CORPORATE LAW REFORMS

The federal Government is seeking comments on a major corporate law reform Bill which includes its legislative response to the ALRC report on insolvency.

The Attorney-General has released a major corporate law reform Bill for three months' public exposure. It is a most significant step in the government's program of corporate law reform.

Balance between protecting investors and facilitating business

The overall aim of the Bill is to draw a balance between protecting investors and facilitating business.

To protect investors, the Bill will regulate transactions more closely where the potential for abuse is high, such as loans to directors, and will increase the penalties for breaches of duty, particularly where a director acts dishonestly.

Outside those areas, and especially in the areas of corporate insolvency and stock exchange settlement, the Bill will aim to streamline procedures and provide guidance and assistance to company directors, thus giving them the flexible and efficient laws that they need to get on with doing business. For instance the Bill will allow the Australian Stock Exchange to implement its new electronic share settlement scheme, called the Clearing House Electronic Sub-Register System (CHESS).

Contents of Bill

The Bill will

- set appropriate standards of conduct for directors
- streamline corporate insolvency procedures
- require more disclosure of loans to directors and related corporate transactions; and
- facilitate electronic settlement procedures for transactions on the Australian Stock Exchange.

The law reform Bill includes the Government's legislative response to reports by the Senate Standing Committee on Legal and Constitutional Affairs: *Social and Fiduciary Duties and Obligations of Company Directors* the ALRC's report: *General Insolvency Inquiry* (ALRC 45) and CASAC's report on loans to directors, loans between companies in a corporate group, executive remuneration and related topics.

Key reforms include:

- implementing a new voluntary administration procedure, modelled on the United States 'Chapter 11' procedure, to help struggling companies trade out of their financial difficulties;
- making a holding company liable for the debts of its insolvent subsidiary, where it knowingly allows the subsidiary to trade while insolvent;
- greater disclosure of executive remuneration, and particularly payments through so-called 'management companies';
- increased shareholder involvement in decisions on loans to directors and, in appropriate cases, loans and asset transfers to related companies;
- increased penalties for breaches of directors' duties involving dishonest intent to a $200 000 fine and/or 5 years' imprisonment;
- scrapping criminal liability for breaches of directors' duties which are committed without a dishonest intent, and replacing it with a civil penalty regime

- setting out in the legislation, for the guidance of directors, a list of fundamental matters which a director should consider in performing his or her duties in areas such as attendance at meetings, supervision of delegates, and other areas where weaknesses in internal company administration have contributed to corporate collapses in recent years;
- making receivers and liquidators more accountable, while at the same time removing technicalities which impede their work;
- making mortgagees who take possession of a company's assets more accountable for their actions
- making share transactions on the stock exchange faster and safer.

ALRC report on insolvency

The exposure draft Bill also deals with the corporate law aspects of the ALRC report *General Insolvency Inquiry* (ALRC 45). The personal bankruptcy aspects of the report are being dealt with as a separate legislative exercise.

ALRC 45 embodies a comprehensive review of corporate insolvency law. The government's response to the report is designed to make corporate insolvency laws operate more effectively than at present to help save businesses whenever possible and, when that is not possible, to deal with the winding-up efficiently and fairly.

Key reforms will:

- introduce a new voluntary scheme for administering companies in financial difficulties, which will provide for:
  - — the appointment of an independent administrator;
  - — a moratorium on actions against the company while the administrator prepares a scheme of arrangement to put the company back on its feet; and
  - — putting in place the scheme of arrangement, subject to appropriate protection for creditors;
- help a trustee in bankruptcy to take control of the bankrupt's rights under shares in family companies;
- enable a liquidator of an insolvent company to sue the company's holding company if the holding company allowed the subsidiary to trade when the holding company knew or should have known that the subsidiary was insolvent;
- impose a positive duty on directors to prevent insolvent trading and remove the current defence which 'rewards' directors for being totally ignorant about the operations of their company;
- spell out (in the Explanatory Memorandum) what practical steps a director can take to minimise the chances of liability for insolvent trading;
- remove the costly and barren technicalities concerning statutory demands, and focus on the reality of inability to pay;
- streamline procedures for challenging statutory demands, so that any genuine dispute about the debt involved is raised early and dealt with expeditiously;
- set out clear rules concerning unwinding past insolvent transactions and unfair loans, replacing the current obscure and complex cross-references to bankruptcy law;
- widen the net of related party transactions which can be unwound by liquidators, both by extending the period of review to a uniform period of four years and also by catching related companies and trusts;
- guarantee, for unpaid employer superannuation contributions, the same special priority in a liquidation that applies to unpaid wages;
- give liquidators the power to apply for seizure and arrest orders where company officers or related persons plan to remove assets or flee Australia;
- set out clearer rules on when a winding up is taken to have begun, to make sure that liquidators are able to attack past insolvent trading and to clarify a company's legal position where an application to wind the company up is pending;
- assist liquidators to wind up companies cheaply and recover preference payments efficiently, by allowing a court to presume that a company was insolvent on a critical day if the accounting records relating to that day have been lost or destroyed, or were never kept;
- ensure that all creditors (and not just the first to take action) get the benefit of compensation recovered in respect of insolvent trading;
- allow the Court to overturn a resolution of creditors, if it was obtained through the votes of creditors who are related to the company or its officers;

- prevent utilities from holding an insolvent company 'to ransom' by refusing to provide service to an insolvency administrator until past debts are paid;
- impose positive duties on company officers to assist liquidators and other insolvency administrators;
- clarify the powers of provisional liquidators to do all things necessary to preserve the company's position, pending determination of the winding up application;
- remove current technical restrictions on the information that a liquidator can obtain through an examination;
- clarify a liquidator's power to disclaim onerous property;
- require receivers and mortgagees-in-possession to make available a full report on the financial position of the company within two months of appointment;
- empower the Court to remove a receiver or mortgagee-in-possession for misconduct, and to prevent an excessively prolonged administration;
- oblige a receiver or a mortgagee-in-possession to obtain the best price that is reasonably obtainable when they sell company assets.

Senate report

With respect to the Senate Standing Committee Report on 'Company Directors' Duties'. The Bill will:

- set out a list of key factors for a director to address in discharging the duty of care and diligence, to offer directors more guidance in this difficult area of the law than they have had previously;
- introduce civil penalties. Currently, company officers who breach key duties are liable to criminal prosecution, even if they acted without any dishonest intent. Under the proposed Bill, breaches committed without any dishonest intent will be subject not to prosecution and possible imprisonment, but only to civil penalties. A civil penalty could comprise an order to pay a sum of money not exceeding $200 000 or disqualification from future participation in company management, depending on the degree of any carelessness involved, and any other relevant factor. Once the Australian Securities Commission has commenced a civil penalty action, the company will be able to join the action to recover compensation for any loss the breach caused to the company;
- increase the maximum penalties for breaches of directors' duties which are committed with a dishonest intent, to a maximum fine of $200 000 (up from $20 000) and five years imprisonment.

CASAC report

With respect to the Companies and Securities Advisory Committee Report — the Bill will:

- tighten up the existing section 234 in the Corporations Law, which concerns loans to directors, and extend the scope of regulation to other corporate financial transactions, by:
  - — broadening the class of regulated transactions (presently only loans, guarantees and security relating to loans and guarantees) to encompass all types of financial assistance;
  - — subject to certain exemptions, such as for approved employee share acquisition schemes and housing assistance schemes, prohibiting a company from entering into loans (and other transactions) with its directors (and certain persons associated with directors);
  - — subject to analogous exemptions (which will cover most group treasury operations), prohibiting a company from entering into transactions such as loans to related bodies corporate, or bodies corporate to which it is 'linked' — that is, in which one body corporate has a significant influence over the other — unless a strict members' approval procedure is followed and approval obtained; and
  - — subject also to appropriate exemptions, prohibiting a company from entering into asset transfer transactions with associates of the company (defined in wide terms), except in accordance with a strict members' approval procedure
- require greater disclosure to the company by directors of matters which may give rise to a conflict of interest;
- extend the operation of existing section 239, relating to the disclosure of benefits given to directors, by:

— requiring disclosure (subject to a $50 000 threshold) of all benefits given to a director of a company or a related company, to relatives of such a director, relatives of the spouse of such a director and to companies and trustees so associated with a director that the director might be the ultimate beneficiary of the payment (in particular, the Division is designed to require disclosure of benefits received by way of artificial devices such as 'consultancies' and 'management companies');

— requiring such disclosure to be made to the ASC, as well as in the company's annual accounts and director's report.

Exposure draft process

The government is encouraging public comment about the Bill. It will be available for public comment for three months before finalisation and introduction into the Parliament during the Autumn 1992 Sittings. Copies of the Bill can be obtained from Commonwealth Government Bookshops in major Australian cities. □

Reform, my dears, is neither banners nor bombs. Reform is unpaid labour, is poverty, is solitude, is the composition of innumerable letters by the midnight oil and the engagement in ignominious struggles with a duplicating machine. Reform means years spent in the mastery of uncongenial and arid themes. Reform is giving up dinners, holidays and sex in order to pore over deadly documents in a basement. Is to be isolated, ignored, insulted, and possibly run over by a government truck. Reform is concentration and endurance.

Shirley Hazzard
The Transit of Venus, 1980