COMMENTS BY CHAIRMAN, COMPANY LAW ADVISORY

COMMITTEE ON OBJECTIONS BY VARIOUS BODIES

to

THE COMPANIES BILL

A. THE LAW COUNCIL OF AUSTRALIA:

I have already prepared a paper dealing with the complaint made by this body about the procedure followed. These comments are intended to deal with the specific points raised so far as they are not dealt with in the earlier paper. In some cases approval to the proposals is given by the Law Council Committee, or the criticism is not specific enough to warrant comment.

Report on Accounts and Audit, Investigations and Defaulting Officers

(a) Page 3, reference to absence of definition of classes of assets: See our first interim report, p.19. If someone can suggest a method of defining current and non-current assets for these purposes, we would be pleased to hear of it.

(b) Page 3, reference to “emoluments” and “other benefits”: See previous paper.

(c) Page 4, reference to section 162(6): The report criticises the use of the word "nominee” and suggests that it is used here to catch situations where there may be some attempt to disguise the true ownership of the subsidiary. This is not so. The word “nominee” is used to provide for the ordinary case in which the shares in a subsidiary are held partly by the holding company itself and partly by nominees. If the holding company wants to disguise its ownership of a subsidiary, it will, so far as this provision is concerned, merely lose the benefit of sub-section (5).

(d) Page 5, reference to section 162(7): This passage has been commented on in the earlier paper.

(e) Page 6, paragraph (a):

The suggestion that this provision requires the directors to forecast the outcome of the current year seems to be a misapprehension. They are required to form a view as to whether an event which has already happened is likely to

affect substantially the effect of the company's operations for the current year. This is the sort of thing director's should be competent to assess.

(e) Page 7, reference to sub-section (9):

I have already suggested that there are indications that the authors have not read our first interim report. Our reasons for recommending this provision were discussed at pp.10-12 and 28. We were not aiming at "compensatory" payments as such, but at disclosure of the fact (but not the amount) of benefits having been received by reason of contracts with the company. Disclosure of the amount would only be necessary if a requisition were made. See also our comment on p.22 of the first report under the heading "Section 162A(1)(f)".

[Transcriber's note: two successive paragraphs in the original are numbered "(e)".]

(f) Page 8, paragraph 7:

See earlier comment as to definition of fixed assets and intangible assets.

(g) Page 10, reference to allowing a receiver or official manager to be auditor:

The object of this provision, as I recall it, was to avoid disqualifying an auditor merely because he had acted as liquidator in the voluntary liquidation of a subsidiary or related corporation. But if the effect of the amendment proposed would be to enable a receiver to audit the accounts kept by him (a receiver being the agent of the company) it seems to me that the proposal is undesirable.

(h) Page 12, paragraph 4:

This question has already been raised and I understand is to be provided for.

(i) Page 13, Special Investigations

Here also it seems likely that the authors have not read the report which we produced on this subject on 2nd June 1969. As some of the criticisms made by the Law Council Committee would have found support in our report, one would have thought that if they had read it they would have cited our views in support.

Page 13, comment 1, reference to vesting powers in the Minister:

It is perhaps more appropriate for the Ministers themselves to assess the relative degree of political motivation as between the Attorney-General and the Governor acting with the advice of the Executive Council.

Page 14, 2(b), definition. of "officer":

I would have thought that the expression “solicitor to the company” was less certain than that which replaces it. I do not think that the expression would include a barrister retained by the company, but no great harm would be done if it did.

Page 14, 2(b) reference to "interests":

I would think that if the request is made by the holders of interests issued by a management company, all interests issued by that company would have to be counted. It may be thought desirable to add some such words as "or of the holders of a particular class of interests issued by the company" at the end of the paragraph.

Page 14, 3, Examination of Officers:

Many witnesses before an inspector are in no different position from an ordinary witness in the Court; they are there to tell what they know, .and. have no other interest in the proceedings. If all witnesses were to be guaranteed payment of their costs of being represented, I am afraid investigations would take years to complete.

Page 14, Section 176(5):

This sub-section was redrafted from the form we recommended in our report at p.18, which was based on the view that the only significant "use" that can be made of the notes is by publishing or communicating them to another person. As sub-section (6) prevents publication or communication for any other purpose, I do not think the objection is a substantial one.

Page 15, paragraph 5, Publication of Interim Reports:

We did not raise any greater objection to the publication of interim reports than in respect of final reports. In both

cases we recommended certain restrictions which were no accepted by the Standing Committee. In fact, in the case of Reid Murray Group, for example, interim reports were published, presumably under Parliamentary privilege.

Page 15, paragraph 6. Section 178(7) and (8):

See our third interim report, p.13. My views remain as there expressed. It must be borne in mind that the definition of "officer" includes a person who has at any time had in his possession any property of the company, or who is capable of giving information concerning the affairs of the company. So far as I am aware, our recommendation for the omission of these provisions was not disapproved by the Standing Committee, and I do not know why they have been included in the Bill.

Page 16, Costs of Investigation:

I agree with the criticism here expressed. See our third report, paragraphs 25 to 28 and recommendation (i) at p.14. According to my note of the discussion in Brisbane, although the Standing Committee rejected our recommendation the draftsman was instructed to consider whether some safeguards could not be provided against the imposition of unfair burdens by the exercise of the power to require costs to be paid. However, what has happened is that the power has been made more extensive than it was before. Previously, under Division 3, if a prosecution was instituted, the expenses were paid out of public funds; in other cases the company or the applicants for the investigation might be ordered to pay. Under the present Bill, the Minister may direct that the expenses (including the expenses incurred and payable by the Minister in any proceedings brought by him in the name of the company) should be paid "by the company or by any other person". I know of no other provision in any statute which empowers a Minister to impose a liability (which may amount to many thousands of dollars) on a person on the basis of an opinion held by the Minister, and without any right of appeal or redress.

Page 16, Part XIII - Defaulting Officers:

I agree with the criticism of section 374A(1)(c)(viii). If a company obtains goods on credit, it is free to dispose of them, either in the ordinary course of business or otherwise. To subject an officer of the company (whether a receiver or

merely an employee) to a penalty for doing what the company itself is entitled to do seems unjust.

Page 17, Miscellaneous Provisions:

Paragraph 2: section 64: Somehow I can't get excited about this.

Paragraph 3: section 76: I think the comment is true of most legislative amendments.

Paragraph 4: Registered Office: There may be a machinery point here. I think it is desirable that a company should have a registered office as from the day of its incorporation, and having regard to the arrangements that have to be made in any case before the actual incorporation, I do not see any great difficulty in complying with the requirement, but it may be necessary to provide in section 112 for someone other than a secretary or director to sign the notice.

Paragraphs 5 and 6: These are not matters with which the Company Law Advisory Committee is concerned.

Report on Substantial Shareholders and Takeovers

I regret that as I have been rather fully occupied with the final revision of our Fifth Report, I have been unable to give the detailed consideration to this report that would be necessary for me to make useful observations on this report.

B. THE INSTITUTE OF DIRECTORS

I have been furnished with copies of correspondence passing between the Chairman of the N.S.W. Branch of the Institute and the Attorney-General for New South Wales. Comments on some of the matters raised may be useful.

Letter of 28th August 1970: "Unfortunately, 'tightening up', plugging of loopholes' type of amendments to any Act has never been successful even if on occasions it is necessary". For one who complains that "there is no attempt to define several vital (and incidentally, somewhat emotive) phrases", the sentence quoted is quite an achievement. It is also rather unjust both to the Attorneys who resisted the temptation merely to plug loopholes, and, if I may say so, to my colleagues and myself who have attempted to bring some systematic approach to legislation which has got into its present state as a result of piecemeal amendments.

Reference to Law Council suggestion for Public Enquiry:

My views on this have been expressed elsewhere.

"We see the presently proposed legislation as based on the belief that the public good is best served by the most onerous controls on Directors that can be devised": Perusal of our first interim report will show that in a number of cases we introduced provisions designed to alleviate the position of directors (e.g. in relation to reports on the group accounts and disclosure of professional fees received). If the author thought we were really acting on the belief stated, he must have a very low view of our capacity.

Section l80J: Two points should be made. The first is that there is nothing new in the inclusion of "misleading" statements with "untrue" statements. Sub-section (3) of section 5, which has been in the Acts for many years, provides that a statement included in a prospectus shall be deemed to be untrue if it is misleading in the form and context in which it is included. This probably did no more than state what was implied in section 47 (see Kylsant's Case).

The second point relates to the omission from section 180J of the provision in section 46 (but not in section 47) that a defendant can establish a defence by proving, in respect of a statement made by an expert, that he had reasonable ground to believe and did believe that the person making the statement was competent to make it. It is said that section 180J(6) "no longer permits a director to rely upon a statement by a competent expert". This is hardly accurate. If a competent expert makes a statement, and a director believes him, he is unlikely to be held not to have done so on reasonable grounds. The anomalous part of the present section is that the only enquiry is as to the competence of the expert. The director may know that statement is untrue (he may have salted the mine himself), but if he proves that he believed on reasonable grounds that the expert was competent he escapes civil, but not criminal, liability.

Sections 124 and 124A: The comments in the letter now under discussion were to some extent based on a misapprehension, viz., that the section set out in the appendix to our report was the one we were recommending. Strangely enough, having wrongly complained that an officer

who bought shares might be sued up to two years later, in a later letter the suggestion was made that there was no reason why the insider trading provisions should not be extended to buyers as well as sellers, and that the provisions should extend to various non-employees of the company. Leaving this aside (and the criticism is perhaps unfair, as the author suggested other limitations on the liability) one of the complaints related to the transfer of the word "improper" from its present position to make it refer to use, instead of advantage, as at present. The author seems to have overlooked that under the present section if an officer makes use of information to cause detriment to the company he is liable for the damage, whether the use of the information is proper or not.

In a later letter to the Premier of New South Wales the author refers to the fact that sections 46 and 47 are not being amended by the Bill, and draws the inference that the Government regards these sections as satisfactory. These provisions have been reviewed by us in our fifth interim report, and in the light of our announced programme, the inference was not one which could properly be drawn. Again somewhat illogically, the suggestion is made that the provisions of sections 46 and 47 should be extended to Part B statements "especially as those statements would tend to express opinions which might be completely unjustified and likely to be detrimental to their own shareholders. Cases of this kind are common."

This second letter also repeats some of the criticisms of the Law Council of Australia, with which I have already dealt.

It also deals with the provisions as to tenure of office by auditors, and says that the Institute would find the position in the United Kingdom acceptable. As the position in the United Kingdom differs from that recommended by us so little as to be virtually indistinguishable in practice, it is difficult to escape the conclusion that some at least of these objections have been taken merely for the sake of objecting.

C. THE AUSTRALIAN FINANCE CONFERENCE

The only point raised in the letter of 27th August 1970 from the Australian Finance Conference is that relating to the requirement to show in the annual accounts the amount written off for bad debts in respect of each class of debtors'

accounts, and the amount set aside for doubtful debts in respect of each class. It is to be noted that the Conference "fully agreed" with the new provisions of sections 162(7)(a), 162(1)(g) and 162A(2)(i), which have caused the Law Council of Australia such distress. The Conference considers that with these safeguards there is no need to require the disclosure of information referred to above, and that such disclosure may have harmful effects, because:

1. As finance companies have higher bad debt rates than other industries, or may appear to, there may be misleading comparisons in the press, often by journalists ill-equipped to make such comparisons.
2. Some finance companies lend on unsecured business to a greater extent than others, and this may lead to unwarranted conclusions.
3. Although the industry is in a healthy position, actual disclosure of amounts, if subjected to uninformed comment, may lead to loss of confidence
4. Because of the amount of public borrowings by finance companies, loss of confidence could well have profound results on the whole credit system.

It may be conceded that the first publication of information under the new legislation may lead to uninformed comment. Indeed, almost all published information does. The finance companies happen to be at one end of the scale as far as bad debts are concerned. Probably builders' suppliers would be high up on the list also. But I do not think that disclosure of the fact that finance companies as a group appear to have a higher incidence of bad debts than other groups is likely to have any material effect on their ability to attract debenture finance. Uninformed speculation about the amount stolen from retail stores by shoplifters might be put in the same category, but I do not think such publicity affects public willingness to invest in the shares or debentures of retailers.

As to 2, it may well be that an investor would prefer to invest in finance companies which invest on secured loans rather than in those which lend without security. This is part of the information which I think an investor should have. In the long run, if a company lending on unsecured loans manages to make a better profit than another that relies on security, the investor will tend to choose the one that makes the better

profit, but he may prefer to play safe in the belief that in times of recession the secured loans are less likely to have to be written off. The important thing is that he should have the information required to make the choice.

As to 3, this is largely in the hands of the companies themselves. If they provide some basis for comparison with prior financial periods, they are unlikely to suffer from such uninformed comment to an extent that would impair public confidence in this form of investment.

As to 4, this point is really consequential on the first three. It is true that borrowings by finance companies represent a large part of borrowings from the public by companies, but I would not regard the risk of any substantial loss of public confidence as high, and in my view the detriment (if any) would be greatly outweighed by the greater availability of information to investors, a factor which might in the long run lead to a strengthening of confidence in this kind of investment.

D. THE LAW INSTITUTE OF VICTORIA

1. Accounts and Audit: Insofar as these comments deal with the question of auditing the accounts of exempt proprietary companies, as this is a matter outside our terms of reference, I make no comment on it.

As to the comment in the table attached, the following comments are made: -

Section 161:

The grouping of definitions is a matter on which there may be two points of view. My own preference is for the method used here, especially as section 5 will be incomplete until the whole Act is reprinted.

Section 161A(6):

This appears to be taken care of in the latest version of the Bill.

Section 162(7):

I think it is clear that explanations are not required unless the asset appears at an over-value. If the comment means that the directors should not have to perform the duty imposed by

the provision if adequate provision for writing down the asset on a recognised basis is made, I do not agree with the suggestion. I assume what is contemplated is that if the directors have decided to write off plant on the basis of an expected life of (say) fifteen years, they need not enquire as that plant thereafter. But if that plant becomes obsolete and unsaleable after five years, and is worth nothing to the company as a going concern, the shareholders should be made aware of the circumstances, unless the whole balance is written off.

Section 162(8):

In view of section 162(4) the words "Not less than fourteen days" would appear to be unnecessary, but by the same token their removal would not make any difference.

Section 162A(1)(l) and 162A(2)(n):

I think the view taken by the Law Institute is tenable but not the natural meaning of the words used. Unless the directors have some apprehension that the company is not going to be able to meet its obligations during the current year, I do not think this clause would require them to make any comment, other than a negative report.

Section 163(3):

See the comments in our first interim report, paragraphs 16 and 17. Where we intended to leave a discretion to omit immaterial information, we said so in the drafts. In the case of information which was specifically required to be given, we did not intend that the directors should be able to decide to leave it; out because they thought that it was not material to disclose it.

Section 166B(4)

The Board has power to "otherwise order" and this should ordinarily be sufficient, but it might be desirable to allow an appeal to the Court or to introduce a provision similar to section 120(4).

Section 167:

In the absence of any affirmative provision requiring this, it does not seem to be necessary to negative the duty.

Section 167(8)

This is outside our field.

Section 375(2)

I think the point taken is a good one.

Ninth Schedule, 1(3):

See comment on section 161 and alteration made in draft of 29.9.1970.

2. Investigations

Section 168

The definition of “affairs” may be an awkward way of achieving the result and I would have preferred our approach, but I do not think it warrants an amendment. With regard to the definition of “officer", in the light of the imposition of the duty to assist in prosecutions (see my earlier comments on section 178(9) and (10)) I think there may be some ground for thinking that the effect of the definition is not always borne in mind.

Section 169

The suggestion that the reference should be to issued shares seems to be correct. The same applies in relation to debentures. I do not think it is necessary to refer to “one tenth in number of the members" as I think the meaning is clear when reference is made to other provisions of the section.

Section 179(2)

I agree with this criticism, and refer to our report and to earlier comments.

Section 174

The words "solicitor with or without counsel" were suggested by us for the reason mentioned by the Law Institute. I would not like to leave the Bill in a condition in which an inspector might refuse to hear counsel on the ground that he was only bound to allow one practitioner to attend. Some solicitors are very capable at instructing counsel, but I would not like to be represented by them on an investigation.

I do not think it is necessary to clarify the term “criminal proceedings”.

Section 176

The use of the evidence itself in criminal proceedings is covered by section 174(3). I note that 176(3) has now been altered to conform with 174(3).

Section 178

I do not think I can usefully comment further on this aspect.

Section 179:

See comments already made.

Section 179B

I do not see the difficulty.

Takeovers

I have not had sufficient time to examine the criticisms here made.