision may also give rise to a criminal offence, if the contravention is accompanied by dishonesty. The civil penalty provisions currently include a number of complex provisions designed to address the situation where a prosecution for the criminal offence has failed, but the court is satisfied that there has been a contravention of the relevant civil penalty provision. In these circumstances the court is currently able to make a civil penalty order. It is proposed to repeal these provisions. Instead, where a criminal prosecution has failed, ASIC would have to commence fresh proceedings to obtain a civil penalty order.

6.7 Currently, the commencement of proceedings for a civil penalty order is a bar to a subsequent prosecution for the corresponding criminal offence. This is intended to prevent evidence obtained in the course of the civil proceedings being used in subsequent criminal proceedings. However, the rule does not operate as a bar to commencing criminal prosecutions under other Acts (for example, the *Crimes Act*). It also provides a significant disincentive for ASIC to commence civil penalty proceedings.

6.8 It is proposed to repeal the bar and provide instead that evidence given in the course of proceedings for a pecuniary penalty order is not admissible against the person in a prosecution for a criminal offence constituted by substantially similar conduct. This is designed to prevent the evidence being used in the prosecution of any offence involving substantially similar conduct, not merely in the criminal prosecution of offences established by the civil penalty provisions. It will also allow a later prosecution to commence where this would be appropriate, without prejudice to the defendant's right to a fair trial because of the earlier proceedings for a pecuniary penalty order.

6.9 It is proposed to remove the power of a criminal court to make a compensation order against a defendant who has not been found guilty. This will make it necessary for ASIC to begin fresh civil proceedings if it wishes to pursue civil remedies following an unsuccessful prosecution.

Oppression

6.1 It is also proposed to rewrite the oppression remedy without making any significant change. It is proposed to make three minor changes to the oppression namely:

- to make it clear that the Court will be able to make orders even if the act, omission or conduct complained of has yet to occur or has ceased;
- if the Court orders the company to be wound up, the provisions relating to a company being wound up by the court under section 461 of the Law are to apply; and
- to repeal the existing prohibition on making a winding-up order where that would unfairly prejudice the oppressed members, because this is an unnecessary fetter on the Court's discretion.

Consequential Amendments to the *Commonwealth Authorities and Companies Act 1997* (the CAC Act)

6.1 The reforms to directors' duties and corporate governance introduced by CLERP will apply to Commonwealth companies (defined in section 34 of the CAC Act as Corporations Law companies in which the Commonwealth has a controlling interest). The CAC Act will be amended to apply the reforms, where appropriate, to Commonwealth authorities (defined in sections 5 and 7 of the CAC Act).

6.2 For example, directors of Commonwealth authorities will be able to rely on a statutory business judgment rule which will offer them a safe harbour from personal liability for breaches of the duty of care and diligence in relation to honest, informed and rational business judgments. In the case of Commonwealth authorities a business judgment is one which relates to a matter concerning any of the operations of the authority.

6.3 Other modifications to maintain alignment with Corporation Law reforms include clarification:

- of the standard of care and diligence in relation to the circumstances of an officer;
- that a breach of the duty of care and diligence will only give rise to civil sanctions;
- that directors may rely on a delegation of their functions (where appropriate under a Commonwealth Authority's enabling legislation) and on the advice of experts;
- of the existing duty of honesty to reflect the fiduciary nature of directors' duties.

6.4 Various amendments are proposed to the CAC Act to align its provisions (where appropriate) with the proposed rewrite of the Law about Officers, and Civil Penalties. In relation to the disclosure of, and voting upon, material personal interests, the following consequential amendments are proposed to the CAC Act:

- a director who has a material personal interest in a matter will be able to give the relevant board a standing notice of the nature and extent of the interest;
- where a board is unable to form a quorum because of conflicts of interest and a matter is urgent, or there is some other compelling reason for the matter to be dealt with at the directors' meeting, the responsible Minister will be able to resolve the matter by authorising directors to vote on the particular matter despite their conflict of interest; and
- the responsible Minister will be able to make a class order in respect of a specified class of Commonwealth authorities, directors, resolutions or interests to enable directors who have a material personal interest in a matter to be present while the matter is being considered at a directors' meeting, to vote on that matter, or both be present and vote.

7

Takeovers

7.1 This Chapter sets out the key changes introduced by the takeover provisions in the Bill.

Mandatory bid rule

7.2 To facilitate a more competitive market for corporate control, a mandatory bid rule will be introduced. Under the rule, a bidder will be able to exceed the takeover threshold (more than 20 per cent of the total voting rights in a company) before being required to make a general takeover offer (proposed section 611, item 5).

7.3 Under the current law, bidders wishing to launch takeovers must do so when their holding in the target company is below 20 per cent (current section 615). This means that they face considerable uncertainty over the likelihood of the success of their bid, as it is relatively easy for other parties to launch takeover bids in response to an initial bid. In addition, the directors of the target have a greater opportunity to take defensive action, even where that may not necessarily be in the best interests of the target shareholders. Hence, potential bidders may decide not to proceed with their bids, due to the risk of spending considerable time and resources being involved in a bidding war or an unsuccessful bid.

7.4 There are two significant advantages of the mandatory bid rule. First, by giving potential bidders the choice of which takeover method to employ, they are more likely to proceed with their bids, resulting in an increased likelihood of assets being used in their most productive manner. Secondly, the mandatory bid rule will ensure that all target company shareholders will have the opportunity to sell their interest at a fair price and to benefit from the premium a bidder for control places on the securities.

7.5 At the same time, minority investors will be protected from being offered insufficient consideration for their holdings, since the procedure will encourage controlling and institutional investors to make an informed assessment about the appropriate premium for control, which will be required by the mandatory bid provisions of the law to be offered to small investors.

7.6 The mandatory bid procedure is broadly based upon a similar rule in the United Kingdom. The majority of takeover bids made in the United Kingdom are voluntary rather than mandatory, indicating that the mandatory bid rule is considered as an alternative rather than the standard means of gaining corporate control.

7.7 As a result of the proposed changes, bidders will be able to choose the type of takeover procedure most conducive to allowing them to achieve their objectives. Subject to the conditions applying to the mandatory bid procedure below, the general procedure for undertaking a mandatory bid will be the same as for other takeover bids.

7.8 Associates of the person who made the acquisition triggering the mandatory bid, such as parent companies, subsidiaries or other vehicles established specifically for the purpose, will be able to undertake the mandatory bid on behalf of the person (proposed section 611, item 5(e)). This

recognises that companies may employ a variety of different ownership structures in order to meet their corporate objectives.

7.9 Under its general power to modify the application of the takeover law in particular cases, ASIC will be able to relieve persons from the obligation to proceed with a mandatory bid, or to allow mandatory bids to be conditional (proposed section 655A).

7.10 The Government will review the operation of the mandatory bid rule two years after its commencement, to ensure that the Government's policy goals with the introduction of the mandatory bid are being achieved.

Conditions applying to the mandatory bid rule

7.11 The conditions that generally apply to takeover bids will usually apply to mandatory bids. However, certain other conditions will also apply to mandatory bids to provide protection for minority shareholders.

7.12 For example, the conditions are designed to ensure that the mandatory bid complies with the equal opportunity principle — that target shareholders be given a fair opportunity to exit the company completely at a fair price. The conditions also recognise that at the time the mandatory bid is made, control may already have passed to the bidder.

7.13 The mandatory bid conditions include:

- the bidder must start from below the 20 per cent threshold with only one acquisition being allowed before the mandatory bid requirement is triggered, which must be immediately followed by the announcement of the mandatory bid (proposed section 611 items 5(d) and (e));
- the bidder should not acquire a relevant interest in any other securities of the body at the same time as the acquisition triggering the mandatory bid occurs (proposed section 611 item 5(c));
- the bidder must disclose to the selling shareholder that the mandatory bid requirement will be triggered by an agreement to sell (proposed section 611 item 5(f), Schedule 3 Part 9 item 363, section 1002LA);
- the bid must include an offer of a cash sum for the securities, thereby giving target shareholders the option of exiting from the company completely. Alternative consideration, such as securities or a combination of cash and securities, may also be offered (proposed subsection 621(2));
- the bid must be for an amount at least equivalent to the highest price paid by the bidder in cash or non-cash transactions in the last four months (proposed subsection 621(4));
- the bid must be unconditional (proposed section 611 item 5(e));
- target shareholders must be provided with an independent expert's report by the target (proposed paragraph 640(1)(d));
- the bidder must not exercise control of the target until the offer period starts for the mandatory bid (proposed paragraph 614(1)(b)) — that is, until the first offer under the bid

is made. Until then, the bidder will only be able to influence the affairs of the target through voting shares already held in the target before the pre-bid acquisition that triggered the mandatory bid procedure; and

- no securities will be able to be issued in the target, nor dividends declared or distributions made, from the time of the pre-bid acquisition until the end of the bid period without shareholder approval by a general meeting (proposed paragraphs 614(1)(c) and (d)). However, this prohibition does not apply in certain circumstances, including where the issuing of securities is announced before the mandatory bid is announced (proposed subsection 614(2)).

Dispute resolution

7.1 Takeover disputes are currently principally determined by the courts, with the jurisdiction of the Corporations and Securities Panel (Panel) depending upon referrals from ASIC. There have been only three matters brought before the Panel since it was established in 1991.

7.2 Target companies often resort to litigation in hostile takeover bids, sometimes for tactical reasons. This can result in bids being delayed and, where a final hearing cannot be held within the bid period, the courts having to decide between disrupting the bid by granting an injunction without the benefit of full evidence and allowing the bid to proceed even though it may later be found to be defective.

7.3 To meet these concerns, a reconstituted Panel will take the place of the courts as the principal forum for resolving takeover disputes under the Corporations Law, with the exception of civil claims after a takeover has occurred and criminal prosecutions. This will allow takeover disputes to be resolved as quickly and efficiently as possible by a specialist body largely comprised of takeover experts, so that the outcome of the bid can be resolved by the target shareholders on the basis of its commercial merits. Other benefits of an effective panel for dispute resolution include the minimisation of tactical litigation and the freeing up of court resources to attend to other priorities.

Panel's role

7.4 The Panel will be the main forum for resolving takeover matters until after the end of the bid period for a takeover bid. Once a takeover bid has been proposed, only ASIC or another public authority of the Commonwealth or a State will be able to apply to the court to stop or affect a takeover bid (proposed section 659B).

7.5 In place of the courts, the Panel will have the power to:

- review on its merits a decision of ASIC to exempt or modify the takeover rules in Chapter 6, replacing the current Administrative Appeals Tribunal (AAT) jurisdiction (proposed section 656A); and
- declare circumstances to be unacceptable and make a wide range of orders, including stopping a takeover bid (proposed sections 657A — 657F).

7.6 This approach retains the benefit of ASIC's experience in making exemptions and modifications under the Law generally and complements its day-to-day enforcement role.

7.7 Any interested person, including the bidder, target and ASIC, will be able to apply to the Panel for a declaration of unacceptable circumstances, interim order and/or final order based upon

those circumstances (proposed section 657C). Similarly, any interested person will be able to apply for review of an ASIC takeover decision (proposed subsection 656A(2)). The Panel will be able to decline to hear a matter or prevent further applications being brought by a person making a frivolous or vexatious application (proposed section 658A).

7.8 To minimise tactical litigation by seeking review of ASIC decisions, a party would not be able to seek review of the following decisions:

- an ASIC application to the Panel under section 657C for a declaration of unacceptable circumstances or an order relating to those circumstances;
- an ASIC application to the court under section 657G for enforcement of a Panel order;
- an ASIC application for the court to make an order before the end of the bid period under section 659B; and
- an ASIC application to the court for an order enforcing the takeover rules under sections 1325A, 1325B and 1325C (proposed Schedule 3 Part 9 item 370, paragraph 1317C(gc)).

7.9 The Panel's jurisdiction to make a declaration of unacceptable circumstances will not depend upon the existence of a general offer to shareholders under a takeover bid. Instead, its discretion will extend to circumstances involving an acquisition of a substantial interest in, or control of, a company (proposed paragraph 657A(2)(a)). In making a declaration of unacceptable circumstances, the Panel must have regard to the spirit of the takeover rules in section 602 in deciding whether the circumstances are unreasonable and whether it is in the public interest to make the declaration (proposed subsection 657A(2)).

7.10 The Panel will have the power to make a wide range of orders, either on an interim basis, following an application for a declaration of unacceptable circumstances, or as a final order once the declaration is made (proposed sections 657D and 657E). For example, the Panel will be able to prevent a person from acquiring securities, direct a person to dispose of securities and award costs (proposed Schedule 3 Part 9 item 295, 'remedial order').

7.11 Findings of fact by the Panel will be able to be used in subsequent proceedings, unless contrary evidence is put forward (proposed section 658B). On the other hand, the Panel will be able to apply to the court to obtain a ruling on a question of law (proposed section 659A).

7.12 A full-time President will be appointed, initially sitting on all matters to provide consistency in decision making. A full-time independent executive will also be established to service the Panel and deal with market participants on a day-to-day basis.

7.13 In light of its expanded role, the Panel will need additional resources. It is intended to apply full cost-recovery to the Panel's operation. This will be achieved by accompanying the introduction of the new takeover arrangements with revised fees payable by the parties.

Courts' role

7.14 Court proceedings in relation to a takeover bid or proposed takeover bid will not be able to be commenced until after the end of the bid period, except on the application of ASIC or another public authority of the Commonwealth or a State (proposed section 659B, Schedule 3 Part 9 item 292). The courts will instead decide after the bid any damages claims, criminal prosecutions

or applications to be relieved from liability arising from contraventions of the Law or procedural irregularities.

7.15 The restriction on court proceedings in relation to a takeover bid or proposed takeover bid until after the end of the bid period will include:

- any proceedings for review of Panel decisions (proposed section 659B); and
- proceedings under Commonwealth and State laws and the general law (proposed subsection 659B(4)).

7.16 If the Panel has refused to make a declaration of unacceptable circumstances during the bid period, but the Court finds that there has been a contravention of the Law, the orders that the Court will be able to make will be limited to (proposed section 659C):

- imposing a penalty if the person is found guilty of an offence or ordering the person to pay money to another person if there is a contravention of the Law; and
- making an order relieving a person from liability arising from a contravention of the Law or procedural irregularity.

Compulsory acquisitions

7.1 The Bill will extend the current legislative mechanisms for the compulsory acquisition of securities. These are intended to balance the interests of facilitating changes in corporate ownership with the need to protect the rights of minority shareholders.

7.2 Extending the power to compulsorily acquire securities will:

- allow better management of company groups;
- reduce the administrative and reporting requirements of associated companies by:
 - helping parent companies distribute funds between subsidiaries;
 - protecting the confidentiality of commercial information and avoiding conflicts of interest in dealings between associated companies; and
- discourage minority shareholders from demanding a price for their securities that is above a fair value (often referred to as ‘greenmailing’).

7.3 The new provisions will:

- allow all securities (rather than just shares) to be compulsorily acquired;
- revise the 75 per cent rule for post-bid compulsory acquisitions;
- facilitate the acquisition of the outstanding securities in a class by any person who already holds 90 per cent of the class; and
- allow an overwhelming interest holder of a company to acquire all the outstanding securities in the company (securities in all classes) in situations where the holder can demonstrate an overwhelming interest in the company.

Post-bid compulsory acquisitions

7.1 A bidder making a takeover bid will be permitted to compulsorily acquire securities in the bid class if:

- the bidder and its associates have a relevant interest in at least 90 per cent of those securities; and
- the bidder has acquired at least 75 per cent, by number, of the outstanding securities, of those securities bid for under the bid.

7.2 The current law only provides for compulsory acquisitions in respect of shares. The draft provisions will allow compulsory acquisitions in respect of all securities and convertible securities, including options over yet to be issued securities, outstanding voting and non-voting equity securities, securities that are convertible into voting or non-voting equity securities, options, convertible notes and converting preference shares (proposed sections 661A and 664A). The Bill applies the same definition of securities as in the fundraising provisions (proposed Schedule 3 Part 1 item 34, subsection 92(3)).

7.3 Under the current law, a post-bid compulsory acquisition can be defeated if 75 per cent by number of the outstanding shareholders (regardless of how many shares they hold between them) object to the compulsory acquisition (current section 701). This provision has been used in the past to defeat takeover bids by splitting down a small number of shares among a large number of shareholders. The Bill will remedy this by enabling a majority securities holder to compulsorily acquire shares if 75 per cent of the outstanding securities, by number of securities, accept the bid (proposed section 661A).

7.4 A court may order that a compulsory acquisition not proceed where the consideration is not fair value for the securities (proposed section 661E).

Compulsory acquisitions of all securities in a class

7.5 The draft provisions introduce a new compulsory acquisition power to enable a person, who has a full beneficial interest (that is, either direct ownership or ownership through a nominee) in at least 90 per cent of any class of securities in a company, to compulsorily acquire the remaining securities in that class (proposed subsection 664A(1)). This new power will be in addition to the post-bid compulsory acquisition power and will allow compulsory acquisitions to take place at any time, not just following a takeover bid.

7.6 Because the compulsory acquisition procedure may not immediately follow a takeover bid:

- the threshold test for this power (full beneficial interest in 90 per cent) will be set higher than under a post-bid compulsory acquisition (relevant interest in 90 per cent); and
- the majority securities holder will be required to provide an independent expert's report to the minority securities holders setting out:
 - whether, in the expert's opinion, the terms of the compulsory acquisition give a fair value for the securities; and
 - the reasons for the opinion.

7.7 If 10 per cent of holders of securities in a class object, the acquisition of that class will not be able to proceed without court approval (proposed subsection 664E(4)).

Compulsory acquisitions of all securities in the company

7.8 The power to compulsorily acquire shares should enable the overwhelming owner of a company to obtain the often substantial benefits of complete ownership. These benefits can only be obtained where a securities holder has 100 per cent beneficial ownership of all securities in the company. Compulsory acquisition of each class of securities can be difficult where there are a large number of different classes or a small number of securities holders in one or more classes, or where there are restrictions on transferring some securities (for example, securities issued under employee share schemes).

7.9 Proposed subsection 664A(2) facilitates the acquisition of 100 per cent of all the securities of a company by any person provided that the person holds:

- full beneficial ownership of securities valued at 90 per cent of the total market value of the company; and
- full beneficial entitlement to 90 per cent of the voting rights to approve a general resolution in a general meeting.

7.10 As the new power will enable a controlling shareholder to acquire complete control of the company and not just the ability to compulsorily acquire securities of a particular class, an overwhelming economic and control interest in the company will be required. This will be based upon the market value of the securities and the voting rights in a general meeting.

7.11 To protect minority shareholders and keep markets informed, the person acquiring the securities will be required to provide a notice of acquisition. The notice will set out the offer price for the securities to be acquired and be accompanied by an independent expert's report valuing the company as a whole, the interests of the person seeking to acquire the remaining securities and the interests of the securities holder being sent the notice. The notice will also disclose any offers made by the acquirer, or an associate, for securities in the class within the 12 months prior to the compulsory acquisition (proposed section 664C).

7.12 The independent expert's report must state whether, in the expert's opinion, the offer price is fair. If at least 10 per cent of the securities holders of any one class object to the acquisition, based upon either the valuation of the company as a whole or the offer price for their securities, then court approval of both the valuation and the offer must be obtained. The court's role will be to determine if the offer gives a fair price for the securities (proposed section 664F).

7.13 The issue of valuing companies for the purposes of compulsory acquisition is a difficult one and the draft provisions provides guidance to experts as to how they should go about valuing a company (proposed section 667C). It is proposed that experts would not account for premiums on account of the special value of the outstanding securities to the acquirer, or discounts on account of the lack of a market for particular securities.

Managed investment schemes

Applying takeover rules to listed managed investment schemes

7.1 Currently, the takeover provisions do not apply to managed investment schemes, which are typically unit trusts. The draft provisions will apply the takeover rules to listed managed investment schemes (proposed section 604).

7.2 The takeover provisions will only apply to listed managed investment schemes because the redemption facility of a listed scheme is suspended and units trade at a price set by the market. This provides an opportunity and incentive for a bidder to pay a premium over the market price for control parcels of undervalued units.

7.3 For most unlisted schemes this is not the case, as the manager provides investors with a withdrawal facility at a price reflecting the net asset backing of the units. This would be a strong disincentive for a bidder who must pay a premium for the units above the value for which they can be redeemed.

7.4 Other operating features of many unlisted schemes make the application of company takeover rules impractical. In particular, in the case of ‘open-ended’ schemes, new interests are issued on a continuous basis as investments are made. While the potential effect of this could be overcome by the imposition of ‘freezes’ on the issue of new interests when a takeover bid is launched, this would appear to amount to an unwarranted interference in the ordinary operation of the scheme.

7.5 To apply the company takeover provisions to managed investment schemes, the provisions equate features of a company to features of a managed investment scheme (proposed subsection 604(1)).

7.6 Applying the draft provisions in this way avoids repeating the provisions specifically for listed managed investment schemes. However, in some instances the application of the provisions to listed managed investment schemes is specifically dealt with. For example, a bidder’s statement must disclose the bidder’s intentions regarding the future of the target. The provisions clarify that this requirement applies differently to targets that are companies and to targets that are schemes (proposed paragraphs 636(1)(c) and (d)).

7.7 In addition, the regulations may modify the application of the takeover provisions to managed investment schemes (proposed subsection 604(2)).

7.8 As the current provisions do not apply to managed investment schemes, most listed schemes include in their trust deed takeover provisions based upon those currently in the Corporations Law. The application of the takeover provisions to managed investment schemes will automatically override any inconsistent takeover rules contained in existing trust deeds without the need for further legislative amendment.

Replacing the scheme manager

7.9 One issue that arises from the application of the takeover provisions to managed investment schemes is the appropriate statutory rule for the replacement of the scheme manager. The current statutory rule requires a vote by 50 per cent by value of unit holders to remove the manager (current regulation 7.12.15(10)(g)). In contrast, ASX Listing Rule 13.3 requires a listed scheme’s trust deed to allow removal of the scheme’s manager by an ordinary resolution of unit holders. Unlike the

statutory rules, the listing rule approach is consistent with the rule for the removal of company directors.

7.10 Another problem with the current statutory voting rules is that they enable the bidder and its associates to vote on the removal of the manager, while the existing manager and its associates are excluded from voting (current regulations 7.12.15(6)(f) and (9)(b)(i)). This disenfranchises those investors who have already indicated a preference in favour of the existing manager by purchasing units in the scheme. Where the manager and its associates hold a large percentage of the units, the manager could be removed by a vote of just half of the value of the minority unit holders.

7.11 The draft provisions will resolve these issues by making it clear that the manager of a listed managed investment scheme can be replaced by a simple majority of unit holders who vote at a duly convened meeting (whether in person or by proxy), without any restrictions on who can vote (proposed Schedule 3 Part 9 item 341 subsection 601FM(1) and items 322 — 325, sections 252L, 252M(1) and 253E). This is consistent with the voting requirements for the removal of company directors.

Compulsory acquisitions

7.12 The compulsory acquisition provisions in Chapter 6A will extend to listed managed investment schemes (proposed section 660B). This will enable a bidder or 90 per cent holder to move to 100 per cent control of a listed managed investment scheme in the same way that a bidder or 90 per cent holder can move to 100 per cent control of a company. Similarly, extending these provisions to schemes will ensure that minority unit holders will have access to the same compulsory buy-out protections as minority shareholders.

Substantial holdings and tracing

7.13 To ensure that changes of control of managed investment schemes take place in an informed market, the proposed provisions on substantial holdings and tracing beneficial interests in Chapter 6C will apply to listed schemes.

7.14 A person will be required to provide the responsible entity and the ASX with particulars of their identity, their interest in the scheme and any associates, where:

- they gain or cease to have a substantial holding in a listed managed investment scheme;
- they have an existing substantial holding that increases or decreases by 1 per cent;
or
- they make a takeover bid for securities of the scheme (proposed subsection 671B(1)).

7.15 ASIC or a listed managed investment scheme will be able to trace the beneficial ownership of interests. A member of a scheme will be able to request ASIC to exercise its tracing powers on behalf of the member (proposed section 672A).

Rewriting the takeover provisions

7.16 The Bill also rewrites the takeover provisions to streamline the rules and remove anomalies and unnecessary requirements, in order to reduce transaction costs and lighten the regulatory

burden on business. This takes into account the recommendations of the Legal Committee of the Companies and Securities Advisory Committee (CASAC Legal Committee) in its reports *Anomalies in the Takeover Provisions of the Corporations Law* (March 1994) and *Compulsory Acquisitions* (January 1996).

Takeover prohibition and exceptions

7.17 The more significant changes to the takeover prohibition and exceptions include:

- applying the takeover provisions to acquisition of shares in listed companies and unlisted companies with more than 50 members (proposed paragraph 606(1)(a)). In contrast, the existing takeover provisions apply to companies with more than 15 members (current subsection 619(1)). It is considered difficult to justify the imposition of takeover regulation to closely held companies in light of the costs involved;
- liberalising the current exemption for downstream acquisitions that occur as a result of an acquisition of shares in an Australian listed company (the upstream acquisition), by allowing the upstream acquisition to fall under any of the exemptions from the 20 per cent threshold and extending the exemption to foreign bodies approved by ASIC (proposed section 611 item 14);
- exempting a relevant interest that arises from:
 - an agreement conditional on shareholder approval under item 7 in section 611; or
 - an agreement conditional on ASIC relief, until fulfilment of the condition

provided that the agreement does not confer control over voting and does not restrict disposal for more than 3 months (proposed subsection 609(7)). This removes the difficulty that a person would be deemed to have a relevant interest in anticipation of the agreement under proposed subsection 608(8);

- measuring voting control of a company by the number of votes attached to shares a person controls, rather than the number of voting shares (more accurately reflecting a person's voting power);
- replacing the concept of entitlement with voting power (proposed section 610). Voting power will be calculated by identifying any share that either the person or an associate has a relevant interest in and determining how many votes are attached to those shares as a proportion of the total number of votes. Given the possibility that the number of votes attached to a share may vary, the number of votes to be counted is:
 - the number that may be cast on the election of a director, or
 - if no votes are cast for the election of a director — the number that may be cast on the amendment of the constitution (proposed subsection 610(2))
- ensuring that a director will not have a relevant interest in shares in which a body corporate has a relevant interest merely because they are a director of the body (proposed subsection 609(9)). This exception means that a director will only have a relevant interest in securities over which they in fact have control (for example, as a result of personal shareholding);

- providing that a member of a company will no longer have a relevant interest in the shares held by other members merely because of pre-emptive rights under the company's constitution (proposed subsection 609(8)). A right of pre-emption occurs where the members of the company are able to purchase the shares of any other member who proposes to sell their parcel, before any outsider can purchase them; and
- providing that a person will only acquire a relevant interest in a security under an exchange traded option or futures contract when the option is exercised or they are obliged to take delivery (proposed subsection 609(6)).

Takeover procedure

7.1 The draft provisions largely replicate the existing law in relation to the processes that must be followed by parties to a takeover bid, with some minor changes (proposed sections 631 - 635).

7.2 Diagrams have been included that show the documentation that a bidder and target must provide to each other, ASIC, the ASX and the holders of securities that are subject to the bid, for off-market and market bids respectively (proposed sections 632 and 634). These diagrams are non-operative — that is, they are only a summary of the substantive requirements in the other provisions (for example, proposed section 633 for off-market bids and section 635 for market bids).

7.3 Changes to the current procedure include:

- bringing the procedural rules relating to off-market and market bids into line where appropriate, including:
 - merging off-market and market statements into a bidder's statement (replacing Part A and Part C statements) and a target's statement (replacing Part B and Part D statements);
 - allowing market bids to be made without the consent of ASIC where the bidder controls more than 30 per cent of the target company, instead applying the off-market bid requirement for an expert's report to accompany the target's statement (proposed paragraph 640(1)(a), current subsection 674(2)); and
 - leaving the mechanical details of making market bids to the ASX Listing Rules
- allowing the bidder to send a copy of the bidder's statement to the target on the same day as lodging the statement with ASIC, rather than requiring lodgment to be no later than the day before the statement is sent to the target (proposed section 633 item 4). This removes an unnecessary delay caused by the current law;
- the target will be able to send its statement to the bidder on the same day it receives the bidder's statement (proposed section 633 item 11); and
- no longer requiring the bidder to send out the target's statement with its own documents to target shareholders, in the event that it has received the target's statement in time (current subsection 639(2)). In the case of a hostile bid, it would be in the interests of the target company to use the maximum time available to prepare its response and commission an expert's report. The bidder may, however, still choose to send the target's statement where the bidder and target agree to this.

7.4 The general rules on takeover procedure in Division 5 of Part 6.5 will facilitate a bidder sending documents to target holders at the addresses that may be obtained from the target (proposed sections 648B and 641). Proposed section 648C modifies the current provisions on sending takeover documents to allow documents to be sent overseas by courier (current section 607 and regulation 6.1.01). The Bill also retains the current takeover approval provisions, in light of concerns that their removal may reduce investor protection (proposed sections 648D - 648H, current Part 6.3 Division 8).

Offers

7.5 A bidder will be able to determine the period that the offer will remain open, subject to a minimum of one month and a maximum of 12 months (proposed subsection 624(1)). This allows a greater degree of flexibility for a bidder. Currently, an offer must remain open for a minimum of one month and can be extended for a further month, but it cannot remain open for more than 6 months (current subsections 638(3) and 681(3)).

7.6 The current provisions limit a bidder to making a takeover bid for the shares in the bid class — that is, not including securities convertible into the bid class. The draft provisions will allow the bidder in an off-market bid to specify in the offer document that the takeover applies to securities that exist or will exist as at the date set by the bidder (proposed section 617).

7.7 This change was introduced to better facilitate the acquisition of securities under a takeover bid. While the provision does not remove the possibility of defensive tactics through the target issuing convertible securities during the bid period, the target company directors will be subject to directors' duties. In addition, draft paragraph 652C(1)(d) allows the bidder in certain circumstances to withdraw the bid for unaccepted shares if such convertible securities are issued.

7.8 Under a market bid, the offer must extend to all convertible securities that will or could be converted to shares of the bid class within the offer period (proposed section 617).

7.9 In determining the highest price paid in the last four months for the purposes of cash consideration, the draft provisions takes into account non-cash consideration, as well as cash consideration as at present (proposed subsection 621(4)).

7.10 The current prohibition against escalator agreements will be modified to provide an exemption for an agreement triggering a mandatory bid (proposed subsection 622(2)). This will allow the agreement to provide that the price paid will be increased to reflect any higher amount payable under the mandatory bid.

7.11 The prohibition relating to the giving of collateral benefits has been modified to focus on inducements offered to a vendor of securities or any associate. It will prohibit a bidder giving a benefit to a person or an associate if that benefit is likely to induce them to accept the takeover bid or dispose of their securities, and the benefit is not given to all holders of the securities in the class (proposed section 623).

7.12 The draft also allows a bidder to make simultaneous takeover bids for different classes of securities in the target (proposed subsection 623(5)). Under the current law, section 698 prevents such simultaneous offers because it amounts to a collateral benefit.

Conditional bids

7.13 Division 4 of Part 6.4 of the draft provisions brings together the rules in relation to conditional offers in one place. The rules have been redrafted to make them easier to read.

7.14 Consistent with the current law, the basic rule is that only off-market bids may be made subject to conditions, and that in an off-market bid, certain types of conditions are prohibited (maximum acceptance conditions, discriminatory conditions, conditions requiring payments to officers of the target and conditions that turn on the opinion of the bidder).

7.15 The Bill retains the prohibitions on certain conditions that exist in the current law that might otherwise frustrate the principles underlying the takeovers rules by restricting the ability of all securities holders to participate equally after an offer has been made (proposed sections 626 — 629). The current requirement to publish certain notices about defeating conditions in a newspaper has been deleted.

Variation of bids

7.16 Provisions dealing with variation of takeover bids in Divisions 4 and 5 of Part 6.3 of the current Law will be recast in Parts 6.6 and 6.7 of the draft provisions. The rules have been revised to give greater protection to investors during the course of a takeover bid. The provisions in the new Bill:

- allow bidders to offer to buy shares to which a dividend is attached and for the dividend to be paid to or retained, in whole or part, by the target holder (proposed paragraph 650B(1)(g));
- better apply the principles that securities holders be given a reasonable period in which to consider a bid, and equal access to benefits arising out of a bid (proposed Part 6.6); and
- improve the operation of the rules governing declarations that offers are free from conditions (proposed section 650F).

7.17 Variations of off-market and market bids will continue to be restricted to improving the consideration and extending the period of the offer (proposed sections 649A and 650A).

7.18 Current section 655 sets out the various ways a bidder may vary consideration in respect of an offer. Section 655 will be replaced by proposed section 650B, which will allow offers to purchase shares cum dividend to be varied so as to enable target holders to retain all or part of the dividend.

7.19 The current law contains mechanisms to ensure that increases in consideration, late in the bid period, do not disadvantage target holders who have already accepted the offer (current sections 655 and 664 - 668). However the current rules do not allow sufficient time for consideration of increased bids, late in the period, by target holders who have not previously accepted the lower offer. This is inconsistent with the principles that shareholders of a target have reasonably sufficient time to consider offers in a takeover bid and equal access to benefits flowing from a bid (proposed section 602).

7.20 In order to give sufficient time for target holders to consider increases in bid offers that occur late in the bid period, off-market bid periods will be extended automatically by 14 days if the consideration in an off-market bid is improved in the last 7 days (proposed subsection 624(2)).

Offers will not be able to be increased in the last 5 trading days of a market bid (proposed section 649B, current subsection 677(3)).

7.21 Proposed section 624 will also provide for the automatic extension of a bid period for 14 days if, during the last week of the bid period, the interests of the bidder rise above 50 per cent. This will assist target holders who might have declined the offer on the basis that they wished to remain with the existing management, but would accept if the bidder obtains a majority holding in the target.

Disclosure requirements

7.22 The present disclosure regime for bidder's and target's statements has an extensive list of specific disclosure requirements as well as a 'catch-all' general disclosure requirement (current section 750). In addition, a bidder's statement for a bid offering securities as consideration must contain information required for a prospectus offering those securities. The large list of specific disclosure requirements in the current law results in some information being included in the bidder's and target's statements that may have limited relevance to target shareholders. The presentation of bidder's and target's statements also tend to follow the checklist. As a result, the statements may be less readable and may obscure significant information.

7.23 The provisions will introduce new disclosure rules that are consistent with the fundraising disclosure rules and have regard to the extent to which reliable information is available and the usefulness of disclosure. Regard is also had to the desirability of avoiding the inclusion of information that would provide a basis for engaging in litigation with a view to frustrating a bid.

7.24 Where a bidder is offering cash as consideration, the bidder's statement will be required to contain:

- more limited specific information identifying the bidder and the bidder's intentions for the target (proposed paragraphs 636(1)(a), (c) and (d));
- details of the cash amounts held by the bidder as well as the identity and arrangements the bidder has made with any other person who is to provide cash consideration (proposed paragraph 636(1)(f)); and
- any other information known to the bidder that is material to a decision by a holder of securities of the target whether or not to accept the offer and that has not been previously disclosed to them (proposed paragraph 636(1)(j)).

7.25 Where cash is offered as consideration, the disclosure of these specified matters together with any other material information known to the bidder, is all that is required from the bidder. The appropriate source of information regarding the target is the target itself.

7.26 Where a bidder is offering securities as consideration, the bidder's statement will also be required to contain information that would be required to be contained in a prospectus (if any) for the offer of those securities (proposed paragraph 636(1)(h)). Thus where new securities are to be issued, the bidder's statement would have to contain the information required under the general prospectus disclosure test and where the securities are in an existing quoted class, the information required for prospectuses for such securities (see proposed sections 710, 711 and 713).

7.27 Where existing securities are offered by a controller of the entity that issued the securities, the statement will also need to include prospectus information (proposed paragraph 636(1)(h)). Consistent with the removal of the existing disclosure requirements for secondary sales by the proposed fundraising provisions (current section 1043D), offers of existing securities as

consideration by a person who is not a controller will not need to include prospectus-like information.

7.28 Where the bid is a mandatory bid, the bidder's statement will also be required to include details of the acquisition that led to the making of the bid (proposed paragraph 636(1)(i)).

7.29 The target's statement will be required to contain:

- all the information that holders of bid class securities and their professional advisers would reasonably require, and reasonably expect to find in the statement, to make an informed assessment of whether to accept the offer under the bid (proposed subsection 638(1)), and
- the recommendations of the target's directors on whether the offer should be accepted, giving reasons for the particular recommendation or, where no recommendation is made, a statement giving reasons why a recommendation is not made (proposed subsection 638(3)).

7.30 The general disclosure rule for the target is based upon the general disclosure rule in the proposed fundraising provisions. This type of disclosure rule is considered appropriate as it will require the target to focus on what information is required by holders of the target's securities to make an informed decision.

7.31 The general disclosure rule will only require information to be included in the target's statement if the target actually knows or ought reasonably to have obtained the information by making enquiries (proposed paragraph 638(1)(b)). In addition, given the different circumstances in which takeovers occur, in determining what information it is reasonable for a target to include, regard may be had to the time period in which the target's statement must be prepared (proposed paragraph 638(2)(d)).

Supplementary takeover documents

7.32 There is currently no express requirement in the Law to update a bidder's or target's statement with additional or alternative information. However, a number of provisions of the current law effectively require the bidder or target to provide supplementary information including:

- the requirement that variations of an offer set out particulars of the modification of the bidder's statement that are necessary because of the modification (current subsection 657(1));
- the requirement for an off-market bidder's statement to be updated where the offer remains open for longer than 6 months (current subsection 657(2));
- the defences against liability for defective takeover documents that require targets and bidders to establish that they had reasonable grounds for believing that the statements were not defective at the time a person acted on them (current section 704);
- the misleading or deceptive conduct prohibitions and in particular the risk that the failure to update renders a continuing representation misleading or deceptive (current section 995); and
- the insider trading provisions that prohibit persons with price sensitive information that is not generally available from dealing in securities (current Division 2A of Part 7.11).

7.33 The provisions will clarify when a supplementary bidder's or target's statement is required. The provisions are consistent with the supplementary disclosure document rules in the proposed fundraising provisions and will ensure that holders of bid class securities are able to make an informed decision on whether or not to accept a takeover offer.

7.34 Bidders and targets will be required to issue a supplementary bidder's or target's statement when they become aware that their statement contains a misleading or deceptive statement or an omission or when they become aware of a new circumstance that would have been required to be included in their statement under the disclosure rules. The misleading or deceptive statement, omission or new circumstance must be one that is material from the point of view of a holder of securities in their assessment of the bid (proposed sections 643 and 644).

7.35 If the target is listed, the supplementary statement will only be required to be lodged with ASIC, given to the securities exchange which lists the target's securities and given to the target. In other cases, the supplementary statement will also be sent to holders of bid class securities who have not accepted an offer under the bid (proposed section 647).

7.36 In light of the new supplementary statement rules, the requirement for an off-market bidder's statement to be updated after 6 months will be removed (current subsection 657(2)).

Liability regime

7.37 The draft provisions will ensure that the liability regime for takeover activity is generally consistent with the liability regime adopted for fundraising.

Prohibitions

7.38 Chapter 6B will bring together the liability provisions for conduct arising under Chapter 6 (takeover activity) and Chapter 6A (compulsory acquisitions).

7.39 The liability provisions will apply to bidder's and target's statements, takeover offer documents and notices of variation, compulsory acquisition and buy-out notices, and expert's reports. A person will be prohibited from giving a takeover or compulsory acquisition document that contains a misleading or deceptive statement (proposed paragraph 670A(1)(h)). A person must not give a bidder's or target's statement that omits material or fails to disclose a new circumstance (proposed paragraphs 670A(1)(i) and (j)). This reflects the positive disclosure obligations and the supplementary statement regime applying to bidder's and target's statements.

7.40 Consistent with the approach taken in the fundraising provisions, liability for defective takeover or compulsory acquisition documents will be dealt with under a specific liability regime to the exclusion of the general prohibition on misleading or deceptive conduct (current section 995). Removing the application of section 995 from conduct arising in relation to takeover and compulsory acquisition documents will make it clear that the positive disclosure obligations in relation to these statements are reinforced by a specific liability and defence regime.

7.41 Similarly, the misleading and deceptive conduct provisions in the Trade Practices Act (and the equivalent provisions in the State and Territory Fair Trading Acts) will no longer apply to securities dealings. These reforms have been implemented in the fundraising provisions.

7.42 Consistent with the approach under section 52 of the Trade Practices Act, it will no longer be necessary in civil actions under the Law to establish that the misleading or deceptive statement, omission or new matter was material (proposed subsection 670A(1)). Recovery of damages will depend on establishing that loss has been suffered (proposed subsection 670B(1)), and an injunction

will remain a discretionary remedy available under current sections 1324 and 1325. It will only be an offence to give a takeover or compulsory acquisition document containing a misleading or deceptive statement, omitting required material or without a new circumstance if it is materially adverse from the point of view of the holder of the securities (proposed subsection 670A(3)).

Persons liable

7.43 The draft provisions clarify the people who could be held liable for the takeover or compulsory acquisition document and the extent of their liability (proposed subsection 670B(1)).

7.44 The person that issues a takeover or compulsory acquisition document, and their directors, will be liable in relation to the document as a whole. For example, the target will be liable for the whole of the target's statement. Directors of the target will also be liable for the whole of the document unless they were not present when the board resolved to adopt the statement or voted against the resolution.

7.45 While the draft provisions preserve the existing civil liability of the bidder, the target and their directors, other persons will only be liable for statements in a takeover or compulsory acquisition document that they have made or which are based upon their statements. A person will need to have consented to being named in the document in relation to a statement before any liability may arise (proposed subsection 670B(1), item 10).

7.46 Clarifying the statutory liability of these persons will strengthen investor protection. The holder of securities may give considerable authority to a proposition or forecast in a takeover or compulsory acquisition document because it is made by or supported by a person who is held out as independent and having a particular expertise. Where these persons consent to being named in the document, consistent with the approach taken in the proposed fundraising provisions, it is appropriate for them to assume liability for their statements.

7.47 Other persons involved in a contravention of the takeover provisions could also be liable to compensate for any loss suffered (proposed subsection 670B(1), item 11).

7.48 Since the liability provisions and the offence provisions operate independently, it will not matter whether or not the person against whom compensation is being sought has been convicted for an offence in respect of the contravention.

7.49 A person who may be liable on a takeover or compulsory acquisition document must inform the person offering the securities in writing as soon as practicable after they become aware of a material misleading or deceptive statement, omission or new circumstance (proposed section 670C).

7.50 The draft provisions will retain the current liability and defence provisions for proposing a takeover bid or announcing a market takeover bid and not carrying through with it (proposed sections 670E and 670F).

Defences

7.51 Under the existing Law, a defence is available where a person can show that they believed on reasonable grounds that a takeover document was not misleading or deceptive in the manner alleged (current section 704). The draft provisions will retain this defence for takeover and compulsory acquisition documents.

7.52 To successfully establish a defence under the new provisions, a person will be required to show either:

- they did not know, that the document was misleading or deceptive, or omitted required information (proposed subsections 670D(1) and (2)); or
- reasonable reliance on another person (proposed subsection 670D(3)).

7.53 The reasonable reliance defence will not be available in respect of information provided by an employee or agent or, if the person is a body, its directors (proposed subsection 670D(3)). This will prevent someone relying on what is effectively their own information. A person will be able to rely on someone who performs a particular advisory or professional function provided they are not an agent for some other reason (proposed subsection 670D(4)).

7.54 Where a person has comments attributed to them in a takeover document, a defence will be available to the person if the person can show that they publicly withdrew their consent to being named in the document (proposed subsection 670D(5)).

Liability for other takeover conduct

7.1 Consistent with the approach taken in relation to the fundraising provisions, conduct in relation to takeover activity and compulsory acquisitions other than the content of the takeover and compulsory acquisition documents will be subject to section 995 of the Law.

Compulsory acquisitions

7.2 The provisions on compulsory acquisitions have been streamlined and extended to make them more consistent and easier to use. The proposed new compulsory acquisition powers will operate consistently with the underlying takeover principles in proposed section 602, as well as the new compulsory acquisition powers proposed by CLERP. In particular:

- the powers of minority shareholders to force majority shareholders to buy them out have been strengthened consistently with the new compulsory acquisition powers; and
- the new provisions are generally consistent with the recommendations in the CASAC Legal Committee's report *Compulsory Acquisitions* (January 1996).

7.3 The new provisions will apply to all companies and listed managed investment schemes and bodies subject to Chapter 6, regardless of any contrary provision in their constitution, although individual shareholders are not prevented from entering into agreements with other shareholders concerning the exercise of the new provisions (proposed sections 660A and 660B).

Treatment of later issued securities

7.4 The CASAC Legal Committee report recommended that a bidder should have an option to compulsorily acquire securities issued after the date of the offers, but before the date the compulsory acquisition notices are sent, provided the threshold is met when these later issued securities are taken into account.

7.5 The Bill gives effect to the recommendations of the Committee by allowing bidders in a post-bid compulsory acquisition to choose to purchase later issued securities for a short period after the end of the bid. Consistent with the CASAC recommendations, the new provisions will give the bidder the choice to acquire:

- bid class securities;

- bid class securities issued before the bidder sends out compulsory acquisition notices; and
- securities of which the bidder is aware and that convert to bid class securities within 6 weeks after the end of the bid (proposed subsection 661A(4)).

7.6 A bidder will still be required to meet the compulsory acquisition thresholds when the later issued securities are taken into account. The bidder will also be permitted to acquire securities in which it, or an associate, has a relevant interest (proposed paragraphs 661B(4)(b) and (c)).

7.7 The Bill also gives effect to the recommendations of the Committee by allowing a bidder to:

- elect to extend a compulsory acquisition to securities that are issued after the end of the offer period (proposed paragraph 661A(4)(b));
- commence compulsory acquisition procedures immediately where the compulsory acquisition threshold is reached during the course of the bid period (proposed subsection 661A(1)); and
- acquire securities that it might already be able to vote, or holds through associates or nominees (proposed paragraph 661A(4)(d)).

Treatment of convertible securities holders

7.1 While a bidder under a post-bid compulsory acquisition will be required to offer to buy out all holders of convertible securities, this rule will not apply to bidders who choose to avail themselves of the new 90 per cent beneficial interest compulsory acquisition power until the bid is successful. That is, the 90 per cent beneficial interest holder will not be required to offer to buy out the convertible securities holders until the holder is the 100 per cent holder of the bid class securities (proposed section 664A).

7.2 This difference in the treatment of convertible securities holders is proposed:

- so as not to denigrate the existing rights of holders of convertible securities in a post-bid acquisition;
- to avoid a bidder with a 90 per cent beneficial interest having to acquire convertible securities despite the acquisition of the bid class having failed; and
- consistently with the recommendations of the CASAC Legal Committee.

Discretion to reduce 90 per cent threshold

7.1 The acquisition thresholds proposed by the Bill may be satisfied at the end of a bid period or during the course of the bid. Consistent with the CASAC Legal Committee recommendations, both ASIC and the courts will be able to reduce the threshold in appropriate cases.

7.2 A majority shareholder will be able to apply to the Court to commence a compulsory acquisition where the compulsory acquisition threshold has not been satisfied (proposed subsection 661A(3)). The power has been added to the Bill to give additional flexibility to the compulsory acquisition procedure and to remove some of the arbitrariness of the 90 per cent threshold, particularly at the margin. The power is not confined merely to cases where shareholders cannot be traced, but might also be applied to other situations, for example:

- where a target dilutes the interests of a majority securities holder during a takeover bid by issuing additional shares; and
- where a bidder's interest is marginally below the threshold.

7.3 It is not the intention of the Bill, however, that the flexibility of the provisions could be used to allow a successful bidder to move, from, say, 80 per cent to 90 per cent where the bidder reached 90 per cent during the bid but was diluted by a genuine placement before the bid closed. Even more so, if a takeover offer was made for the placed shares and rejected.

Role of the Court in compulsory acquisition disputes

7.4 The role of the Court will be to determine a fair price for the securities. It is envisaged that in the context of determining whether to disallow an acquisition, the Court would:

- assess the value of the company as a whole and determine the value of each class of issued security (taking into account its relative financial risk and its distribution rights); and
- then proportion that value to the remaining securities without any premium or discount (proposed section 667C).

7.5 In order to discourage minority shareholders from improperly using the objection process to obstruct a bidder, the Bill limits the number of applications that may be made to the court by holders in a bid to stop a compulsory acquisition. Regardless of how many securities holders apply to the court to stop an acquisition, once the court makes a decision in relation to one of them, that decision applies to all future or pending applications before the court on the particular compulsory acquisition (proposed subsection 661E(3)).

Substantial shareholdings

7.6 Chapter 6C of the Bill largely replicates the existing law in respect of substantial holding information and the tracing of shares (proposed sections 671A — 672F). Minor amendments to the existing law include:

- in providing information on substantial holdings and changes, additional information is required on a person's associates, such as the nature of the association (proposed paragraph 671B(3)(d)); and
- the definition of 'relevant interest' in which the holding of securities is to be disclosed has been expanded to include exchange traded options and conditional agreements (proposed subsection 671B(7)).

8

Fundraising

8.1 New Chapter 6D will replace the current fundraising provisions in Divisions 2, 3, 6 and 7 of Part 7.12. Chapter 6D will also replace the current fundraising liability provisions in section 996 and Division 1, Subdivision B of Division 4 and Division 5 of Part 7.11.

Improving disclosure

8.2 The primary function of prospectus disclosure is to address the imbalance of information between issuers of securities and potential investors. Given the important role of disclosure in the market, the Bill makes a number of changes to improve the current disclosure requirements.

General disclosure requirement

8.3 The Bill will substantially retain the general prospectus content rule in current subsection 1022(1). Retaining the current flexible disclosure requirement will allow the length of a prospectus to vary depending on the investors' needs.

8.4 The general content rule requires a prospectus to contain all information that investors and their professional advisers would both reasonably require, and reasonably expect to find in the prospectus, to make an informed investment decision (proposed section 710).

8.5 The requirement that a prospectus contain all information that investors and their professional advisers 'expect to find' has in practice expanded the disclosure test. For example, in practice issuers have had regard to other prospectuses and included certain types of information merely because it has been included historically or is contained in other prospectuses. This is not the intention of the provision. The words 'expect to find' are intended to limit, and not expand, the disclosure test.

Shorter prospectuses

8.6 Prospectus length and complexity is a particular concern for retail investors, who may not be experienced in reading and comprehending technical information. The Bill will facilitate the presentation of prospectuses to retail investors in a manner best suited to their needs, while still making available a more technical analysis to investors, professional analysts and advisers who wish to seek further information.

8.7 This is achieved by changing current section 1024F to facilitate the use of short form prospectuses. The Bill will allow a prospectus to identify documents which are lodged with ASIC and thereby incorporate the information in the document into the prospectus (proposed subsection 712(1)). The prospectus does not need to summarise each material fact in the incorporated document. However, where the issuer considers that the information may be of interest to retail investors, the prospectus must include sufficient information for investors to determine whether they need to obtain a copy of the document or part of the document to be incorporated by reference.

8.8 Where the issuer considers the information is primarily of interest to professional advisers, the prospectus must state this and describe the contents of the disclosure document (proposed subsection 712(2)). A document incorporated in this way is treated as being included in the prospectus (proposed subsection 712(3)). This will ensure that the incorporated document is subject to the content and liability rules under the new provisions.

8.9 The Bill will allow a prospectus to refer to any document lodged with ASIC, including documents that are not required to be lodged (proposed subsection 712(4)).

Profile statements

8.10 The Bill will provide for capital raising through the use of a profile statement (proposed subsections 709(2) and (3)). A prospectus will still need to be prepared and lodged with ASIC.

8.11 ASIC is empowered to authorise the use of profile statements for offers of securities in suitable industries (proposed subsections 709(2) and (3)). Industry specific profile statements will give investors the ability to make comparisons between similar products. The profile statement must:

- identify the body and the nature of the securities;
- state the nature of the risks involved;
- detail all amounts payable in respect of the securities;
- include any other information required by the regulations or ASIC; and
- state that the profile statement has been lodged with ASIC and that the investor is entitled to a copy of the prospectus (proposed subsection 714(1)).

8.12 As a primary source of information for retail investors, the profile statement attracts liability for any failure to adequately address matters required to be disclosed in it (proposed section 728). However, to ensure that issuers continue to provide full disclosure in the associated prospectus, issuers will be liable to investors in relation to the prospectus regardless of whether an investor actually received a copy of the prospectus (proposed subsection 729(2)). The defence provisions will be applicable to profile statements. A person will not be liable for a misstatement in or an omission from a profile statement if they can prove that they did not know that the statement was misleading or deceptive or that there was a material omission from the statement in relation to that matter (proposed section 732, see also proposed section 733).

Forward-looking statements

8.13 Current subsection 765(1) requires a person who makes representations about future matters to have reasonable grounds for the representation. A provision to the effect of subsection 765(1) is included in the Bill. However, the current reverse onus of proof for representations about future matters has been removed (proposed subsection 728(2) and Schedule 3, Part 1, item 55). This will encourage the inclusion of material of potential use to investors without exposing issuers to liability for legitimate forecasting. The provision also ensures that forecasts are made where there is a reasonable basis for them and not made on the basis of genuine but unreasonable beliefs of issuers.

Rights issues

8.14 The Law currently requires a prospectus for rights issues, but allows reduced disclosure for offers of securities which are already traded on the ASX. The prospectus is only required to contain information about the transaction and other information not already disclosed to the market. The Bill will maintain the current position in relation to rights issues (proposed section 713).

Advertising

Listed securities

8.15 The Bill will significantly liberalise the current advertising restrictions for issues of securities which are already listed on the ASX. Prior to the issue of a disclosure document, advertising for these securities will be permitted if the advertisement states that a disclosure document will be made available and that an application form in, or accompanying, the disclosure document must be completed in order to acquire the securities (proposed paragraph 734(5)(a)).

8.16 The current law generally allows advertising only after the prospectus is lodged provided the advertisement states that a prospectus has been lodged and contains certain details about the prospectus (current section 1025). Relaxing the advertising restrictions for quoted securities will not compromise investor protection as information regarding the issuer and the nature of the securities is publicly available (through the continuous disclosure regime) and provides a basis upon which investors may assess the merits of acquiring the securities.

Unlisted securities

8.17 In relation to issues of securities which are not listed on the ASX, the draft provisions will limit advertising prior to the issue of the disclosure document to the following:

- a statement identifying the offer or and the securities;
- a statement that a disclosure document will be made available when the securities are offered;
- a statement that persons wanting to acquire the securities will have to complete an application form in, or accompanying, the disclosure document; or
- a statement of how to receive a copy of the disclosure document (proposed paragraph 734(5)(b)). This last statement is optional.

8.18 These rules are designed to minimise the potential for persons seeking to raise funds to generate expectations among potential investors about the desirability of a proposed offer before all relevant information reaches the market and investors are able to make an informed investment decision.

8.19 For post-disclosure document advertising, the Bill will allow a streamlined statement to be made that informs potential investors that offers will be accompanied by a disclosure document and that the application form will need to be completed (proposed subsection 734(6)).

8.20 As at present, the advertising restrictions will not apply to notices lodged with a securities exchange, reports on the body's general meeting, news reports and reports by persons who have no

interest in the offer (proposed subsection 734(7)). Such notices and reports should not be tainted by promotional material intended to induce persons to purchase the securities.

8.21 The restrictions on advertising are designed to encourage investors to rely on a disclosure document, rather than the contents of an advertisement, and to ensure that the disclosure document is the principal information document. The prohibitions against misleading and deceptive conduct and the market offence provisions in Part 7.11 of the Law will continue to apply to securities advertising and will provide additional investor protection.

Image advertising

8.1 There is often uncertainty under current paragraph 1026(2)(c)) as to whether a particular image advertising campaign breaches the restrictions on pre-prospectus advertising or is permissible advertising of the body's general business in the ordinary course of trade. In practice image advertising can be very influential on investors, extolling the virtues of a body without referring to a pending public offer. The Bill will clarify the Law in order to ensure that a body is not inhibited from promoting its products or services in the course of trade and to provide protection to investors. The Bill specifies criteria which should be taken into account in deciding whether image advertising exists (proposed subsection 734(3)).

Pathfinder documents

8.2 To assist an issuer to set a realistic price and finalise the contents of a disclosure document, the Bill will allow draft or 'pathfinder' documents to be circulated for comment to 'sophisticated' and 'professional' investors (proposed subsection 734(9)). Pathfinder documents serve a useful purpose without causing any detriment to investors, as such, pathfinder documents will be exempt from the advertising restrictions in the Bill.

Liability

Prohibitions

8.3 Division 1 of Part 6D.3 will bring together the provisions on prohibited conduct.

8.4 The Bill will remove the current overlap between the general prohibition on misleading and deceptive conduct and the prohibition on misstatements in or omissions from a prospectus (current sections 995 and 996). The current overlap is unsatisfactory as it is unclear whether the current defences available for an action under section 996 are also available for an action under section 995 where the misleading or deceptive conduct is constituted by the issue of a defective prospectus.

8.5 Actions for damages or injunctions for misleading or deceptive conduct in connection with a disclosure document will no longer be available under section 995 (proposed Schedule 3, Part 1, item 59). Instead, Division 1 of Part 6D.3 will provide a self-contained liability regime for misstatements and omissions from disclosure documents.

8.6 Similarly, the misleading and deceptive conduct provisions in the Australian Securities and Investments Commission Act will no longer apply to securities dealings (proposed Schedule 4, Part 1, items 1, 2 and 3). This will ensure that there is no overlap between the Corporations Law and the Australian Securities and Investments Commission Act in relation to securities dealings. One of the main effects of this change would be to provide a self-contained liability regime in the Law for dealings in securities.

8.7 Consistent with this approach, the misleading and deceptive conduct provisions in the State and Territory Fair Trading Acts will no longer apply to securities dealings (proposed Schedule 3, Part 1, items 24 and 61). Again, this will ensure a self-contained liability regime in the Law for dealings in securities.

8.8 It will no longer be necessary in civil actions under the Law to establish that the misleading or deceptive statement, omission or new matter was material (proposed subsection 728(1)). However, in place of a materiality element, recovery of damages will depend on establishing that loss has been suffered as a result of the misleading or deceptive statement, omission or new matter (proposed subsection 729(1)). An injunction will remain a discretionary remedy available under current sections 1324 and 1325. It will only be an offence to offer securities under a disclosure document containing a misleading or deceptive statement, omitting required material or without a significant new matter if it is materially adverse from an investor's point of view (proposed subsection 728(3)).

Persons liable

8.9 The Bill will clarify the people who could be held liable for the disclosure document and the extent of their liability (proposed subsection 729(1)).

8.10 The issuer of a disclosure document, the directors and proposed directors and underwriters will be liable in relation to the disclosure document as a whole. Other persons will only be liable for statements in the disclosure document that they have made or which are based on their statements. A person will need to have consented to being named in the disclosure document in relation to a statement, or as a proposed director, before any liability may arise.

8.11 Other persons involved in a contravention of the fundraising provisions could also be liable to compensate for any loss suffered (proposed subsection 729(1), item 6).

8.12 Since the liability provisions and the offence provisions operate independently, it will not matter whether or not the person against whom compensation is being sought has been convicted for an offence in respect of the contravention.

8.13 A person who may be liable on a disclosure document must inform the person offering the securities in writing as soon as practicable after they become aware of a material misleading or deceptive statement, omission or new circumstance (proposed section 730).

8.14 The Bill will retain the current prohibitions on offering securities without a current disclosure document or in a body that does not exist (proposed sections 726 and 727).

Defences

8.15 The Law currently contains a complex set of defences for people who are liable in connection with a prospectus. These defences have been criticised as lacking coherence and a clear underlying policy. Furthermore, substantially similar concepts are expressed in different ways.

8.16 The Bill will make it easier for a person to determine whether defences are available by providing a uniform defence to all persons who are potentially liable in relation to disclosure documents. For disclosure under a prospectus, a person will not be liable if they made such inquiries as were reasonable and they believed on reasonable grounds that the prospectus did not contain any materially misleading or deceptive statements or omit any material matter (proposed section 731).

8.17 The defence provisions are modified to take account of the reduced disclosure requirements for profile statements and OISs (in particular, there is no requirement for the issuer of an OIS to undertake reasonable inquiries). A person will not be liable if they prove that they did not know that the statement made was misleading or deceptive or that there was a material omission from the statement (proposed section 732).

8.18 Because all aspects of a disclosure document will not necessarily be within the expertise of all persons who may be potentially liable, a person who places reasonable reliance on information provided by someone else will also have a defence to any liability that arises from statements or omissions in relation to that information (proposed subsection 733(1)). The Bill will extend this defence to all persons who may be liable, rather than its current application to the auditor's report.

8.19 However, a person will not be able to rely on information provided by an employee or agent or, if the person is a body, its directors (proposed subsection 733(1)). This will prevent someone relying on what is effectively their own information. Although the body will not be able to rely on information supplied by its employees for the purpose of establishing a subsection 733(1) defence, it will be able to carry out due diligence through its officers and employees for the purpose of establishing a defence under proposed section 731.

8.20 The proposed limitation will not preclude a director of a fundraising body relying on information supplied by the fundraising body's employees as those persons are not employees of the director. A person will be able to rely on someone who performs a particular advisory or professional function provided they are not an agent for some other reason (proposed subsection 733(2)).

8.21 A defence will also be available to persons who are liable as a result of being named in the disclosure document if they publicly withdraw their consent to being named (proposed subsection 733(3)). This defence is extended to underwriters.

8.22 As under the current law, there will not be a defence to an action for an injunction. A court will be able to restrain the circulation of a disclosure document that has a misleading or deceptive statement or omits required information even if due diligence has been taken in its preparation (current sections 1324 and 1325).

Small business fundraising

8.1 Access to capital has been a concern for SMEs, as they may find that the cost of preparing and lodging a prospectus can be excessive having regard to the amount of capital which is sought to be raised. The provisions will facilitate fundraising by SMEs in a number of ways.

Small scale offerings

8.2 A disclosure document will not be required if a person makes an unlimited number of personal offers of securities that result in securities being issued to 20 or fewer persons in a rolling 1 year period with no more than \$2 million being raised (proposed subsections 708(1) — (7)). This will reduce the costs for small business when making small scale offerings and will free them from constraints in fundraising without exposing investors to unnecessary risks.

8.3 The 20 issue exclusion will facilitate fundraising by SMEs that are currently required to prepare a prospectus if they do not raise enough funds after making 20 offers in 12 months (current paragraphs 66(2)(d) and (3)(d)). The current exclusion for 20 offers in 12 months is considered to

be unduly restrictive and difficult to apply in practice. For example, it can be difficult to ascertain whether an offer has been made.

8.4 Offers under the proposed 20 issue exclusion are limited to ‘personal’ offers, which is consistent with the existing exclusion. This will prevent the exclusion being abused by making offers to retail investors at large without proper disclosure in a disclosure document. The Bill will remove uncertainty about what constitutes a ‘personal’ offer. An offer will be a personal offer only if it can be accepted by the person it is made to, and if the person is likely to be interested in the offer because of any previous contact, professional or other connection to the person making the offer, or because they have indicated that they are interested in offers of that kind (proposed subsection 708(2)). This will allow offers to be made to self designated small business investors (known as ‘business angels’) who have previously stated their interest in the offer, even though there had been no previous contact between the person making the offer and the prospective investor.

8.5 Furthermore, by limiting the amount raised in any 12 month period to \$2 million, the Bill will prevent an unlimited amount of funds being raised from 20 investors (proposed subsections 708(1) and (7)). Issuers seeking to raise larger amounts of capital are expected to bear the costs of preparing a disclosure document.

8.6 The Bill will rectify other unsatisfactory aspects of the existing 20 offer exclusion by:

- making it clear that securities issued as a result of offers made under other exclusions are not counted towards the 20 issues (proposed paragraph 708(5)(a)); and
- extending the exclusion to registered managed investment schemes (the 20 investors required before a scheme must be registered would be counted towards the 20 issues allowed in any 12 months).

Sophisticated investors

8.1 The current sophisticated investor exemption (current paragraphs 66(3)(a) and 66(3)(ba)) applies only to persons who invest over \$500,000 in the securities in question. There are a number of avoidance problems with the current exemption. The Bill will resolve these by ensuring that:

- any moneys lent to the investor by the person offering the securities, or an associate, are not included when calculating the \$500,000 (proposed subsection 708(9)); and
- the \$500,000 is ‘payable for the securities on acceptance of the offer’ rather than payable by instalments of much smaller amounts over a prolonged period of time (proposed paragraphs 708(8)(a) and (b)).

8.2 However, from an issuer’s perspective the problem is that the \$500,000 threshold is too high because of the difficulty of finding investors willing to invest such large sums or because less than \$500,000 is sought in total. Consequently, in addition to the \$500,000 exemption, the Bill will introduce two new sophisticated investor thresholds.

8.3 Investors will be able to invest less than \$500,000 if the offer is made through a licensed dealer and the dealer is satisfied on reasonable grounds that they have previous experience in investing in securities which allows them to assess the investment (proposed paragraph 708(8)(c)). Placing experience as a test for sophistication will allow issuers to offer securities to those who do not fit the threshold income and asset tests referred to below but are ‘sophisticated’ because of their experience in investing in securities without the need for a disclosure document.

8.4 In addition, investors will be able to invest less than \$500,000 if a qualified accountant certifies that they have a gross income over the previous 2 financial years of at least \$250,000 or have net assets of at least \$2.5 million (proposed paragraph 708(8)(d)).

8.5 The Bill will also extend the current \$500,000 exemption to allow investors to top up existing investments to over \$500,000 (proposed paragraph 708(8)(b)). This is consistent with the rationale of the exclusion to allow persons who are considered to have sufficient resources to obtain independent professional advice or who, because of the size of their potential investment, have sufficient leverage over the issuer to obtain the required information. The exclusion will be amended to make it clear that this amount is the amount invested and not the amount of the offer (proposed subsection 708(8)(b)).

Offer information statements

8.6 The Bill introduces the Offer Information Statement (OIS) as a new fundraising mechanism for SMEs (proposed subsection 709(4)). An issuer will be able to raise up to \$5 million by way of an OIS instead of a prospectus. An issuer could raise several tranches of capital under OISs provided the total raised during its life did not exceed \$5 million. The limit of \$5 million would accommodate the fundraising targets of SMEs. Issuers seeking to raise larger amounts of capital are expected to bear the costs of prospectus preparation.

8.7 Disclosure obligations under the OIS are limited to the information that proposed subsection 715(1) requires to be included in the OIS. This is expected to be material information known to the corporation. External inquiries are not expected to be undertaken to ascertain information about matters on which disclosure is required.

8.8 An OIS will be required to include a prominent statement that it is not a prospectus, that it has a lower disclosure requirement than a prospectus and that investors should obtain professional advice before accepting the offer (proposed paragraphs 715(1)(g) and (h)). The warnings are particularly important in making investors aware of the risks involved in an OIS offering. An OIS will also be required to include a financial report prepared in accordance with Chapter 2M of the Law. A person is not liable for a misstatement in or an omission from an OIS if they can prove that they did not know that the statement was misleading or deceptive or that there was a material omission from the statement (proposed section 732).

8.9 Use of an OIS to raise up to \$5 million will not be limited to SMEs. However, to prevent abuse of the exemption, ASIC will be able to determine that the transactions of different bodies are to be aggregated (proposed section 740). As at present, a proprietary company will not be able to engage in fundraising which would require a disclosure document (proposed Schedule 3, Part 1, item 46). This will include fundraising under an OIS.

Electronic commerce

8.10 The Bill will facilitate the issue of a disclosure document in electronic form as well as paper documents. The Bill will remove barriers to electronic commerce by providing a statutory framework for electronic disclosure documents which is designed to promote investor confidence in the integrity of the electronic financial services marketplace.

8.11 The existing requirement for all directors to sign a disclosure document will be replaced with a requirement that all directors consent to the issue of the disclosure document in writing (proposed section 720). This approach avoids having a requirement for signatures on the lodged

copy of the disclosure document, which would be difficult if the disclosure document is lodged electronically, while preserving the policy that each director is to have a veto on the issue of the disclosure document.

8.12 The general provisions dealing with the lodgment of documents in Part 2N.2 of the Law will apply to the lodgment of disclosure documents. This means that a disclosure document lodged in writing must be signed by a director or secretary. Section 352 of the Law permits a document to be lodged and authenticated electronically if agreed to by the person lodging the document and ASIC. ASIC has indicated in Policy Statement 107 on electronic prospectuses that it will allow a body to issue an electronic prospectus provided that certain conditions are satisfied.

8.13 The difficulty with the current requirement that the application form be 'attached to' the prospectus or supplementary prospectus (current paragraph 1020(b) and subsection 1024(3)) is dealt with in the Bill by allowing an application form to be 'included in, or accompanied by,' the disclosure document (proposed subsection 723(1)).

8.14 The Bill will also make it clear that offers received in Australia, irrespective of where the securities are transferred or issued, are subject to the fundraising provisions (proposed subsection 700(4)). Therefore, offers transmitted electronically into Australia from outside Australia will be caught. Similarly, an offer placed on an Internet site generated by a server situated outside Australia will be subject to the fundraising provisions if it is capable of being received in Australia. The existing territorial limitations of the provisions will be retained and will not apply to offers made overseas by Australian companies.

8.15 The securities hawking provisions in current sections 1077 to 1082 have been identified as an impediment to electronic commerce. Instead, the Bill will prohibit the making of unsolicited offers of securities, whether by meeting with another person or by a telephone call (proposed subsection 736(1)). This prohibition is based on the unsolicited calls provisions in the *Financial Services Act 1986* (UK). It is an improvement on the existing securities hawking prohibition (current section 1078) in that it:

- focuses more directly on the mischief sought to be prevented, namely the unsolicited offer; and
- only covers those forms of communication that result in badgering the potential investor, rather than applying to all eligible telecommunications services including post or fax.

8.16 As at present, there will be exclusions for offers of quoted securities by licensed dealers, offers by dealers to their clients, offers to professional investors and offers to sophisticated investors (proposed subsection 736(2)).

8.17 The Bill will also improve the remedies available to persons who acquire securities as a result of an unsolicited offer (proposed section 738). Those persons will be entitled to return the securities within a period of 1 month and receive their money back. Unlike current section 1082, this remedy does not depend on there having been a conviction. Nor does it require an order to be made by the Court.

Prospectus lodgment

8.18 The Bill will continue to require the lodgment of a disclosure document with ASIC (proposed section 718 and subsection 727(1)). However, the Bill will remove the current requirement that certain prospectuses must be registered with ASIC.

8.19 Instead, a person offering securities will be able to distribute the disclosure document immediately after it has been lodged with ASIC. However, a person offering non quoted securities will not be allowed to accept an application for the issue or transfer of the securities until 7 days after lodgment of the disclosure document with ASIC (proposed subsection 727(3)). ASIC may extend this 7 day period to a maximum of 14 days. The 7 to 14 day period gives ASIC and the market an opportunity to consider the disclosure document before the commencement of subscriptions for the securities on offer. Where the disclosure document was defective, the market could draw it to the attention of ASIC or aggrieved parties could, if appropriate, seek injunctions preventing the fundraising.

8.20 The 7 to 14 day period will not apply to a person offering quoted securities. These securities already have an established market price and are subject to the continuous disclosure regime.

8.21 The Bill will continue to require a disclosure document to state that ASIC takes no responsibility for its contents (proposed paragraphs 711(7)(b), 714(1)(e) and 715(1)(f)).

Fundraising by the Federal Government

8.22 The Bill will remove the immunity of the Federal Government and its agencies from the fundraising provisions of the Law (proposed Schedule 5, items 14 and 15).

8.23 Applying the fundraising provisions to the Federal Government and Federal Government entities will require them to compete with private sector bodies for investors' funds on the same terms. This is consistent with the tenor of the competitive neutrality principles agreed to by all Australian Governments for government business enterprises.

8.24 Investors will benefit significantly as government entities will be required to disclose information that will allow investors to make informed investment decisions. They will also have greater protection in relation to the fundraising activities of the Federal Government and Federal Government entities.

8.25 Competitive neutrality is part of broader economic policies aimed at increasing reliance on market based mechanisms and competition to promote efficiency and competitiveness. An advantage of removing governmental immunity is that the Federal Government and its entities will be able to issue a disclosure document in a form that is familiar to the marketplace. This could increase the marketability of the securities offered in the disclosure document in local and overseas markets by providing investors with the confidence that the full requirements of the Law are applicable. This encourages increased public investment which may in turn increase the price that can be obtained for the securities as well as leading to more competitive returns.

8.26 Applying the fundraising provisions of the Law to the Crown has already been implemented in the partial privatisation of Telstra (section 8AT of the *Telstra (Dilution of Public Ownership) Act 1996*).

8.27 Debt instruments offered by the Federal Government and its agencies that are guaranteed by the Government will continue to be exempt from the fundraising provisions. These securities are

more secure than bank and building society deposits that are exempt from the fundraising provisions, because there is a Government guarantee and they are subject to a specific prudential supervision regime.

Rewriting the fundraising provisions

8.28 When the Government announced the Corporate Law Economic Reform Program, it was noted that the project of rewriting the Law in order to simplify it would be subsumed within the Government's overall corporate law reform program. Accordingly, as well as implementing the CLERP proposals, the Bill will rewrite the fundraising provisions. As a result of this 'rewrite', a number of reforms have been made to modernise the existing provisions and ensure they are consistent with the earlier work on simplifying the Law. The key changes made as part of this process are set out below.

'Securities' covered by the fundraising provisions

8.29 The securities covered by the fundraising provisions will continue to include shares and debentures and will apply to interests in registered managed investment schemes (proposed paragraph 700(1)(c) and section 701). Under Part 5C.1 of the Law, a managed investment scheme must be registered where it has more than 20 members.

8.30 The current definition of 'securities' of a body includes 'units' of shares and prescribed interests (current paragraph 92(2)(d)). 'Unit' is defined in current section 9. The securities which will be covered by the fundraising provisions will include the instruments currently known as 'units', namely any legal or equitable right or interest in relation to shares, debentures or interests in registered managed investment schemes and options to acquire these rights or interests (proposed paragraphs 700(1)(d) and (e)).

8.31 The provisions will, however, be redrafted so that they no longer apply to offers of securities of a corporation but to offers of securities of a body. By avoiding the use of the term 'corporation' there is no longer an implication that the provisions only apply to securities of incorporated bodies.

8.32 The shift to securities of bodies results in substantially the same entities being covered. However, the change in focus will remove an anomaly in the current coverage of the provisions by applying them to unincorporated bodies, which may be sued in the name of their secretary, in their jurisdiction of formation. This will ensure that unincorporated entities offering securities will be covered by the fundraising provisions.

8.33 Offers of securities of various bodies established under specialist State and Territory legislation, such as co-operatives, will continue to not be subject to the prospectus provisions in their jurisdiction of incorporation (proposed subsection 708(19)).

Options

8.34 The Bill will apply the fundraising provisions to options to acquire shares by way of issue (proposed paragraph 700(1)(e)). It is currently unclear whether the definition of securities in subsection 92(2) of the Law includes rights or options over unissued securities. A person may not acquire a legal or equitable interest in an unissued share until it is issued, and therefore the definition of 'unit' may be interpreted to not include options over unissued shares (see, for example, *Exicom Pty Ltd v Futuris Corporation Ltd* (1995) 18 ACSR 404). However, as the offer of a right or option in relation to an unissued security constitutes an offer of the underlying security, a

prospectus will generally be required in relation to that offer: *AG (NSW) v Mutual Home Loans Fund of Australia Ltd* [1971] 2 NSWLR 162. As the right or option is not itself a security, currently the prospectus only has to contain information about the underlying security and not about the option itself.

8.35 The fundraising provisions will also apply to options to acquire shares by way of transfer (proposed paragraph 700(1)(e)). Under the existing law, it appears that such options are only securities if they fall within the definition of 'unit'. However, where options relate to a particular class of securities rather than particular identifiable securities, it is generally accepted that the instrument will not constitute a right or interest over a security and hence will not be a unit. It seems anomalous that options over identified securities should be subject to the fundraising provisions but offers of options over a class of securities are not. The Bill will rectify this.

8.36 One consequence of the change is that it clarifies the application of the fundraising provisions to offers to subscribe for long-dated options over quoted securities (generally marketed as warrants). Issuers of listed warrants are currently required to provide Offering Circulars containing prospectus-type disclosure: ASX Business Rule 8.7. While at present a prospectus will not be required for a direct offer of an existing quoted security, a disclosure document is proposed to be required in relation to warrants because of the additional need of investors to make an assessment of the capacity of the party issuing the option to meet its obligations under the option.

8.37 It will be made clear that options are securities in their own right for both the issue and transfer of securities. As a result, the fundraising provisions will ensure that information about the options themselves as well as any underlying securities will be disclosed when required (proposed section 710). This will ensure that investors receive adequate information in relation to fundraising involving options where the bulk of the consideration is obtained through the option premium.

8.38 As at present, the fundraising provisions will apply in relation to offers of securities rather than the issue of securities. Accordingly, a disclosure document will be required for the offer of options but not for exercise unless there is a further offer made at that point (proposed section 702). While investor protection considerations suggest that a prospectus should be required upon the exercise of long-dated options where the bulk of the consideration is paid upon exercise, this approach has not been proposed because of the significant practical difficulties it would create, particularly where options may be exercised at any stage over their lifetime.

8.39 The fundraising provisions will not apply to options to sell a security, known as a put option. This is because the fundraising provisions seek to regulate people who make securities available. Put options, however, are issued by the person who has the obligation to buy the security and are more appropriately regulated by other provisions of the Law.

8.40 As at present, exchange traded options, namely those options quoted on the Australian Options Market, will also not be subject to the fundraising provisions (proposed subsection 700(1)). These options can be distinguished from other options as they are subject to clearing arrangements which provide investors with an added degree of protection. Similarly, the fundraising provisions will not apply to futures contracts over securities (proposed subsection 700(1)).

8.41 The CLERP Financial Markets and Investment Products paper proposed that a consistent and comparable disclosure regime for all financial instruments, other than securities which are subject to the fundraising provisions, be developed (proposal no 7). There is a question whether some of the securities covered by the disclosure obligations of the draft fundraising provisions should instead be covered by the disclosure regime developed as a result of the CLERP Financial Markets and Investment Products paper.

8.42 In the interim, it is appropriate that these products are subject to the fundraising provisions, with ASIC being able to provide relief from certain requirements where appropriate. Accordingly, it is recognised that the application of the fundraising provisions to some securities will be examined in developing provisions implementing the CLERP Financial Markets and Investment Products paper.

General disclosure requirement

8.43 As noted above, the Bill will retain the requirement that a prospectus contain all information that investors and their professional advisers would reasonably require to make an informed investment decision (proposed section 710). However, the provision has been recast to overcome ambiguities in the language of the existing provision. Under the redrafted provision, a prospectus must contain:

- all the information that a reasonable investor would both reasonably require and reasonably expect to find in the prospectus, having regard to what investors could reasonably be expected to already know, and
- all the information that professional advisers would both reasonably require and reasonably expect to find in the prospectus, having regard to what professional advisers could reasonably be expected to already know.

8.44 The general disclosure test will only require information to be included if certain persons actually know or ought reasonably to have obtained the information by making enquiries (proposed subsection 710(1)). The persons whose knowledge is relevant include directors and proposed directors of the body offering the securities and others who are involved in preparing the prospectus (proposed subsection 710(3)).

8.45 For an offer to issue or transfer a share, debenture or interest in a managed investment scheme, the draft provisions will require the person making the offer to include information that would allow an investor and a professional adviser to make an informed assessment of:

- the rights and liabilities attaching to the securities offered; and
- the assets and liabilities, financial position and performance, profits and losses, and prospects, of the body issuing the securities (proposed subsection 710(1), item 1).

8.46 This substantially retains the current position. However, to be consistent with the financial reporting requirements in Chapter 2M of the Law, the Bill includes a requirement that the company disclose its financial performance. The use of these words is not intended to mean that an issuer must always include forward looking statements in a prospectus. The inclusion of forward looking statements is a matter for the issuer, having regard to its obligations under the general disclosure test.

8.47 Consistent with their treatment as securities in their own right, a prospectus for an offer to grant or transfer an interest, option or warrant over securities will also need to contain information on the rights and liabilities attaching to the interest, option or warrant. This ensures that investors can assess the value of both the security and the underlying securities. Information will be required about the capacity of the person offering options or warrants to complete the contracts so that investors can assess the counterparty risk (proposed subsection 710(1), item 2). However, the prospectus will only be required to contain information on the body issuing the underlying securities where the person making the offer will have access to the information or in the case of an indirect issue with an anti-avoidance purpose (proposed subsection 710(1), item 2).

8.48 The Law currently allows a prospectus to omit information previously disclosed to the market under any law or the business rules or listing rules of a securities exchange (current paragraph 1022(3)(d)). However, in practice, persons issuing prospectuses are reluctant to omit the information because there is uncertainty about the meaning of the provision. Also, the provision has been supplanted by the concessional requirements for continuously quoted securities which allow a transaction specific prospectus to be prepared and the short form prospectus provisions (proposed sections 712 and 713). Consequently, the Bill will repeal the provision ensuring that the prospectus contains information reasonably required for an informed investment decision.

8.49 Current paragraph 1022(3)(e) allows a prospectus to omit information known to investors or their professional advisers because of any Commonwealth, State or Territory legislation. However, the effect of this provision is uncertain. One view is that the paragraph allows relevant statutory provisions to be omitted from a prospectus. Another view is that the paragraph allows information made available to investors under any law to be excluded from the prospectus. The Bill will repeal the provision as it is incorrect in principle. It is unclear why information of this kind should not be made available in a prospectus if it is reasonably required by investors to make an informed decision about the offer. The extent to which this information should be included in a prospectus should therefore be determined in accordance with the general disclosure test in proposed section 710.

Specific disclosure requirement

8.50 Where persons involved in the preparation of a prospectus have an interest in the outcome of the offer, the draft provisions will require these interests to be disclosed. This will extend the current disclosure requirement for directors, proposed directors and promoters in the case of schemes (current subsection 1021(6) and regulation 7.12.11), as other persons involved in the preparation of a prospectus may have an equal, if not greater, interest in the outcome of the offer. The Bill will also cover persons named in the prospectus as performing a professional, advisory or other function in connection with the preparation or distribution of the prospectus, and if the securities are interests in a managed investment scheme the person or directors of a body that is making the interests available, promoters for bodies, stockbrokers and underwriters (proposed subsections 711(2)-(4)). Requiring the disclosure of all significant interests in the body or in the issue will provide a significant disincentive for persons involved in the offer to act improperly.

Offers of securities issued for resale

8.51 The Bill will provide that a disclosure document is required if a person offers securities for sale within 12 months after their issue and the body issuing the securities did so without a disclosure document and with the purpose of having the securities resold by the person to whom they were issued (proposed subsection 707(3)).

8.52 In the absence of evidence to the contrary, where securities are sold within 12 months of their issue, that issue will be regarded as having been for the purpose of resale (proposed subsection 707(4)). The body or the person who controls the body issuing the securities will have to show that there was no purpose of resale. The Bill will make it clear that the obligation to prepare a disclosure document is on the person offering the securities for sale. However, the directors of the issuing body or the controller must consent to the issue of the disclosure document (proposed section 720, item 3). After 12 months, the securities would be able to be traded freely in the market.

8.53 This anti-avoidance provision replaces current section 1030, which deems a document offering securities issued for the purpose of on-sale to be a prospectus issued by the corporation

which issued the securities. Where securities are sold within 6 months of their issue, they are deemed to have been issued for the purpose of on-sale. The aim of section 1030 was to prevent avoidance of the prospectus provisions by issuing securities to an intermediary under one of the exclusions and the intermediary then on-selling the securities at large.

8.54 The Bill will rectify a number of problems which have been identified with the operation of current section 1030, including:

- the indefinite tainting of securities issued for the purpose of resale (at present, whenever the securities are resold in the future, a prospectus is required);
- the potential for subsection 1030(1A), which provides an exemption for offers made on the Stock Exchange Automated Trading System screens, to undermine the anti-avoidance purpose of section 1030;
- uncertainty whether the resale purpose is that of the issuer or the seller; and
- deeming a sale document to be a prospectus, with the corporation potentially being made liable for the contents of a document prepared by another party, and the persons purchasing the securities to be subscribers, with uncertainty whether the rules relating to offers for subscription apply.

Secondary sales notices

8.1 The Bill will remove the existing disclosure requirements for offers of unquoted securities for sale other than by a person who controls the body (current section 1043D).

8.2 Current sections 1043B and 1043D require the person offering the securities to lodge with ASIC a notice containing certain information about the securities, the seller, the corporation and its directors. The notice only contains information which is already publicly available. Consequently, the preparation of the notice imposes additional costs on the seller of the securities, without providing purchasers of securities with any additional information. The regulation of these offers will therefore be governed by the general prohibitions on insider trading and misleading and deceptive conduct.

8.3 Where an offer of unquoted securities for sale is made by a person who controls the body, the Bill will require the person to prepare a disclosure document (proposed subsection 707(5)). Currently, the Law requires an offer of at least 30 per cent of a company's unquoted shares to be accompanied by a prospectus-type document (current section 1043C). This is consistent with equating a secondary sale by a controller with a primary offer of securities. A controller of a body will either have direct access to, or be in a position to obtain, the necessary information to prepare a disclosure document. This is readily apparent in relation to so called 'spin off' floats where a body corporate sells off a business by a secondary sale of the shares of the subsidiary conducting the business.

8.4 The Bill will make a number of other important changes to the disclosure requirements for these offers.

- It will replace the current arbitrary 30 per cent threshold with a test based on control. The current 30 per cent threshold is effectively a proxy for control of the company. However, the disclosure requirements can be avoided where the person who controls the company limits any secondary sales of shares to less than 30 per cent. The Bill will overcome this by adopting the definition of control in proposed section 50AA.

- It will extend the disclosure requirements to off-market sales of quoted securities by controllers.
- It will extend the disclosure requirements to securities. Currently, the provisions only apply to voting shares (current subsection 1043C(1)).
- The exception for 20 issues in 12 months will not be available to a controller effecting an indirect off-market sale under proposed subsection 707(5) (proposed subsection 708(1)).

Restrictions on issuing securities

8.1 The Bill will remove procedural difficulties created by the current restrictions on issuing securities in Divisions 2 and 3 of Part 7.12. In particular, the current rules are inconsistent and are poorly integrated with the provisions on supplementary and replacement disclosure documents and out of date application forms.

8.2 The Bill will replace current sections 1024E, 1028, 1031 and 1035 to 1043. The Bill will restate the current sections in plain English to clarify their operation and the choices available to the issuer (proposed sections 723, 724 and 725).

8.3 A person will be prohibited from offering securities under a disclosure document if there is a misleading or deceptive statement in, or omission from, the disclosure document, or a new circumstance has arisen which should have been included in the disclosure document. In addition, a person cannot offer securities where a condition in the disclosure document has not been met, for example, a shortfall on the minimum subscription of shares (proposed subsection 723(2)), or a failure to obtain quotation on a securities exchange (proposed subsection 723(3)). A person cannot offer securities where the disclosure document passes its expiry date (proposed section 725).

8.4 Where a person offering securities ceases to comply with any of these requirements, the Bill will provide uniform procedures for dealing with any unprocessed application forms. The person will be able either to:

- repay the application money received;
- continue to hold the application money in trust and issue a supplementary, replacement or new disclosure document and give the investor an opportunity to withdraw their application and be repaid; or
- issue the securities and give the investor a supplementary, replacement or new disclosure document and an opportunity to return the securities and be repaid (proposed sections 724 and 725).

8.5 Application money is to be held on trust (proposed section 722). The Bill will remove the requirement that the trust account be held at a 'bank'. The money will be able to be held by any financial institution.

13 month prospectus life

8.6 Currently, the maximum period during which a prospectus can remain on issue is 12 months. This requirement has been criticised by continuous issuers because in practice a prospectus must be prepared and lodged before the expiration of the 12 month period to ensure that a current prospectus

is always on issue. The Bill will extend that period to 13 months to facilitate issuers 'rolling over' prospectuses on an annual basis (proposed subsection 711(6)).

Clearing house

8.7 An amendment will also clarify the entitlement of a clearing house to realise securities lodged by clients for margin obligations. The treatment of such securities will be brought into line with the existing treatment, under paragraphs 1209(5)(a) and (b) of the Corporations Law, of cash lodged by clients in similar circumstances. In so doing it will overcome any existing uncertainty as to whether a clearing house has constructive notice that a client has an equitable interest in those securities (proposed Schedule 6, item 15).

Debentures

8.8 To complete the reform of Part 7.12, new Chapter 2L will replace the current debenture provisions in Division 4 of Part 7.12. The Bill will rewrite the debenture provisions to streamline and update them to reflect actual commercial practices.

Definition of debentures

8.9 The current definition of debenture reflects the common law definition which is based on a class of documents issued by a company acknowledging or creating a debt. However, not all instruments which satisfy these criteria are necessarily debentures and the Law currently excludes a number of items from the definition (current section 9).

8.10 To facilitate electronic commerce in debentures, the definition of 'debenture' will be recast. The definition will focus on the legal right to repayment of the debt, rather than on the piece of paper evidencing the debt. The Bill will define a debenture as a chose in action (or property right), which more accurately reflects the true nature of debentures (proposed Schedule 3, Part 2, item 78). This will also bring the definition of debenture more closely into line with the definition of securities.

8.11 The Bill will retain the current exclusions from the definition of debenture (proposed Schedule 3, Part 2, item 78), except the exclusion in relation to current section 1023, which is repealed by the new fundraising provisions.

What can be called debentures

8.12 The Law currently prevents issuers from describing a document evidencing a corporation's debt as a debenture unless the deposit or loan is secured. Where the loan is unsecured, it must be referred to as an unsecured note (current section 1045). This provision will be rewritten and retained by the Bill (proposed section 260GH).

Definition of borrower and guarantor

8.13 The Bill will replace the terminology used in the current debenture provisions of 'borrowing corporation' and 'guarantor corporation' with 'borrower' and 'guarantor' (proposed Schedule 3, Part 2, items 76, 77, 82 and 83). This reflects the application of the provisions to debentures of a body rather than debentures of a corporation and is consistent with the application of the new fundraising provisions to bodies.

When an offer of debentures needs a trust deed and trustee

8.14 The Bill will retain the current requirements for a trust deed and a trustee where a borrower makes a public issue of debentures. Where an offer of debentures needs a disclosure document under the fundraising provisions or is made as consideration for an off-market takeover bid, or an issue of debentures is made under a compromise or arrangement under Part 5.1, the body making the offer or issue must enter into a trust deed, appoint a trustee and comply with Chapter 2L (proposed section 260FA).

The Trust Deed

8.15 The Bill will require the trust deed to contain a provision specifying the property that is held on trust under the deed is in the nature of a bundle of rights. This provision has been inserted to avoid any ambiguity concerning the actual nature of the trust property (proposed section 260FB).

8.16 The Bill will no longer require trust deeds to contain a limitation on the amount that the borrower may borrow under the deed or the debentures. The current requirement contained in subsections 1054(1) and (2) is considered meaningless as it does not provide any guidance as to the extent or nature of the limitation which is required. It is also considered possible to reduce a corporation's capacity to pay back the debt under the debenture by, for example, creating prior or equal ranking charges.

8.17 The removal of the rule against perpetuities for issues of debentures in current section 1050 has been restated without change (proposed subsection 1481(1) and Schedule 3, Part 2 item 87). The rules on the redemption of debentures in current section 1051 have been restated and moved into the winding up provisions of the Law (proposed section 1481(2) and Schedule 3, Part 2 item 103 section 563AAA).

The Trustee

8.1 The Bill will retain the current categories of bodies corporate who are eligible to appointed as trustee (current subsection 1052(1), proposed subsection 260FC(1)). ASIC will continue to have the ability to approve other bodies corporate as eligible trustees (proposed paragraph 260FC(1)(f) and section 260MB).

8.2 The Law currently contains a complicated list of situations in which a person cannot be a trustee for an issue of debentures (current subsections 1052(5) to (7)). The current rules are based on an arbitrary set of situations. The Bill will replace the current rules with a simple 'conflict of interest' test (proposed subsection 260FC(2)). The new test reflects the trustee's common law fiduciary duty to avoid conflicts of interest.

8.3 The rules on the appointment of a replacement trustee in current section 1053 are replicated with only one significant change. The Law currently allows, but does not require, a borrower to appoint a new trustee where the existing trustee retires. The Bill removes this anomaly by placing a positive obligation on the borrower to replace a trustee where they become incapable of continuing as trustee (proposed sections 260FD, 260FE and 260GD). This is intended to ensure that there is a validly appointed trustee at all times.

Specific performance of debenture contracts

8.4 The Bill will remove the specific provision allowing a contract for debentures to be enforced by an order for specific performance (current section 1049).

8.5 This provision is no longer necessary in light of the development of the common law in this area. It was initially inserted into the Law in response to a Privy Council decision preventing an order of specific performance for a contract to lend money to a company upon the security of debentures to be issued by the company: *The South African Territories Ltd v Wallington* [1898] AC 309. The common law position has subsequently changed and a series of decisions have held that specific performance will be available in relation to these contracts where an award of damages is not an adequate remedy (see, for example, *Wight v Haberdan Pty Ltd* [1984] 2 NSWLR 280).

Debenture issues for particular purposes

8.6 The Law currently specifies a number of requirements with which a borrower and trustee must comply where debentures have been issued and money raised for a particular purpose (current section 1060). This provision is considered outdated and will be repealed for the following reasons:

- there is no statutory requirement to state in the disclosure document a purpose for which the money is to be applied (in practice, purposes are seldom, if ever, stated);
- additional statutory requirements are not essential where a purpose for the debenture issue is stated in the disclosure document (what is essential is that the issuer complies with the agreed terms of the debenture and their duties under the deed); and
- there is no similar statutory requirement in the fundraising provisions covering cases where a purpose for the share issue is set out in the disclosure document.

Borrower's and guarantor's duties

8.1 Current section 1054 requires a debenture trust deed to contain covenants which impose obligations on the borrower and the guarantor. The Bill will restate most of these covenants as direct statutory obligations (proposed sections 260GA and 260HA). This will avoid the need for each trust deed to include these covenants and will place borrowers and guarantors under a statutory obligation to comply with each covenant. The imposition of the obligations in terms of direct statutory obligations is consistent with the approach taken under Chapter 5C of the Law in relation to responsible entities.

8.2 For example, a borrower will be under a duty to carry on and conduct its business in a proper and efficient manner, to provide a copy of the trust deed to debenture holders and the trustee, to make its financial records available for inspection by the trustee and to notify the trustee about any charges it creates (proposed sections 260GB to 260GF). The borrower is also under a duty to call a meeting of unit holders where the holders of 10 per cent or more of the nominal value of the issued debentures direct the borrower to call a meeting (proposed section 260KA).

8.3 A guarantor will be under a duty to carry on and conduct its business in a proper and efficient manner, to make its financial records available for inspection by the trustee and to notify the trustee about any charges it creates (proposed sections 260HB and 260HC).

8.4 If a borrower or guarantor is under external administration or has a receiver appointed, it will be exempt from complying with some of its duties (proposed sections 260GG and 260HD). This is consistent with exemptions in current subsection 1058(11).

8.5 The Bill will create a specific offence if the borrower or guarantor intentionally or recklessly contravene any of the statutory covenants (proposed sections 260GI and 260HE).

8.6 Borrowers will be prohibited from describing debentures as mortgage debentures or debentures unless the debentures are secured by a first mortgage over land or a charge over property of the borrower or any of the guarantors (proposed section 260GH). If an issue of debentures does not have either of these forms of security, borrowers will only be able to describe the debentures as unsecured notes or unsecured deposit notes. This reflects the existing prohibition in current section 1045.

8.7 Borrowers will continue to be required to maintain registers of debentures. The provisions applicable to registers of debentures maintained by companies were reformed by the *First Corporate Law Simplification Act 1995* and now appear at current sections 168 to 178. The remaining provisions in current section 1047 apply to registers of debentures maintained by non-companies. The Bill will replace these remaining provisions and bring them into line with the provisions applicable to registers of debentures maintained by companies (proposed Schedule 3, Part 2, item 102 sections 601CZA to 601CZD).

Reporting requirements of borrowers and guarantors

8.8 The quarterly reporting requirements for borrowers and guarantors contained in current section 1058 will be retained (proposed section 260GF). These requirements are intended to ensure that borrowers focus and report on compliance with their obligations under the Law every 3 months. All other special reporting requirements in current section 1058 will be repealed.

8.9 Current section 1058 requires borrowers which are holding companies to lodge audited annual and half-year accounts consolidating any guarantor subsidiaries and requires guarantors to lodge audited annual and half-year accounts and balance sheets (and provide copies to the trustee). Borrowers that are locally incorporated disclosing entities will be subject to half-year and annual reporting requirements under Chapter 2M of the Law. Guarantors that are companies will also be subject to annual reporting requirements under that Chapter.

8.10 To ensure that there is no regulatory gap in relation to foreign borrowers and guarantors, section 601CD of the Law will be extended to apply to these bodies (proposed Schedule 3, Part 2, item 101). This section currently requires registered foreign companies to lodge with ASIC a balance sheet and profit and loss account complying with the requirements of the law in the company's home jurisdiction. Half-year accounts of these bodies will no longer be required.

Trustees duties

8.11 The Bill will restate most of the duties imposed on trustees by current section 1056 (proposed section 260JA). However, the current duty of the trustee to satisfy itself that the debenture prospectus does not contain any false or misleading statements is omitted. This is consistent with the fundraising reforms which ensure that liability for false or misleading statements in a disclosure document only attach to persons involved in the preparation of the disclosure document.

8.12 The Bill will restate current section 1062, setting out when a trustee can properly be released from liability for something done or omitted to be done (proposed section 260JB and subsections 1481(3) and (4)). The Bill will also clarify that the trustee is not liable for anything done by it in accordance with a direction given by a meeting of debenture holders (proposed section 260JC).

ASIC and court powers

8.1 ASIC has the power under current section 1084 to exempt a person from the debenture provisions or modify the application of the debenture provisions. The Bill will retain this power (proposed section 260MA).

8.2 Currently the court's powers in relation to debentures are scattered throughout Division 6 of Part 7.12. The Bill will restate the court's powers and relocate them in one place (proposed sections 260NA and 260NB). The Bill will make a number of changes which streamline the court's powers and the processes involved in obtaining a court order.

8.3 The most significant change will be to clarify the ability of ASIC and the trustee to apply to the court. Under the current law, if the trustee believes the borrower or any of the guarantors will not be able to repay the debentures, the trustee may apply to ASIC for certain orders or may apply to the court for remedial orders. ASIC may even direct the trustee to apply to the court (current subsections 1056(2) to (8)).

8.4 The Bill will remove the complexity of the current procedures for applying to the Court. The Bill gives ASIC and the trustee a clear right to apply to the court for remedial orders. The right to apply to the court can be exercised at any time, and does not require the trustee to believe the borrower or any of the guarantors will not be able to repay the debentures (proposed subsection 260NB(1)). The current power of ASIC to make an order restricting the borrower's advertising for deposits and restricting its borrowing have been given to the court (proposed paragraphs 260NB(1)(e) and (f)).

8.5 The court's current power to order that irredeemable debentures are enforceable immediately is subject to a number of conditions (current section 1055). The Bill will remove these conditions (proposed paragraph 260NB(1)(c)). Placing conditions on the court's powers is unnecessary given the overriding requirement that the court have regard to the interests of each of the parties.

8.6 The trustee's ability to apply to the court for directions in current subsection 1057(1) has been restated without change (proposed section 260NA). The court's power to order a meeting of debenture holders in current subsections 1057(2) and (3) has also been restated without change (proposed section 260KC).

Civil liability

8.7 The current location of the debenture provisions in Part 7.12 means that a person who suffers loss or damage as a result of a contravention of the debenture provisions can recover the amount of their loss or damage under section 1005. As the debenture provisions will be moved to Chapter 2L, that Chapter will contain a civil liability provision which restates current section 1005 (proposed section 260L).

9

Accounting standards

9.1 The accounting standards provisions provide for the establishment of new institutional arrangements for the Australian accounting standard setting process and for the adoption of new procedures that must be followed by the standard setter when it is making or formulating accounting standards.

Schedule 2 — New Accounting standards provisions

Item 1 — Part 12

9.2 Item 1 provides that the *Australian Securities and Investments Commission Act 1989* (the ASIC Act) is amended by replacing the existing Part 12 (Australian Accounting Standards Board) with a proposed new Part 12 (Accounting standards).

9.3 The proposed new Part 12 has three divisions:

- the Australian financial reporting system;
- accounting standards; and
- administrative provisions.

Section 224 — Main objectives of this Part

9.1 Proposed section 224 is an introductory provision which outlines the objectives of the provisions contained in the proposed new Part 12. Three objectives are specified:

- facilitating the development of accounting standards that require the provision of financial information that:
 - enables users to make and evaluate decisions about allocating scarce resources;
 - assists directors in meeting their obligations in relation to financial reporting;
 - discloses information relevant to assessing issues such as performance and financial position; and
 - is relevant and reliable, facilitates comparability and is readily understandable
- facilitating the Australian economy through reducing the cost of capital, enabling entities to compete effectively overseas and having financial reporting requirements that are clearly stated and easy to understand; and
- maintaining investor confidence in the Australian economy.

Division 1 — The Australian financial reporting system

Section 225 — establishment, functions and powers of the Financial Reporting Council

9.1 A Financial Reporting Council (FRC) will be established (proposed subsection 225(1)) to perform a wide range of functions associated with the standard setting process. In particular, the FRC will be responsible for:

- advancing or promoting the main objectives of proposed Part 12;
- providing broad oversight of the standard setting process and giving the Minister reports and advice on the process;
- seeking contributions towards the costs of the standard setting process;
- the operations of the AASB, including the appointment of all members of the AASB, except the Chairman (who will be appointed by the Minister);
- approving the AASB's priorities, business plan, budget and staffing arrangements; determining its broad strategic direction and giving the AASB directions, advice or feedback on matters of general policy and the AASB's procedures;
- monitoring the development of international accounting standards and furthering the harmonisation of Australian standards with those international standards;
- monitoring the operation of accounting standards to assess their continued relevance and effectiveness in achieving their objectives in respect of both the public and private sectors of the Australian economy; and
- establishing appropriate consultative arrangements in respect of its own functions (proposed subsection 225(2)).

9.2 The provisions have been designed to ensure that the FRC is in a position to provide broad oversight over the standard setting process without being able to determine the content of particular standards. In particular, the FRC will not have any influence over the technical deliberations of the standard setter and will not be able to veto, either in whole or in part, any accounting standard made by the standard setter. In performing its functions and exercising its powers, it is expected that the FRC will operate in a manner that is open and consultative in nature.

9.3 It is envisaged that funding for the standard setting process will be provided by the Government, the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia (jointly) and preparers/users in the public and private sectors in broadly equal proportions.

9.4 Proposed subsections 225(3) and (4) provide that, in addition to the powers given to it by the ASIC Act, the FRC has power to do those things necessary or convenient to be done in connection with the performance of its functions, including the establishment of committees and advisory groups.

9.5 One of the bodies that it is envisaged would be established by the FRC is a committee equivalent to the existing Urgent Issues Group (UIG). Such a committee would, like the UIG, be responsible for reviewing accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance, with a view to reaching a consensus on the

appropriate accounting treatment. Although the legislation will not establish a regime for approving or enforcing these consensus views, it is envisaged that compliance will be achieved through the rules of the professional accounting bodies and pronouncements of the Australian Securities and Investments Commission (ASIC).

9.6 Provisions dealing with the membership of the FRC and its reporting and procedural requirements are contained in proposed Subdivision A of Division 3.

Section 226 — Establishment of the Australian Accounting Standards Board

9.7 Proposed section 226 provides for the establishment of the Australian Accounting Standards Board (AASB) as a body corporate. This will enable the AASB to employ staff and acquire property in its own right.

9.8 The AASB will be a Commonwealth authority for the purposes of the *Commonwealth Authorities and Companies Act 1997* (CAC Act). The CAC Act sets out the reporting, financial and other requirements with which Commonwealth authorities must comply.

9.9 While the AASB will be required to prepare an annual report in accordance with the requirements of the CAC Act, it is envisaged that these reporting obligations will be covered by the report that the FRC prepares in accordance with proposed subsection 235B(1) and not by requiring the AASB to prepare a separate report specifically for the purposes of the CAC Act.

Section 227 — AASB's functions and powers

9.10 Proposed subsection 227(1) provides that the functions of the AASB include:

- the development of a conceptual framework (not having the force of an accounting standard) for the purpose of evaluating proposed Australian and international accounting standards;
- making accounting standards for the purposes of national scheme laws, such as the Corporations Law;
- formulating accounting standards for other purposes, such as the public sector and non-Corporations Law entities (the legal effect of these standards will depend on the particular regulations/legislation governing the entities; however, it is expected that the practice of the ICAA and ASCPA in mandating compliance by members with accounting standards and consensus views in the preparation, presentation and audit of general purpose financial reports will continue to apply in respect of those standards);
- participation in the formulation of international accounting standards so as to influence their content towards the achievement of the objectives set out in proposed section 224; and
- advancing or promoting the main objectives of proposed Part 12.

9.11 For the purpose of performing these functions, the AASB will have a range of powers including the ability to engage staff and consultants and establish committees, advisory panels and consultative groups (proposed subsection 227(2)).

9.12 In performing its functions and exercising its powers, it is expected that the processes of the AASB will be open and consultative in nature. In particular, the AASB is expected to consult widely on both its own and international accounting standards.

9.13 The AASB is empowered to make an Australian accounting standard by simply issuing the text of an international standard with any modifications that may be needed to ensure that the standard operates effectively having regard to the existing legislative framework and institutional regulatory arrangements. The AASB may make such a standard regardless of the fact that the international standard does not reflect the views of the AASB when it provided comments on the exposure draft of the standard or when the AASB participated in any deliberations during the standard's development. This is because it may be considered in Australia's best interests to adopt an international standard with minimum modification as it represents the results of many deliberations and compromises necessary to achieve international acceptance and thereby facilitate international trade and investment.

9.14 The provisions in proposed Part 12 refer to the AASB 'making' and 'formulating' accounting standards. The word 'making' is used when the AASB issues a standard for the purposes of a national scheme law (for example, the Corporations Law) while the word 'formulating' is used where the AASB issues a standard for other purposes (for example, non-Corporations Law entities) or seeks to influence the content of an international standard.

Division 2 — Accounting standards

9.15 Proposed Division 2 contains provisions dealing with the interpretation of accounting standards, some of the powers of the AASB to make standards, requirements with which the AASB must comply when making standards and the ability of the FRC and the Minister to give directions to the AASB.

Section 228 — Purposive interpretation of standards

9.16 Accounting standards are to be interpreted in a manner that promotes the purpose or objective of proposed Part 12 of the ASIC Act (proposed subsection 228(1)).

9.17 In addition, each accounting standard made by the AASB is to be interpreted in a manner that promotes the purpose or objective of that accounting standard, provided that that purpose or objective is not contrary to the purpose or objective of proposed Part 12 of the ASIC Act (proposed subsection 228(2)).

Section 229 — Generic and specific standards

9.18 Proposed subsection 229(1) provides that accounting standards may be of general application (that is, apply to all entities that are required to prepare financial statements) or limited application (that is, apply to specific industries or entities).

9.19 Proposed subsection 229(2) provides that, when making an accounting standard, the AASB must have regard to whether an accounting standard is suitable for different types of entities. The AASB will also be able to express standards to apply on a differential basis; that is, requiring different classes of entity to provide different levels of information in respect of a particular disclosure requirement.

9.20 Proposed subsection 229(2) also requires the AASB to ensure that there are appropriate accounting standards in place for each type of entity that must comply with accounting standards. The purpose of this provision is to ensure that there are accounting standards that are applicable to all companies and other entities that are required by law to prepare financial statements.

9.21 However, in the case of both Corporations Law and non-Corporations Law entities, the issue of whether individual entities are required to comply with accounting standards is one for the legislation governing those entities rather than the AASB.

Section 230 — Comparative amounts

9.22 Proposed section 230 provides that an accounting standard may require financial statements to contain comparative amounts in respect of earlier periods.

Section 231 — Cost/benefit analysis

9.23 Proposed subsection 231(1) will require the AASB to undertake a cost/benefit analysis of the effect that a proposed accounting standard would have on the entities to which it applies before making or formulating the standard.

9.24 While the requirement to undertake a cost/benefit analysis would not apply to standards which effectively adopt the text of an international accounting standard (proposed subsection 231(1)), the AASB would be required to undertake a cost/benefit analysis of a proposed international standard either before providing comments to the international body that makes the standard or advocating its adoption as an international standard (proposed subsection 231(2)).

9.25 Proposed subsection 231(3) provides that the AASB has to comply with the requirements to undertake a cost/benefit analysis only to the extent that it is reasonably practicable. It is not expected that any cost/benefit analysis would necessarily be undertaken in a scientific manner by quantifying each cost and benefit. However, the analysis could involve the production of a form of economic impact statement by the standard setter which canvassed the merits of a proposed standard and assessed its impact on users and preparers and the economy as a whole.

Section 232 — FRC views

9.26 Proposed section 232 provides that, when it is performing its functions, the AASB must have regard to the FRC's views concerning the broad strategic direction of the standard setter, follow the general policy directions given to the standard setter by the FRC and take into account the advice and feedback provided by the FRC on matters of general policy.

9.27 The FRC does not have a power to direct the AASB in relation to the development, or making, of a particular standard.

9.28 Examples of a general policy direction which the FRC may give to the AASB, include how quickly Australia should move towards greater adoption of international standards and/or market value accounting.

Section 233 — International accounting standards

9.1 Proposed section 233 provides that the Minister may give the AASB a direction about the role of international accounting standards in the Australian accounting standard setting system.

However, prior to giving a direction to the FRC, the Minister must obtain and consider a report from the FRC about the desirability of giving the direction.

9.2 This provision therefore provides a mechanism for the Minister, upon the advice of the FRC, to require the AASB to move towards greater adoption of international standards if that is considered appropriate and the AASB has not moved in that direction of its own accord.

9.3 Issues that the FRC would be expected to have regard to when it is preparing a report for the purposes of this provision include:

- whether the standards made by the international standard setter had been endorsed by the International Organisation of Securities Commissions for cross-border raisings and listings;
- the level of acceptance of international accounting standards in the world's major capital markets (including the United Kingdom, France, Germany, the United States and Japan); and
- whether the adoption of international accounting standards would be in Australia's best interests.

Section 234 — Validity of accounting standards

9.1 Should the AASB, through error or oversight, fail to follow all the procedures associated with the making of accounting standards when it makes or formulates a particular standard (for example, omits to undertake a cost/benefit analysis or fails to have regard to the views of the FRC), the error or oversight will not affect the validity of the standard made as a result of those defective procedures (proposed section 234).

Saving existing standards

9.2 Proposed section 1493 of the Corporations Law is a transitional provision to ensure that accounting standards made by the AASB prior to the commencement of proposed Part 12 continue in operation as if they were standards made by the reconstituted AASB.

Division 3 — Administrative provisions

9.3 Proposed Division 3 of Part 12 of the ASIC Act contains the detailed administrative provisions for the management and operations of the FRC, the AASB, the confidentiality of information and financial matters.

Subdivision A — The Financial Reporting Council

Section 235A — Membership of FRC

9.4 The Minister will be responsible for appointing, by written instrument, the Chairman and other members of the FRC (proposed subsections 235A(1) and (3)). The members of the FRC may appoint one of their number to be the Deputy Chairman (proposed subsection 235A(3)).

9.5 The terms and conditions under which members of the FRC hold office will be determined by the Minister (proposed subsection 235A(2)) and will be set out in the instrument of appointment. Appointments will normally be for three years, although some initial appointments may be for shorter periods to ensure that all appointments do not expire at the same time.

9.6 It is envisaged that the members of the FRC will be drawn from nominations made by the following groups:

- the professional accounting bodies;
- users, preparers and analysts of financial statements;
- governments and public sector entities; and
- regulatory agencies, such as the ASIC and the Australian Stock Exchange.

Section 235B — Annual report

9.1 Proposed subsection 235B(1) provides that, before 31 October in each calendar year, the FRC must give the Minister a report on the operations of the FRC, the AASB and their respective committees and groups during the 12 months that ended on 30 June in that calendar year and the achievement of the objectives listed in proposed section 224. In special circumstances, the Minister may grant an extension of time for the preparation of the report (proposed subsection 235B(2)).

9.2 Proposed subsection 235B(3) requires the Minister to table the FRC's report in each House of the Parliament as soon as practicable after it has been received.

9.3 Proposed subsections 235B(4) and (5) are transitional provisions dealing with the reporting requirements for the year in which the FRC is established. If the FRC is established during the last three months of a financial year, the matters relating to that period of time may be dealt with in the following annual report of the FRC, while if it is established in the first nine months of a financial year, it must prepare a report covering the period from the time of its establishment until the end of the financial year.

Section 235C — Procedure

9.4 The members of the FRC will be able to set the rules under which the FRC operates (proposed section 235C). These rules include the length and form of notice that must be given for meetings of the FRC, the number of members who need to be present to enable a meeting to be held, and the procedures to be used for voting on issues for which a vote is required.

Subdivision B — The Australian Accounting Standards Board

Section 236A — Procedure

9.5 Meetings of the AASB will be chaired by the Chairman or, in his absence, the Deputy Chairman. In the event that the Deputy Chairman is also absent, the members of the AASB may choose one of their number to chair the meeting (proposed subsection 236A(1)).

9.6 Meetings, or parts of meetings, that consider the contents of accounting standards or international accounting standards, must be held in public (proposed subsection 236A(2)).

9.7 Subject to the need to comply with any directions that the FRC may give the AASB about its procedures (proposed subsection 236A(3)), the members of the AASB will be able to set the rules under which the AASB operates (proposed subsection 236A(4)). These rules could, subject to any directions given by the FRC, include the length and form of notice that must be given for meetings of the AASB, the number of members who need to be present to enable a meeting to be held and the procedures to be used for voting on issues for which a vote is required.

Section 236B — Appointment of members of the AASB

9.8 Proposed section 236B sets out the procedures for appointing the Chairman and other members of the AASB.

9.9 The Chairman is to be appointed by the Minister while the other members are appointed by the FRC. The members of the AASB may appoint one of their number to be Deputy Chairman (proposed subsections 236B(1) and (2)). The Chairman holds office on the terms and conditions that are determined by the Minister while the other members hold office on the terms and conditions determined by the FRC (proposed subsection 236B(6)).

9.10 Under proposed subsection 236B(3), a person must not be appointed to the AASB unless they have appropriate knowledge of, or experience in, business, accounting, law or government.

9.11 Appointments to the AASB are to be made in writing and may be for a maximum period of five years, although retiring members are eligible for reappointment. The actual term of appointment, along with particulars of the terms and conditions, are to be set out in the appointment document (proposed subsections 236B(4) and (5)).

Section 236C — Resignation and termination of appointment

9.12 Proposed section 236C deals with the manner in which the Chairman or another member of the AASB may either resign or have their appointment terminated. The independence of the AASB is preserved by strictly limiting the grounds upon which an appointment can be terminated.

9.13 In the case of resignation, the Chairman is required to provide a written resignation to the Minister, while other members are required to provide a written resignation to the Chairman of the FRC (proposed subsection 236C(1)).

9.14 The Minister may terminate the appointment of the Chairman for misbehaviour, physical or mental incapacity or for breaching the terms and conditions of his or her appointment. The Minister must terminate the appointment of the Chairman if the Chairman:

- becomes bankrupt;
- applies to take the benefit of any law for the relief of bankrupt or insolvent debtors;
- compounds with his or her creditors;
- makes an assignment of his or her remuneration for the benefit of his or her creditors; or
- contravenes section 227 (proposed subsections 236C(3) and (4)).

9.15 Proposed subsections 236C(6) and (7) deal with the circumstances in which the FRC may or must terminate the appointment of a member of the AASB (other than the Chairman). These

subsections are expressed in terms similar to proposed subsections 236C(3) and (4) and give the FRC the same powers in respect of AASB members as the Minister has in respect of the AASB's Chairman.

Section 236D — Acting appointments

9.16 The Minister will be able to appoint a person to act as Chairman of the AASB during any vacancy in the office of Chairman or at any time when the Chairman is absent from duty (proposed subsection 236D(1)). Similarly, the members of the AASB will also have the ability to appoint one of their number to act as Deputy Chairman during any vacancy in the office of Deputy Chairman or at any time when the Deputy Chairman is absent from duty (proposed subsection 236D(2)). The FRC will also be able to appoint a person to act as a member of the AASB (other than Chairman) during any vacancy in the office of member or at any time when a member is absent from duty (proposed subsection 236D(3)).

9.17 Subsection 236D(1) is primarily intended to ensure that any delegations, functions or powers that can only be exercised by the Chairman of the AASB can continue to be dealt with during any period in which there is either no Chairman (for example, because of death, resignation or expiration of appointment) or the Chairman is absent (for example, because of overseas representational requirements or recreation leave or illness). The other provisions are intended to ensure that the AASB retains the structure and the number of members needed to operate effectively and efficiently.

Subdivision C — Confidentiality

Section 237 — Confidentiality

9.18 Both the FRC and the AASB are required to protect from unauthorised use or disclosure information that is given to them in confidence (proposed subsection 237(1)).

9.19 The bodies may, however, disclose information where such disclosure is allowed by a law of the Commonwealth, is made to enable an authority or a person in a jurisdiction outside Australia perform or exercise a function or power that corresponds to any of the functions or powers of the FRC or AASB, or is made to a body that sets international accounting standards (proposed subsection 237(2)).

9.20 In addition, the bodies may disclose information to the ASIC to facilitate the latter's performance of its functions under national scheme laws.

Subdivision D — Financial matters

Section 238 — Application of money

9.21 Proposed section 238 provides that the money of the AASB may only be used for three purposes:

- for paying the costs, expenses and other obligations incurred by the AASB in the performance of its functions or the exercise of its powers;

- for paying the administrative expenses of the FRC and any committees or groups that it establishes;
- for paying the remuneration and allowances of any person appointed under Part 12 of the ASIC Act.

9.22 This provision would cover the expenses of employing research staff and/or consultants.

Schedule 4, Part 3 — Consequential amendments

Australian Securities and Investments Commission Act 1989

Items 1, 3 and 4 — Section 5 (new definitions)

9.23 It is proposed that three new definitions, ‘AASB’, ‘FRC’ and ‘international accounting standards’, be added to section 5 of the ASIC Act.

9.24 ‘AASB’ is used in Part 12 of the ASIC Act as an abbreviation for Australian Accounting Standards Board, the standards setting body established by proposed section 226.

9.25 ‘FRC’ is used in Part 12 of the ASIC Act as an abbreviation for Financial Reporting Council, the advisory body established by proposed section 225.

9.26 The expression ‘international accounting standards’ is used in Part 12 of the ASIC Act to refer to accounting standards made by the International Accounting Standards Committee (IASC) (paragraph (a) of the definition). However, the regulations may provide that accounting standards made by another overseas standard setting body are to be treated as international accounting standards for the purposes of proposed Part 12 (paragraph (b) of the definition). Paragraph (b) has been included principally to provide flexibility in the event that the IASC changes its name or another overseas body/standard setter takes over the role of the IASC in developing a set of internationally accepted standards.

9.27 It should be noted that this definition is not an ‘operative’ provision in the sense that it will be a matter for the FRC, the AASB and the Minister to determine the appropriateness of the international standards for Australia under proposed section 233 before they would become applicable in Australia.

Items 2 and 9 — Section 5 (definitions of ‘Director’ and ‘Standards Board’)

9.28 In conjunction with the repeal of the existing Part 12 of the ASIC Act, dealing with the establishment and operation of the Australian Accounting Standards Board as originally constituted, the definitions of ‘Director’ and ‘Standards Board’ are no longer required and, accordingly, are also repealed.

Items 5 and 6 — Section 5 (definition of ‘meeting’)

9.29 Paragraph (d) of the definition of ‘meeting’, which refers to meetings of the ‘Standards Board’, is no longer required and, accordingly, is repealed.

Items 7 and 8 — Section 5 (definition of ‘member’)

9.30 In paragraph (a) of the definition of ‘member’, the reference to ‘Standards Board’ is to be changed to ‘AASB’. This change is in keeping with the revised drafting style used in the new provisions, where the standard setting body is referred to either by its full name or its initials.

9.31 Paragraph (e) of the definition of ‘member’ is to be replaced by proposed paragraphs (e) and (ea), which define ‘member’ for the purposes of the FRC and AASB respectively.

Item 10 — Subparagraph 135(1)(a)(iv)

9.32 This subparagraph, which provides that the moneys of the ASIC may be applied for the purposes of the ‘Standards Board’, is to be amended by changing ‘Standards Board’ to ‘AASB’.

Corporations Law

Items 11 and 12 — Subsection 334(3) and section 336

9.33 Subsection 334(3) and section 336 of the Corporations Law (the Law) deal with the AASB’s power to make accounting standards of general or limited application and the inclusion of requirements for the disclosure of comparative amounts in accounting standards. These provisions will be repealed when the proposed Part 12 of the ASIC Act comes into operation.

9.34 The matters in current subsection 334(3) will be dealt with in proposed subsection 229(1) of the new accounting standards provisions while the matters in current section 336 will be dealt with in proposed section 230.

9.35 These amendments are designed to bring together, in Part 12 of the ASIC Act, the AASB’s general powers for making and formulating accounting standards. As a consequence of these amendments, the standard making powers that are retained in the Law will relate specifically to the AASB’s powers to make standards for entities that are required by the Law to prepare financial statements.