Corporations Law Simplification program

Second Corporate Law Simplification Bill

Exposure Draft

Volume 2
Commentary

Task Force
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SECOND CORPORATE LAW SIMPLIFICATION BILL

Volume 2 Commentary

The Second Bill in the Corporations Law Simplification Program simplifies the provisions in the Law on:

- forming a company
- company names
- meetings
- share capital
- accounts and audit
- annual returns
- defunct companies.

Commentary on how the Second Bill simplifies the Corporations Law is contained in this volume. The provisions are set out in a separate volume.

You are invited to send comments on any of the provisions. Submissions may be formal responses or short informal reactions. The Task Force wants to be alerted to provisions that would create difficulties or need more explanation so that they can be refined to improve the Law and make it easier to understand.

As part of the consultation with users of the Law, the Task Force is planning a series of evening seminars on the Bill. The schedule for the seminars is:

- Brisbane, 1 August
- Sydney, 2 August
- Perth, 8 August
- Adelaide, 10 August
- Hobart, 15 August
- Melbourne, 16 August 1995.

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SUMMARY OF CHANGES

Registration and basic features of a company

- setting up a company will be a simplified, single stage process
- rules to govern the internal affairs of companies will be put into the Law and companies will only need to have articles (ie a constitution) if they want different rules
- existing companies will retain their constitutions (the memorandum and articles of association) unless they repeal them
- constitutions of proprietary companies will be available from the ASC
- the registered office of a proprietary company need not be open to the public
- it will not be possible to form no liability companies or companies limited both by shares and by guarantee (existing companies will not be affected)
- companies will no longer be required to have a common seal.

Meetings

- the law will recognise members' rights to ask questions or comment on company management at AGMs
- members will be able to question auditors at AGMs about their audit report
- members holding at least 5% of the votes will be entitled to call a general meeting
- all general meetings will require 21 days notice to be given to members
- it will be easier to appoint a proxy
- holding company meetings using electronic communication devices will be facilitated
- statutory meetings after a company's first fundraising will be abolished.

Share capital

- shares will no longer have a par value (existing contractual arrangements will be preserved)
- capital reductions will no longer require court confirmation
- capital reductions must be fair and reasonable to all shareholders
- after a capital reduction, a company must be solvent and have positive net assets
- financial assistance for acquiring a company's shares must not result in a material deterioration of the company's financial position (without shareholder approval)
- the rules against a company acquiring its own shares will focus on a company's actual control over those shares.

Accounts and audit

- accounting rules and special rules for banks, life insurance companies, investment companies and collective investments will be matters for accounting standards
- directors' reports to members will be more meaningful
- companies will be able to send concise annual reports to members, although the full report will be available.

Annual returns

- over half the items in annual returns will be deleted
- electronic lodgment of documents with the ASC will be facilitated.

Defunct companies

- third parties will be able to sue a deregistered company's insurer directly, without the need for reinstatement of the company
- deregistering defunct companies will be streamlined, with advertising requirements removed.

DEVELOPMENT OF THE SECOND BILL

This Bill assumes the enactment of the First Corporate Law Simplification Bill which was introduced into the Parliament on 8 December 1994 and passed by the House of Representatives on 9 March 1995. The Bill is presently before the Senate. It will simplify the law on share buy-backs, proprietary companies and company registers.

Task Force proposals for change in the areas covered by the Second Bill were published between May and December 1994. The Bill has been prepared by the Task Force with the assistance of the Consultative Group, following extensive consultation and testing with users of the Law.

A separate Task Force paper has been released on the proposed new structure of the Corporations Law and that paper (which is available on request) shows how the new provisions in the Second Bill fit in with the intended overall structure.

Small Business Guide

The Small Business Guide in the First Corporate Law Simplification Bill will be amended to take into account the changes proposed in the Second Bill. Those amendments will be included in the Bill on its introduction into Parliament, following any necessary revisions which result from comments made during the exposure period.

Collective investments

The Bill will provide rules for collective investment schemes on the following topics, based on those in the Bill for companies:

- accounts and audit
- meetings
- annual returns.

The provisions in the Second Bill dealing with collective investment schemes have been drafted on the assumption that a separate Bill will provide a regulatory structure for collective investment schemes having the following principal features:

- there will be a single entity, to be known as the `responsible entity', which will have responsibility for the conduct of schemes and in so doing will be liable to investors
- scheme assets will be held by a custodian so that the property is held separately from that of the responsible entity
- the responsible entity will be required to have in place a compliance plan, which has been approved by the ASC, setting out measures designed to ensure compliance with both the scheme constitution and the Corporations Law
- existing prescribed interest schemes will have 2 years in which to restructure their affairs into collective investment schemes.

The schemes to which that proposed structure will apply will be required to be registered with the ASC (and are referred to in the Second Bill as registered collective investment schemes).

The Bill will implement in part the Government's decision on reform of the law regulating collective investment schemes. The other, more substantial part of this reform will be dealt with in a separate Bill, which is expected to be released for public exposure shortly.

The separate Bill will also extend the company register provisions, set out in the First Corporate Law Simplification Bill, to collective investment schemes.

Statutory derivative action

Chapter 2F of the Second Bill contains certain provisions on members' rights and remedies. New statutory derivative action provisions are intended to be located in this Chapter. These provisions will be contained in the separate Bill with the proposed amendments for the regulation of collective investment schemes. The statutory derivative action provisions are designed to enhance investors' rights by improving and expanding the existing restrictive common law rules on when a shareholder can take a derivative action on behalf of a company against a company officer or former officer.

REGISTRATION AND BASIC FEATURES OF A COMPANY

New Chapters 2A and 2B will replace current Part 2.1, Part 2.2 Division 1, Part 2.3 and Part 4.2 Divisions 1 and 2 (in so far as they deal with companies).

How a company is registered

The current rules for setting up a company are unnecessarily complicated. Under the new rules, setting up a company will be simpler. In particular:

- lodging a completed application form will be the only step required to set up a company
- there will be no memorandum of association
- having a constitution will be optional
- having a common seal will be optional
- the minimum number of members for public companies, as well as proprietary companies, will be 1.

New Part 2A.2 sets out the process for the registration of companies. Consistent with the move away from the concept of incorporation of a group of persons to the concept of creating a new legal entity through registration, the Law will provide that a company comes into existence on the day on which it is registered (Bill section 119) and extends to public companies the facility for 1 member proprietary companies which was introduced in the First Corporate Law Simplification Bill (Bill section 112).

Should a company cease to have at least 1 member, the ASC will be empowered to seek its winding up after giving the company at least 1 months notice (Bill Schedule l, Item 57 to 60).

The application form will be improved in that the lodgment of a completed form will become the only step required to set up a company (Bill section ll7). In particular, persons listed with their consent in the form as directors and secretaries will be appointed automatically on registration of the company and so no further notification to the ASC of their appointment will be necessary (Bill section 120). On registration persons listed with their consent as members will automatically become members entitled to the number of shares listed in the application. Notice of the issue of these shares will not have to be lodged with the ASC, but details will need to be recorded in the register of members.

As at present, the applicant will be required to list the address of the company's proposed registered office which will become the company's registered office on registration (Bill section 121). The applicant will also be required to disclose the address of the proposed principal place of business if it is to be different from the registered office (Bill section 117). This is to enable this important information about the company to be placed on the ASC database and thus to be available to the public. If the company is to have a constitution on registration, a copy will have to be lodged with the application.

The Bill will remove the requirement for companies to have a seal. Companies will be able to execute documents having the effect of a deed without the application of a seal and outsiders will be able to make appropriate assumptions of regularity in relation to documents so executed. If a company adopts or retains a seal, it will have to show the company's name and its ACN (Bill section 123).

The concept of the certificate of registration has been retained. As at present, a certificate from any Australian jurisdiction will be conclusive evidence that the company was duly registered on the day shown in the certificate as the day of registration (Bill section 118). This means that the fact that the company was brought into existence on a particular date will not be subject to challenge.

Types of companies and changes of type

The Law will no longer distinguish between `type' and `class' of companies. The term `type' is to be used in both cases. Thus the Bill treats `a proprietary company limited by shares' and `a public company limited by shares' as different `types' of companies (Bill sections 112 to 114).

The present types of companies (numbers in brackets indicating the numbers registered as at 2 June 1995) are:

- companies limited by shares (910,789 of which 7,714 are public companies and 903,075 are proprietary companies)
- companies limited by guarantee (8,498)
- companies limited both by shares and by guarantee (161)
- no liability companies (968)
- unlimited companies (572).

The existence of so many types of companies unnecessarily complicates the Law. The Law will therefore no longer allow registration of companies limited both by shares and by guarantee or no liability companies. However, existing companies of these types will not be affected.

At present, the Law does not enable companies limited by guarantee to convert into companies limited by shares. As a result, a company limited by guarantee can gain access to share capital only if it converts into a company limited both by shares and by guarantee. Companies limited by guarantee will no longer have to use this route as the Bill will allow them to convert directly into companies limited by shares (Bill section 161).

The move away from companies limited both by shares and by guarantee is consistent with international practice. The United Kingdom ceased to facilitate the incorporation of this type of company in 1981.

The Bill will enable, but not require, existing companies limited both by shares and guarantee to convert into either companies limited by shares or companies limited by guarantee (Bill Schedule 1, Item 101).

As a change of a company limited by guarantee into a company limited by shares raises a possibility of creditors being disadvantaged in the liquidation of the company, the ASC will register an application for a change only if satisfied that creditors of the company would not be materially disadvantaged (Bill section 163). This will also be the case for a company limited both by shares and by guarantee seeking to convert into a company limited by shares or a company limited by guarantee (Bill Schedule 1, Item 101). (Other conversions will, as at present, proceed `as of right'.)

Under the new share capital rules in the Bill, the main advantage of no liability companies of being able to issue shares at a discount, without court or member approval, will be available to all companies. Under the current rules, a no liability company must be a mining company. The various bodies representing the petroleum and mining industries have indicated that they do not oppose the Law ceasing to provide for registration of no liability companies.

Existing no liability companies, all the shares in which are fully paid up, will continue to be able to convert into companies limited by shares (Bill Schedule 1, Item 100).

The third type of company with a small number of registrations (unlimited company) will be retained because the States which allow incorporation of legal firms allow it only through this type. However, under the Bill, all unlimited companies will have share capital. Although it is theoretically possible for unlimited companies not to have share capital, there are no companies of this kind.

The current rules regarding change of status (current subsection 167(7) and section 172) allow members of a company, and its debenture holders, to challenge any conversion of the company in the courts. The right applies only where the challenge is undertaken by applicants representing at least 10% of the relevant class. In some cases this could mean a concerted effort of a very large number of members, which would be a difficult task within the 21 days available for the application to be made. The Bill removes this cumbersome mechanism thus leaving the right to challenge to the existing oppression remedy which is available to all members. Persons aggrieved by the ASC's decision, in particular creditors (including debenture holders) will be able to seek merits review of a decision of the ASC to effect a change of type in the Administrative Appeals Tribunal.

Company powers and how they are exercised

New Part 2B.1 replaces sections 159 to162 and 182 and subsection 123(2). The provisions have been substantially redrafted and contain 3 important changes.

First, provisions dealing with the powers and attributes of a company (current subsections 123(2) and 161(1)) have been combined (Bill section 124). The specific powers listed in subsection 123(2) (power to hold land and sue) have been omitted, as these are inherent in the powers of an individual. Similarly, the specific reference to perpetual succession has been abandoned as the Bill provides that a company will come into existence on registration and cease to exist on deregistration.

Secondly, companies may still restrict the exercise of their powers in a constitution, but acts contrary to these restrictions will no longer constitute contraventions of the Law (Bill section 125). Current paragraph 162(7)(g) has been interpreted as preserving the common law doctrine that a director of a company who causes the company to act outside its powers is automatically liable to the company for any loss resulting from the breach. Repealing this provision will make it clear that the doctrine has no further application.

These changes will remove the last vestiges of the doctrine of ultra vires, which was abolished in Australia through the 1983 amendments of the Companies Code. Acts which are contrary to restrictions on a company's exercise of its powers will now be treated in the same way as a breach of a company's constitution.

Contracts before registration

New Part 2B.2 contains substantially redrafted provisions based on existing section 183 which deals with 'pre-incorporation contracts'. The new provisions address the criticism that section 183 does not cover contracts entered `for the benefit' (as opposed to `on behalf') of a company before its registration and that it does not allow parties to set the period for the ratification of the contract (Bill sections 128 to 130).

Assumptions people dealing with companies are entitled to make

New Part 2B.3 contains redrafts of sections 164 and 165 which deal with assumptions that can be made about a company by a person dealing with the company and the effect of constructive notice. In order to facilitate the execution of deeds without the use of a seal, a new presumption has been introduced regarding the execution of documents by company officers (Bill section 131).

Replaceable rules and constitution

The Bill will insert in the Law a set of basic rules necessary for the internal management of companies. As a result, many companies will no longer need a constitution and all new companies will have a choice whether or not to adopt one.

The new rules will apply to all new companies unless they are displaced or modified. This approach is consistent with the present operation of Table A.

Under existing subsection 175(2), the regulations in Table A apply to all companies limited by shares incorporated under the Law except in so far as they are displaced or modified by the company's articles.

The new rules will not apply to existing companies unless they repeal their constitution (Bill section 135).

These rules will be replaceable in that a company to which they apply can modify them or displace them by 1 or more provisions in its constitution. Companies may also wish to adopt a constitution to supplement these rules. For example, a company wanting to issue partly paid shares may wish to adopt provisions dealing with calls and forfeiture. Similarly, a company may wish to adopt rules dealing with rotation of directors, appointment of associate directors or indemnity of company officers.

Some of the rules will apply to public companies as ordinary provisions of the Law, in that they will not be replaceable by the company's constitution. Headings to these rules will tell the reader whether a particular rule is replaceable for all companies or only for proprietary companies (Bill section 135).

To ensure that breaches of these rules have the same effect as breaches of a company constitution, these rules will have the same effect as a company constitution, namely a contract binding the company, its officers and members (Bill section 138).

A major advantage of the replaceable rules will be that, unlike the provisions of Table A articles, they will apply to companies as amended from time to time. As a result, companies choosing not to replace them will not have to incur expenses in keeping their constitutions up to date with the Law.

Another advantage of the replaceable rules is that they will also be located in the relevant place in the Law rather than in a table. For instance, the replaceable rules on meetings will be located with the statutory provisions on meetings.

A company with a single member who is also the sole director has little need for a formal set of rules governing its internal relationships, whether those rules are in the constitution or in the replaceable rules. A company of this kind needs a set of rules which allows the company to conduct its business and which deals with contingencies such as the appointment of additional directors. The replaceable rules will not apply to these companies, but the Bill includes a provision containing several basic rules applying specifically to these companies, under which:

- the company may appoint, and set the remuneration of, the director by ordinary resolution
- subject to the Law, the director can exercise all the powers of the company and is responsible for its management
- the director may execute negotiable instruments of the company (Bill section 224B).

The replaceable rules will apply if another director is appointed or another person takes up shares in the company.

Companies will continue to have the power to entrench a provision in their constitutions by providing for additional requirements which must be satisfied before the provision can be amended or repealed (Bill section 136) Examples of such requirements are:

- that the relevant special resolution be passed by a majority consisting of a greater number of members than is required to constitute the resolution as a special resolution
- that the consent or approval of a particular person be obtained, or
- that a particular condition be fulfilled.

Proprietary companies are not required at present to lodge copies of their constitution or any amendments of their constitution with the ASC. This has resulted in difficulties with obtaining up to date copies of constitutions of these companies. The Bill will facilitate access to the constitution of companies by requiring every company which adopts a constitution to lodge a copy of it with the ASC. Amendments of a constitution will also be required to be lodged. The ASC's power to request a copy from a proprietary company limited by shares will be extended to cover all companies (Bill section 139).

Existing proprietary companies will be required to take action within 2 years of the commencement of the provisions to bring the information which they have lodged with the ASC regarding their constitution up to date. Those proprietary companies which have not previously lodged their current constitution will be required to do so unless they decide to rely on the replaceable rules (by repealing their constitution) (Bill Schedule 1, Items 98 and 99). Companies which have Table A articles in an unamended form will not be required to lodge them, but will need to notify the ASC accordingly.

Registered office and principal place of business

New Part 2B.5 will replace provisions of the current Part 3.1 dealing with registered offices.

As at present, it will be possible to serve documents (including legal process) on companies by posting them to the registered office (Bill section 141). To simplify service on companies where there is a difficulty in sending documents to the company's registered office, the Bill will allow service on a company by personal

service on 1 director of the company rather than 2. The change is consistent with the degree of responsibility which individual directors have in relation to the affairs of their company.

Public companies will continue to be under an obligation to open their registered office during the standard hours specified in the legislation or for other hours of which the company has notified the ASC. The standard opening hours will involve exact times and will not permit the office to be closed for a period within a range of times (Bill section 145). Thus persons seeking to serve documents on the company or visit the registered office for other purposes will be able to rely on information on the ASC database for the exact opening hours.

Proprietary companies will not be required to open their registered office. This relaxation of the existing requirement for all companies to open their registered offices recognises that little use is made of the registered offices of the majority of proprietary companies in the manner envisaged in the Law. In order to facilitate where necessary, access to documents or registers by persons entitled to inspect them, proprietary companies will be required to make the relevant documents or registers available for inspection within 7 days of a written request being received by the company. Existing requirements to provide copies on request will not be affected.

The removal of the requirement for proprietary companies to have their registered offices open for certain hours will not affect the statutory or common law rules on service of documents on a company by leaving them at the registered office of the company.

Proprietary companies will also no longer be required to display their name and the words `registered office' outside their registered office. The requirement in relation to public companies will be modified so that a sign at the registered office will be sufficient (Bill section 144). This will overcome the difficulties with displaying signs outside multistorey buildings.

Currently, the ASC cannot change the address of the registered office of a company unless notified by the company itself. Yet companies often use the office of their accountant or lawyer, or some other service provider, as their registered office. Under the Bill, the ASC will be able to change the address of the company's registered office to the residential address of a director on the basis of an occupiers' notification that the consent has been withdrawn or that consent has never been given to the particular company (Bill section 142). The ASC must give the director the opportunity to notify it of a new address for the registered office before making such a change.

Companies will also be required to notify the ASC within 14 days after the company changes the address of its principal place of business (Bill section 143) The purpose of this provision is to ensure that accurate details of this address are available on the ASC database to facilitate access to any registers which may be kept at that address.

Company names

By separating the names rules relating to companies and other bodies the Bill will make them easier to follow and the process of registering a name simpler and more logical (current sections 99A, 120, 219, 358, 361, 362 and 366 to 383C, Corporations Regulations 4.2.01 and Schedules 6, 6A and 7, Bill Part 2B.6 and Part 5B.1). The rules for determining whether names are identical will be moved from the Law into the Corporations Regulations (current subsection 362(2), Bill paragraph 147(1)).

The Ministerial Council for Corporations has agreed `in principle' that the use of the singular or plural form, the indefinite article, and words `Corporation', `Corp', `Incorporated' and `Inc' should be disregarded for the purposes of the identical names test. This decision will be taken up in the Regulations to be made under the Second Bill.

The new rules will only allow companies limited by guarantee that pursue charitable purposes to omit the word `Limited' from their name. Existing companies with licences to omit the word `Limited' from their name will not be affected by this change (Bill sections 149 and 150).

The Bill will also allow the ASC to direct a company to change its name if the name should not have been registered or the company breaks a condition attached to the Minister's consent making the name available

to the company. If the company does not comply with the direction, the ASC will be able to change the company's name to its Australian Company Number (ACN) (Bill section 157).

To facilitate document design, the Bill will allow a company to set out its name and ACN at any place on the page of a public document on which its name first appears (Bill section 152). This contrasts with the requirements in existing section 362 under which the ACN must be set out after the first occurrence of the company name.

Outsize partnerships

The provisions dealing with outsize partnerships have been redrafted without changing their effect, except that the reference to bodies formed under letters patent has been deleted as it is no longer necessary to retain the possibility of relying on the prerogative power to form bodies corporate for purposes of gain (Bill section 115).

MEMBERS' RIGHTS AND REMEDIES

New Chapter 2F will replace Part 3.4, section 256 and Division 3 of Part 2.4. It will also deal with the rights of members to inspect certain documents.

Class rights

The Bill substantially redrafts current sections 197 to 199 which deal with variations of class rights and removes technical deficiencies which have been identified in those sections. In particular, the new provisions will make it clear that unless the company's constitution provides otherwise, any variation has to be approved by special resolution of the company and special resolution (or written consent) of the class.

The provisions also contain several policy changes. First, unless the variation receives unanimous consent of the company members, it will have no effect until:

- the expiration of 1 month from the variation without an application being lodged with a court to set the variation aside, or
- if an application is made it is withdrawn or finally determined (Bill section 246D).

Secondly, a notice will have to be given to any affected class member within 7 days of the variation (Bill section 246A). As a result, members who are affected by a variation will be informed of the variation and thus able to exercise their right to challenge it in court.

Thirdly, where the rights of only some members of a class are proposed to be varied, those members will be treated as a separate class for the purposes of the new provisions (Bill section 246B). As a result, members representing at least 75% of a class will no longer be able to vary rights of the remaining members.

As at present, members entitled to at least 10% of the votes in the class will be able to challenge in the court any variation of the rights in that class (Bill section 246C).

The capacity of members of companies to access documents concerning their rights will be enhanced under the Bill.

Documents and resolutions dealing with rights attached to shares which are not required to be lodged under a specific provision in the Law will be required to be lodged under new section 246E. This provision is based on existing section 256, but has been widened in scope to apply to proprietary companies. Further, the time period for these lodgments has been reduced from 1 month to 14 days. These changes have been made because existing and potential members of both public and proprietary companies should have ready access to information about their rights.

The right of members of proprietary companies under current subsection 256(3) to obtain copies of documents dealing with rights attached to shares will be extended to members of all companies under new section 246F. Members should not, as is presently the case, be denied a right to obtain a copy of the document from the company, merely because it is available from the ASC.

There will no longer be a general requirement to lodge special resolutions (current section 256). Instead, the various provisions in the Law which require the passing of special resolutions will also require lodgment of the resolution. Consistent with the approach taken in new section 246E, special resolutions in relation to proprietary companies will also need to be lodged.

Part 2F.3 also contains a redraft of the current section 196 which requires companies to notify the ASC of any division or conversion of shares (Bill section 246G).

Inspection of books

Following the November 1991 recommendation of the House of Representatives Standing Committee on Legal and Constitutional Affairs in its report on shareholders' rights, the provisions dealing with the rights of members to inspect books will be altered to allow a Court to authorise a suitable person (and not only a registered company auditor or legal practitioner) to inspect the books on behalf of a member.

If the Court determines that the member is a suitable person, the Court will be able to authorise the member to carry out the inspection (Bill section 247A). These access arrangements will also apply to members of registered collective investment schemes seeking access to the books of the scheme (Bill section 247B).

In addition to the statutory rights which will be available under new section 247A, there will be a replaceable rule enabling the directors or the company in general meeting to authorise a member to inspect the books of the company (Bill section 247B). This rule is based on regulation 85 of Table A.

MEETINGS

Company meeting rules are mostly located in Part 3.3 of the Law and Table A. Parts 2G.1 to 2G.3 of Chapter 2G replace these rules and bring together all of the provisions on meetings to make them more accessible and easier to follow. Where appropriate, the rules have been updated to make them consistent with current practices. The consolidation of the rules has also removed duplication between Part 3.3 and Table A.

Rules for meetings of members of collective investment schemes are set out in Part 2G.4 of Chapter 2G. Many of the provisions are based on those for companies.

Notice of meetings

There are currently 2 minimum time periods for giving notice of a members' meeting:

- if a special resolution is proposed - 21 days (current paragraphs 253(1)(a), (2)(a) and (3)(a))
- otherwise - 14 days or any longer period set out in the company's constitution (current subsection 247(2)).

As a general rule, 14 days appears to be insufficient notice of a meeting, particularly where the company has institutional or overseas shareholders. This view is supported by peak shareholder and investor bodies. To give members and persons holding shares on behalf of members more time to prepare for a meeting, a company will be required to give at least 21 days notice of all members' meetings (Bill subsection 249H(1)). This will facilitate uniform notice periods, but will not affect the ability of members to consent to shorter notice (Bill subsections 249H(2) to (4)).

A company will be required to give members entitled to vote and directors notice of all meetings (Bill subsection 249J(1)).

This rule, which will not be capable of being displaced by a company's constitution, recognises the importance of members being aware of meetings in order to be able to exercise their rights as members. An accidental omission to give notice to a member will not invalidate the meeting (current subsection 1322(3)). As at present, the auditor will be required to be notified of all general meetings (current subsection 332(8), Bill section 249K).

Notices may be sent by fax in addition to the existing modes of service (current Table A subregulations 95(1) and (2), Bill subsection 249J(3)).

Holding meetings using new technology

The extent to which technology can be used to conduct meetings when all those attending are not at the same place is currently unclear. The Bill will expressly enable the use of technology to hold meetings at which those attending are not all at the same place. Directors will be able to determine for themselves the appropriate technology for their meetings (Bill subsection 248C(2)). The requirement that all directors agree will allow directors to veto the use of technology which may, in their view, disadvantage them.

Companies will be able to take advantage of technology in holding members' meetings at different places so long as those attending have a reasonable opportunity to participate in the meeting (Bill section 249R).

If a company uses technology to hold its meetings in more than 1 place, it will need to take into account factors such as:

- the ability of the chairperson to conduct and control the proceedings
- the number of persons attending the meeting
- whether persons at the meeting can communicate with the chairperson and follow the proceedings, to ensure that those attending the meeting have a reasonable opportunity to participate.

Flying minutes for proprietary companies

Under the Bill, a proprietary company will be able to use the flying minute procedure for all special and ordinary resolutions except a resolution to remove an auditor under section 329 (Bill subsection 249A(1)). This exception is designed to ensure that auditors are given an opportunity to present their case personally to the members (current subsection 329(4)).

Any document that would otherwise have been given to members if the resolution were being proposed at a general meeting will need to be circulated with the flying minute (Bill subsection 249A(3)). This is intended to ensure that members will not be disadvantaged by the flying minute procedure.

Flying minutes will need to be recorded in the minute books (Bill paragraph 251A(1)(c)).

Holding an AGM

As a matter of common practice, members are given an opportunity to ask questions at the annual general meeting (AGM) about the management of their company. The Bill will recognise this practice by requiring the chairperson to allow members as a whole a reasonable opportunity to ask questions about, or comment on, the company's management (Bill section 250Q). This amendment is based on similar provisions in the companies legislation in Ontario and New Zealand.

The Bill will also give the members as a whole a reasonable opportunity to ask the auditor questions relevant to the audit report (Bill section 250R). This will not affect the auditor's right to attend and speak at general meetings (current subsection 332(8), Bill section 249U). The auditor will, as at present, be able to appoint a representative to attend in their place (Bill subsection 249U(4)).

While strengthening members' rights in these matters, the Bill will not affect the chairperson's ability to run an orderly meeting under the common law. Sections 250Q and 250R in the Bill will not give each individual member the right to ask questions.

Statutory meeting

The Law will no longer require a company to hold a statutory meeting or send its members a statutory report following the issue of shares under its first prospectus (current section 244). This requirement has been overtaken by the continuous disclosure obligations.

Proxies

As under the current law (current section 250), a member of a public company will have a right to appoint a proxy (Bill subsection 249W(1)). This provision in the Bill will also allow members of a proprietary company to appoint a proxy.

In its simplification proposal for company meetings, the Task Force proposed that the right to appoint a proxy be mandatory for proprietary companies. However, submissions suggested that proprietary companies which are closely held may have legitimate reasons for allowing only members to be present and vote at meetings. Consistent with these concerns, proprietary companies will be able to displace the rule allowing its members to appoint a proxy.

A proxy's appointment will be valid if it is signed by the member and contains certain minimum information (Bill subsection 249Z(1)).

The new proxy rules will also make it clear that:

- proxies may be given standing appointments or be appointed for more than 1 meeting (Bill paragraph 249Z(1)(d))
- appointments where the signature has not been witnessed are valid (Bill subsection 249Z(5))

- an appointment is effective if the company receives the proxy documents at least 48 hours before the meeting or in a shorter time period set out in the company's constitution (current paragraph 248(1)(c) and Table A regulation 55, Bill section 250A).

Calling general meetings

Directors will be required to call a general meeting if requested to do so by at least 200 members entitled to vote or members holding at least 5% of the votes that may be cast at the meeting (Bill sections 249D and 249E). The Bill will repeal the rule allowing 100 members who have each paid up an average of $200 on their shares to request a general meeting (current paragraph 246(1)(a)), because this is not consistent with the abolition of par values.

A company will no longer be able to displace its members' right to call a general meeting (current subsection 247(1), Bill section 249F). This procedure can be particularly useful if there are no directors to call meetings (Bill section 249C), as the alternative court procedure is relatively costly and time consuming (Bill section 249G). As at present, the members will be required to bear the expense of calling and holding the meeting.

Members' resolutions and statements

Members can currently require the company to circulate resolutions for, and statements about, matters to be dealt with at an AGM (current section 252). The Bill extends this right to all general meetings (Bill sections 249N and 249Q). Consistent with a request for directors to call a general meeting, a threshold of 200 members entitled to vote at the meeting or members holding 5°Io of votes able to be cast on the resolution will be applied to all companies.

The company will not be required to circulate a resolution or statement if it is more than 1,000 words long, defamatory or not accompanied by a payment to meet expenses (Bill subsections 249P(3) and 249Q(7)). Under the new rules, a statement will be able to be provided for each matter to be considered at the meeting. The new rules depart from the current requirement that a company obtain court approval before it refuses to circulate defamatory material (current subsection 252(6)).

Resolutions will be required to be considered at the first general meeting held at least 1 month after the members' request is served (Bill subsection 249P(1)). This time period should generally allow a company to include the resolution in the notice of meeting. If this is not possible, a copy of the resolution will need to be circulated as soon as practicable (Bill subsection 249P(2)). Statements will need to be provided to the company at least 10 days before the meeting (Bill subparagraph 249Q(7)(a)(ii)).

Companies with only 1 member

Under the Bill, a public company, as well as a proprietary company, will be able to have only 1 member (Bill section 112). Rather than artificially deeming a sole member to have held a meeting, the Bill will allow them to record their decision in writing (Bill section 249B).

Directors' meetings and flying minutes

If all directors agree to a resolution, the flying minute procedure will avoid the need for holding a meeting (Bill section 248A). Otherwise, Division 2 of Part 2G.1 will set out the core rules necessary to conduct a directors' meeting (Bill sections 248C to 248G). Rules for alternate directors and directors voting on matters in which they have an interest will be located with the other provisions about officers in Part 3.2 (Bill Schedule 2, Items 10 and 12).

Holding members' meetings

The quorum for a members' meeting will be 2 for both proprietary and public companies (current paragraph 249(1)(a), Bill subsection 249S(1)). Each individual will be counted only once towards the quorum. This will prevent 1 person constituting a meeting by holding 1 or more proxies (Bill subsection 2495(2)).

A meeting requested by members will be adjourned if there is no quorum within 30 minutes of the time specified in the notice for the start of the meeting (current Table A regulation 43, Bill subsections 2495(3) and

(4)). This means that all meetings will be given a second chance to conduct the scheduled business without incurring the cost of calling another meeting.

Body corporate representatives

A body corporate will have greater flexibility in its appointment of a representative (Bill section 250C). An appointment will be able to refer to an office holder, avoiding the cost of making another appointment if a specified person is not available (current subsection 249(3)), Bill paragraph 250C(2)(a)). In addition, it will be clear that a company will be able to make a standing appointment for all meetings which it could attend as a member (Bill paragraph 250C(2)(c)). All appointments will be revokable (current subsection 109ZB(8)).

Powers of attorney

The Table A rules currently accommodate the exercise of voting rights by an attorney (eg current Table A regulations 49 and 50). As powers of attorney are used for many purposes in addition to meetings, it is more appropriate that the rules relating to them be left to the common law. However, where a member's attorney appoints a proxy, the power of attorney will need to be lodged with the proxy so that the company can be certain that the appointment is valid (Bill paragraph 250A(1)(b)).

Voting

The current overlap between the rules on demanding a poll will be removed (current paragraph 248(1)(b) and Table A subregulation 46(1), Bill section 250J). Other voting rules will reflect the current provisions (current paragraph 248(1)(a) and Table A regulations 46-50 and 53, Bill sections 250D-250H, 250K).

Collective investment schemes

The provisions in Part 2G.4 of Chapter 2G implement the Government's response to the Australian Law Reform Commission and Companies and Securities Advisory Committee's report on collective investments in so far as it concerns meetings. They are designed to clarify and enhance the rights of investors in those collective investment schemes which will be regulated under the Corporations Law.

Section 252B in the Bill will enable members of registered schemes to request the responsible entity to call meetings for the purpose of considering proposed special or extraordinary resolutions. The main collective investment provisions will provide that resolutions of this kind are necessary for certain important purposes. For example:

- a special resolution will be required to amend the scheme constitution
- an extraordinary resolution will be required to either:
    - replace the responsible entity, or
    - terminate the scheme.

Consistent with the approach taken in the prescribed interest provisions (current Part 7.12 Divisions 5 and 5A), votes on special and extraordinary resolutions will be weighted according to the value of the collective investment interests. A special resolution will require the approval of 75% (by value) of the votes cast at a meeting, while an extraordinary resolution will require the approval of the holders of 50% (by value) of the interests in the scheme. Consistent with the approach taken in relation to members' requests for company meetings, a request will need to be made by the holders of at least 5 % of the votes or at least 200 members (Bill section 252B).

When members request a meeting, they will be required to state the proposed resolution. Members will also be able to provide a supporting statement, not exceeding 1,000 words. The responsible entity will be required to circulate the resolution and statement with the notice of meeting (Bill subsection 252C(1)).

If the responsible entity fails to comply with a request to call a meeting, the members will be able to call and hold the meeting themselves (Bill section 252D). The responsible entity will be liable for the reasonable cost of calling and holding the members' meeting (Bill subsection 252D(5)).

Consistent with the approach taken for companies, the Court will be empowered to call a meeting where it is impractical for the meeting to otherwise be called (Bill section 252F).

In most other respects, the rules for meetings of members of collective investment schemes will mirror those applying to public companies. These include the rules on the period for notice, proxies, keeping minutes and bodies corporate appointing representatives.

SHARE CAPITAL

The new share capital rules in Chapters 2H and 2J take up the 3 themes of solvency, fairness and disclosure developed in relation to the new share buy-back rules in the First Corporate Law Simplification Bill. Three further principles are relevant:

- reducing unnecessary procedural requirements, particularly for transactions which do not threaten the interests of the company, its shareholders or creditors
- removing Court involvement from transactions which do not involve a dispute
- promoting certainty by validating transactions contravening the Law and making available a right to seek compensation for those who have suffered a loss as a result of the contravention.

The changes to the share capital rules will also involve a number of consequential amendments to the Income Tax Assessment Act. These amendments will be necessary to accommodate the abolition of par values.

The Attorney-General's Department has been liaising closely with the Treasury and the Australian Taxation Office on the changes to the share capital rules to enable timely and appropriate amendments to be made. It is expected that a Ministerial announcement will be made at an early stage indicating the nature of the changes.

Authorised share capital

The total amount of the company's share capital is sometimes referred to as its `nominal share capital', `authorised capital' or `registered capital'. The fixed amount into which the nominal share capital is divided is known as the par or nominal value of the share.

An issue of shares in excess of the company's authorised capital is void. However, under current section 194, the Court may validate an issue of shares that is void because it is in excess of the company's authorised share capital.

The notion of authorised capital was originally intended to allow a company's creditors to assess the size of its business undertaking. However, this goal has not been achieved because a company:

- • need not issue shares up to the amount of its authorised capital
- may finance its activities through debt
- may increase or decrease the amount of its authorised capital by ordinary resolution without notice to its creditors.

In light of these considerations the Bill will repeal the requirement in paragraph 117(1)(b) that companies limited by shares must include in their constitution a statement indicating the amount of their authorised share capital.

The repeal will not affect future companies, especially joint venture companies, that want to prevent the dilution of their shareholders' interests in the company by the directors or to require their shareholders' consent for the bringing of new members into the company. Companies formed after commencement of the Second Bill will be able to achieve this by including in their constitution a provision setting a numerical limit on the number of shares which the directors may issue.

As a transitional measure for existing companies, if 5% of, or 200, members serve a notice on a company before its shares cease to have par value, the Bill will amend its constitution by inserting a new provision preventing it from issuing more shares than it could have issued prior to commencement (Bill Schedule 3, Item 32). A company will be able to amend this new provision in the same way that it can amend any other provision in its constitution.

No par value

A share is a proportionate interest in the net worth of a business. What matters to an investor is the proportionate size of the investment in the company, not the arbitrary monetary denomination attributed to that investment. The arguments in favour of the abolition of par values were canvassed in detail by the Companies and Securities Law Review Committee in its 1990 report on shares of no par value and partly-paid shares. Submissions on the share capital proposal indicated that there is strong support in the professional and business community for the abolition. As a result, the Bill provides that shares are not to have a par value (Bill paragraph 254F(a), Schedule 3, Item 26).

A company will be able, by ordinary resolution, to convert all or any of its shares into a smaller or larger number of shares, in the same way as it may currently do this under section 193 of the Corporations Law (Bill section 254R).

To accommodate no par value, the Bill will amend those provisions in the Corporations Law that refer to a percentage of the par or nominal value of a company's share capital, or a class of share capital, and other provisions that refer to the amount of any share premium which may form part of the consideration on the issue of a share (Bill Schedule 3, Items 5 to 11, and 17).

The Bill will also preserve the effect of existing contracts and other instruments executed before commencement which refer to the par or nominal value of a share (Bill Schedule 3, Item 31).

Stock

The Bill will repeal paragraph 193(1)(c) and subsection 216B(4) and remove the concept of stock from the Corporations Law (Bill paragraph 254F(c), Schedule 3, Item 4). All companies which have stock on issue will be required to convert their stock to shares (Bill Schedule 3, Item 33).

Redeemable preference shares

The Bill will make a number of changes to accommodate the abolition of par value. In particular, redeemable preference shares issued after commencement will only be redeemable out of profits or the proceeds of a fresh issue of shares made for the purpose of the redemption (Bill section 254H).

The Bill will repeal the requirement for companies to establish a `capital redemption reserve' when shares are redeemed out of profits. When a company's shares cease to have a par value any share premium account and capital redemption reserve will be transferred to its share capital account (Bill Schedule 3, Item 28). However, companies will be able to apply any money in their share premium account on commencement to:

- pay any premium payable on the redemption of redeemable preference shares or debentures issued before commencement
- write off preliminary expenses or discounts allowed on the issue of shares or debentures before commencement (Bill Schedule 3, Item 29).

If the shares are redeemable at the company's option, the company must be solvent immediately after the option is exercised. For other redeemable shares the company must be solvent immediately after issue (Bill Schedule 3, Item 12). A company's creditors and shareholders will be able to seek an injunction to prevent a redemption that would make the company insolvent (Bill Schedule 3, Item 25).

Dividends

Currently, a company may only pay dividends in accordance with its constitution. The Bill will reverse this rule and allow directors to pay a dividend without the need for constitutional authorisation (Bill section 254N).

The Bill requires that the profits must exist at the time of payment, rather than when the dividend becomes payable, as currently provided for by section 201(1) (Bill section 254M). As the directors will be able to pay a dividend, it will not be necessary for them to declare a final dividend before the date for payment and liability to pay a dividend will not arise before it is paid.

Under an amendment to section 588G, directors will be liable to compensate the company for dividends rendering the company insolvent in much the same way that they may currently be liable for insolvent trading by the company (Bill Schedule 3, Item 12). The company's members and creditors will also be able to seek an injunction where the payment of a dividend would lead to the company's insolvency (Bill Schedule 3, Item 25). The directors may be liable for a wrongful reduction of capital if dividends are paid otherwise than out of profits (Bill section 256C).

Capital maintenance

Division 1 of Part 2J.1 will provide a procedure to allow a company limited by shares to reduce its share capital in addition to any way specifically authorised by law. Capital reductions that are otherwise authorised by law include share buy-backs made under Division 4B of Part 2.4, the cancellation of the allotment of a share incidental to a takeover (current subsection 667(3)) and the return of shares in certain circumstances in the course of a fundraising (current subsection 1024E(7)). The new Division will replace section 195 of the Corporations Law.

The new provisions reflect a concern to abolish unnecessarily onerous, expensive and ineffectual restrictions (eg Court confirmation, creditor consent and constitutional authorisation). Instead, the existing restrictions will be replaced with specific measures intended to adequately protect shareholders and creditors.

Under section 195 a company may reduce its share capital in any way, provided it is:

- authorised by the company's articles (eg Table A regulation 39) approved by a special resolution of the company, and
- confirmed by the Court.

No need for authorisation by articles

The Bill will repeal the requirement that a reduction of share capital must be authorised by the company's constitution. The constitutions of most companies currently include an authorising provision as a matter of course (eg Table A regulation 39). This reduces the effectiveness of the rule as a brake on reductions of capital.

Companies will be able to include in their constitution a provision restricting or prohibiting the exercise of their power to reduce their share capital. This will, in effect, give members the same power to prevent a reduction of share capital that they currently have through the requirement that the reduction be authorised by the company's constitution.

Shareholder approval

Under the Bill, reductions of share capital will continue to require shareholder approval. An equal reduction must be approved by a resolution passed at a general meeting of the company (Bill subsection 256B(1)). Other reductions of capital, referred to as selective reductions, must be approved by either a resolution agreed to by all ordinary shareholders at a general meeting or a special resolution passed at a general meeting of the company (Bill subsection 256B(2)).

A special resolution or unanimous shareholder agreement is required for selective reductions of capital because they have the capacity to advantage some shareholders over others. If the reduction is approved by a special resolution, a vote may not be cast in favour of the resolution by a person to whom capital is proposed to be paid or whose liability in respect of amounts unpaid on shares is to be reduced (Bill paragraph 256B(2)(a)). This ensures that the resolution is approved by the company's disinterested shareholders and is consistent with the approach taken in section 206E(1) in relation to shareholder approval for a selective share buy-back.

No Court confirmation

The Bill will repeal the requirement that reductions of capital be subject to confirmation by the Court. Court confirmation currently provides the following safeguards for shareholders and creditors:

- the provision of adequate information to shareholders before voting on a resolution to approve a reduction of capital
- the reduction must not be contrary to the public interest, in the sense that the company should retain assets at least equal in value to its share capital
- the reduction of capital must be fair and reasonable to all of the company's shareholders
- notice of the reduction of capital, and
- an opportunity to stop an improper reduction of capital.

These safeguards will be available to members and creditors under the new rules, but in a different way.

Adequate information

The company will be required to include with the notice of the meeting at which shareholder approval for a capital reduction will be sought a statement setting out all information known to the company that is material to the decision to vote in favour of the resolution. The company will not be required to disclose information if it would be unreasonable to require the company to do so because the company had previously disclosed the information to its shareholders (Bill subsection 256B(3)). These rules are the same as those required for shareholder approval under the new share buy-back provisions.

Public interest

A company will only be able to reduce its capital if it has net positive assets immediately after the transaction. For the purposes of this balance sheet test a company will be able to count both its tangible and identifiable intangible assets (Bill paragraph 256A(1)(b)). A company will not be able to count goodwill as an asset because of the difficulties associated with obtaining accurate valuations and the potential for goodwill to be eroded within a short period.

Under the Bill, a company's directors may be personally liable if the company is insolvent immediately after a capital reduction. This liability will be based on, and subject to the same defences as, liability for insolvent trading under sections 588G and 588H of the Law (Bill Schedule 3, Item 12).

Fair and reasonable

To protect the interests of shareholders, a company will only be able to reduce its share capital if the reduction is fair and reasonable to all of the company's shareholders (Bill paragraph 256A(1)(a)). The company will have the onus of showing that the reduction is fair and reasonable (Bill Schedule 3, Item 25). The fairness of a reduction will be assessed on the adequacy of any consideration paid to shareholders, while the reasonableness test takes up the Court's existing general discretion to refuse to confirm a reduction in capital. This general discretion might be exercised where the reduction:

- is being used inappropriately to effect a takeover, by passing Chapter 6 of the Law
- involves an arrangement that should more properly proceed under Part 5.1 of the Law
- has the practical effect of depriving some shareholders of their rights, perhaps by stripping the company of funds that would otherwise be available for distribution to preference shareholders.

Notice of the reduction of capital

It would be inappropriate and indeed impracticable to require companies to notify every creditor of a proposed reduction of capital. The Law currently envisages that notice to creditors will be achieved by the requirement in subsection 195(3) that the company discharge or secure its debts or obtain its creditors' consent to the reduction. However, under subsection 195(4) a Court will usually make an order dispensing with the need for this notice if the company is able to show that all of its secured and major trading creditors have consented to the reduction and demonstrate that after the reduction its assets will exceed its liabilities.

For a selective reduction of capital, the requirement to lodge the notice of the meeting and the accompanying disclosure statement with the ASC will, in effect, require that 35 days notice be given to the ASC of a

proposed reduction of capital (Bill subsection 256B(4)). Where this occurs creditors and other interested persons will be able to receive notice of the proposed reduction through ASC Alert. (This service will give a subscriber notice of a specified type of document lodged with the ASC or documents lodged with it in relation to a specified company.) For companies to which the short notice rules are available, the ASC will be given at least 14 days notice of a proposed reduction of capital through the requirement to lodge a copy of the shareholder approval resolution 14 days in advance of a proposed reduction.

If a company reduces its share capital on terms involving the cancellation of a share, it will be required to lodge a notice with the ASC setting out particulars relating to the cancellation (Bill section 254T). For large proprietary companies and public companies, the impact of the reduction of capital will also be reflected in the financial statements they must lodge with the ASC.

Currently, subsections 195(6), (7) and (8) promote commercial certainty by denying a right to challenge a reduction of capital once the ASC has issued a compliance certificate. The Bill will achieve this certainty more directly by validating an improper reduction of capital (Bill paragraph 256C(2)(a)).

Stopping an improper capital reduction

A shareholder will be able to seek an injunction to stop a reduction of capital that is not fair and reasonable to all of the company's shareholders (Bill Schedule 3, Item 25). Shareholders and creditors will be able to seek an injunction to stop a reduction of capital that would not pass the balance sheet test or render the company insolvent (Bill Schedule 3, Item 25). Consistent with the present approach, the onus of proof will be on the company to show that the reduction is fair and reasonable or satisfies the balance sheet and solvency tests (Bill Schedule 3, Item 25). Together with the ASC Alert, the obligation to lodge the following documents with the ASC will provide shareholders and creditors with sufficient information to decide whether they should seek an injunction:

- the notice of the shareholder approval meeting together with any shareholder approval statement, to be lodged before the notice is sent to shareholders (Bill subsection 256B(4))
- a copy of the resolution approving the transaction, to be lodged within 14 days after it is passed (Bill subsection 256B(2))
- a notice stating that the shareholders have approved the reduction, to be lodged at least 14 days in advance of the reduction (Bill subsection 256B(5)).

Consistent with the approach taken in relation to share buy-backs, the ASC will be able to refer to the Corporations and Securities Panel a reduction of capital that is unreasonable having regard to its effect on the control of the company or another company (Bill Schedule 3, Item 15).

Capital reductions for no consideration

The Bill will allow companies to cancel a share, subject to the safeguards to be made available in relation to reductions of capital. Currently, the nominal value of a company's issued share capital must be a multiple of the number of shares it has on issue (current paragraph 117(1)(b)). Accordingly, when a company reduces its share capital under section 195 it must either reduce the par value of, or cancel, some of its issued shares. However, the introduction of no par value will break the link between the amount of a company's share capital and the number of shares it has on issue. Under no par value it will be possible for a company to cancel a share without reducing its share capital.

As the cancellation of a share for no consideration will not affect the company's financial position balance sheet, these cancellations will not be subject to the balance sheet test (Bill subsection 256A(1)). A shareholder whose fully paid up share is being cancelled for no consideration will be able to vote either in favour of or against the shareholder approval resolution (Bill paragraph 256B(2)(a)). This is intended to ensure that selective share cancellations for no consideration treat all shareholders fairly and are approved by the company's shareholders.

Other reductions of capital

The common law prohibition on companies reducing their share capital does not apply to unlimited companies. The Bill therefore preserves the existing exemption in subsection 195(12) for these companies (Bill section 256D).

In order to remove any doubt about the validity of brokerage or commission paid to the underwriter of a share issue, the Bill will preserve and streamline current sections 203 and 204. In particular, it will remove the existing restriction on the amount of any brokerage or commission that may be paid (Bill section 256F).

The Bill will repeal section 202, and allow schemes prohibited by that section to be undertaken as selective capital reductions.

Changes to proposal on capital reductions

The Bill contains a number of safeguards which were not put forward in the Task Force proposal on reductions of share capital:

- all reductions of capital involving a diminution of the company's resources will require shareholder approval, instead of only selective reductions of capital as originally proposed
- any shareholder will be able to oppose a reduction on the grounds that it is not fair and reasonable
- where a shareholder or creditor challenges a reduction, the company will have the onus of showing that the reduction is fair and reasonable, or that it will pass the balance sheet test and remain solvent.

Share buy-backs

In order to make them consistent with the rules proposed for reductions of share capital, it is proposed that the rules relating to share buy-backs will be amended to:

- allow the buy-back of redeemable preference shares
- introduce a balance sheet test
- require 14 days notice to the ASC before making a buy-back approved by shareholders
- relocate the purpose section so that it applies generally to Chapter 2J.

These provisions have not been included in the exposure draft Bill, but they will be included in the Bill when it is introduced into the Parliament.

Direct self-acquisitions

The Law will continue to prohibit the acquisition by a company of its shares or units of its shares. The provisions relating to share buy-backs will continue' to provide an exception to this prohibition (Bill subsection 258A(1)). To facilitate employee share schemes companies will be able to take a security over shares issued under an approved employee share ownership scheme. A company which acquires its shares because it has exercised the security must cease to hold those shares within 12 months of the acquisition (Bill section 258B).

Indirect self-acquisitions

The Bill will make 2 changes to the rules on indirect self-acquisitions in section 185 and subsection 205(1)(b). First, it will extend the prohibition on indirect self-acquisitions to situations where a company is able to control another entity that holds an interest in the company. For example, the prohibition will apply where a partnership controlled by the company holds an interest in the company.

Secondly, the prohibition will be extended to cover cases of actual control, rather than merely legal control as under the present subsidiary holding company definition. Control will be defined in section 258E consistently with the definition in AASB 1024. That is, a company will control an entity where it has the

capacity to determine the outcome of the entity's financial or operating policies in terms of the practical influence the company can exert.

Control will not need to be actively exercised. Under subsection 258E(2), that an entity acts in a manner consistent with the interests of a `controlling' company will be sufficient to indicate a controlled relationship. While the economic dependence of an entity on the company (eg where a company is a major creditor of an entity) may also indicate control, the level of voting interest will usually be more important. As a practice or pattern of behaviour must be taken into account, the test will not be affected by short term changes in control (Bill paragraph 258E(2)(b)). A shortlived capacity to exercise `control' would not give a company the practical ability to determine (ie make final) decisions about the company's policies. As under AASB 1024, a company will not control an entity where it is 1 of 2 joint venture partners having an equal interest in the entity.

The Task Force proposal on share capital proposed that a controlled entity should be prohibited from acquiring a relevant interest in a controlling company in order to prevent companies controlling their own shares. This approach would have had a number of unintended consequences which are avoided because of the approach of preventing a controlled entity becoming a member of the controlling company.

The Bill also incorporates a number of measures intended to allow companies to take some steps preparatory to the unwinding of a `controlled member' relationship. For example, the company will be able to increase its control over the entity, and entities that are wholly-owned subsidiaries will be able to transfer the shares to another wholly-owned subsidiary. However, in each case, the entity must within 12 months either cease to hold the shares or cease to be controlled by the company that has issued them.

In line with the current paragraph 185(8)(a), the Bill will prohibit a controlled entity voting at meetings of its controlling company (Bill subsection 258D(3)). As at present, the entity will cease to be a member of the controlling company if the shares held by it are cancelled under a reduction of capital or share buy-back. If at the end of the 12 months the entity retains an interest in the controlling company and is still controlled by the controlling company, both the controlling company and the controlled entity will be guilty of an offence for each day that the situation continues.

Currently, the Court may extend the 12 month period (current paragraph 185 (8)(b)). This power does not involve a dispute between parties and is analogous to the ASC's power to modify the Law under sections 728 and 730 in relation to takeovers. For these reasons, the Bill confers on the ASC the power to extend the 12 month period (Bill subsection 258D(2)).

Issue or transfer of shares to a controlled entity

Section 185 and subparagraph 205(1)(b)(ii) currently regulate the acquisition by a company of shares or units of shares in a holding company. Under the Bill, the issue or transfer of shares or units of shares by a company to an entity controlled by that company will generally be void (Bill section 258C). The Bill will establish new exceptions for the issue or transfer of shares:

- by a company to its existing members in a non-discriminatory manner (Bill paragraph 258C(1)(c))
- by a wholly-owned subsidiary of a body corporate to another wholly-owned subsidiary of that body corporate (Bill paragraph 258C(1)(d)).

In each case the acquiring entity will be obliged to dispose of the shares within 12 months of the acquisition (Bill subsection 258D(2)).

Controlling an entity that holds shares in the company

A company may come to control an entity that holds shares in the company without itself having acquired any new interest in the entity. For example:

- company A holds 35% of company *B*
- company *B* holds a small interest in company A
- company C holds 51% of company *B* and therefore controls company *B*

- the remaining 14% of company *B* is widely held:

If C divests itself entirely of its 51 °Io interest to unassociated small shareholders, A will be left with a controlling 35°Io interest in *B*, which holds shares A has on issue. Because A has not acquired anything, the Bill will not require A to end its control of *B*, or *B* to dispose of these shares. However, if A were to increase its control over *B* then within 12 months either A must end its control of *B*, or *B* must cease to hold the shares (Bill paragraph 258D(1)(b), subsection 258D(2)).

Unacceptable self acquisition schemes

Division 4A of Part 2.4 will be repealed. Instead, the ASC will be able to apply to the Panel for a declaration where a company acquires a relevant interest in at least 5°Io of its voting shares (the substantial shareholder threshold) and that acquisition has an unreasonable effect upon the control of the company or another company (Bill Schedule 3, Item 15).

Financial assistance

The financial assistance prohibition in paragraph 205(1)(a) currently impedes many normal commercial transactions, which are only permitted if the company complies with an expensive shareholder approval procedure. Nevertheless, the prohibition performs a useful function in deterring a range of undesirable transactions having the potential to prejudice a company's financial position. Reaction to the Task Force proposal on financial assistance confirmed that the prohibition should be retained in some form, but suggested that it would be appropriate for it to be narrowly confined.

The Bill will therefore prevent a company giving financial assistance to a person to acquire shares, or units of shares, in the company or a holding company if the transaction involves a deterioration in the company's financial position that is material to the interests of its shareholders or creditors. A company will only be able to give financial assistance involving a material deterioration in the company's financial position if the transaction has been approved by the company's shareholders (Bill paragraph 259A(1)(b) and section 259B). This approach is intended to minimise the difficulties the rule currently causes for ordinary commercial transactions. For transactions which do not involve a material deterioration in the company's financial position, the new rules will make it unnecessary to decide whether the transaction involves the giving of financial assistance.

Whether a particular transaction requires shareholder approval will be a question of fact to be answered in light of the circumstances of each case. For example, shareholder approval would presumably be required where a company withdraws a large amount of money from its bank and lends it to a company that is bordering on insolvency, or where a company guarantees a loan to a company that is likely to default.

When a company giving financial assistance has a different holding company before and after the acquisition to which the financial assistance relates, shareholder approval will be required from the company that will be its holding company after the acquisition occurs (Bill subsections 259B(2) and (3)).

Currently, if shareholder approval is sought for a subsidiary giving financial assistance, the transaction must be approved by any listed corporation that is its holding company or, if there is no listed holding company, any ultimate holding company that is incorporated in Australia. This rule leads to unnecessary expense where the listed corporation is a foreign company. It also means that if there is no listed holding company, and the ultimate holding company is incorporated outside Australia, shareholder approval is not required for any holding company of the company. The Bill will address these issues by confining the need to seek shareholder approval to listed corporations which are formed in Australia and, if there is no Australian listed holding company, requiring shareholder approval by any holding company that does not itself have a holding company incorporated in Australia (Bill subsections 259B(2) and (3)).

The Bill will also retain the existing exceptions to the prohibition in subsections 205(8) and (9).

Validation of improper transactions

The Bill will validate a number of transactions whose validity might otherwise be tainted by illegality (Bill paragraphs 254J(1)(a), 256C(2)(a) and 259D(1)(a)). This is intended to protect the interests of third parties

whose interests would be affected by the transactions (eg financiers). The transactions will however be subject to the civil penalty provisions in Part 9.413 of the Corporations Law (Bill Schedule 3, Item 24).

Transfer and transmission of shares

The Bill will move to Part 7.13 of the Law the existing rules in Part 2.4 and Table A concerning the transfer and transmission of shares (Bill Schedule 3, Items 18 and 20 to 22). It will also add a new rule concerning mental incapacity based on the existing rules for bankruptcy (Bill Schedule 3, Item 19).

Regulations 19(1) and (2) of Table A have been omitted because the absolute discretion to be vested in the directors of a proprietary company should be sufficient to enable them to control the transfer of the company's shares (Bill section 1091E). This provision will also allow proprietary companies to protect their closely-held status without needing to rely on a provision to similar effect in a constitution.

Calls may be limited to when company is externally administered

New section 254L will differ from subsection 188(2) in that:

- a company seeking to establish reserve capital will be required to set out in its constitution the restriction on making calls
- the company's reserve capital will be able to be called up if the company becomes an externally administered body corporate, rather than when the company is being wound-up. This will make the company's unpaid share capital available in a range of circumstances involving insolvency other than its winding-up.

Notice of issue

New section 254S will improve on section 187 in that:

- the notice must be lodged within 1 month after the issue of the shares, rather than their allotment
- the obligation to lodge the shareholders' name and address will be repealed
- where shares are issued for non-cash consideration under a contract in writing, companies will have the choice of lodging the written contract or the prescribed particulars.

Notice of cancellation to ASC

So that it will be possible to ascertain from a search at the ASC how many shares a company has on issue, the Bill will oblige a company to lodge a notice with the ASC within 1 month after it cancels a share (Bill section 254T). A company will be obliged to lodge a notice under this section when it redeems a redeemable preference share. The Bill therefore extends the period within which a notice of the redemption of redeemable preference shares must be lodged from 14 days to 1 month.

Options over unissued public company shares

Submissions on the Task Force proposal in relation to the maximum period for options did not identify any convincing policy rationale for the rule that a public company may not grant an option over unissued shares that may be exercised more than 5 years after the date on which the option was granted **(current section** 216). They indicated that it:

- may be avoided by restructuring the transaction (eg piggy-backing on a convertible note)
- is inconsistent with the position overseas
- introduces inefficiencies and complexities to international capital transactions.

The Bill will therefore repeal the rule (Bill Schedule 3, Item 2).

FINANCIAL STATEMENTS AND AUDIT

New Chapter 2M will replace existing Part 3.6 and Divisions 2 and 3 of Part 3.7. Part 4.4 and Part 4.5 of the Law will also be repealed.

Chapter 2M of the Law will place obligations to prepare and audit financial statements on companies, registered collective investment schemes and certain disclosing entities.

The Law and accounting standards

At present, the Law contains specific accounting details and procedures which are better dealt with in accounting standards issued by the Australian Accounting Standards Board. An example is current section 294, which contains rules for the valuation of assets and writing down of bad and doubtful debts.

The inclusion of specific accounting rules in the Law:

- burdens the Law with material handled elsewhere
- constrains the AASB's ability to make and amend accounting standards.

The Bill reduces the overlap between the Law and the accounting standards by leaving these details and procedures to the accounting standards. For example, instead of setting out details and procedures for the preparation and lodgment of consolidated financial statements, the Bill merely refers, within the context of financial statements requirements, to the obligation to prepare consolidated financial statements as required by the accounting standards (Bill paragraphs 297(1)(d) and 305(1)(b)).

This approach has the advantage of giving greater flexibility to the AASB. By allowing the AASB control over the rules for consolidating financial statements, the Law does not prevent accounting standards from incorporating equity accounting principles, which were arguably incompatible with previous legislative provisions (Bill section 335).

Removal of special rules and exemptions

At present, the Law contains special rules and exemptions for investment companies, property trusts and other prescribed interest schemes, banks and life insurance bodies (in particular, current Divisions 10 and 11 of Part 3.6, Part 4.4 and Part 4.5). These rules were developed piecemeal and make it difficult for users to draw comparisons between the financial status of different types of entities. The Bill will remove these special rules and exemptions.

Most of the financial statement and audit rules for companies will also apply to registered collective investment schemes. The responsible entity for the scheme will be responsible for performance of the obligations. Chapter 2M integrates the accounting requirements for registered schemes with the rules for companies and disclosing entities. These new rules will replace the existing accounting requirements relating to prescribed interest schemes presently set out in Division 11 of Part 3.6, Division 5 of Part 7.12 and the special rules applying to property trusts set out in Corporations Regulations, reg 7.12.15 (5)(0) and (p).

Part 4.4 contains detailed requirements for a company that has been declared by the ASC to be an investment company. In addition to special accounting requirements, there are special requirements for the nature and extent of permitted investments, disclosure of investment policy, borrowing, and distribution by way of cash dividend.

No company has been declared an investment company since 1986 and these provisions will be repealed.

In relation to banks and life insurance corporations, current Part 4.5 will be repealed and replaced with accounting standards currently being developed to govern the preparation of financial statements by these bodies. This adopts the recommendation of the Working Party established by the Attorney-General and Treasurer in 1992 to examine Part 4.5. If necessary, it is proposed that a temporary exemption be given to these bodies, pending the adoption of the new standards.

The October 1994 Task Force proposal on accounts and audit indicated that the special accounting requirements for borrowing corporations would be removed from the Law. The current borrowing corporation provisions are retained, pending consideration of the fundraising provisions in Stage 3 of the Simplification Program.

Terminology

Comments by users revealed that there was a difference between the accounting terminology in the Corporations Law and that used by users and preparers of accounts. To fit in with practice in the market, profit and loss accounts, balance sheets and statement of cash flows will be referred to in Chapter 2M as `financial statements', rather than `accounts'. References to `accounting records' have been changed to `financial records'.

Structure

The Bill rearranges the financial statements and audit provisions to reflect the needs of users in consulting the Law. Users of the provisions will be able to find out at the beginning of the Chapter whether they are affected by the annual reporting provisions and what their record-keeping obligations are. They will not have to search through the provisions to locate this elementary information.

Bill Part 2M.3 sets out what users have to do to prepare and lodge reports and send reports to members. Since the quality and preparation of reports is subject to the auditor's scrutiny, it is appropriate that the provisions relating to the auditor's gathering of information and preparing the auditor's report on the financial statements also be contained in this Part. This is a major change to the structure of the current provisions in Divisions 2 and 3 of Part 3.7.

The more technical provisions, such as the accounting standards provisions, appointment and removal of the auditor, ASC exemption and modification powers and sanctions are located at the end of the Chapter (Bill Parts 2M.5 to 2M.7)).

Financial records

The obligation to keep financial records for 7 years after the transaction covered by the records is complete will be retained (Bill section 286). The Bill draws a distinction between the language in which records are kept and their physical format (Bill sections 287 and 288). The current approach, which requires records to be kept in English and to be readily convertible into writing (current subsection 289(7)) is expanded to allow financial records to be kept in a foreign language and in electronic format as long as an English translation of the records is available within a reasonable time for inspection (Bill subsection 287(2)).

Financial records will be permitted to be kept anywhere (Bill section 289). To prevent abuse of this arrangement, the ASC will have power to require production of financial records kept outside Australia and to require notice to be given to the ASC of record keeping arrangements which do not involve the registered office (Bill subsection 289(7)).

Director access provisions and signposts to the provisions that give members, auditors, controllers and the ASC access to financial records are located in Bill sections 290 and 291. The former member access provisions (current sections 319 and 320) will be moved from Division 8 Part 3.6 to Chapter 2F (Members rights and remedies).

Annual financial statements

Deadlines for the preparation, audit and lodgment of annual financial statements and reports are set out in a table (Bill section 292). Annual financial deadlines will now be able to be calculated without searching through a number of different areas of the Law.

Following the distinction between small and large proprietary companies introduced by the First Corporate Law Simplification Bill, small proprietary companies will not have to prepare and lodge annual financial statements and reports unless foreign controlled; requested by at least 5°Io of members; or directed by the

ASC (Bill sections 294 to 296). The exemptions for certain companies which have their accounts audited were preserved by the First Bill and this will be continued (Bill subsection 321(3)).

The Bill retains the same approach to financial reporting requirements for proprietary companies introduced by the First Bill (sections 283B, 283C and 317). The section establishing when small proprietary companies must prepare financial statements and reports has been reworded to ensure that small proprietary companies controlled by registered foreign companies will not be required to prepare accounts (Bill subsection 294(2)).

When determining whether a proprietary company is small or large, a proprietary company will control a company if the company has the capacity to determine the outcome of decisions about the entity's financial or operating policies (Schedule 4 Item 13, amending subsection 45A(4)). This new test is consistent with the test of control to be introduced in Chapter 2J (Transactions affecting share capital) to deal with self acquisition and control of shares (Bill section 258E).

The content of the annual financial statements is set out in Bill section 297 and will be easier to locate. They have been expanded to include a statement of cash flows (Bill paragraph 297(1)(c)). At present, reporting entities are required to prepare a statement of cash flows under the accounting standards (AASB 1026 Statement of Cash Flows).

Financial statements must comply with the accounting standards and any further requirements in the regulations (Bill section 298). However, the Bill does not determine the application of accounting standards to financial statements. This remains a matter for accounting standards and, in particular, AASB 1025 (Application of the Reporting Entity Concept and Other Amendments). A reporting entity which is required to prepare and lodge financial statements will be required to do so in accordance with applicable accounting standards. A non-reporting entity will be required to prepare and lodge financial statements in the same way as it is required to prepare financial statements at present.

The Bill makes it clear that any notes required by accounting standards and disclosures required by the regulations will be part of the annual financial statements (Bill paragraphs 297(1)(e) and (f)). In addition, statements by the directors (Bill paragraphs 297(1)(g) to (i), 297(2) and 297(3)) will also be part of the financial statements.

Directors' reporting responsibilities

It has been suggested that directors' reports do not always give shareholders useful information relating to the company's performance and outlook. This view has been reinforced by provisions which require a number of detailed disclosures, but which do not promote focused or clear reporting. The major criticism of the current Law is that it can lead to a check list approach to compliance with disclosure obligations and does not encourage the presentation of information of interest to members.

The Bill draws a distinction between directors' general reporting obligations (Bill section 300) and specific reporting obligations (Bill section 301). The general obligations represent a significant change from the current provisions in Division 6 of Part 3.6. The new requirement for general discussion and analysis is intended to provide a framework for directors to give a detailed overview of the business' performance and the factors underlying the company's results and financial position.

The general discussion and analysis is to include a report on any major changes to the business and an indication of risks the business is facing. The discussion of trends or events and likely future developments will involve explaining their significance to the business. No attempt at profit forecasting will need to be made.

This enhanced form of directors' report is intended to benefit members by requiring that they be given information about the business which they can understand, even if they are unaccustomed to reading financial statements.

In the course of developing the Bill, directors' financial reporting obligations in the US, Canada, the UK and New Zealand were reviewed. Whilst requirements varied, common themes for discussion in directors' reports included:

- results of operation
- key strategic initiatives
- major commitments and sources of funding for these commitments
- unusual or infrequent events or transactions
- likely future developments in the business
- trends or events which have affected or are likely to affect the business.

The framework in new subsection 300(4) has been formulated against the background of these overseas requirements.

When preparing a directors' report, the directors should focus on the overall position of the company, scheme or entity (if consolidated financial statements are not required) and the consolidated entity (if consolidated financial statements are required) (Bill subsection 300 (3)). The directors' report may also omit material that would be, if included, prejudicial to the company (Bill subsection 300(5)). The approach taken is similar to current section 306 of the Law, but omissions will only be permitted if disclosure would be likely to result in unreasonable prejudice.

To address concerns that directors' reporting obligations would be onerous and unnecessary if applied to wholly owned subsidiaries, a directors' report will not have to be prepared if all members agree in writing (Bill subsection 300(2).

The specific annual directors' reports disclosure requirements are covered in Bill section 301. Details of dividends paid or recommended and the names of directors repeat the current obligations in the Law. However, the obligation to disclose options (current section 308) has been revised. The new approach takes into account the wide-spread use of employee share schemes, the operation of existing ASC class orders and the need to provide information to shareholders in relation to the most significant employees (Bill subsection 301(1)(d)). Some specific disclosure requirements have been removed to take into account the disclosure requirements in relation to the enhanced register of options introduced by the First Bill (section 216C).

The requirements for disclosure of shares or interests issued as a result of the exercise of an option, unissued shares or interests under option and any indemnity or insurance premium paid for an officer's or auditor's liability covered by existing subsection 241A(3), reflect the current Law (current subsection 308(4) and section 309A).

Additional disclosures by directors in reports for certain public companies (current section 307) have been rationalised. Disclosures of directors' shares or interests in contracts or proposed contracts with related parties have been omitted from the Law, as these disclosures are dealt with for reporting entities by the related parties accounting standard (Bill subsection 301(8)).

Consistent with the Government's response to the recommendations of the Australian Law Reform Commission and the Companies and Securities Advisory Committee on collective investments, the annual directors' report for a registered collective investment scheme will be required to include a number of additional details (Bill subsection 301(9)).

Half-year financial statements and reports (disclosing entities)

The Bill sets out half-year financial reporting responsibilities in a separate Division (Bill Division 2 of Part 2M.3). Half-year reporting requirements for disclosing entities, which have been in operation since September 1994, will be substantively unchanged from the current Law.

This approach means that half-year reporting provisions will be easier to locate and read and a user will be able to determine half-year reporting obligations without having to cross check with the annual financial reporting provisions.

Audit and audit report

The statutory duties of the auditor when conducting an audit of financial statements are now located in Division 3 of Part 2M.3. The choice of a full audit or a review of financial statements for half-year financial statements, introduced by the *Corporate Law Reform Act 1994, will* be preserved.

The information an auditor will be required to include in an audit or review of financial statements has been spelt out (Bill sections 311 and 312). This approach avoids the extensive cross-referencing and lack of clarity in the current provisions (current sections 331A to 332A).

The auditor's obligation to describe defects or omissions in the audit report has been made more precise. Instead of having to report omissions of information necessary to give a true and fair view (current subsection 331D(b)), the auditor will be required to give details of deficiencies, failures or shortcomings in respect of a number of the matters in relation to which the auditor is required to form an opinion when carrying out the audit (Bill section 310 and paragraph 311(3)(b)).

The position of the auditor will be strengthened by converting the negative obligation on company officers not to obstruct the auditor without lawful excuse (current section 333) to a positive obligation to assist the auditor in the conduct of an audit or review (Bill section 315). The auditor's current access rights and ability to request assistance from any officer for the purpose of the audit or review will be maintained (Bill section 313).

Under current subsection 332(10) an auditor is required to report to the ASC if the auditor is satisfied that a contravention of the Law has occurred. Following the recommendation of the House of Representatives Standing Committee on Legal and Constitutional Affairs in its 1991 report on shareholders' rights, the Bill provides that an auditor will have to report to the ASC if there are reasonable grounds to suspect that a contravention of the Law has occurred (Bill section 314).

Where there has been a contravention of the accounting standards, auditors will be required to report the matter to the ASC if it cannot be adequately dealt with by the auditor by comment in the audit report or by it being brought to the attention of the directors (Bill section 314). This is a departure from the current approach involving reports being made through the AASB (current sections 287 and 332 and 332A). The new approach recognises that the AASB is not a regulator and that the contravention of a standard is a breach of the Law.

Annual financial reporting to members

Public companies will have to report to members either within 4 months of the end of the financial year or by 21 days before the annual general meeting (Bill subsection 317(1)). Public company directors' will still be under an obligation to lay financial statements and reports before the annual general meeting (Bill section 319). As at present, debenture holders will be entitled to ask for a copy of the annual financial report (Bill section 320).

Other bodies required to prepare financial statements under this Chapter will be required to report to members before the financial deadline for that year (Bill subsections 292(1) and 317(1)).

Concise financial reports for members

The Bill will allow bodies subject to the financial statement provisions to choose to send a concise financial report to members instead of the full annual financial statements and reports (Bill section 317). Members would receive a report which focuses on information relevant in evaluating the performance and prospects of the business. A similar system, which allows businesses to supply concise financial reports, is used in some countries with a comparable system of corporate regulation to Australia.

Members will benefit because they will receive information which is of interest to them and which is easier to understand. Preparers will benefit from the reduced costs associated with printing and sending members a shorter document.

A concise financial report will comprise:

- concise financial statements drawn up in accordance with an accounting standard
- the directors' report
- an auditor's statement:
  - o that the full financial statements or consolidated financial statements have been audited, and
  - o whether the concise financial report complies with the applicable accounting standards.
- a statement informing members that the full financial statements and reports will be sent to them free of charge, on request.

The full annual directors' report is to be included in any concise financial report because this report is often the primary method of communicating information about a business to members. In addition, a copy of any qualification made by the auditor on the full or concise financial statements will be required to be included. This will ensure that members receiving the concise financial report are fully informed about any deficiencies in the full financial report.

Lodging financial statements and reports with the ASC

Financial statements and reports prepared under Chapter 2M will be required to be lodged with the ASC before the financial deadline (Bill subsections 321(1) and 292).

Financial statements will not have to be lodged with the ASC where they are those large proprietary company accounts (former exempt proprietary companies) that are covered by the grandparenting arrangement (Bill subsections 321(2) and(3)). Small proprietary companies will not have to lodge financial statements unless required to in a direction by the ASC under new section 296.

The ASC will be able to direct that financial statements and reports prepared under Chapter 2M be lodged. However, as the obligation to keep financial records is only 7 years, the ASC will only be able to make the request 6 years after the end of the financial year or half-year (Bill paragraph 322(2)(d)). If financial statements and reports are amended after lodgment with the ASC, they will have to be relodged within 14 days of amendment (Bill section 323).

Consolidated financial statements

New sections 324 and 325 are intended to make it clear that directors and officers of a controlled entity must furnish information to preparers of consolidated financial statements and assist any auditor involved in an audit or review of financial statements. The provisions are intended to clarify the position in relation to the preparation of consolidated entity accounts and assistance with the preparation of those accounts, where an entity was controlled for part, but not all, of the financial year or half-year in question.

Financial years and half-years

The Bill will simplify and improve the rules on synchronisation. The first financial year of a body required to prepare financial statements and reports under this Chapter will be able to be extended to 18 months, but thereafter an ASC exemption will be needed to vary a financial year by more than 7 days in either direction. Seven days' grace will allow a necessary degree of flexibility to retailers and similar businesses which may wish to use calendar years to calculate their balancing date. There is a similar flexibility to shorten or extend half years by 7 days.

Notwithstanding the general restrictions, the financial year for a consolidated entity will be able to be extended up to 18 months or shortened to achieve synchronisation within the group (Bill section 327).

The existing ASC exemption power (in current subsections 290(4) to 290(14)) has been removed and combined with the general ASC exemption power (Bill section 340).

Auditor

In 1994 the Ministerial Council for Corporations (MINCO) agreed that the present regulation of auditors should be reviewed with a view to ensuring that an appropriate legal framework applied to the supervision and disciplining of auditors in relation to their functions under the Corporations Law.

The Attorney-General subsequently established a Working Party, consisting of representatives of the Commonwealth, the Australian Securities Commission, the States and Territories and the accounting profession, to undertake the review.

The Working Party is currently preparing a discussion paper which outlines the options available for reform of the requirements for registering and regulating auditors. The report of the Working Party is expected to be completed by the end of 1995.

ASC exemptions and modifications

The ASC's exemption and modification powers (current sections 290 and 313) are located in Bill Part 2M.6. The ambit of the ASC's exemption power will be extended to apply to financial record keeping obligations under Part 2M.2.

The new provisions distinguish between specific ASC exemption orders (Bill section 340) and ASC class orders (Bill section 341). Applications for specific exemptions will need to be signed by 1 director, rather than 2 directors as at present. The application will need to be authorised by resolution of the directors, as at present (Bill subsection 340(3)). The criteria for specific exemptions and class orders (current subsection 313(11)) will be streamlined (Bill section 342).

The general power to make regulations to modify the operation of the Chapter will be retained (Bill section 343).

Sanctions for non-compliance

The civil penalty regime in Part 9.413 of the Law will be applied to breaches of the financial record keeping and the financial statement and reporting requirements (Bill section 344). Under the current Law, the civil penalty regime applies only to financial statement and reporting obligations and does not extend to record keeping obligations (current sections 318 and 591).

ANNUAL RETURNS

Chapter 2N deals with annual returns for companies and registered collective investment schemes. The new rules will omit over half of the items currently required to be included in the company annual return. These matters are either not relevant for corporate law regulatory purposes or can be ascertained readily by a search of the ASC database. Their removal will make the annual return less time consuming and demanding.

The new rules replace sections 335 to 339 and 1071 in the Corporations Law and Corporations Regulation 3.8.01. They also cover the lodgment of documents with the ASC, including electronic lodgment.

Easy to find

The first table in Chapter 2N sets out the contents of the annual return for companies. Putting this information in the Law, rather than in the regulations as at present, will make it easier for users of the Law to find (Bill section 348).

The second table sets out the contents of the annual return for a registered collective investment scheme (Bill section 349).

Company annual return

A company will be required to include in its annual return the address of its principal place of business (Bill section 348, Item 4 of the Table). Comments on the Task Force proposal on annual returns suggested that this information is useful for creditors. This is especially the case when the address of the registered office, which must also be included in the return, is different from the address of the principal place of business.

The new rules also simplify the complex current rules on including lists of members in the annual return. Rather than requiring the annual lodgment of a list of all members, the new rules focus on the shareholders who hold a significant proportion of the company's shares. A company which has 20 or fewer members will still be required to supply a full list of members with the annual return. If the company has more than 20 shareholders, it will only have to supply details of the top 20 shareholders in each class of share. However, if there are more than 20 people whose interests could be listed in the largest 20 shareholdings, the return must include the details of each of those shareholders. For example, if 15 people each hold 5% of the shares in a particular class, and 10 people each hold 2°Io, the details of a1125 shareholders must be included in the annual return. If somebody needs further information about who holds the remaining 5°Io of the shares, they can get it from the company's register of members (Bill section 348, Item 8 of the Table).

The proposal on annual returns suggested that the solvency declaration should be deleted from the return. Comments made in response to the proposal indicated that the declaration should be retained in some form. While company directors have an obligation under the Law to ensure the company is solvent at all times, a number of comments indicated that the solvency declaration is a useful discipline for directors because it requires them to focus, at least once every year, on the company's solvency. As a result, companies which have not lodged financial statements with the ASC in the previous 12 months will be required to include in their annual returns a statement that the directors have, within the previous month, resolved that the company is solvent. (Companies which are required to lodge financial statements are already required to include a solvency declaration in the directors' statement about the accounts, so there is no need to make them repeat the declaration when they lodge their annual return.) The solvency declaration will not have to be included in the first annual return lodged after the new rules commence if the company has lodged accounts with the ASC during the 12 months before the lodgment of that return (Bill sections 346 and 348, Item 9 of the Table, Schedule 5, Item 7).

Collective investment annual return

The matters required to be disclosed on annual returns for collective investment schemes have been rationalised. The specific disclosure requirements (current section 1071 and Form 723) which will be omitted include:

- the summary of all part shares and sales of lands and marketable securities
- brokerage and other benefits charged by the management company

- lists of investments.

Instead, relevant information of this character will be required under proposed Chapter 2M to be included in the annual financial reports and directors' statements for the scheme. These will be available to the public on the ASC database and required to be sent to scheme investors (Bill section 317).

The proposed rules for annual returns for registered collective schemes largely parallel those for companies. The differences take into account the peculiar characteristics and diversity of such schemes. The obligation to lodge the return will be imposed on the responsible entity. The disclosure required in relation to units of unit trusts will be similar to that for companies limited by shares (with units in the trust treated in the same way as shares). However, the approach in relation to interests in other schemes will be based on that presently taken in the Corporations Regulations (Form 723) in relation to returns for prescribed interests (Bill section 349).

Lodgment

Chapter 2N will improve the rules about lodging information with the ASC:

- it will establish fixed lodgment dates for the annual returns of companies and responsible entities, while allowing a company or a responsible entity and the ASC to agree on an alternative date (Bill section 345)
- electronic lodgment of annual returns and other applications and notices will be expressly recognised on the basis of an agreement between the company or responsible entity and the ASC. Companies or responsible entities which lodge documents electronically with the ASC and those seeking access to information contained in those documents will benefit from more efficient and timely dealings with the ASC (Bill sections 347 and 351)
- the rules for signing applications, returns and notices lodged with the ASC in writing will be located in the Law, rather than in the regulations as at present (Bill section 350).

DEREGISTRATION

The rules on the deregistration and reinstatement of companies (Chapter SA) will replace Division 8 in Part 5.6 in the Law (current sections 571 to 579).

Voluntary deregistration

The new provisions will make voluntary deregistration easier and cheaper than is presently the case. A person will be able to apply for deregistration if:

- all the members of the company agree
- the company is not carrying on business
- the company has minimal assets
- the company has no outstanding liabilities and has paid all outstanding fees and penalties
- the company is not a party to any current legal proceedings.

Three changes will be made to the rules on who can apply for voluntary deregistration (Bill subsection 601AA):

- A director of the company will be able to apply for deregistration (Bill paragraph 601AA(1)(b)). This recognises the reality that it is the officers of the company who customarily lodge applications with the ASC.
- A liquidator of the company will be able to apply for deregistration (Bill paragraph 601AA(1)(c)). This option will be relevant if a formal liquidation process is not necessary, although it will not be available to avoid normal liquidation procedures, since 1 of the pre-conditions for voluntary deregistration is that the company has no outstanding liabilities.
- The current category of `any other interested person' will be omitted - the categories created by Bill subsection 601 AA(1) cover all those who are appropriate.

Newspaper advertisements of intention to deregister will no longer be required. Instead, the ASC will have to give 2 months notice of the intended deregistration on its database and by publication in the Commonwealth of Australia *Gazette* (Bill section 601AA). The ASC Alert system will enable subscribers to receive timely notice of the proposed deregistration of a company in which they may have an interest.

ASC deregistration

The new rules clearly set out the circumstances under which the ASC will be able to, or required to, deregister a company. The most common situation will be where the company is at least 6 months late in lodging its annual return with the ASC and has not lodged any documents for at least 18 months and the ASC has no reason to believe that the company is carrying on business (Bill subsection 601AB(1)).

To ensure that a company will not be deregistered only because it has forgotten to notify a change of registered office, the ASC will have to give notice of the intended deregistration to all of the company's directors, as well as to the company. As is the case for voluntary deregistrations, the ASC will also be required to give notice in the *Gazette* and on its database (Bill subsection 601AB(3)).

Deregistration - following amalgamation or winding up

Current section 571 assumes that deregistration may also occur under other provisions in Chapter 5. This position has been preserved, pending examination of Chapter 5 in the Simplification Program (Bill section 601AC).

Effect of deregistration

Current sections 574 and 576 establish the consequences of deregistration, but this information is obscured by the multiple issues that are dealt with in these sections. Bill section 601AD clarifies the effect of deregistration by providing that:

- a company will cease to exist on deregistration, but this will not affect the liabilities of individuals or entities associated with the deregistered company prior to deregistration
- on deregistration, the property of the deregistered company will vest in the ASC, subject to any existing security or other interest
- directors of a company immediately prior to deregistration will have a statutory obligation to keep the company books for 3 years after deregistration.

Powers of the ASC

Under the current Law, the ASC's power to deal with the assets of a deregistered company is unclear in a number of situations. The Bill addresses these ambiguities by distinguishing between circumstances when the ASC holds property on trust (Bill subsection 601AE(1)) and circumstances when the ASC does not hold the property on trust (Bill subsection 601AE(2)).

Bill subsection 601AE(3) also provides that the property of a deregistered company vested in the ASC remains subject to all liabilities imposed on the property under a law, without the benefit of any exemption the property might have because it is vested in the ASC.

When the ASC has to deal with trust property, the ASC will be able to choose to continue to act as trustee. This will enable the ASC to carry out any action permitted by law under the trust deed (Bill paragraph 601AE(1)(a)). Alternatively, the ASC will be able to apply to the Court for the appointment of a new trustee (Bill paragraph 601AE (1)(b)).

When the ASC deals with property of a deregistered company which is not held on trust, the ASC will be able to dispose of the property as it sees fit; defray any expenses; discharge obligations attaching to the property (to the extent that the proceeds are available to satisfy those obligations (Bill subsection 601AE(4)); and deal with any remaining funds under the Unclaimed Property provisions in Part 9.7 of the Law (Bill subsection 601AE(2)).

The ASC has a statutory obligation to keep a record of any property of a deregistered company that it knows has vested in it under Chapter 5A. This obligation includes keeping a record of the ASC's dealings with any property, keeping accounts of all money received from those dealings and keeping all receipts relating to that property (Bill subsection 601AE(5)).

Bill section 601AF enables the ASC to fulfill the outstanding obligations of a deregistered company without limiting this power to situations where property of a deregistered company has vested in the ASC.

Reinstatement

The new provisions give the ASC clear powers to reinstate companies which have been inadvertently deregistered even though they are still carrying on business. This will avoid the cost of a court application for reinstatement (Bill subsection 601AH(1)).

At present, the ASC may only reinstate a company which has been deregistered if it was deregistered as the result of an error on the part of the ASC. Bill subsection 601AH(1) clarifies the ASC's reinstatement power and will allow it to reinstate any company that should not have been deregistered, irrespective of the reason for the erroneous deregistration. However, it is envisaged that the ASC will only exercise this power where no dealings with the property of a deregistered company have been carried out during the intervening period, which give rise to third party rights. Where third parties have become involved, it is expected reinstatement will generally proceed via the Court.

The Court reinstatement power has been preserved (Bill subsection 601AH(2)). As under the current Law, the Court will be able to make such ancillary orders as are just for putting the company and any other person in the same position, so far as is possible, as if the company had not been deregistered (Bill subsection 601AH(3)). The 15 year time limit on reinstatement applications has been abolished.

Bill subsection 601AH(4) will require the ASC to give notice of any reinstatement in the Commonwealth of Australia *Gazette* and in cases of reinstatement by the ASC, to the applicant for reinstatement.

Bill subsection 601AH(5) states the effect of reinstatement and will suspend directors' liability during the period of deregistration until reinstatement. The property of a deregistered company that has vested in the ASC will revest in the company upon reinstatement.

Third party rights against insured, deregistered companies

At present, a person wishing to make a claim against a deregistered company may need to apply to a court for reinstatement of the company so as to bring an action against it. The Bill overcomes this problem by enabling a person to proceed directly against the insurer of a deregistered company, without the necessity of reinstatement (Bill section 601AG). Comparable rights have previously been provided in other legislation.

New section 601AG will enable a third party to recover directly from the insurer of the deregistered company an amount payable under their contract of insurance if 2 preconditions are met:

- the deregistered company had a liability to the third party, and
- the insurance contract covered that liability.

Terminology in Bill

The Corporations Law uses a number of different concepts to describe the deregistration of a company, including `dissolving', `canceling' and `deregistering' the company.

There is no need for the Law to continue to use these different concepts which are inconsistent with the use in Chapter 2A of the notion of the `registration' of companies, rather than their `incorporation' or 'formation'. The new deregistration provisions use the concept of `deregistration'.