COMMENTS BY CHAIRMAN COMPANY LAW ADVISORY COMMITTEE

ON THE

PRESS RELEASE OF THE LAW COUNCIL OF AUSTRALIA

The Law Council of Australia issued a press release on 7th August 1970, in which it expressed severe criticism of the failure of the Attorneys to consult it before the amending Bills were introduced into Parliament. The following aspects of the complaint of the Law Council require consideration:

(a) Is it true that the Law Council was not consulted?

(b) Should a public enquiry of the kind envisaged by the Law Council be held before legislation of this kind is introduced?

(c) Are the specific criticisms of the Bill advanced by the Law Council such as to indicate that the failure to consult the Law Council (if any) has resulted in avoidable defects in the Bill?

(d) Has the Law Council shown itself capable of giving the kind of assistance that it is (by implication) offering'?

As to (a), the Law Council stated that it "was not given any opportunity to consider the legislation before it became public. Its views were not sought, for example, on the proposal to extend the duties of directors into the field of management." This is presumably a reference to the provisions criticised in their sub-committee's report, under which directors are to be required to take reasonable steps to ascertain what action has been taken in relation to the writing off of bad debts, and providing for doubtful debts, and to satisfy themselves that all known bad debts have been written off and that adequate provision has been made for doubtful debts, together with somewhat similar obligations in relation to current and non-current assets.

Prior to the appointment of the Company Law Advisory Committee, an "Accounts and Audit draft" had been widely circulated amongst professional bodies. More than one version of this draft was prepared. Comments on the latest version (dated 18th February 1967) were received by the Standing Committee from the Law Society of N.S.W., the Law Institute of Victoria, and the N.S.W. Bar Association. When the Company Law Advisory Committee was appointed, it advertised for

submissions in newspapers throughout Australia, and indicated at the same time that it would take into account material already submitted to the Standing Committee. A letter in substantially similar terms was sent to each of the bodies which had commented on the draft, including the three legal professional associations referred to above.

Apart from the general advertisement in the press, the Company Law Advisory Committee did not invite submissions from the Law Council of Australia, as it was not one of the bodies which had submitted comments on the draft Bill. However, on 20th March 1968, the then Secretary of the Law Council forwarded to me, as Chairman, a submission dealing in general terms with the protection of investors. This submission was prepared by the Law Reform Committee of the N.S.W. Bar Association, acting as a committee of the Law Council. As it had already forwarded comments on the draft Bill to the Registrar of Companies for N.S.W. it is clear that the committee entrusted by the Law Council with the task of preparing a submission had not only had the draft but had considered it and commented on it.

In the course of its submission to the Company Law Advisory Committee, it referred to "the frequent provision of intelligible end reliable information as to the company's financial affairs" and the following comment was made: “... the present provision of Divisions 1 and 2 of Part VI of the Act coupled with amendments thereof in the nature of those foreshadowed during 1967 substantially cover this requirement subject to the following provisos - First, attention should be directed to giving auditors a greater measure of independence. Secondly, the stipulation in sec. 162 that balance sheets and accounts should not only comply with the Ninth Schedule but should also ‘give a true and fair view of the state of affairs of the company' seems in many cases to be overlooked or disregarded and it may well be desirable to particularise to some extent at least what elements are involved in showing a 'true and fair view'. In this regard accounting practices concerning the values to be attributed especially to fixed assets result in the statement of quite unreal and over-depreciated values. The misleading effect of this feature has been manifested in recent years in the case of takeovers. As a corollary to the disclosure of true values, provision should be made requiring periodic independent valuation." No other comment on the accounts and audit provisions was made in the submission. The comments made by the same body (i.e. the Law

Reform Committee of the N.S.W. Bar Association) on the Accounts and Audi t Draft in June 1967 were confined to one point only, namely, whether the bulk of the directors' report might not be reduced by allowing them to omit "nil returns" as to matters required to be dealt with.

It is to be noted that the Law Reform Committee of the N.S.W. Bar Association also submitted comments to the Standing Committee on the Investigations Draft of 1966. The part of the present Bill dealing with investigations was also the subject of comment in the report attached to the Law Council's press statement of 7th August 1970.

The conclusion seems to me to be inescapable that when the Law Council asserted that it was not given any opportunity to consider the legislation before it became public, those who issued the statement were at best unaware of the previous history of the matter.

It is of course true that the proposals ultimately embodied in the present Bill are different from those commented on in the passage cited above. The differences are referred to below. If however the complaint of the Law Council amounts to an assertion that after draft legislation has been circulated every change adopted as a result of the review of the comments of the bodies consulted, or as a result of the deliberations of an advisory committee, should be referred back to all those bodies for further comment, I can only say that the mere statement of the proposition seems to provide its own answer. If the Law Council is suggesting that it is in a special position to claim such a reference, I would suggest that its performance in relation to the present proposals does not provide convincing evidence in support of its claim. I should add that the date originally specified by us for receipt of submissions was 1st November 1967. That of the Law Council was received on 20th March 1968, together with an intimation that the submission was being circulated to constituent bodies with a request for their views. On 12th September 1968 a further letter was received from the Secretary of the Law Council forwarding comments by various constituent bodies, of which the latest was dated 3rd July. Reference will be made below to a later experience of the same kind as to the delays involved in getting any views from the Law Council.

The second question posed above is whether a public enquiry of the kind envisaged by the Law Council should be held before

legislation of this kind is introduced. It may be noted that when advertising for submissions it was specifically stated that no public enquiry would be held, and it has taken the Law Council three years to form the view that there are defects in the procedure which was then announced. Even if its members were unaware of the terms of the advertisement, the procedure followed in relation to the preparation and presentation of our reports has been a matter of notoriety at least since the date of the first report in October 1968. Be that as it may, on the basic question of public enquiries, opinions may well differ, but it is my view that little advantage is obtained from the conduct of public enquiries of this kind. The chances of getting detailed recommendations from a "Committee from experienced members of each sector of the community concerned with this field or whose interests are affected by it" (to quote the Chairman of the Companies Committee of the Law Council) are in my view rather slim, and I do not think that such a committee is in a position to "see that the proposed changes are capable of practical application and that the law can be drafted with certainty". It may be noted. that the Jenkins Committee, which conducted the kind of enquiry that the Law Council seems to have in mind, did not attempt to make detailed proposals, but contented itself with general recommendations (see Jenkins Report, paras. 18, 19). My experience with the present exercise, and also with an earlier operation of the same kind in relation to the Landlord and Tenant Act of the State of Victoria, leads me to the belief that the most effective results are obtained by a small committee that is prepared to devote a considerable amount of time to examining the submissions and recommendations made by various interested bodies and individuals and to the detailed discussion of the problems that are involved, and, in particular, to considering the actual form of the legislation that will be needed to give effect to any proposals put forward. Whether the drafts so prepared are accepted or not (and we have not expected that they would be found not to require revision) the preparation of such drafts, followed by their scrutiny by a team of draftsmen, affords the best assurance that the proposals will be found. workable in practice. I would add that neither, in the present instance (until the complaint of the Law Council) nor in the case of the Landlord and Tenant Act, did I find any demand for a public hearing. Indeed in the case of the Landlord and Tenant Act, although it was announced at the outset that public

hearings were contemplated, it became necessary in the end to recruit a few witnesses to make the public hearings look respectable, as we found that once interested parties had made written submissions they were not very interested in giving evidence. Perhaps I should say no more on this subject than that I am an interested party, and that others should judge whether the method of procedure adopted by my Committee has been successful.

The third question is whether the specific criticisms of the Law Council are such as to indicate that failure to consult the Law Council (if it was not in fact consulted, as to which see above) resulted in avoidable defects in the draft legislation. In discussing this topic I shall confine myself to the provisions relating to accounts and audit, since the report attached to the press statement deals mainly with that subject, although reference is made in the report to uncertainty in the drafting of the provisions relating to Substantial Shareholdings and Takeovers and there is some criticism of other provisions. At the outset I should point out that there is some internal evidence in the report that its compilers have not read the relevant parts either of the existing legislation or of the report of the Company Law Advisory Committee. Thus in dealing with the disclosure of emoluments of directors, the authors say that this term is "redefined to limit the term to directors and to introduce reference to 'the money value of any allowances and perquisites given '." They remark that difficulty will be experienced in quantifying in money terms some of those perquisites. The reference to "the money value of any allowances or perquisites" has been in the Act since 1961, and was not "introduced" by the Bill.

Similarly, the authors comment on an apparent redundancy in section 131, and enquire what extension is made to the word "perquisites" by the additions of the words "and other benefits". If the authors had read paragraphs 25 - 32 of our first interim report they would have discovered that in an endeavour to ease the burden on directors we had proposed a limitation of the term "emoluments" in such a way as to make the addition of the words "other benefits" quite intelligible. They would also have found from the same source, even if they were not familiar with the existing legislation, that the reference to allowances and perquisites was already in the legislation.

The main criticism of the accounts and audit provisions is contained in the assertion that "the accounting provisions in particular involve a misconception of the proper function of a Board of Directors of a public company and are open to criticism for their lack of definition and certainty". It is stated that the obligations of directors in regard to accounts seem to require individual judgments on matters, many of which are within the sphere of management. After pointing out that the statutory accounts must be compiled by management for the directors, the covering letter of the chairman says "The Bill gives some recognition to this in Section 162(12) but still leaves the directors with a penal responsibility for the accounts generally and, in particular, in relation to bad debts and values of current and non-current assets. This responsibility apparently cannot be discharged by reliance on certificates or other information from management." In the report itself, it is stated that the requirement as to bad debts and assets "imposes a more onerous responsibility on directors than they can reasonably discharge unless they can be deemed to have taken reasonable steps by procuring the statement of the principal accounting officer or other person as mentioned in sub-section (12)." It is also stated that "directors will in the majority of cases have to rely upon advice given by others following enquiries which they have made".

Dealing with these points in order, the suggestion that a requirement for directors to concern themselves with such matters as the value of assets involves a new principle which depends on a misconception of the function of directors is simply untrue. Directors have since 1963 been required to state in the annual report "whether or not any circumstances have arisen which render adherence to the existing method of valuation of assets or liabilities of the company misleading or inappropriate" (Section 162(6)(ba)). They can hardly perform this duty without making the same kind of enquiries as would be involved in "taking reasonable steps" to ascertain what action has been taken in relation to the writing off of bad debts and the making of provision for doubtful debts, and satisfying themselves that all bad debts have been written off and that adequate provision has been made for doubtful debts. Even earlier than 1963, the report was required to include a statement as to whether or not the results of the company’s operations had in the opinion of the directors been materially affected by items of an abnormal character, including "any

writing off of substantial amounts of bad debts." This must necessarily have involved some enquiry as to whether any substantial amounts of bad debts had been written off, and the formation of an opinion as to whether such writing off was "abnormal", so that directors who performed their duty must have had a knowledge of the company' s practice with regard to the writing off of debts, and what amount of writing off could be regarded as normal. Similarly, in regard to the valuation of current assets, there has for many years been a provision requiring the directors, "where the directors are of opinion that any current assets would not at least realise the value at which they are shown in the accounts o' the company" to state "their opinion as to the amount that those current assets might reasonably be expected to realise in the ordinary course of business of the company". The Accounts and Audit draft required the directors to state whether or not, in their opinion, all current assets (as defined) and all fixed assets, would realise the value at which they are shown in the accounts of the company, and if not, their opinion as to the amount that those assets might reasonably be expected to realise. In their comments on this draft, the Law Society of N.S.W. took the view that the provision in the present Act should be retained, and that the duty of the directors should be confined to current assets, while the Law Council submission expressed the view that the Act should go further and require a periodical independent valuation of all assets. It may be added, in case it is suggested that the present provision does not actually require the directors to form an opinion (as to which see the comments in our first interim report, at p.23) that the Fifth Schedule requires directors who issue a prospectus to state, after due enquiry by them, whether "the current assets appear in the books at values which are believed to be realisable in the ordinary course of business".

It will be seen from the foregoing that there is nothing novel in requiring directors to make enquiries as to the values of assets or as to what has been done in relation to the writing off of bad debts. One of the difficulties about the existing Act is that although it requires a statement about "abnormal" writing off, where that has occurred, it does nothing to direct attention specifically to the question whether the amount written off is adequate, and experience had shown that this was in fact a source of weakness The accounts and audit draft would have required a statement as to the adequacy of

the provisions for "bad and doubtful debts", and no objection was taken to this proposal by any of the legal professional bodies, except as to the difficulty of making a statement as to a subsidiary. Our recommendations in relation to these matters are explained in our first interim report, at pp. 23,24.

As to the allegation that the obligations seem to require individual judgement on matters many of which are within the sphere of management, what has already been said is relevant, but it shou1d also be added that the criticism does not in my view take adequate account of the provisions of the Act with regard to the liability of directors. This is dealt with as part of the next subject matter.

The comment that the Bill "still leaves the directors with a penal responsibility for the accounts generally" is ambiguous. It may mean that the Bill leaves the existing liability under the present Act untouched, or that the Bill has imposed new criminal liabilities on directors. Probably in the context it was meant to convey the second meaning.

If it was, and if it was intended to imply that directors were previously under no liability in respect of the accounts, the implication would be incorrect. But the subject is complex, and I shall try to set out shortly the present position and the changes proposed.

Section 162 of the Act requires the directors to make a report containing various matters, some of fact and some of opinion. Under section 375(2) heavy penalties are imposed for wilfully making a statement false in any material particular knowing it to be false. Under section 379, a person who does that which by the Act he is forbidden to do, or does not do that which by or under the Act he is required or directed to do, or otherwise contravenes or fails to comply with any provision of the Act, is guilty of an offence, for which the penalty is a fine not exceeding $100, unless a different

penalty is specified in the relevant section. These provisions wou1d be applicable to the obligations imposed on directors by section 162, although a question would arise as to whether a director would have been liable under section 379 where he made a statement in the annual report which was in fact untrue without taking any steps to ascertain the truth. This question involves the related question whether when the Act says that

directors are to give their opinion as to certain matters they are under any responsibility to take reasonable steps to ensure that they are sufficiently informed to give such an opinion. I would have thought that there was an implication. that the directors should make reasonable enquiries as to the facts before expressing such an opinion and that they would be guilty of a breach of section 379 if they merely expressed an opinion in the report without making such enquiries. If no such implication arises under the present Act,. there is obviously a loophole, since directors can merely claim that they made no inquiry. Hence our recommendation for the addition of new subsections in section 162.

Section 163 of the existing Act imposes criminal liability on any director who fails to take reasonable steps to secure compliance "by the company" or has by his own wilful act been the cause of any default "by the company" in respect of the foregoing provisions of the Division. As the only obligation imposed on the company by those provisions was that of keeping proper accounts, this section had no operation in respect of the duties of directors with regard to the annual report.

The accounts and audit draft proposed to amend subsection (1) of section 163, to read, as far as material, "If ... a director of a company fails to comply with, or fails to take reasonable steps to comply or to secure compliance with, any of the preceding provisions of this Division, or ... has by his own wilful act; been the cause of any default by the company ...". The Law Society of N.S.W. suggested the omission of the words "fails to comply with". It also suggested a new subsection, which we thought should be omitted as it tended to shift the burden of proof to the defendant, whereas we thought that the burden of proving failure to take reasonable steps should always be on the prosecution. The suggestion that the words quoted be omitted was accepted by our Committee, for reasons stated in our report, pp.28,29. It will be seen that in so far as the new sect ion 163 provides for a more onerous liability than under the existing Act, it does so after consideration of objections raised by one of the constituent bodies of the Law Council, and in the absence of any objection by the Law Council itself to the more onerous clause contained in the accounts and audit draft. In my view .it was essential that the Act should impose a duty to take reasonable steps to comply or to secure compliance, as otherwise there would be doubt as to whether any individual director incurred any

liability for the failure of the directors as a Board to perform their duties under Section 162.

Turning now to the particular complaint as to bad and doubtful debts and values of assets, it has been shown above that no new principle is involved in these provisions, although of course every amendment aimed at securing more effective reporting by companies will necessarily increase to some extent the burden on directors. With regard to the assertion that the responsibility "apparently cannot be discharged by reliance on certificates or other information from management" there is nothing in the proposed amendments to suggest that directors are not entitled to rely on information obtained from others, and indeed the reference to taking reasonable steps to ascertain what action has been taken is a clear indication that the directors are not expected to perform the task themselves. The statement that a requirement to take reasonable steps (which is all that is required of a director) "imposes a more onerous responsibility on directors than they can reasonably discharge unless ...." seems to involve a contradiction in terms.

It is relevant to look at the provisions of the accounts and audit draft to see whether the provision in that draft was more or less severe than that now in the Bill. That draft required the directors to report "whether or not, in the opinion of the directors, adequate provision is made to cover bad and doubtful debts". All the criticism that is now levelled at the present Bill could have been urged when this draft, was made available. In my view it would have had no greater validity, except that the form of the accounts and audit draft required the directors to form an opinion about matters which might well have been considered to be beyond their capacity; whereas the present Bill can be complied with by taking reasonable steps to ascertain what has been done and being satisfied that the procedures adopted achieve the desired result. The same observation can be made as to the proposal in the accounts and audit draft dealing with current and fixed assets, referred to above. The present provisions are less onerous than those to which the Law Reform Committee of the N.S.W. Bar Association raised no objection. With regard to non-current assets, the obligation in the present Bill is new, but it is not different in kind from those already existing.

For the reasons above set out, I do not think the objections of the Law Council are of a kind which should move the Standing Committee to take the view that it should not proceed with any legislation in this field without ascertaining whether the Law Council has any objections to offer to the proposed legislation.

I should add that the more recent experience of the Company Law Advisory Committee suggests that if we are to wait for the Law Council to express its views about matters which we are considering, we may have to wait a very long time indeed. In May 1969, as it was some time since our first advertisement, we advertised again for submissions relating to (inter alia) "the control of fund-raising (new capital and borrowings) including the form and content of prospectuses". In May 1970 we ascertained from the Law Council's Newsletter dated April 1970 that in November 1969 the Companies Committee of the Law Council had presented to the Executive of that body a report dealing with public borrowings, which was of course an important part of the topic on which we were engaged. A personal enquiry was made by a member of our Committee as to whether it was intended to make any submission to us, and on 1st. July a letter was written to the Law Council in response to a request for a copy of our advertisement. On 27th August the Secretary of the Law Council wrote to us asking what particular aspects of the subject we were interested in, as without some guidance of this kind there might not be sufficient time available for them to make a useful contribution. As eight weeks had elapsed since we sent a copy of our advertisement and by this time the final text of our fifth report was almost complete, we informed the Law Council that we did not propose to wait for any submission from it. It is obvious that a body which moves as slowly as the Law Council does can hardly claim the right to be consulted about legislative proposals. Moreover its technique of circulating a report for comment by constituent bodies, and then forwarding those comments, sometimes in conflict with each other or with the original report, does not suggest that the Law Council speaks with any single voice, let alone that of the legal profession of Australia.

I should like to conclude this lengthy recital by suggesting that the Standing Committee should not allow the Law Council to appear, as it suggested in its press release, as an aggrieved institution, which has been unjustly deprived of the

right to comment on legislation about which it claims to be competent to give advice. I am attaching a statement which might be considered worthy of release to the press, even though it is now some time since their statement was released.

STANDING COMMITTEE OF ATTORNEYS-GENERAL

PRESS STATEMENT

On 7th August the Law Council of Australia issued a press statement criticising the procedure pursued in the preparation of Bills relating to the Uniform Companies Acts which is now before the legislatures of N.S.W. This statement referred specifically to provisions dealing with accounts and audit and with investigations of the affairs of companies, and was accompanied by a copy of a report on the proposed amendments relating to those matters.

In its statement the Law Council said that it was not given any opportunity to consider the legislation before it became public, and this assertion was given wide publicity, although it was some time before the targets of the criticism received from the Law Council copies of the documents released to the press.

This is the first opportunity the Standing Committee has had to consider the matter since the statement was published.

The Law Council has as its members legal professional associations such as the N.S.W. Bar Association and the Law Society of N.S.W. and similar bodies in other States and the A.C.T. Copies of draft Bills dealing with accounts and audit and investigations were widely circulated amongst those bodies prior to the appointment of the Company Law Advisory Committee, and comments on them were received from the Law Reform Committee of the N.SW. Bar Association and from other constituent bodies of the Law Council. Subsequently, the Law Reform Committee of the N.S.W. Bar Association, on behalf of the Law Council of Australia, prepared a submission to the Company Law Advisory Committee, in which it referred to the draft proposals relating to accounts and audit which had been circulated.

It is therefore clear that the constituent bodies of the Law Council, and also the sub-committee which the Law Council deputed to prepare its submission to the Company Law Advisory Committee, were made aware of the proposals relating to accounts and audit and investigations at an early stage. Changes were of course made in the draft after the comments of-interested bodies were received. If the Law Council's complaint is that these changes were not in turn referred to

each of the numerous bodies, legal and non-legal, which had previously been consulted, it is obvious that such a process might well go on for ever. Nevertheless, in order to give all interested parties an opportunity of considering the changes in the draft, and also because other provisions in the Bill had n6t been previously published, the Bills were introduced in N.S.W. on and in Vic. on and held over to allow them to be examined by those concerned. Submissions from several other bodies were received by the Standing Committee at its meeting in July, and considered at that time.

It was therefore with considerable surprise that the members of the Standing Committee learnt from the press statement issued in August that the Law Council thought that there had not been adequate consultation in respect of the matters which were criticised in the report which accompanied its press release. Moreover, a perusal of the detailed criticisms contained in that report reveals indications that the sub-committee which prepared it was unaware that at least one of the provisions on which it commented had been in the Acts since 1961, and also that the sub-committee had not read the report of the Company Law Advisory Committee on Accounts and Audit. It also appears that some of the provisions of the draft Bill, to which no objection was raised by the sub-committee whose report was adopted by the Law Council for submission to the Company Law Advisory Committee, would have been open to the same objections (whether or not they are valid) as have been voiced by the Committee which now speaks for the Law Council.

The Standing Committee can only assume that those who are now directing the affairs of the Law Council are unaware of the past history of the matter, and would suggest to that body that before it releases to the press criticism of the kind contained in its press statement it should take steps to ascertain what has occurred, and to study the materials available for its information, such as the published reports of the Company Law Advisory Committee. Nevertheless, the Standing Committee will at its present meeting review all the objections that have been raised, whether by the Law Council or by others, to the provisions of the Bill.