ATTACHMENT TO

ASX SUPPLEMENTARY SUBMISSION

FINANCIAL SYSTEM INQUIRY

CORPORATIONS LAW MODEL

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ASX

AUSTRALIAN STOCK EXCHANGE

Contents

Chapter 1
Introduction

Background

ASX recommended to the Wallis Inquiry at paragraph 8.2.1 and following:

As a high priority, a Treasury led task force should be appointed to urgently undertake a fundamental review of the Corporations Law with a view to the law being reduced to a high level policy document dealing with the core subjects of basic framework, takeovers, markets and intermediaries and fundraising.

In undertaking its work the task force should:

- *base its review on the philosophy of 'minimum regulation' commensurate with the promotion of user confidence in financial markets;*
- *review the balance of regulation across all financial products and markets to ensure that current anomalies are removed;*
- *review the fund raising provisions to remove aspects which impede efficient capital raising through unnecessary regulation (such as the consequences of making forward-looking statements); and*
- *take care to avoid an artificial and inefficient dichotomy between derivatives and securities. ASX considers that the optimal approach is a common regulatory regime for financial products (both securities and derivatives) with appropriate specific regulatory measures for individual product types according to the risks or other features of those products.*

The task force should be established as a high priority and be required to report within 12 months.

ASX submitted to the Wallis Inquiry that the Corporations Law should be reduced to four core subjects:

- **Basic framework:** These are the mechanical and necessary procedural aspects of Corporations Law. They would specify a framework for beginning and ending a body corporate, some basic rules (eg. director's duties) and give the courts jurisdiction. Offences would be set out in the law, although many of the current offences are of no practical regulatory significance and should be streamlined.

- **Takeovers:** These provisions should remain, but be rewritten with far less detail. The ASC should have power to fill in the detail, and to modify all aspects of the provisions (within guidelines such as s731). The Takeovers Panel should be able to act quickly and in accordance with the intention and purpose of the provisions. In other words, the Panel should take on a character more like the UK City Panel.

- **Markets and Intermediaries:** The securities and futures provisions should be merged, eliminating the distinction between types of product. The Law should set up a broad definition of 'Investment Business' and 'Investment Product'. Within that framework, the type of business, the persons authorised to conduct it, the markets for it, and the instruments that can be sold, can all be regulated. The tailoring of the details (eg, prudential requirements, conduct requirements etc) can be left to the ASC (or other agency), the exchanges and other professional bodies. Such details can be set out in 'rules'. ASX expanded on this in its submission on Stage 4 of the Corporations Law Simplification Project.

- **Fundraising**: The fundraising provisions are in urgent need of overhaul and there are two special areas of concern. (These are the difficulty of making forward-looking statements at reasonable cost, and the problem of overlap with s52 of the Trade Practices Act.) ASX is concerned that the regulatory burden being applied to growth SMEs is both onerous and inappropriate. In a well functioning market, such companies will attract capital because of the higher return they offer investors. However, if the direct and compliance costs of regulation are too onerous then such companies have to pay an excessive premium for their capital.

This document outlines a model for the Corporations Law dealing with the four core subjects as set out in ***Appendix 1***.

The model is an outline only

The model in appendix 1 is what the Corporations Law might look like if the framework were changed to reflect the idea of a high level policy document dealing with core subjects in which:

- Objectives (and principles) are articulated.
- The Law sets out fundamental provisions to achieve the objectives.
- The regulations, or in appropriate areas the rules of a self regulatory organisation, set out the detail, giving fuller effect to the objectives and fundamental rules. In this respect note that there are already many ways in which the existing Corporations Law is supplemented (indeed, even modified) - see ***Appendix 2***. Perhaps these should be rationalized anyway.

Appendix 3 sets out the background to the Corporations Law.

Model is policy neutral

A model like the one in appendix 1 can address two things:

- the framework of the existing law (ie, structural change), and
- the policies of the existing law.

ASX's submission to the Wallis Inquiry identified that policy change, as well as structural change was desirable. The model is designed to address the issue of structural change. But the following qualifications apply:

(a) There will necessarily be some policy changes made merely because the framework is changed. Details of the model, in Chapters 3, 4, 5 and 6, touch on policy issues, though ASX should not necessarily be taken to be promoting these proposals. They are suggestions only. Development of appropriate policies would involve considerable work, which has not been carried out.

(b) Even without policy changes, the model merely expresses the way that the Law is moving in many respects already (eg, takeovers). ASX recognises the work that the Corporations Law Simplification task force is undertaking in this respect, though there are limitations on any simplification exercise making major policy changes.

(c) Debate about the model might be a suitable vehicle for debate about policy change. Indeed, one might ask the purpose of making the structural changes that this model seeks if there are no policy changes.

It is stressed that it is not necessary for acceptance of this model to make any policy change to the existing Corporations Law (except those that will necessarily be made merely because the framework is changed).

How a Corporations Law based on the model would ultimately look will depend on the objectives and principles accepted.

ASX notes that the Corporations Law Simplification task force has issued a paper titled *Organising the Law* in which testing was to feature prominently in development of that model. The model in appendix 1 would also benefit from user-testing, which could be undertaken as part of the model's further development.

ASX also notes the Legislative Instruments Bill 1996. The Bill proposes that consultation on legislative instruments (eg, regulations) be encouraged, scrutiny of registered legislative instruments by Parliament is facilitated, and that instruments cease to be effective after 5 years. This means that the instruments would need to be re-justified (eg, on cost-benefit terms) after 5 years in operation. The model in appendix 1 relies heavily on the use of regulations. While under the Legislative Instruments Bill regime this would create additional burden, it would also bring additional benefits. These are, notably, broader consultation before the making of regulations, and periodic reconsideration of the costs and benefits of the particular regulations.

Qualification

As noted above, while it is necessary to touch on policy issues in order to demonstrate how the model might work, ASX is not necessarily to be taken to be promoting those particular policies. They have been included only to show how the model might articulate objectives and principles and so lead to rules that differ from (and address problems in) the existing Corporations Law.

Chapter 2
Philosophy of the model

Objective of the Corporations Law

The Corporations Law should be recognised as an instrument for achieving economic policy goals. There are a number of ways it must achieve this:

- Provide a legal structure for the existence and operation of the numerous corporate enterprises of widely different sizes, engaged in widely different activities, which comprise a market-based economy. Such an economy is characterised by choice, competition, and the growth (and decay) of individual enterprises.

- Provide a legal structure to facilitate strong, dynamic markets (ie, provide foundations for bringing together enterprises and investors to raise capital, allocate savings and manage risks).

- Promote confidence in the structures created by the Corporations Law. Confidence is a particularly important objective. Without it, markets will not operate effectively and the free flow of capital will not occur. Confidence is easily lost and so care is needed when reforming the Corporations Law.

Indeed, the relevance of the Corporations Law to achieving economic policy goals has been recognised, at least partly, by the present Government. It has transferred responsibility for the Corporations Law from the Attorney-General's Department to the Treasury. This will give regulation of companies and markets more economic focus; that is, it will take into account economic policies as well as regulatory policies.

However, even if the purpose of the Corporations Law was purely regulatory, the model in appendix 1 offers advantages and remains relevant.

Policies of the Corporations Law

To meet these objectives, the legal structure established by the Corporations Law must efficiently and consciously facilitate policies in relation to each of the following:

- enterprise establishment, development, and re-organisation.

- market establishment, development, and re-organisation.

- the pooling and transfer of capital (ie, partnerships between passive capital providers and active participants in enterprises).

- innovation in ways of raising capital, transferring interests and managing risk.

- competition for capital between enterprises (ie, providing choice for investors).

- appropriate means of sharing risk and the rewards of risk taking.

A look at the objectives quickly tells you that they may compete for prominence. Balance between competing objectives is hard to achieve but essential for economic growth. The fact that there has been a balancing of objectives should be more apparent under the proposed model than it currently is. This should assist in the interpretation of the provisions. It should also lead (during the development stage) to an open, informed debate about the appropriate balance.

The model will necessarily result in change

The model in appendix 1 will necessarily result in some change. In any change there are gains and losses, although decisions not to allow losses may be taken even though they do not fit the principles expressed in the model. There may be historical or fairness reasons for retaining an existing right. An example may be section 618 of the Corporations Law (allowing 3% creep every 6 months as an exception to the takeovers prohibition). Arguably that section does not fit with the principles underpinning takeovers. However, it may be kept notwithstanding. Therefore, it may be said, even where the review unmasks the fact that there is no principle underpinning a particular provision, it does not necessarily follow that the provision must be deleted.

"Grandfather" and transitional provisions are a related issue. It will be necessary to make appropriate rules for the smooth transition to the new model and to accommodate certain vested rights.

Achieving desired outcomes is the philosophy

The philosophy that should guide the drafting of the Corporations Law is that the Law is intended to achieve desired outcomes. On our assumption, the outcomes are meeting economic and regulatory policy goals, but it might equally be meeting purely regulatory goals. Objectives, principles and rules must be formulated on the basis of how effectively (and at what economic cost) they achieve those outcomes.

An outcome-oriented Corporations Law might have the following features:

· *Articulation of objectives & principles*
An aspect of the organic development of the existing Corporations Law is that many of the principles that underlie it are not expressly articulated. In some cases, the lack of articulation masks the absence of underlying principles. Stating the principles upon which the rules are based would enable debate on how effectively the articulated principles achieve the outcomes. Stating the principles will also minimise the problem, where underlying principles are absent, that rules may be essentially arbitrary or derived from historical accident and counter-productive.

ASX's listing rules provide something of a model by exemplifying an approach of articulating principles. . The principles on which the listing rules are based are set out in the Introduction to the listing manual. The listing rule principles embrace the interests of listed entities, maintenance of investor protection, and the need to protect the reputation of the market. The listing rules (which are at least as flexible as regulations) are to be interpreted:

■ in accordance with their spirit, intention and purpose;

■ by looking beyond form to substance; and

■ in a way that best promotes the princlps upon which they are based

A difference, of course, is that the listing rules do not have a subordinate instrument to flesh out the details (although some aspects of this are present in the use of Guidance Notes). Nevertheless, the same model could apply to the Corporations Law, although it would be more useful to have separate principles set out for each of the four core subject-areas. This is because, as the Corporations Law Simplification task force points out in *Organising the Law*, the coherent grouping of material is critical to the effective communication of the Law.

Example: An example of the articulation of objectives is found in Section 1(2) of the ASC Act. It sets out the ASC's objectives. Another example of the articulation of principles may be found in the takeovers area. The Eggleston principles are generally recognized as underpinning much of chapter 6 of the Law. They are encapsulated in sections 731 and 732 of the Law. If retained, they could be given more prominence and reference could be made to them in interpreting all the takeovers provisions.

- *Rules that give effect to objectives and principles*
  An outcome-oriented Corporations Law would explicitly recognise that there will need to be rules to give effect to principles and that, in some cases, the limits fixed in those rules are arbitrary. It will also recognise that rules fleshing out the detail should be placed in regulations or, in appropriate cases, the rules of SROs. That structure gives effect to the principles and leaves enough flexibility to adjust the details to suit developments.

  Example: A principle in the area of takeovers is that shareholders and directors have a reasonable time in which to consider the proposal. One rule to give effect to the principle is that an offer must remain open for a reasonable time. This could translate into a regulation requiring the offer to be open for at least one month. The one month is arbitrary and may be adjusted without necessarily affecting the principle. The objectives of the Corporations Law would still be met if the time were 3 weeks, or 6 weeks. (Other requirements of the offer could also be in the regulations, rather than the Corporations Law.)

- *Flexible content rules giving effect to objectives*
  An outcome-oriented Corporations Law would avoid rigid, prescriptive rules; it would favour rules that achieve the desired outcome in a wide range of circumstances. It does that by rules that are capable of having variable content, depending upon the situation to which they are being applied. A further advantage of this style of drafting is that amendment of variable content rules would be necessary only when the desired outcome changes; not when circumstances change.

  Variable content rules can usually be expressed more simply, in readily understood terms, eg, in terms of concepts of honesty, fairness or reasonableness. For example, many existing offences depend upon the concept of "honesty" but don't articulate it.

Example: Replacing existing s164(3) might be a rule that the actions of all employees of a company create a direct statutory right against the company in favour of third parties, unless it would not be reasonable for the company to be bound. The "reasonableness" test in the rule would allow for variations in business practice from industry to industry, and from time to time. The regulations could flesh out some particular matters that would be reasonable (eg, relying on what appears to be a sealed document).

- *Cascading levels of regulation*
  The Corporations Law need not go beyond stating the objectives and principles of the Law, and the fundamental rules derived from those principles. Elaboration of the principles and fundamental rules into detailed provisions would not be a function of the Corporations Law. It would be achieved through regulations, or in appropriate cases the rules of SROs. This approach would give flexibility to correct provisions that prove to be inadequate or unworkable. This may also allow a greater degree of consultation with participants in the processes that the Corporations Law seeks to regulate. Currently there is some consultation for draft regulations but it is not as extensive as for Bills, but it could be made so even without the Legislative Instruments Bill). The futility, perhaps impossibility, of including detailed provisions in legislation is evident in the existing Corporations Law. Indeed, it is recognised by the current form of the Corporations Law. There are already a variety of ways that subordinate legislation, rules, orders and administrative acts affect the Corporations Law (see appendix 2).

While it is not necessarily simpler to have to look in the Law and the regulations to get the full content of an obligation or right, some simplification could attend the rewrite. For example, regulations could be set out in full, not merely as substituting one thing for another. The current regulation 7.12.12 substitutes a complete section 1022(1) in relation to prescribed interests. It is the preferable model compared to, say, regulation 7.3.17(3) which says that section 774(5) has effect as if certain references were other references (which requires the reader to go back to s774(5) and substitute the references). Arguably the model results in merely shifting the bulk from the Law to the Regulations, but this, too, could be addressed by simplification. The opportunity to review the utility of each of the provision should be taken before the provisions are merely transferred from one place to another. This is worthwhile, whatever becomes of the Legislative Instruments proposal.

Example: A principle that assists the objective of encouraging enterprise formation is that of limited liability for artificial legal entities. A rule derived from that principle is that a company must disclose to third parties its nature as an artificial legal entity for which liability is limited. Detailed provisions giving effect to that rule, which should be contained in the regulations not the Corporations Law, might be requirements that the name and registered number of the company be printed on all company documents. There could also be naming conventions described.

The following proposed rule shows how the Corporations Law rule regarding limited liability might dovetail with this example. The proposed rule raises issues about the relationship between owners and managers of the company. These must be addressed before such a rule would be adopted, but it is illustrative of the idea behind the model and of the utility that can be derived from rethinking.

Limited liability

1. A member of a company, or a person who was a member in the last 12 months, is not responsible for any of the following:

- meeting the liabilities of the company,
- meeting the costs of the company's dissolution,
- paying an amount to adjust the rights of members among themselves,

except as follows:

Exception	*Circumstance when liability arises*
1. For any unpaid amount of capital of the member	On dissolution of the company Cross-reference sections #, regulations #. This liability arises regardless of reliance on any other exception.
2. For a proportionate share of an unpaid debt	If disclosure of the corporate identity in accordance with the regulations was not made to the creditor at the time when the liability was incurred. Cross-reference sections #, regulations #.
3. For a proportionate share of an unpaid debt	If there was no reasonable likelihood of creditors being paid by the company at the time when the liability was incurred. Cross-reference sections # and regulations #. A creditor may also recover personally against directors. See sections # and regulations #.
4. For a proportionate share of an unpaid debt	If assets of the company have been transferred to another company with effectively the same owners, leaving the company unable to meet the liability. Cross-reference sections # and regulations #. This provision deals with 'phoenix companies'. A creditor may also recover personally against directors. See sections # and regulations #.

· *True statutory basis for an artificial legal entity*

The limited liability company was originally developed from the deed-of-settlement company, created by a trust deed. As the law tends to develop from what it knows, the Corporations Law contains an amalgam of partnership, agency, trust and contract law that represents an organic development of the law. There has been incremental change and some reform. This process was both necessary and valuable. However, a Corporations Law that is explicitly directed to achieving outcomes would provide a true statutory basis for the establishment of artificial legal entities. It would not concern itself with (or be restricted by) legal history.

Example: The device of deeming the company's constitution to have effect as if was a contract between each member and between the company and each member would not be used. There would simply be a rule that the company and its members must comply with its constitution. (Other provisions will deal with enforceability between two members.)

- *Limits on acceptable behaviour set by reference to objectives*
  Rights are granted by the Law in order to achieve objectives. Limitations on those rights should also be established by reference to those objectives or other, possibly competing, objectives.

Example: The right of limited liability is available to participants in artificial legal entities in order to encourage enterprise formation. Another objective is the creation of confidence in legal structures. Accordingly, the assets of a 'phoenix company' should be available to creditors of the predecessor company. This is addressed in the proposed rule concerning limited liability above.

By way of further example, it is an objective of the Corporations Law to encourage enterprise establishment and participation. The principle that a participant in an artificial legal entity has a property right in shares issued by the entity promotes that objective. If another objective is to enable efficient re-organisation of entities, a principle that persons who hold an overwhelming majority interest in a company should be able to secure a 100% interest may be justified. The CASAC Legal Committee January 1996 "Compulsory Acquisitions Report" identified considerable economic, administrative and taxation benefits resulting from a compulsory acquisition power. The Committee considered such a power to be a necessary and desirable means of corporate rationalisation. A general compulsory acquisition provision is included in the model in appendix 1. It is part of the Basic Framework, but perhaps all reorganisations should be part of a separate chapter that would incorporate the Takeovers chapter.

- *Reduced scope for uncertainty*
  An objective of the Corporations Law is to reduce uncertainty, and therefore the scope for disputes. This will reduce calls on the Courts' time. The objective may be met by setting standards (eg, standard constitutions) and by fixing standard procedures for ending companies. This justifies regulation where it may not otherwise be justified.

  ASX recognises that the shift to variable content rules may (initially at least) compete with this objective. However, once the Law "settles in", and there is a body of case law, understanding and culture developed, this is unlikely to be a problem. Difficulties and expenses in the interim should not be underestimated, but there are real gains to be had by the move from black letter law and the consequential change in the way obligations and entitlements are viewed.

Example: Rights and obligations could be standardised by mandating standard constitutional provisions, similar to those envisaged by the Draft Second Corporate Law Simplification Bill 1996 proposals to introduce "mandatory" and "replaceable" rules.

- *Regulation will depend upon activities carried out*

The model in appendix 1 focuses on companies that have public involvement, not those that rely on private capital. Companies that rely on private capital may be called private companies. Private companies may go beyond the existing proprietary company. They may include public companies, except those that raise funds by, for example, the issue of a prospectus. It seems that there is a useful distinction that can be drawn between private companies and those that have public involvement. The rules for private companies can be much simpler, the takeovers regime need not apply, many of the markets provisions are not relevant and so on.

The Corporations Law provides for the incorporation of different types of companies. For example, companies limited by shares and companies limited by guarantee. The latter tend to have objectives of charitable purposes. They could be separately regulated. The model focuses on commercial companies, rather than companies that, for example, have charitable purposes as their object. Again, there seems to be a useful distinction. Based a philosophy of minimum regulation commensurate with the promotion of user confidence in financial markets, the level of regulation should depend upon the activities carried out by the company.

Example: Requirements to produce financial statements would depend upon whether the company relies upon public capital and support rather than upon a distinction between (a) a "proprietary" company and a "public" company, or (b) the scale of activities carried out by the company (as the current distinction between ‘large’ and ‘small’ proprietary companies does).

· *Utilisation of Self Regulatory Organisations (“SROs”)*

An outcome-oriented Corporations Law would make maximum use of SROs to achieve its objectives where appropriate. SROs could be given responsibility for devising workable provisions to give effect to the principles and rules in the Corporations Law (even in some of the regulations). They could also share responsibility with the ASC (eg, in the area of licensing) or divide responsibility between the SRO and ASC (eg, if some persons affected were not SRO members). There may also be scope to extend the 'reach' of an SRO's rules to cover, for example, non-members. The advantage of this is that SROs are best placed to formulate detailed provisions and to monitor their operation in some areas of operation (eg, conduct of securities business).

Simon Longstaff (Executive director of the St James Ethics Centre) suggested in a recent article in The Australian Financial Review (12 December 1996, p.14) that:

- the preferred basis for corporate governance is not fear of punishment or an over-reliance on control mechanisms, but a fair degree of self-regulation; and

- good corporate governance is fostered by inclusive procedures designed to bring all relevant parties into the process.

This view is consistent with the view that a greater role for SROs is appropriate., It would assist in achieving the objectives of, say, maintaining stable, open and ethical markets.

Example: ASX and its listing and business rules (which are reviewed at least annually and for which there is Ministerial disallowance of amendments) provide an example. The Corporations Law can contain rules providing for the establishment of stock markets, and the securities exchanges that conduct those markets could make detailed provisions for the day to day operation of the market. This largely happens now and is the way that s776 operates. The model proposes simply extending the application of s776.

Chapter 3
Basic Framework

Introduction

This chapter deals with the following one of the four core subjects:

- ***Basic framework:*** *These are the mechanical and necessary procedural aspects of Corporations Law. They would specify a framework for beginning and ending a body corporate, some basic rules (eg. director's duties) and give the courts jurisdiction. Offences would be set out in the law, although many of the current offences are of no practical regulatory significance and should be streamlined.*
- Takeovers.
- Markets and Intermediaries.
- Fundraising.

The basic framework part of the Corporations Law might address the following matters:

Introduction	Principles	
	Types of companies............................	This might include a distinction between public and private companies, or, on the current provisions, the small business guide, companies limited by shares, guarantee etc.
Starting life	Registration	
	Constitution	
	Capacity and status	
	Membership..	This might include members' rights as between themselves, to sue the company, oppression etc.
On-going	Governance...	This might include officers, directors' duties, related party benefits, meetings etc.
	Reorganisation......................................	This might include buy-backs, mergers etc. (A better model might be to draw together all the aspects of reorganisation. In that case, perhaps the chapter on Takeovers becomes a chapter on reorganisations that includes takeovers, buy-backs, reductions of capital, compulsory acquisition, and so on.)
	Financial Statements and Returns	
	Charges	
	Securities	
	Receivership	
	Voluntary administration	

Ending life	Winding up	
Bodies that aren't 'companies'	Additional rules for Collective investments	Collective investment rules might be spread throughout the Law, here dealing only with additional rules. This is the way collective investments are treated in the listing rules and in the Collective Investments Bill.
	Foreign entities	
Miscellaneous	Court powers	
	ASC powers..	This might include general powers to modify the Law and Regulations.
	Offences	
	Civil penalties	
	Company Information	This might include registers, record keeping, substantial shareholding notices, tracing beneficial ownership provisions etc.
	Compulsory acquisition	
	Definitions	

In this section of the Corporations Law, which owes most to organic development, the model offers an opportunity to re-examine existing provisions and streamline those that should be retained.

Application of the model

One way in which the model could be applied is as follows:

Types of companies

It was suggested above that the level of regulation should depend on the activities carried out by the company and that, perhaps, the Corporations Law need not provide for the incorporation of different types of companies. The model does not mandate that this be done, but the possibility could be explored.

Another relevant distinction that was suggested is, arguably, between companies that rely on private capital and those that seek to raise funds from the public. The Corporations Law Simplification project has already accepted this type of distinction in the provisions for 'small' and 'large' proprietary companies. However, a disadvantage of that distinction is that it creates multiple tests, which is complex.

Assuming these distinctions are accepted, the principle might be that there are two types of company limited by shares - public and private.

Rules derived from this principle might be, for example:

- Only a public company (which issues a prospectus, or seeks public support through a public market such as a stock exchange) must have a detailed constitution containing, eg, shareholder democracy provisions. These provisions are for the benefit of new members attracted by the prospectus (or into the market). The constitution could be deemed to be in a standard form (but the ability to change it must be recognized, so that, for example, the listing rules could be met). Private companies (which do not issue prospectuses) can be deemed to have less detailed standard form constitutions. The constitutions of those companies do not need the same detail. However, the companies still need a constitution in order to reduce the burden on the courts of determining disputes between members. . The regulations could set out the two forms of constitution. The "mandatory" and "replaceable" rules proposed by the Draft Second Corporate Law Simplification Bill 1996 are a step in the other direction

- Only a public company must prepare accounts or make continuous disclosure. The onus would be on owners and creditors of companies that rely on private capital to satisfy themselves as to the substance of the company before investing in, or dealing with, the company. For example, a person proposing to acquire shares may choose not to acquire them without some financial and other information. Equally, a lender may require the preparation of accounts before lending money (if the debt was sufficiently significant). This does not usually apply to trade creditors (but might, for example, in the case of a running account) but query how many trade creditors make such inquiries now. The accounts provisions and the current disclosing entity provisions could be in the regulations.

Limitation of liability

There would be a basic principle of limited liability. This should be stated directly, rather than by implication as in Division 2 of Part 5.6. The Law would then state that a member's liability was limited to the amount of the shares held at the relevant time (the regulations could expand on the time, eg at winding up, etc).

However, the model requires that rules derived from this principle should be limited by reference to other principles. For example, a Corporations Law that is an instrument of economic policy would view limited liability as a benefit that encourages participation by allowing participants to quarantine their personal affairs from their business affairs. Limited liability would not be regarded simply as an incident of artificial legal personality. It should also be interpreted in conjunction with the principle, discussed below, that unsuccessful enterprises should be ended. This leads in the direction of "lifting the corporate veil" in a more robust and direct fashion where necessary.

Other rules in the Law relating to limited liability might be, for example:

- The benefit of limited liability is available only where there is proper disclosure to outsiders of the fact that they are dealing with a company. Provisions belonging in the regulations giving effect to the rule might be, for example that the name and registered number of the company be printed on all company documents.

- Limited liability should cease to apply if it is no longer reasonable to continue the enterprise. An example is when the company seeks to trade when insolvent. Section 592 therefore might be placed in the regulations.

- Limited liability should not apply if it would not be reasonable, for example where a "phoenix company" operates as a successor company with the same assets and staff and from the same, or perhaps even a geographically proximate, premises. The regulations could describe the machinery for creditors to recover.

- Participants in an enterprise should rank last in a distribution of assets. Loans by a participant (or other debts) should be treated on the same basis as contributions of capital for this purpose. Section 556 might be in the regulations.

A draft of a possible provision is set out in chapter 2.

Principles for starting and ending life

Registration

There would be a basic principle that an artificial legal entity comes into existence upon registration. The Law would provide for registration by the ASC on lodgement of documents and payment of a fee. The proposals in the draft Second Corporate Law Simplification Bill are a step in this direction.

Provisions belonging in the regulations giving effect to the rule might be, for example:

- Allocation of a distinguishing number.
- The detail of what forms must be completed and what supporting documentation and fee is required

Another rule - derived from artificial legal existence - is that a company has perpetual existence unless unsuccessful or participants desire its dissolution. A company should continue in existence only while its existence is justified. Lack of success in business should not be punished, otherwise than by loss of funds contributed by the participants. However, an enterprise that is not successful in terms of its purpose for existing, or does not enjoy the confidence of participants, has no valid reason to continue to exist. Rules might be, for example:

- An unpaid creditor should readily be able to end an enterprise and get access to its assets (including unpaid contributions of capital). Standard procedures for creditors to end an enterprise would be contained in regulations.
- Participants should readily be able to end the enterprise and free their capital for other uses if they wish (eg, they are not satisfied with the enterprise), or if other participants persistently ignore constitutional obligations. This, of course, must be tempered if the company is insolvent. However, if the company is solvent, and there are no objectors, there is no reason it should not be simply (and cheaply) a question of deregistration. Standard procedures for members to end an enterprise would be contained in regulations.

Capacity and status

There would be a basic principle that outsiders should be able to deal with a company as if it were a natural person. This is currently part of section 161 (and is carried over into section 124 of the draft Second Corporate Law Simplification Bill). Outsiders should not need to be concerned with the constitution of the company, or with internal disputes. This is a strengthening of section 164.

A rule derived from this principle might be, for example, that a company is directly bound by the acts of its representatives unless it would not be reasonable in the circumstances. In other words it is bound by operation of the statute, without resort to concepts of agency law or to assumptions that outsiders are entitled to rely on. (The idea of assumptions that an outsider is entitled to rely on has been carried over into Part 2B.2 of the draft Second Corporate Law Simplification Bill.) Again the concept of ‘reasonableness’ has been introduced. Here it has two operations:

- The outsider might have acted unreasonably. If so, the outsider cannot complain. An outsider would act unreasonably if it would be obvious that the person with whom they were dealing could not have authority to bind the company. If there is a reasonable doubt about whether the person could have that ability, the benefit of the doubt should be given to the outsider. It would also be unreasonable for a third party with actual knowledge of a constitutional limitation to argue that the company was bound by a contract made in breach of that limitation.
- The representative might have acted unreasonably. If so, but it was not such as to clearly put the outsider on inquiry, perhaps the representative should be personally liable if the company cannot honour the agreement.

If detailed provisions expanding upon what is “reasonable” can be drafted, they belong in the regulations.

Principles for on-going existence

Reorganisation

The principle might be that reorganisation should be facilitated if the majority of participants want it (eg, under a scheme of arrangement), or it would be in the public interest. It might be in the public interest, for example, if the economic benefit outweighed the detriment of expropriation it might be regarded as in the public interest to allow compulsory acquisition of minorities.

Rules derived from that principle might be, for example:

- Companies can agree on terms on which the first company will become a 100% owned subsidiary of the second company. Such a merger would result from shareholder approval. The terms of the agreement would have to address the matters specified in the regulations. The regulations could also set out the information and voting requirements.

- Creditors can bring about an arrangement or reconstruction because it would be in the public interest (eg, if their debts are outstanding and this is an efficient way for them to be paid).

- Groups of companies can reorganize. The regulations would set out the information and voting requirements (eg, whether creditors needed to participate, and how).

- Compulsory acquisition of minorities can take place. Currently, according to the Corporations Law Simplification proposal on takeovers, compulsory acquisition is possible under sections 176, 195, 411, 413, 414, 501, 507, and 701 of the Corporations Law. The CASAC Legal Committee January 1996 "Compulsory Acquisitions Report" recommended reforms to the existing provisions and that the decision in *Gambotto* v *WCP Limited* (1995) 16 ACSR 1 be limited (*Gambotto* requires a special proper purpose test to be met before compulsory acquisition through article amendments can happen.)

Arguably, a better place for the provisions dealing with reorganisation is in a revised chapter dealing with all forms of reorganisation including takeovers. It could incorporate buy-backs, reductions of capital, compulsory acquisitions, takeovers, schemes of arrangement and so on.

Membership

Whether economic or regulatory outcomes are sought to be achieved by the Corporations Law, certainty of rights and obligations is desirable because it reduces the scope for disputes to arise. There should be efficient dispute prevention and resolution mechanisms. If disputes do arise, the Law needs to provide for appropriate means of resolving disputes, and for adequate remedies.

From this objective of promoting certainty might be a principle that a member may enforce the constitution against the company or another member.

Rules might then be as follows:

- All companies have standard constitutions established by the Corporations Law, but they may elect to depart from those standards. Participants are under a statutory obligation to comply with the constitution. The rights of outsiders are not, however, affected by restrictions in constitutions (this is embodied in s160 of the Corporations Law). The constitutional provisions themselves would be contained in the regulations.

- The remedy of ending the enterprise should be readily available where participants persistently ignore constitutional obligations. Procedures for ending the enterprise would be set out in the regulations.

Corporate governance

A principle underlying the basis of the separation of ownership and management should be articulated in the Law. There appear to be two competing models:

(a) the traditional view of shareholders as an "electorate" that elects directors to manage the enterprise (without "interference" by shareholders); and

(b) management powers are delegated by shareholders as "owners" to their selected agents.

If the first view is adopted, as it is in the current Corporations Law, rules derived from the principle might be, for example:

- Directors owe fiduciary duties and duties of competence to the company (perhaps subject to a business judgement rule).

- Shareholders have powers to call extraordinary meetings to replace directors but no other power to influence management of the enterprise.

An additional rule might be that the directors must reasonably attend to the affairs of the company.

If the second view is adopted, this leads away from the concept of fiduciary duties owed by directors to the body corporate. It leads in the direction of duties of honesty and obedience (analogous to the duties owed by employees) owed by directors to the shareholders. Rules derived from the principle might be, for example:

- Directors owe duties of honesty and obedience to shareholders. An aspect of the duty of honesty is that candidates for election as directors must provide full information to shareholders, as specified in the regulations (eg, information about their experience, abilities, other commitments, and existing or known proposed dealings with the company). Directors who are not frank may be held liable to shareholders. Otherwise, shareholders should have no remedy for errors made by honest, attentive and obedient directors that they have selected. (Again, an additional rule might be that the directors must reasonably attend to the affairs of the company.)

- Small shareholders should be encouraged to participate in decision making by a further development of the proxy voting rules (which would be contained in the regulations). (If the view is taken that the collective action problem is intractable, the possibility of weighted voting rights favouring small shareholders could be explored.)

- Shareholders might have a direct right of action for breaches of duties owed to them. Procedures for enforcing that right would be contained in the regulations.

Principles for the miscellaneous section

Company information

The principles suggested above would result in rules having the effect that neither company constitutions nor returns of directors and officers would be of interest to "outsiders". However, a principle of transparency (which would also operate to reduce disputes between "insiders") suggests that a central database would still be required. It could also record the address of registered office, etc, and provide access by the public to the prospectuses and financial statements of unlisted disclosing entities. The regulations would deal with the documents required to be filed, and maintenance of the database. The database could be privatised.

Part 6.7 and 6.8 of the Law should also be moved to this section on Company Information, as they go beyond takeovers policy. So should rules relating to companies keeping records.

The principle underpinning Part 6.7 of the Corporations Law is that there should be disclosure of large shareholdings in public companies.

Rules derived from that principle might be, for example:

- A shareholder must notify the company (and the market) within a reasonable time of aggregating a substantial holding. The regulations could set the time at 2 days (as per s709(4) and the holding at 5% (as per s708(5)). The relevant form could be prescribed in the regulations.

- A shareholder must notify the company (and the market) when the holding changes by a substantial amount. The regulations could cover percentage changes and ceasing to be a substantial shareholder.

ASC powers
The functions of the ASC under the model might include, for example, to:

- prosecute offences;

- exercise a general modification power;

- monitor performance by SROs of ASC-delegated functions;

- monitor performance of disclosure obligations by unlisted disclosing entities; and

- approve markets and investment products.

The Corporations Law could establish the powers of the ASC in these areas and indicate how the ASC might discharge them (ie, what matters the ASC should take into account). If it was felt necessary, the regulations could cover the ASC's ability to issue Practice Notes or Policy Statements. The regulations could also cover other matters of detail.

The Law would also provide for appeals or review.

Chapter 4
Takeovers

Introduction

This chapter deals with the following one of the four core subjects:

- Basic framework.

- ***Takeovers:*** *These provisions should remain, but be rewritten with far less detail. The ASC should have power to fill in the detail, and to modify all aspects of the provisions (within guidelines such as s731). The Takeovers Panel should be able to act quickly and in accordance with the intention and purpose of the provisions. In other words, the Panel should take on a character more like the UK City Panel.*

- Markets and Intermediaries.

- Fundraising.

Unlike those parts of the Corporations Law that deal with the basic legal framework for artificial legal entities (which developed incrementally over a period of more than one hundred years), Chapter 6 has been, to a certain extent, consciously developed in the recent past to achieve objectives. Some of the principles underlying Chapter 6 were articulated at paragraph 16 of the Company Law Advisory Committee, Report to the Standing Committee of Attorneys-General on Disclosure of Substantial Shareholdings and Takeovers, 28 February 1969 (the Eggleston Report). The Eggleston Report said that where an offer for control is made:

- all existing shareholders should have an opportunity to participate equally in the benefits offered, as far as practicable.

- the offeror should disclose its identity to shareholders and directors and give sufficient information to enable shareholders to form a judgement on the merits of the proposal.

- a reasonable time for shareholders to consider the proposal is required.

These principles have been translated into sections 731 and 732 of the Corporations Law. Those sections deal with matters the ASC must take into account when exercising some of its powers (eg, to exempt a person from compliance with Chapter 6).

A review of Chapter 6 suggests that to the Eggleston principles may be added a further principle: the market should be protected from speculative or ill founded takeover proposals. The objective that this principle seeks to meet is that speculative or ill-founded takeover proposals are an inefficient diversion of energy and resources and sap confidence. Under this principle, for example, takeover offers that are not genuine (eg, where the offeror controls the outcome of one of the conditions) should be prohibited. The current requirement in section 746(2) that an announced bid must proceed would also be justified by this principle.

The compulsory acquisition rules in Chapter 6 suggest a principle that if benefits for control have been paid, the offeror should receive what it has paid for. The Corporations Law Simplification proposal to introduce a general power of compulsory acquisition (adopting a recommendation from the CASAC Legal Committee January 1996 "Compulsory Acquisitions Report"), which ASX supports, suggests a wider principle. The wider principle is that efficient reorganisations should be promoted. Consequently, we have dealt with the issue of compulsory acquisition as part of the Basic Framework (noting that there might be a chapter on reorganisation instead).

Under a Corporations Law that promotes economic policy, the takeovers area will be seen to be influenced by competing objectives.

- Competition for access to resources should be encouraged as it leads to more efficient utilisation of resources.
- Building confidence and encouraging the pooling of capital require rules that protect investors from changes of control taking place without either warning of the impending change of control or an opportunity to participate in benefits paid for control.

The currently accepted principles should be reviewed in the light of these objectives. (The Eggleston principle of equality of opportunity has recently been questioned on the basis that it does not assist in achieving economic objectives - see J Mannolini, "The Reform of Takeovers Law - Beyond Simplification" (1996) 14 *Companies & Securities Law Journal* 471.)

If, however, the Corporations Law is purely regulatory, the model can nevertheless be applied as the regulatory objectives underlying the current Chapter 6 are fairly transparent.

Some provisions that currently exist may not be justified by reference to objectives. For example, the "creep" rule seems hard to justify. It is not clear why a mere lapse of time since the last acquisition should justify an exemption from the requirement to make a takeover offer. This may be a rule that is retained for other reasons.

Application of the model

The model should be applied to changes of control of public companies (ie, those that rely on public involvement either through the issue of a prospectus or by participating in a market). It is debatable whether a takeovers regime is required for companies that do not rely on public involvement. An outcome-oriented Corporations Law would impose differing levels of regulation on a company depending upon the company's activities. Section 619 of the Corporations Law already partly does impose differing levels of regulation.

Based on the Eggleston principles, the model might look like this:

"Equal opportunity" principle

The principle is that all existing shareholders should have an opportunity to participate equally in the benefits offered, as far as practicable.

Rules derived from that principle might be, for example:

- The acquisition of sufficient shares to achieve control is prohibited, except through an offer to all shareholders.

  The prohibition, and exceptions to the prohibition, should be in the Corporations Law. However, further articulation of the prohibition against acquiring control should be in regulations.

  Articulation of "control" in terms of percentage ownership is essentially arbitrary. The current 20% threshold is drawing a line in the sand. Its benefit is certainty. If "control" is articulated in the regulations, the possibility of expressing the prohibition against achieving control in the same terms as the prohibition against self-acquisition proposed in the Draft Second Corporate Law Simplification Bill 1996 could be explored. (For the purposes of that prohibition, a company controls an entity if the company has the capacity to determine the outcome of decisions about the entity's financial and operating policies.) The attraction of this is that it expressly acknowledges that the shareholding required for control can vary widely depending upon circumstances. As noted in paragraph 12.51 of the Explanatory Memorandum to the Draft Second Corporate Law Simplification Bill, as a practice or pattern of behaviour must be taken into account, the test proposed for self-acquisitions will not be affected by short-term changes in control. A short-term capacity to exercise "control" would not give a company the practical ability to make final decisions about the company's policies. This would have advantages in relation to proxy voting and institutional voting as a 'bloc'. The disadvantage of this is, of course, its uncertainty in application to a particular circumstance.

Even if it is considered too difficult to devise a flexible test for "control", the percentage test and articulation of how the percentage is calculated can be in the regulations. So, too, can the prohibition on a maximum acceptance condition. The prohibition is merely an articulation of the principle of equal opportunity, since maximum acceptance conditions may operate to exclude some shareholders from participating in the offer.

- All shareholders whose shares are required to achieve control should receive the same effective price.

  The regulations could address details, like adjusting the price to take unpaid dividends into account. The regulations should deal with the procedures for making offers (including the procedures for on market takeovers - this would give maximum flexibility to change the procedures to follow any changes in ASX Business Rules), and ensuring the equality principle is observed if there are subsequent increases in the price offered.

  Issues such as the following should be determined by reference to the principle:

  - whether there should be a prohibition on offering a price which is less than the price paid for the last share acquired before the takeover prohibition applied; and

  - whether there should be a prohibition on agreements under which shares are sold on the basis that if a takeover offer is made the seller receives an adjustment to the price paid; and

  - whether there should be a prohibition on agreements that if a takeover offer is made the seller commits to accepting it,.

An aspect of the equality of opportunity principle could be expressed in rules that entitle shareholders to determine the outcome of a bid, such as the following:

- No shares may be issued following the announcement of a takeover offer, without shareholder approval. What constitutes the making of an announcement, and the period during which issues cannot be made, could be dealt with in regulations.

- Provisions in employment contracts that entrench rights in circumstances where there is a change of control of the company are prohibited.

(In other words, conduct of the target could be regulated. There are currently ASX listing rules to similar effect to the rules above. ASX has previously suggested to the Corporations Law Simplification Task Force that they be transferred to the Corporations Law, to enhance a prohibition on "unacceptable conduct" by targets.)

"Disclosure" principle

The principle is that the offeror should disclose its identity to shareholders and directors and give sufficient information to enable shareholders to form a judgement on the merits of the proposal.

The Corporations Law currently takes the view that this principle requires extensive disclosure by the offeror, together with disclosure by the target.

Rules derived from this principle might be, for example:

- Both the offeror and target must produce a statement providing all the information that a target shareholder reasonably requires to consider the merits of the proposal (ie, to decide whether or not to accept the offer). The approach taken by the Corporations Law Simplification Task Force is consistent with this. The task force proposes combining Part A and Part C statements into "bidder's statements", and Part B and Part D statements into "target's statements", and abandoning the "checklist" approach in section 750. This is useful simplification. Requirements relating to the formal parts of the statements, eg a requirement that the offeror's statement be signed by the directors of an offeror company, would be dealt with in the regulations.

- A material deficiency in an offeror's statement or a target's statement would not necessarily, or even primarily, halt the takeover offer. The deficiency must be corrected by a supplementary statement. This is based on the prospectus model (which the Eggleston Report specifically drew a parallel with) and perhaps should be coupled with a power in the ASC or Panel to issue a "stop" order. If the deficiency is in the offeror's statement, accepting shareholders have the right to withdraw (they may elect to do so after receiving a supplementary statement). The approach taken by the Corporations Law Simplification Task Force of requiring a supplementary statement is consistent with this. The regulations would deal with the mechanics of sending a supplementary statement, and exercising the right to withdraw.

- The level of acceptances should be promptly reported to target shareholders. The requirements for completion and service of progress notices should be contained in the regulations. This might largely follow the current model under which the ASC allows both the section 689 notice and the substantial shareholder notice to be combined, effectively accelerating substantial shareholder disclosure.

- Persons holding substantial shareholdings must disclose the extent of their interests and their identities. Information about substantial shareholdings is relevant market information. Substantial shareholder disclosure may provide warning of intentions and capture some "control premium" for shareholders who sell before a takeover is launched. For example, if a potential offeror is thought to be increasing its stake to the permitted threshold, some indications will be given by substantial shareholder disclosure (subject to timing issues). Sellers may then have an opportunity to exact a higher price. Substantial shareholder disclosure requirements (including requirements for accelerated and more detailed disclosure once a takeover offer had been announced) would be contained in the regulations.

  The model proposes that information about the ownership of listed companies, although fundamentally important in this context, has wider importance. It is relevant to the maintenance generally of an informed market. Therefore, it need not be linked to takeovers specifically and could be in the section dealing with Basic Framework.

Arguably, the principle of equality of opportunity requires only that benefits offered for control must be shared equally. The principle does not require that the benefits offered for control must be maximised (eg, by forcing the offeror to disclose its calculations of its maximum benefit and therefore its maximum offer price). If so, the only disclosure required to enable a shareholder to determine whether to accept an offer (as opposed to any other offer to purchase where there are no special disclosure requirements) would be:

- the offeror's identity;

- the offeror's present holding in the company (supplemented by periodic progress reports); and

- the offeror's intention to assume control of the company, and the offeror's proposals for dealing with the company if it obtains control.

"Reasonable time" principle
The principle is that a reasonable time for shareholders to consider the proposal is required.

This could be expressed simply as a rule that an offer must remain open for enough time to allow target shareholders and directors an opportunity to consider the merits of the proposal and respond. This manifests itself in two ways:

(a) keeping the offer open for a reasonable time once it is made (currently at least one month, see s638), and

(b) before the offer is made, giving the target an opportunity to put its statement together (ie, currently 14 days after service of the Part A - see s637) and giving shareholders an opportunity to assess the target's response.

The regulations could fix the time periods, on the basis that any period will be arbitrary and should be capable of being changed easily if it is found to be inappropriate.

"Market integrity" principle
The principle is that the market should be protected from speculative or ill founded takeover proposals.

Rules derived from this principle might be, for example:

- If a takeover is announced it is an offence not to proceed with it. This is currently s746. The regulations would set out the time period within which a takeover offer must be commenced and deal with compensation.

- A takeover offer on conditions that are within the control of the offeror is not permitted. The regulations could list some of the conditions that are considered to be within the control of the offeror.

- A takeover may be withdrawn or not proceeded with only if it would be unreasonable to require it to proceed. The regulations could list some of the circumstances in which it would be reasonable to withdraw the takeover or not proceed with it, for example where the target changes materially. Section 746(10) sets out a principle along these lines.

- Extensions of a bid ought to be regulated (eg, to discourage lingering offers that cause uncertainty and tie up an offeree's scrip). The regulations should deal with the mechanics of extending an offer.

A role for Practitioners?

The model calls for greater utilisation of SROs where appropriate. In the takeovers area, it is difficult to see a role for a self regulatory organisation. However, the area could benefit from more practitioner-based involvement. This occurs in the United Kingdom and Hong Kong, for example. An option that could be explored is using the Takeovers Panel as a practitioner-based regulator for takeovers of listed companies. The Panel might have the power to deal with the matters that it has been suggested could be dealt with in the regulations. Initially, therefore, the Takeovers Panel could perhaps be drawn from (amongst others) listed companies. It could prepare a Code that would apply to listed companies. An advantage of this is its flexibility. The ASC currently exercises wide powers in relation to facilitating takeovers by modifying the Law and stopping unacceptable acquisitions (by referring them to the current Panel). This could all be handled by the Panel if there were thought to be benefits of such a body regulating (essentially) conduct of its constituents. Whatever role the Panel is given, the model would not reduce the amount of flexibility the Corporations Law currently gives the ASC (and Panel).

Chapter 5
Markets and Intermediaries

Introduction

This chapter deals with the following one of the 4 core subjects:

- Basic framework.
- Takeovers.
- ***Markets and Intermediaries:*** *The securities and futures provisions should be merged, eliminating the distinction between types of product. The Law should set up a broad definition of 'Investment Business' and 'Investment Product'. Within that framework, the type of business, the persons authorised to conduct it, the markets for it, and the instruments that can be sold, can all be regulated. The tailoring of the details (eg. prudential requirements, conduct requirements etc.) can be left to the ASC (or other agency), the exchanges and other professional bodies. Such details can be set out in 'rules'. ASX expanded on this in its submission on Stage 4 of the Corporations Law Simplification Project.*
- Fundraising.

The current legislative provisions contained in Chapters 7 and 8 reflect three problems for securities and futures regulation in Australia:

(a) the lack of a unified structure;

(b) the lack of a structure that creates a dynamic, consistent framework; and

(c) piecemeal "cut and paste" development, which has left gaps and policy incoherence.

In this area it is more difficult to separate the policy from the structural changes.

Merger of chapters 7 and 8 of the Corporations Law

As a policy change, there should be a single framework governing both securities and futures products. Financial markets around the world have difficulty in accommodating innovative financial instruments when regulatory regimes seek to put products into separate boxes. The result has been to distort product development as originators seek to obtain the most desirable regulatory (and tax) outcome for their product.

This would require amalgamating chapters 7 and 8. However, this is not as radical as it might seem. When chapters 7 and 8 of the Corporations Law are compared on a line by line basis there is an evident consistency of principle. See ***Appendix 4.*** However, there is also often a lack of consistent terminology and approach for no apparent reason. The differences tend to be in the detail concerning the conduct of the respective businesses, which may be seen as merely different ways to achieve similar policy outcomes. Even adoption of only the structural aspects of the model would involve restructuring of the chapters that would be likely to address many of these issues.

The model assumes the amalgamation. The single framework will make it possible to focus on the risks associated with a type of product (or other features) and attach the appropriate regulatory requirements. When it matters, distinctions between products may still be employed.

The Markets and Intermediaries provisions of the Law might be broken into two parts, Investment Products and Investment Business.

Investment products

The Investment products section defines what is in the regime of the Corporations Law and what falls outside it. But it also regulates aspects of the things that are in the regime (eg, disclosure under a prospectus). This suggests that Fundraising may belong here, not as a separate chapter.

In this part would be cash-market products (eg, equities, debt) and derivatives-market products. There would be no distinction between securities and futures, but a regime under which the level of regulation depended on the type of product. There may be many levels of regulation, according to the particular needs of the product in question, not necessarily only a 'physical' product level and a 'derivative' product level. For example, shares are subject to disclosure requirements addressed in the Fundraising chapter (ie, prospectuses). Whether warrants and other structured products should be subject to prospectus requirements is an issue. Warrants are securities (under the current definition in the Corporations Law) but will simply be a type of Investment product under the proposed regime. Perhaps they could be regulated as they are now (ie, under the ASX Business Rules). Any structure that is adopted will at least have to contemplate the interaction of disclosure requirements under an SRO's rules and the fundraising provisions.

Investment products set the parameters for much of the regulation in the Corporations Law. The definition is a classification system which in turn defines what behaviour is regulated in the primary market, secondary market and by intermediaries whose business is dealing in, or advising on, the Investment products. To this extent, arguably, Investment products is a subject for the Basic Framework chapter. (Similarly, the markets provisions might encompass also the primary market. Since behaviour in relation to in the primary market is addressed in the Fundraising chapter, arguably it belongs as part of this section on Markets and Intermediaries.)

The Law would again lay down the framework which would be supplemented by regulations or the rules of an SRO as necessary for individual types of products.

Definition

Under the UK model in the Financial Services Act, an 'investment' means any asset, right or interest falling within a paragraph of Part 1 of the Schedule to the Act. The Secretary of State may by order amend the Schedule to extend or restrict the meaning of investment for the purposes of the Act. The Schedule identifies shares, debentures, government and public securities, instruments entitling to shares or securities, certificates representing securities, units in collective investment schemes, options, futures, contracts for differences, long term insurance contracts, and rights and interests in investments as 'investments'.

If the economic purpose and effect of different types of product are the same, or even similar, it makes sense to regulate them under a common regime (although in tailoring regulation there may be a need to distinguish between products).

Based on the UK model, an Investment product might be any investment or risk management tool prescribed in the regulations as an Investment product. The regulations could include as Investment products shares, options, warrants, futures, debentures, units etc. There may be investments that are expressly exempted for historical or practical reasons (eg, bank deposits). As products were developed, a decision would be taken about whether they were Investment products and so had to comply with the Corporations Law. There may be scope to allow the ASC also to declare products to be Investment products. Of course, some new products will fall within an existing definition (eg, a new futures contract). Approval to trade the new product would depend on appropriate mechanisms for trading, clearing and settlement and so on.

Promoting confidence and investment

The objectives of regulating Investment products are the promotion of confidence and the encouragement of investment. Confidence must exist in the products (eg, there needs to be appropriate disclosure of rights, obligations, risks) and in those who advise on the products and in the integrity of any markets that trade the products. If there is confidence then, in a free market economy, products will be developed that attract investment. Investor protection is an aspect of confidence. So are efficiency, stability and predictability.

Rules derived from this principle might be, for example:

- Investment products must not be issued without adequate disclosure. This might pick up the prospectus requirements of the Law. It might also cover the ability of products like warrants to be issued with disclosure documents that comply with the rules of an SRO.

- Investment products must not be promoted except by qualified people. This is a rule that justifies provisions governing intermediaries. Intermediaries act, of course, in both the primary and secondary markets.

- Misleading and deceptive conduct in relation to Investment products is prohibited. As noted below, this has a primary market and secondary market aspect.

- Investment products are personal property and may be transferred or cleared using various methods, including those set out in Part 7.13 of the Law. See also 'Clearing Houses' below.

Investment business

Markets

In this part would be principles and fundamental rules dealing with markets, advisers and dealers. (Regulation of dealers and advisers might substitute for regulation of markets in some over-the-counter situations.) Markets would be approved for the trading of certain products according to the level of regulation and type of rules they had. Advisers and dealers would be licensed to deal in certain products. This model adopts the current distinction between dealers and advisers but the distinction itself might be questioned. It is not used in the UK model. If the distinction were maintained, there still should be only one type of licence. The distinction could be maintained by a licence condition or restriction.

The regulation of markets encompasses both the primary (or issuer) market and the secondary (or trading) market. Regulation of them, and the types of secondary market structures that should exist, are issues in their own right.

The primary market is partly dealt with in the Fundraising chapter and partly dealt with in this chapter. For example, the prohibition on misleading and deceptive conduct is a behavioural control that applies to each market. It is addressed in this chapter.

Under the Corporations Law, secondary market structures take many different forms. This raises concerns about market fragmentation and loss of market liquidity, and inefficiency arising from the competitive advantages which flow from different regulatory regimes and requirements. The ASC's policy statement, PS100, explains the policy for the assessment of applications for approval as stock markets. A balance must be struck between:

- the need for regulation to promote confidence in Australian capital markets by the provision of adequate protection for market users and the enhancement of the integrity of Australian markets; and

- the need for the regulatory regime to adapt to innovation and technology as well as enhancing the ability of Australian markets to fit into global markets.

Section 767 prohibits a person from establishing or operating an unauthorised stock market. PS100 examines applications to the Minister for authorisation, and the Commission's role in making recommendations about such applications, under:

- s769 and 770 (approval of a body corporate as a stock exchange or as an approved securities organisation);

- s770A (approval of a stock market in unquoted prescribed interests);
- s771 (a declaration that a stock market is an exempt stock market).

In addition, it sets out circumstances in which the Commission will not enforce the prohibition under s767.

The ASC has also published a policy statement on futures markets, PS70. It is based on the ASC's review of regulatory issues associated with over-the-counter derivatives transactions, and sets out the circumstances in which the ASC will advise the Attorney-General of its view that a futures market should be declared an exempt futures market under section 1127(1) of the Corporations Law. It contains a ‘safe harbour’ policy for individually-negotiated transactions between sophisticated participants in over-the-counter futures markets (being the first tier of the ASC’s three tiers of regulation applying to over-the-counter derivatives market activity). The second tier (tradeable contracts between sophisticated participants) is not addressed. PS100 is a better model, in that it approves markets rather than merely exempting individuals.

The current requirements for different types of authorised stock markets are different in significant respects. The requirements for stock markets and futures markets are also different. Under the model, there should be a market approval mechanism that encompasses both areas of market activity. The preference under the model is to eliminate such distinctions and allow trading in products according to the rules in place, but this is not essential. What is essential is that the market approval process is sufficiently flexible to accommodate different types of market structures if they are to be retained. In retaining them it would be useful to ask - what activities are appropriately regulated by alternative market mechanisms? Another important issue is free riding on the (expensive) regulatory mechanisms of another market. There should be regulatory equivalence for comparable products.

And there should be a single approval process. In appropriate cases approval would lead to an ability to trade any Investment product (ie, if the applicant met the requirements of the Law and there were rules for that type of product). Approvals could be supplemented, that is, the approval to incorporate trading of new types of products if rules for them were developed and not disallowed. Disallowance of rules could take place as it now can under section 774.

In short, there seems to be no sensible reason to split markets as they are currently split in the Corporations Law, and maybe the best solution is one market but with trading distinctions.

Market must promote confidence

The objectives of regulating markets are the promotion of confidence and the encouragement of investment. Confidence must exist in the integrity of any markets that trade Investment products. The principle is that to operate a market that trades in an Investment product, there must be adequate provision for efficient and fair trading to take place.

The rule in the Corporations Law derived from that principle might be, for example, that only a market approved to trade an identified product type may trade that product. The approval to operate a market would only be given if the applicant met the requirements described in the Corporations Law. Section 769 provides a model (although technological developments may ultimately require relaxation of its provisions to allow for greater flexibility concerning governance and regulatory issues). Based on that model a market could be approved if:

(1) the body proposing to operate the market (whether through rules or other arrangements) made adequate provision in the following areas:

   (a) trading of the product, and standards entitling access to trading status/membership.

   (b) listing/quoting/etc in relation to the product, and standards entitling access to such status.

(c) clearing and settlement for the product, and standards entitling access to clearing and settlement systems.

(d) monitoring of compliance with, and enforcement of, the rules (traditionally there is a distinction - recognised in the Corporations Law - between listing rules and business rules but it is not essential).

(e) any fidelity fund arrangements for the product.

(f) carrying on the business of operating the market with due regard to the interests and protection of the public.

(2) the interests of the public would be served by the granting of the approval.

These requirements should explicitly apply to the establishment of the market and to it continuing to operate.

The regulations would set out how an application is made and cover any detail filling in the requirements. For example, in the trading area the regulations might say that there must be rules addressing hours of opening, trading halts, reporting and so on. It is not suggested that the rules should specify the hours etc, only that there should be rules covering that subject.

Adaptability

As an objective, the markets provisions should encourage investment. The markets provisions do this by efficient secondary trading of the products so that investors can readily substitute one investment for another. This means that markets must adapt to innovation, technology and global competition. The provisions must be structured to allow flexibility.

Under a more radical model, there would not be different types of markets (stock markets, approved securities organisations, section 770A markets, exempt markets and so on). Instead there would simply be limitations on a market. For instance, ASX can currently trade any securities for which it has rules. Under the model, ASX could trade any Investment product (eg, futures) for which it has rules. The same would apply to the SFE. An exempt market would be of the same type, but could only trade a particular, identified Investment product (eg, a particular security). An exempt market would not need to meet all the requirements that ASX must meet. However, it might need to do so if it decided to seek an extension of the Investment products it was permitted to trade.

The markets provisions will need to address the following issues:

- Distinctions between products have increasingly blurred. As a result, it has become increasingly difficult to devise a workable classification for regulatory purposes. This, in turn, has led to too many types of markets (eg, securities markets, futures markets, section 770A markets). These distinctions could be dropped, relying instead on permission to trade types of products according to the level of regulation and types of rules adopted by the market.

- There is an increasing mismatch between legislative requirements and the conduct of various businesses. This stems from an inability to achieve timely law reform in the face of significant technological innovation. This is addressed by the model because of the flexibility reliance on regulations or the rules of an SRO provides.

- The operation of existing fidelity funds.

- Accommodating some form of regulation of OTC derivatives. As noted, this may hang off the licensing provisions.

Clearing houses

One aspect of efficiency (and perhaps confidence) in a market is its clearing and settlement mechanism. Indeed, this is directly relevant to Investment products being transferred using the methods set out in the Law. There are two policy possibilities:

(a) approve the clearing system that an exchange proposes to use for the Investment products traded. Under this model, the clearing and settlement arrangements for the products to be traded must be satisfactory in order for the market to be authorised. The arrangements, if in-house to the exchange, mean that the concept of approved clearing houses would not be needed.

(b) approve the clearing house that will clear and settle for the exchange. This is the model employed for futures clearing under s1128 of the Corporations Law. For the exchange's part under this model, satisfactory arrangements with the clearing house would be needed in order for the exchange to be 'approved'. Note that the clearing house might be related to the exchange or independent. An advantage of this policy model is that some of the requirements (eg, capital and personnel requirements) are more clearly relevant to a clearing house than to a clearing system. This model currently applies, for example, to SCH which clears and settles for some of the products that are traded on ASX.

The models are not necessarily mutually exclusive. A hybrid policy might accommodate approval of clearing systems if the clearing house is related to the exchange and approval of the clearing house itself if it is independent. The current policy of the ASC is to require at least some independence even of clearing houses related to the exchange.

Principles underlying settlement systems under either policy model are predictability, minimisation of funding costs and minimisation of counterparty risk.

Rules derived from the principles might be, for example:

- There must be adequate risk management. The regulations could address the specific requirements (eg, position limits, margining, marking to market, as appropriate to the product).

- There must be adequate resource backing. The regulations could address external funding, guarantors, recourse to clearing members etc.

- There must be adequate systems to ensure timely clearing and settlement. The regulations could address qualified personnel, methods of identifying transactions, netting, back-up etc.

Currently SCH is the approved clearing house in Part 7.2A of the Law. A question arises about the special recognition currently given to SCH under Part 7.2A. SCH presumably would be "grandfathered", as would currently approved futures clearing houses. ASX's Options Clearing House has no formal approval under the Corporations Law but would also presumably be "grandfathered".

The requirements for clearing derivatives products that are margined may be different to clearing other derivative products (CHESS clears warrants that are not, and do not need to be, margined).

The regulations could set out the approval process for independent clearing houses in the same way that they would for market authorisation.

Section 779B provides a model. Thus, there could be a provision in the Corporations Law that a clearing house could be approved if:

(1) the body proposing to operate the clearing house (whether through rules or other arrangements) made adequate provision in the following areas:

  (a) facilities for the clearing and settlement of transactions and any other services that the body proposes to provide;

  (b) standards entitling access to its clearing and settlement systems;

  (c) monitoring of compliance with, and enforcement of, the rules.

(2) the interests of the public would be served by granting the application.

Just as for the market authorisation provisions, these requirements should explicitly apply to the establishment of the facility and to it continuing to operate.

The regulations would set out how an application is made and cover any detail filling in the requirements. CASAC has already proposed going in this direction. In its Draft Report on Regulation of On-Exchange Derivatives Markets, CASAC said the requirements might reflect, in the case of clearing arrangements for some derivative products, the matters referred to in Draft Recommendation 10 of its report. Draft Recommendation 10 addresses key issues such as risk control and resource backing, proper recording of transactions, co-ordination of delivery, and the public interest being served by the clearing house being authorised. It then recommends specific procedures as evidence of satisfactory compliance with the key issues. For example, specific procedures that an applicant clearing house could refer to as evidence that it has satisfactory risk controls include:

- procedures for novating contracts, and becoming counterparty to clearing members,
- adequate initial and subsequent margining requirements,
- credit standards, and obligations to promptly meet margin calls,
- minimum capital requirements for clearing members etc.

Intermediaries

The objectives of regulating Intermediaries are also the promotion of confidence and the encouragement of investment. Confidence must exist in those who deal in, or advise on, Investment products. A necessary part of confidence is management of systemic risk. Accordingly, intermediaries must meet certain business practice requirements. As part of the consumer protection aspect of confidence, intermediaries must meet certain professional standards. Principles for intermediaries therefore may be divided into 2 categories.

Business principles

These are designed for confidence in the system and the protection of all participants. The principle is that an intermediary must conduct its business efficiently and prudently.

Rules derived from this principle might include, for example, prudential requirements, acting efficiently, rules relating to supervision of proper authority holders, keeping records, accounts and audit, trust accounts, rules regulating the admission requirements that must be met and a dealer’s continuing education requirements. The requirement for a licence is justified under this principle.

In the case of proper authority holders, the Corporations Law could set out rules establishing a system of representatives of dealers. It could then set out that they must be authorised and are subject to many of the same duties as their principals (particularly as to client dealing). The regulations would address the particular rules to which they were subject. A variation on the model is to make them directly subject to the rules of the SRO to which their principals belong.

Client principles

These are designed for the protection of the client specifically. The principles are that an intermediary must (1) act efficiently, honestly and fairly and (2) adequately deal with (ie, disclose or avoid) conflicts of interest. Arguably, (2) is part of (1) in that is an aspect of fairness.

In relation to acting efficiently, honestly and fairly, *Erlington Nominees v CAC* (1989) 1 ACSR 93 held that 'honestly' in this expression may comprehend conduct that is not criminal but morally wrong in a commercial sense. It comprehends conduct that is not straightforward. The efficiency, honesty and fairness principle therefore supports a prohibition on conduct that is detrimental in a general sense. Then, in the regulations, provisions regarding not contracting out of liability for a representative's conduct, and knowing the client, might be included as rules under this principle.

If a conflict of interest is disclosed the client has a choice whether to proceed. For example, if a proposed crossing involved the broker as principal, and that was disclosed, the transaction could be completed because the client has decided not to withdraw the instructions (and so consented to the conflict). This principle requires disclosure of the fees and other charges that will be levied, and whether other benefits will accrue (eg, rebates from the issuer). Not trading ahead of a client's order would be a rule under this principle, as would giving priority to client orders.

Section 844 is a current legislative example of a principle and fundamental rule for intermediaries in the Corporations Law and detailed provisions in the rules of an SRO or regulations. It deals with client order precedence, excepting certain transactions by a member of a stock exchange in accordance with the business rules of that stock exchange. The regulations apply to those persons in circumstances not covered by the Rules of the exchange.

Based on the model, Rules would apply to those persons who are subject to them. The regulations (or the Corporations Law itself) could exclude from the application of the regulations those persons who are subject to the Rules of an SRO. It would not necessarily matter that the regulations and the Rules were not exactly the same, provided that the important, relevant matters were addressed. Offences would remain in the law (or perhaps the regulations).

The ASC's role would involve ensuring compliance with the regulations that apply to persons who are not members of an SRO, and overseeing the SROs in relevant areas. The SROs would have the primary responsibility for supervising and enforcing their Rules. There are two mechanisms to ensure that the SROs are doing the job properly. They must supervise the activities of persons admitted to trading status/members in order to be, and remain, approved; and the ASC's role could be periodically to 'audit' their performance in relation to those supervisory areas.

Currently the ASC is responsible for licensing and checks on licensees from time to time. ASX is responsible for checking on its members (who are also licensees). Accordingly, ASX and the ASC have entered a Memorandum of Understanding under which ASX performs the checks and the ASC "audits" the discharge of that responsibility by ASX. But for a Memorandum of Understanding with ASX, the ASC would check on ASX members who are licensees. The basis for the "audit" is that the ASC has effectively delegated one of its functions. Under the proposed model, there might be delegation (eg, in the licensing area) or direct statutory oversight. Direct oversight is radical. The current relationship between the ASC and ASX is, generally, co-regulatory. It does not involve "oversight" except in the membership area where there is overlap. The Corporations Law suggests a relationship that gives each body its own area of responsibility (but with overlap - for example in lodging rule amendments with the ASC).

Key advantages to reliance on an SRO are closeness to the participants, understanding of the issues they face, flexibility in ways to deal with issues and speed of response.

An example under the model involving delegation is a licence to act as a dealer where the person is a member of an SRO. The SRO could issue the licence if its admission rules were met (ie, as part of the admission requirements). The rules could include the requirements necessary to obtain a licence. The licence could be issued "on behalf of" the ASC. If the person was not a member of an SRO the ASC would issue the licence. As ASX's submission on stage 4 of the Corporations Law Simplification project said:

The ASC is responsible for administering licensing and imposing appropriate licensing conditions. The ASC should transfer responsibility for supervising exchange members to recognised exchanges. Admission and ongoing access to the stockbroking industry is determined by ASX on the basis of key educational and admission criteria and compliance with ASX's Articles of Association and Business Rules, and the SCH Business Rules. The administration of the current licensing regime in the Corporations Law adds an additional and duplicative regulatory overlay. The Draft Report of the Working Party on Review of the Requirements for the Registration and Regulation of Auditors recommends that the ASC be authorised to delegate responsibility for the registration and supervision of company auditors to Australian accounting bodies that satisfy certain conditions. In a similar fashion ASX should assume the primary role for the regulation of stockbrokers' activities.

This idea is developed in the example in Chapter 7.

The intermediaries provisions will need to address the following issues:

- they are unduly complex, have proved difficult to administer and some are of minimal regulatory benefit;
- there is a lack of clear policy justification for some;
- drafting deficiencies have been perpetuated over time; and
- there is unnecessary regulatory duplication.

Fidelity funds

Merging chapters 7 and 8 will involve rethinking the current fidelity fund arrangements (ie, apart from merely rearranging the law). They are based on a distinction between securities and futures and there are vested equity and contribution issues. There will also be a lot of debate about what constitutes suitable minimum regulation.

Currently, for example, NGF cover is tied to 'securities', 'securities businesses', securities dealers, securities exchanges, etc. There are separate futures arrangements. The assets of the NGF have been built up over many years. (The initial assets of the NGF consisted of the amalgamated assets of the state stock exchange fidelity funds. Its primary source of income now is the income tax exempt earnings on investment of the Fund). It is likely that there will still be a need to distinguish between various financial products for at least the following purposes:

- to exclude those products to which the regime is not intended to apply (eg, OTC derivatives products).
- to apply only those regulatory provisions that are relevant to particular products.

Thus, for historical or other reasons, it might be considered desirable to distinguish between products to protect the existing diversity in the statutory and other investor protection arrangements relating to the securities market and the futures market. Also, if an entity is a member of the clearing house of both ASX and the SFE there may be potential for overlap, with a client dealing in "derivatives" being entitled to make a claim against both the NGF and the Futures fidelity fund.

(Note that the CASAC proposal to replace the distinction between securities and futures with a distinction between securities and derivatives will cut across the lines established in relation to statutory fund protection for securities and futures markets.)

Chapter 6
Fundraising

Introduction

This chapter deals with the following one of the four core subjects:

- Basic framework.
- Takeovers.
- Markets and Intermediaries.
- ***Fundraising****: The fundraising provisions are in urgent need of overhaul and there are two special areas of concern. (These are the difficulty of making forward-looking statements at reasonable cost, and the problem of overlap with s52 of the Trade Practices Act.) ASX is concerned that the current regulatory system results in a burden being applied to growth SMEs is both onerous and inappropriate. In a well functioning market, such companies will attract capital because of the higher return they offer investors. However, if the direct and compliance costs of regulation are too onerous then such companies have to pay an excessive premium for their capital.*

There are important policy issues in this area. Some were included in ASX's submission to the Financial system inquiry (as the quotation above identifies). Policy issues in this area are taken up in a further submission to that inquiry and are not explored here.

The fundraising provisions of the Corporations Law, like the takeover provisions, are already to a certain extent consciously drafted to achieve objectives. The principles that can be drawn from the fundraising provisions appear to be as follows:

- The acquirer of securities is entitled to be given information. The existing legislation requires a prospectus because securities do not lend themselves to examination by the buyer without assistance from the seller (see *Ford's Principles of Corporations Law*, 6th ed, p 388). Therefore offers to subscribe for securities can, as a rule, be made only through an extensive disclosure document ("prospectus"). The major exceptions from the prospectus requirement are where the offer is to a "professional investor", or made as a "personal offer".

- A prospectus must contain all the information that an investor reasonably requires in order to decide whether to invest. Civil and criminal liability result from failure to make the required disclosure. "Due diligence" is a defence to liability for certain persons involved in the issue of the prospectus (eg, the corporation, the promoters).

- If circumstances change after a prospectus is issued, supplementary information must be provided.

- Companies that must make regular disclosure ("disclosing entities" under the Corporations Law) need only satisfy a 'lesser' disclosure requirement for their prospectus. The total disclosure made is the same but less needs to be in the prospectus because it is already known by reason of already having been released.

The outline below of how the model might be applied to the fundraising provisions does not depart from these basic principles. It deals with the requirements applicable to a company that initially seeks public support through an initial raising of capital. It then deals with the on-going requirements applicable to a company that relies upon public support through participation in a public market. It deals with both of these as one topic. Currently, these requirements are dealt with separately - in the prospectus provisions and the continuous disclosure provisions. The model also does not generally distinguish between sales of securities and offers to subscribe for securities.

The model suggests (without exploring) that liability rules could differ a little from those in the Corporations Law. Sections 1022 and 1022A express the fundamental information requirement as a “variable content rule”. However, the fundraising provisions do not appear to be striking the right balance between the quantity and quality of information provided, and the costs of providing it. The flexibility and adaptability to circumstances inherent in sections 1022 and 1022A do not appear to have been explored as fully as they could be. Perhaps this is because of the liability regime and the context in which the requirements are interpreted. For example, ASX has received correspondence from the managing director of a petroleum exploration company describing his company's prospectus preparation process. He described the process as due diligence meetings with accountants, legal advisers, petroleum consulting firms, and brokers treating the process, not with the end objective of the success of the project in mind, but as a disclaimer to minimise their own risk. He expressed the view that the fear of potential personal liability led to a conservative, unmarketable prospectus that could not readily be understood and would not interest any average investor.

The (economic policy) objective of the fundraising provisions is to facilitate enterprise formation and the pooling of capital. This objective cannot be achieved unless investors have confidence in the information on which they base the decision to invest. Confidence requires that information be provided which investors can understand and rely upon (“quality”). However, quality information is costly and the issues of who pays the costs of obtaining quality information, and who receives the benefit of the expenditure, require exploration. Ultimately, the investors pay for the information (as the costs of the fundraising are paid out the assets of the company into which the investor is buying), but they do not control the expenditure. The persons controlling the expenditure (the directors) may benefit (or perceive that they benefit) tangibly from the expenditure: they decrease their risk of liability under the prospectus provisions. The investors benefit less tangibly, although they may get ‘better’ disclosure. The cost of obtaining quality information, and the disincentives provided by an overly harsh liability regime, should be expressly taken into account in formulating principles and rules. The safe harbour rules proposed below are only one way in which the problems currently being experienced in the fundraising area might be addressed.

Application of the model

An acquirer of securities is entitled to be given "quality" information.

It may be uncontentious that securities do not lend themselves to examination by the buyer without assistance from the seller, but the Law does not require disclosure by the seller in all cases. The principle underlying the distinction between when the Law intervenes, and when it does not, appears to be a ‘private’ versus a ‘public’ distinction. If securities are sold ‘privately’ the buyer has an opportunity to negotiate to obtain information (eg, an opportunity to examine financial statements, or to work in the business for a period). If securities are sold ‘publicly’ the buyer has no such opportunity. The distinction admits of professional investor and existing shareholder exceptions.

Rules derived from this principle might be, for example:

- Entry by a company into an organised market attracts an initial disclosure obligation and a regular disclosure obligation. Listing on ASX would be the clearest example of entry into a market. This rule would be expanded in regulations. If the prospectus offer to 100 persons test for the regular disclosure obligation (which operates as a proxy for an active subsequent market in the securities) were to be retained, it should be in the regulations.

- An offer of issued securities in a company that is subject to a regular disclosure obligation need not place a further disclosure obligation on the seller. This follows from the above rule. (There may be an exception in the case of a company that is changing its activities.) It also follows that an offer of securities by a company that is a regular discloser need only attract a lower disclosure obligation for the offer of new securities. This is the idea behind section 1022AA.

- An offer of securities to a person with whom there is no prior connection places a disclosure obligation on the offeror. There would be an exception for offers of issued securities in a company that is subject to a regular disclosure obligation (ie, the rule above). This rule would clearly include offers of securities to anonymous persons through a public forum such as newspaper advertisements (but not advertisements that merely sought expressions of interest). This rule would be expanded by regulations dealing with when there is an acceptable prior connection (eg, an existing client relationship between a broker and the person). If the 20 person exception (which currently operates as a proxy for the making of a personal offer) were to be retained, it should be in the regulations.

- An offer of securities to a person who is able to negotiate on an individual basis for information does not attract a disclosure obligation (ie, the sale of securities is "private"). This rule would be expanded on in regulations. For example, a person who is offered a large dollar value of securities (the current $500,000 exception) would presumably be able to negotiate for adequate information.

Content of disclosure obligation
If the disclosure obligation applies, investors are entitled to the information that they reasonably require, and ought reasonably to be provided with, which will affect the decision to invest. This requires the disclosure of information known to the person who is subject to the disclosure obligation, together with information that the person could obtain by making reasonable inquiries. The requirement would apply regardless of whether the securities offered are issued or unissued.

Rules derived from this principle might be, for example:

- The general disclosure obligation is restricted to material information (analogous to price sensitive information). Any specific procedural disclosure requirements supplementing the general disclosure requirement would be contained in the regulations. Specific procedural disclosure requirements might be considered useful because, although not relating to information that is necessarily material, they relate to information in which investors have a legitimate interest. For example, a requirement for prominent disclosure of the details of the cost of the fundraising might be useful because it might act as a constraint against excessive expenditure by directors on due diligence protection. A requirement for prominent disclosure of unusual limitations on any underwriting obligation might also be useful. It might act as a constraint against entry into such agreements or indicate what the underwriter thinks of the float. At least these disclosures would serve to fully inform potential investors. The regulations would give flexibility to amend the list of specific disclosures as problems arose.

- An initial disclosure obligation attaches to a company because it enters an organised market. ASX currently imposes this requirement. A company is required to produce a disclosure document ("prospectus") for release to that market before the commencement of trading in its securities. The prospectus may be the document issued in respect of an issue of securities. A section 1022 type test would apply. If the requirement were in the Law (ie, for disclosure in the absence of an issue of securities), the regulations would deal with the formal aspects. The formal aspects might include the requirement for the document to be dated and signed, and registration of the document by the ASC. (In other areas the model suggests that a self regulatory organisation might act under a delegation from the ASC. It is not suggested here that such a proposal should lead to pre-vetting of a prospectus by an SRO under a delegation.)

- A regular disclosure obligation attaches to a listed company (ie, as in the current listing rule 3.1 backed by section 1001A). The regulations would deal with the detailed requirements for the backing of the disclosure, as they would be the same for all disclosing companies. In the case of a company that participates in an organised market, the rules of the market would govern its continuous disclosure obligations. In the case of other companies, the regulations could prescribe continuous disclosure standards.

- Where additional disclosure is required because circumstances change after the date of a prospectus but before the applications closing date, a supplementary prospectus must be issued. In that event, all investors who have committed themselves must be given an opportunity to reconsider the decision to invest. The regulations would deal with the mechanics of issuing a supplementary prospectus and exercising the right to reconsider.

Liability for failure to disclose
The liability regime, which provides the context for the interpretation and application of the disclosure content rules, is a vital element in achieving the right balance between the quality and cost of information provided. On one view the liability provisions are less susceptible to the treatment proposed in the model (high-level principles and regulations filling in details) because of the strict interpretation that tends to be accorded to liability provisions given the consequences. This view can be taken in a number of other areas as well and is not an answer. Courts have been well used to interpreting variable content liability rules (eg, negligence as expounded in *Donoghue v Stevenson*) and partly tend to strict interpretation in response to black letter laws that encourage it. A principle based approach is still possible.

For example, the principles might be as follows:

"Primary participants" (eg, issuers of the prospectus, and directors of a company issuing a prospectus) attract civil liability for loss incurred as a result of their failure to make all material disclosure, or their making materially wrong disclosure, subject to "safe harbour" rules.

Rules derived from this principle might be, for example:

- There should be no liability for non-disclosure of information unless it is information that is reasonably required for an investor to determine whether or not to invest *in securities of the kind offered* . This is a clarification of something that is arguably inherent in the existing provisions. It follows from the basic principle that only information which is material to the decision to invest needs to be disclosed and might be assumed because no reliance is placed on immaterial information. However, that is not necessarily a safe assumption.

- There are safe harbours. This could pick up, for example, s1008A of the Corporations Law.

"Secondary participants" (eg, advisers and experts) who advise primary participants in making the disclosure required by the Corporations Law should be liable in relation to their participation only.

Rules derived from this principle might be, for example:

- An expert is entitled to include a disclaimer in a prospectus. This would clearly constitute useful information for the potential investor, perhaps beyond its face value. The regulations could set out forms of acceptable disclaimers.

Dishonest failure to disclose or dishonest disclosure of a false or misleading statement by either primary or secondary participants attracts criminal as well as civil liability.

Rules derived from this principle might be, for example, like those in sections 995, 996 etc of the Corporations Law.

Chapter 7
An example under the model

Division 1 of Part 7.3 - Participants in the Securities Industry

Under the Corporations Law the ASC is responsible for licensing. Admission and on-going access to the stockbroking industry is determined by ASX. ASX makes its determination on the basis of key educational and admission criteria and compliance with ASX's Articles of Association and Business Rules, and the SCH Business Rules. The administration of the licensing regime adds an additional, and duplicative, regulatory overlay. Under the model, the ASC could delegate responsibility for the licensing of stockbrokers' activities to ASX.

The detailed provisions concerning conditions of a licence, notification of breaches and register-keeping obligations should be moved from the Corporations Law to the regulations. This will achieve greater focus on substantive regulation in the Corporations Law. It will also allow greater flexibility in terms of subsequent amendment to the details to take account of industry developments.

The following exposition of the model is necessarily incomplete, but is enough to give a sense of how the provisions might work.

In the Corporations Law would be the following principle and rules:

1. *Persons involved in the business of dealing in, or advising on, investment products must have appropriate qualifications and act in a way that gives users confidence and appropriately protects their interests. (This is the principle.)*

2. *Unless a person holds a licence or is exempt under the regulations, that person must not:*

   (a) carry on a business of dealing in or advising on investment products; or

   (b) hold out that they are doing so. [s780]

3. *A licence holder must give written notice to the issuer of the licence setting out particulars of the following events within 1 day after its happening:*

   (a) an event constituting a contravention of a licence condition,

   (b) an event that may adversely affect the financial position of the licence holder.

   However, failure to do this is not an offence if the licence holder was unaware of a fact or occurrence that gave rise to the requirement and lodged the notice as soon as practicable after becoming aware. [s787/Reg 7.3.01]

In the regulations would be the following provisions:

<u>Issue of licence</u>

R1 The Commission may issue a licence to carry on a business of dealing in, or advising on, investment products if it is satisfied of the following matters:

Condition 1 — the person is not an insolvent under administration (in the case of a body corporate, is not an externally-administered body corporate);

Condition 2 — the person's educational qualifications and experience are adequate having regard to the nature of the duties of such a licence holder (in the case of a body corporate, the educational qualifications and experience of each responsible officer of the *applicant are adequate having regard to the duties that the officer would perform in connection with the holding of the licence);*

Condition 3 *it has no reason to believe that the person is not of good fame and character; and*

Condition 4 *it has no reason to believe that the person will not perform those duties efficiently, honestly and fairly. In the case of a body corporate, the Commission must assess this having regard to each of the following (but these do not limit what the Commission may have regard to):*

(a) whether the officer is an insolvent under administration;

(b) any conviction of the officer of serious fraud during the 10 years before the day the application was made;

(c) any reason it has to believe that the officer is not of good fame and character; and

(d) any reason it has to believe that the officer will not perform the duties that the officer would perform in connection with the holding of the licence efficiently, honestly and fairly. [s783/784]

R2 The Commission may delegate the function of issuing the licence to an SRO. If so, the delegate must be satisfied of the matters in R1.[new]

R3 To apply for a licence to carry on a business of dealing in, or advising on, investment products a person must do each of the following:

(a) complete Form [701 - see Sched 1 of Regs] and give it to the Commission (if the function is delegated, the delegate);

(b) pay the prescribed fee to the Commission;

(c) satisfy any additional information or procedural requirements imposed by the Commission (delegate). [s782]

Conditions of licence

R4 A licence is subject to any conditions and restrictions imposed. Conditions and restrictions may be imposed when the licence is granted or at any time subsequently. These may include conditions and restrictions:

(a) relating to the limitation of the liability that may be incurred by the licence holder in connection with the business;

(b) relating to the incurring and disclosure of liabilities arising except in connection with the business;

(c) relating to the financial position of the licence holder, whether in relation to the business or otherwise. This may extend to:

(i) the assets of the licence holder including (or not including) assets of a particular kind, or

(ii) the value of the assets of a particular kind being not less than (or more than) an amount ascertained in accordance with the condition;

(d) requiring the licence holder to lodge and maintain with the Commission a security approved by it for an amount (not exceeding $20,000) determined by the Commission from time to time in relation to the licence holder;

(e) about what the licence holder must do, by way of supervision and otherwise, in order to prevent the holder's representatives from contravening a securities law or condition of the licence; and

(f) about what the licence holder must do to ensure that each of its representatives has adequate qualifications and experience having regard to what they will do on the holder's behalf in connection with the business. [s786/Regs 7.3.02/7.3.02A/7.3.03]

R5 The Commission may impose, vary or revoke a licence condition on a licence issued by a delegate. If so, it must inform the delegate. [new, based on s786(7)]

R6 A delegate may impose, vary or revoke a licence condition on a licence it issues. If so, it must inform the Commission.[new, based on s786(8)].

R7 If the Commission or a delegate imposes, varies or revokes a licence condition of a member of an SRO who is a partner in a [member firm], it must inform the firm.[s786(8)]

R8 The following conditions are imposed by virtue of this provision in all licences issued by the Commission or a delegate:

(a) the licence holder must ensure that each of its representatives:

(i) is adequately supervised in the performance of the duties that he or she is required by the licence holder to perform; and

(ii) is sufficiently trained in relation to those duties before acting as a representative; and

(iii) keeps up to date in relation to those duties by means of continuing training programs.

(b) if the licence was issued to the management company of an unlisted property trust constituted by or under a deed that is, or was at any time, an approved deed (except an exempted property trust), the following net tangible assets requirements apply:

(i) if the value of the gross assets of relevant property trusts managed by the management company does not exceed $50,000,000 - the management company must, at all times, have net tangible assets of a value of at least $500,000; and

(ii) if the value of the gross assets of relevant property trusts managed by the management company exceeds $50,000,000, but does not exceed $500,000,000 - the management company must, at all times, have net tangible assets of a value of at least the sum of:

- *$500,000; and*
- *$10,000 for each $1,000,000 by which the assets exceed $50,000,000; and*

(iii) *if the value of the gross assets of relevant property trusts managed by the management company exceeds $500,000,000 - the management company must, at all times, have net tangible assets of a value of at least $5,000,000. [Reg 7.3.02/7.3.02A]* (Note that this might be done by imposition under R4 and advised through the ASC Practice Note)

Information about licence

R9 A licence holder must give such written information to the Commission in relation to the business it carries on as licence holder as the Commission from time to time directs. The Commission may require the licence holder to have some or all of the information audited by a registered company auditor before it is lodged. [s788. This regulation could extend to a delegate, or the delegate's rules could pick up a requirement to give information to the delegate.]

[R10 insert s790 (eg, if the licensee ceases to carry on the business to which the licence relates the holder must notify the ASC within 21 days) and s791/860 (ie, an annual report in a prescribed form in respect of each year or part of a year during which the licence was in force. Alternatively these could be published in an ASC Practice Note as directions under R9, although it is probably easier for users if they are part of the regulations. Under ASX Business Rules 1.3 and 1.5, stockbrokers lodge annual accounts with ASX in the prescribed form. We see little regulatory benefit in the current legislative structure. If it is appropriate to continue to impose annual reporting obligations on dealers, stockbrokers should be expressly exempted from compliance if they report to ASX under the Business Rules.

R11 Perhaps s861/862 could also be included here, drawing all relevant material together. However, s861 should be redrafted to focus on material matters relating to a broker's financial position. It should require reporting by auditors to the delegate instead of the ASC - MOU arrangements will ensure that material matters are brought to the attention of the ASC. On the assumption that section 776(2A) is to be retained, the statutory reporting obligations on ASX should be reviewed as a whole.]

Registers

R10 The Commission must keep a register of current licence holders, and include each of the following in it:

(a) a copy of the licence;

(b) a copy of any instrument that imposes conditions on the licence, or revokes or varies conditions of the licence, after the licence is granted.

(c) the name of the licence holder;

(d) if the licence holder is a body corporate - the name of each director, and of each secretary, of the body;

(e) the day on which the licence was granted;

(f) in relation to each business to which the licence relates:

(i) the address of the principal place at which the business is carried on;

(ii) the addresses of any other place at which the business is carried on; and

(iii) if the business is carried on under a name or style other than the name of the holder of the licence - that name or style; and

(g) particulars of any suspension of the licence. [s789]

R11 A licence holder must keep a register of interests for its proper authority holders, and include each of the following in it:

(a) a copy ofthe proper authority;

(b) the name and address of the proper authority holder; and

(c) if the business address of the proper authority holder is different, the business address of the licence holder. [s810 -if all the register-keeping provisions should be kept together sections 811 and 812 should be added]

Exemptions from requirement to hold a licence
R12 Pick up Regs 7.3.01A, 7.3.10, 7.3.11, 7.3.12, 7.3.13, 7.3.14, 7.3.15 and 7.3.16.

In a Practice Note the ASC might include the following directions:

Directions under R9 in relation to:

- *s790 (eg, if the licensee ceases to carry on the business to which the licence relates the holder must notify the ASC within 21 days)*
- *s791 (ie, annual report in a prescribed form in respect of each year or part of a year during which the licence was in force).*

Alternatively, there may be regulations about these matters.

Other Practice notes would still have a place. In particular, there could be a replacement for Practice Note 46: Transition to Corporations Law. This Practice Note explained the process of transition from the co-operative scheme codes to the Corporations Law and the status of actions and decisions under the former codes.

Simplification of the licensing requirements in Division 1 of Part 7.3 would also allow ASX to integrate relevant licensing requirements with ASX trading access status and continuous compliance requirements, thereby minimising duplication.

The general provisions governing activities of unlicensed persons (Division 2), liability (Division 4) and disciplinary sanctions (Division 5) could remain in the Corporations Law as the responsibility of the ASC. There is, however, scope for simplification.

Appendix 1
The model

The Corporations Law Simplification task force points out, in *Organising the Law*, that there is no clear cut solution to the problem of order. There is not one logic but several logics affecting groupings and not one set of users but many, all with different interests and needs

Part	Subjects covered	Contents
Introduction	Objectives	Outline of law, objectives it sets out to achieve
Basic Framework	Introduction	Principles
		Types of companies
	Starting life	Registration
		Constitution
		Capacity and status
		Membership
	On-going	Governance
		Reorganisation*
		Financial Statements and Returns
		Charges
		Securities
		Receivership
		Voluntary administration
	Ending life	Winding up
	Bodies that are not companies	Collective investments
		Foreign companies
	Miscellaneous	Court powers
		ASC powers
		Offences
		Civil penalties
		Company Information
		Compulsory acquisition*
		Definitions
Takeovers* (largely follows the model proposed by the Corporations Law Simplification task force)	Introduction	Principles
	Prohibition & exceptions	
	Making a takeover	Types of takeover
		Requirements of the offer
		Disclosure
		Varying a takeover
		Procedural issues
	Completing a takeover	Conditional offers
		Payment
	Intervention	ASC powers (assumes the ASC is given specific powers in relation to takeovers. If it is given broad powers to modify the Law this section belongs above)
		Takeovers Panel
Markets & Intermediaries	Introduction	Principles

	Investment business	Markets Advisers Dealers Clearing houses
	Investment products	
	Fidelity funds	
	Prohibited conduct	Market offences
Fundraising	Introduction	Principles
	Disclosure	Disclosure content (the regulations would prescribe regimes for shares, debentures etc/warrants?) Safe harbours Exceptions Remedies for failure Defences
	Miscellaneous	Registration Advertising Share hawking Additional requirements (eg, s1031 if application for quotation)

* As noted in the text explaining the model, arguably, a better place for the provisions dealing with reorganisation is in a revised chapter dealing with all forms of reorganisation including takeovers. It could incorporate buy-backs, reductions of capital, compulsory acquisitions, takeovers, schemes of arrangement and so on.

Appendix 2

Non-parliamentary additions to the legislation

The legislation can be affected in various ways:

- **Regulations**. Sections 21-31 of the Corporations Act 1989 (Cth) provide for the making of regulations by the Governor-General. Under s 8 of the Corporations Act of each State and of the Northern Territory, the regulations for the time being in force under s 22 of the Corporations Act (Cth) apply as regulations in force for the purposes of the Corporations Law of the particular State or of the Northern Territory.

- **Application orders**. The Commonwealth minister can make written orders specifying matters that the Corporations Law requires or permits to be specified (see s 111A of the Corporations Law). The orders are known as 'application orders'; and must be consistent with the legislation. Under the Corporations Act of each State and the Northern Territory they can be made only with the consent of the State minister. An example of a matter on which application orders is made in s 112 of the Corporations Law. An application order under that section can specify callings and professions, partnerships, in which the maximum membership can exceed 20 persons. Another example is in s 273, which is a provision designed to obviate double registration of company charges under both the Corporations Law and some other law.

- **Gazette notices**. The ASC has power to publish a notice in the Commonwealth *Gazette* for certain purposes. For example, s 165A gives power to specify a standard time for the purposes of registration of charges by such a notice.

- **Accounting standards**. The supplementation of the Corporations Law by written accounting standards made by the Australian Accounting Standards Board is provided for by s 32. The Australian Accounting Standards Board is established under s 224 of the ASC Act.

- **ASC orders**. The Australian Securities Commission has power under the Corporations Law to issue class orders and other instruments amending the application of the Corporations Law.

- **s 777 of the Corporations Law.** Section 777 of the Corporations Law recognises and makes enforceable in a court the rules of an SRO such as ASX. Thus, ASX's business rules and listing rules may be enforced by court order. This is statutory recognition that rules other than those made by Parliament may be enforceable by third parties under the Corporations Law. This is perhaps based on the position of an SRO's rules under section 774, which gives the minister the power to disallow amendments.

Appendix 3
Background to the Corporations Law

Applied Laws regime

The Corporations Law is an applied laws regime. That is, the Corporations Law applies in the ACT as Commonwealth legislation and is applied as State law by each State and the Northern Territory. It was brought about by the Corporations Legislation Amendment Act 1990 (Cth) (which came into effect on 1 January 1991). The Corporations Law came into operation throughout Australia on 1 January 1991.

The CCH Corporations Law sets out the current structure of the Corporations Law as follows.

The Corporations Act 1989 has two parts. The first contains covering provisions which apply the Corporations Law (as set out in the second part) as a law of the ACT. The second contains the text of the Corporations Law. (Our model concentrates on the second part - the Law itself.)

The first part establishes the legal framework in which the Corporations Law operates as part of a national scheme. The provisions cover such topics as the way the Corporations Law is cited, its enforcement, and its administration. Section 82 of the Corporations Act then sets out the text of the Corporations Law. State application legislation adopts the Corporations Law as set out in sec 82.

The application legislation applies the Corporations Law and regulations as a law of the State or Territory, in much the same way as the covering provisions in the Corporations Act apply the Corporations Law to the ACT. Each piece of application legislation contains complementary provisions allowing cross-vesting of Court jurisdictions, applying Commonwealth laws relating to offences as if they were State laws, conferring power on the ASC and the Federal Police, and applying Commonwealth administrative law.

The Explanatory Memorandum to the Corporations Legislation Amendment Bill 1990 makes it clear that each applied law "is to have the characteristics of, and is to be treated, for all practical purposes within each jurisdiction as if it were, a Commonwealth rather than a State Law".

The Corporations Law includes other things besides companies and takeovers legislation. It also includes securities and futures legislation, and markets and intermediaries legislation.

Law reform

In line with the national nature of the regulatory scheme, the Commonwealth Government has the most important role to play in reforming the Corporations Law. The Commonwealth has the sole responsibility for reform proposals relating to national markets (ie, takeovers, securities, public fundraising and futures - these are core subjects in our model). However, the advice of the Ministerial Council must be tabled in Parliament when the legislative proposals are introduced. Other legislative proposals must be approved by the Ministerial Council before being introduced into Parliament. The Commonwealth is not, however, obliged to introduce any proposals with which it does not agree.

If reform proposals cover areas for which the Commonwealth and States share responsibility, the Commonwealth must use its best endeavours to consult with the Ministerial Council for Corporations.

History of company law

Ford's Principles of Corporations Law outlines the history of company law.

In seventeenth century England persons who wished to operate jointly in commercial undertakings but who did not want, or could not obtain, incorporation by charter or statute could trade as partners. The extension of trade necessitated the raising of large sums of capital, and encouraged the solicitation of funds from the public. The resulting large associations of investors became known as joint stock companies. To attract investment it was necessary that shares in the company be transferable and that, unlike the position in a partnership, membership be transferable without the consent of other investors in the company. This made speculation possible and in some economic conditions a speculative boom could develop. Such a boom occurred in the early part of the eighteenth century.

A new legal basis for unincorporated business groups which did not seek incorporation was developed - that basis being the trust. Funds subscribed by investors were vested in trustees who were to deal with them on the terms of a deed of settlement which contained a series of mutual promises between the investors, the directors and the trustees.

Incorporation continued to be treated as a privilege to be specially granted rather than as something to be obtained as of right. The Board of Trade commissioned a barrister, Bellenden Ker, to report on the law of partnership. He proposed the establishment of a registration system of partnerships and joint stock companies and suggested that all partnerships consisting of more than 15 members should be illegal unless formed by registered deed of settlement. The latter suggestion is the inspiration for the current provision against outsize partnerships in the Corporations Law s112. The Act that was passed after Ker's report, the Chartered Companies Act 1837, clung to the idea that incorporation should be a specially granted privilege and few deed-of-settlement companies sought registration. In 1841 a select committee was set up to inquire into the law respecting the joint stock companies. In 1844, its chairman, Gladstone, furnished its report and the outcome was the Joint Stock Companies Registration and Regulation Act 1844 which took over the deed-of-settlement company as developed in the Court of Chancery and made it a statutory creature generally available on presentation to the Registrar of Joint Stock Companies of prescribed papers and payment of fees. The deed of settlement did not differ greatly in form from that which had evolved before the 1844 Act and it is the parent of the modern articles of association.

The Limited Liability Act 1855 (UK) enabled companies to be formed on the principle that the liability of the members would be limited. Following Parliamentary acceptance in 1855 of the principle of limited liability for joint stock companies, the whole of the legislation relating to companies was reshaped in the Joint Stock Companies Act 1856.

The contents of the memorandum of association were prescribed in terms not very different from those obtaining today. The Act of 1856 provided its own machinery for winding up companies incorporated under it.

The legislation relating to joint stock companies from 1844 onwards was consolidated in the Companies Act 1862. One noteworthy change was the introduction of companies limited by guarantee. Later legislative history shows a series of improvements without departure from the fundamentals of company law established by the legislation which the 1862 Act consolidated.

Company law in Australia was for a long time the result of a series of local adoptions in the colonies and, in their later form, States, of the legislation passed in England.

Most of the colonies passed legislation modelled on the English Companies Act 1862 and this formed the basic legislation for a long time. Many of the provisions of that Act can be traced into current legislation. Over the years provisions have been added in the light of experience gained in particular waves of company failures brought about by the sudden imposition of credit restrictions by governments or the sudden collapse of stock market booms. Other changes in the legislation have arisen from the emergence of new ways of fund-raising and dealing in securities.

In an effort to remove inconvenience to the business community caused by varying legislative requirements as between the States and Territories, moves were made in the late 1950s to obtain uniform companies legislation. In 1961 a draft Companies Bill was prepared, largely based on the Victorian Companies Act 1958.

During 1961 and 1962 each of the States passed a Companies Act based on the draft Bill and the Commonwealth made Companies Ordinances for the Territories of the Australian Capital Territory, the Northern Territory and the Territory of Papua and New Guinea.

Following the crash in the early 1960s of groups of companies that had made large borrowings from the public, the Companies (Public Borrowings) Act 1963 introduced major controls over corporate borrowing from the public.

In August 1967 the Standing Committee of Attorneys-General appointed a three member committee under the chairmanship of Sir Richard Eggleston to enquire into and report on the extent of the protection afforded to the investing public by the uniform Companies Acts. Many of the Committee's recommendations were implemented in 1971-72 by legislation on accounts and audit, disclosure of substantial shareholdings and take-overs, special investigations and insider trading.

History of securities legislation

Four States (New South Wales, Victoria, Queensland and Western Australia), beginning with New South Wales in 1970, enacted Securities Industry Acts which replaced stockbrokers legislation with more elaborate provisions about the establishment of stock exchanges, licensing of securities dealers and investment advisers, the keeping of accounts by dealers, the establishment of fidelity funds by stock exchanges and new offences of false trading, market rigging and the making of false statements about securities. Many of these provisions were inspired by the Prevention of Fraud (Investments) legislation in the United Kingdom.

The dependence of many investors on professional advice and the need to exclude untrustworthy dealers and advisers from the securities business prompted the enactment of the Securities Industry Acts. A system of licensing of securities dealers and investment advisers was introduced. The legislation prohibited undesirable practices such as false trading, market rigging, fictitious dealing and the spreading of false information about securities. The Commonwealth Corporations and Securities Industry Bill (CSIB) introduced into the Commonwealth Parliament in 1974 would have contained similar provisions, with further controls to be administered by a Corporations and Exchange Commission. The Rae Committee's report confirmed the need for such legislation. The Bill lapsed when the Whitlam Labor Government lost office in November 1975. However, New South Wales, Victoria, Queensland and Western Australia enacted new Securities Industry Acts in 1975 and some of the new provisions in those Acts were inspired by CSIB.

In preparation for the co-operative Commonwealth-State scheme which operated from 1981 to 1990 the Commonwealth passed the Securities Industry Act 1980. That Act was locally applied in each State and, from 1 July 1986, the Northern Territory. The Act, with other Acts in the co-operative scheme, was placed under the administration of the National Companies and Securities Commission and its delegates, the State and Territorial corporate affairs authorities. The NCSC and corporate affairs authorities were answerable to the Ministerial Council for Companies and Securities made up of the Attorneys-General.

The Corporations Law reproduced many of the provisions of the Securities Industry Act 1980. They are in Chapter 7, which also contains the prospectus provisions.

The Corporations Law attempts to achieve a single national system of licensing for dealers and advisers (recall that the Corporations Law applies as State law rather than as an exercise of Commonwealth constitutional power for the whole of Australia). The Law attempts to achieve the result that an applicant for a licence may apply to the ASC anywhere in Australia, and upon the issue of the licence, the licensee may operate nationally. This is achieved principally through s 102A and the ‘sliced’ definitions of ‘dealers licence’ and ‘investment advisers licence’ in s 9. Section 102A requires that an application for a licence must be made under the Corporations Law of each jurisdiction, but allows an application to be made under the law of each jurisdiction by lodging a single application form stated to be made under the ‘Corporations Law’. Approval of the application results, in effect, in the grant of a licence under the Corporations Law of each jurisdiction.

Existing licences are deemed to continue, and to be for all purposes licences under the Corporations Law of the jurisdiction where the licence was originally granted. The holding of a licence now entitles the licensee to carry on business and to employ representatives in any Australian jurisdiction.

Appendix 4

Chapters 7 and 8 of the Corporations Law

CHAPTER 7	CHAPTER 8
MARKET REGULATION	
Both Chapters 7 and 8 create systems of market regulation, under which the conduct of a market other than an exempt market is prohibited unless the market operator is authorised	
CRITERIA FOR APPROVAL AS EXCHANGE	
The criteria in s769 are slightly different to those in s1126.	The criteria for approval as a futures exchange (s1126(2)) are more extensive than the criteria listed in s769(2) for approval as a stock exchange. However, there is no substantive difference
JUDICIAL REVIEW OF DECISIONS	
A similar result is achieved by s777 under which the court has jurisdiction to make an order against various parties, including ASX, for failure to comply with ASX Rules	There are certain statutory rights to appeal against decisions of a futures exchange (s1135)
CLEARING HOUSES	
There is no requirement for a separate clearing house and hence no equivalent provision	There is a prohibition on a person offering clearing house facilities for a futures market without approval (s1128)
There is no requirement on OCH to guarantee, and it does not guarantee, the transactions it clears. However OCH's position in clearing options and share ratios is supported by the National Guarantee Fund (Part 7.10 Division 6B). Default by a clearing member in meeting net payment obligations (including obligations with respect to share ratios) will be covered by the NGF by virtue of s954N and associated Business Rules. The risk to the NGF is contained by the OCH margining system and the arrangements for daily marking to market. Since OCH has the 'asset' of a claim against the NGF, the NGF will meet the defaulting clearing member's non payment obligation and there is no need to rely on a clearing house guarantee	In considering an application for approval as a clearing house, the Minister may have regard to the applicant's business rules relating to the guaranteeing of performance of futures contracts (s1131(3)). There is no requirement for the giving of a guarantee although in practice it is expected.

ORDERLY AND FAIR MARKETS	
There is no comparable express statutory duty although as a matter of prudent commercial practice and, to avoid liability, such a duty is observed. The ASX Business Rules grant power to, and impose obligations on, ASX/OCH to take action to maintain a fair and orderly market in a range of circumstances. The regulations complementing the Corporations Law (Securities and Futures) Act applied s1137 to share ratio contracts(which suggests that provisions in each area are transportable)	Futures exchanges and clearing houses have a duty to do what is necessary to ensure an orderly and fair market for dealings in futures contracts (s1137)
DIRECTIONS TO THIRD PARTIES	
There is no equivalent provision. The regulations complementing the Corporations Law (Securities and Futures) Act applied s1137 to share ratio contracts	A futures exchange may give a binding direction to a party to a futures contract who is not a member of the exchange (s1137(2))
ASC POWERS OF INTERVENTION	
The ASC has power to intervene by giving a notice to the stock exchange to act (s775). The regulations complementing the Corporations Law (Securities and Futures) Act applied s1138 to share ratio contracts	The ASC has power to intervene in futures market trading (s1138)
LICENSING PROVISIONS	
A securities licence must be granted if: (a) proper application is made; (b) not insolvent/externally administered; (c) educational qualifications and experience are adequate having regard to the nature of the duties of the holder of a licence of the kind applied for; (d) no reason to believe not of good fame and character; (e) no reason to believe won't perform duties efficiently, honestly and fairly.	A futures brokers licence must be granted if the matters opposite are satisfied and the applicant is a member of a futures organisation (s1148(1)(a))
The conditions of a licence are as prescribed or imposed by the ASC. Under the ASX Articles if the securities licence of an ASX Member is cancelled or suspended the Member will be required to show cause why it should not cease to be a Member	A futures brokers licence is also subject to a condition that: (a) the licensee be, throughout the currency of the licence, a member of a futures organisation; and (b) the licence is suspended throughout a period in which the licensee is not a member of, or is suspended from membership of, a futures organisation
Securities licensees must lodge and maintain with the ASC an approved security: (s786(2)(d))	Futures licensees are not so required

There is a prohibition on carrying on any securities business without a licence	The prohibition is on dealing in a futures contract *on another person's behalf* without a licence. Accordingly, those who only trade in futures contracts as principal, or only on behalf of related companies, and who give no advice concerning futures contracts need not be licensed as either futures brokers or futures advisers
CIVIL LIABILITY FOR BREACH OF LICENSING PROVISIONS	
Unless exempt, unlicensed persons must not carry on a securities business or investment advice business or hold out that they carry on such a business	Unless exempt, unlicensed persons must not carry on a futures business or investment advice business or hold out that they carry on such a business
Civil liability attaches in respect of breach	There is no civil liability on persons who merely hold themselves out as carrying on a futures broking business
DISCLOSURE OBLIGATIONS	
If derivatives are securities of a corporation (which is debatable in the context of options and warrants) they are caught by the prospectus disclosure provisions (Part 7.12). The ASX Business Rules also prescribe disclosure obligations for ASX Members and Member Organisations	If derivatives are futures contracts they are not subject to prospectus-like disclosure obligations. Instead disclosure responsibility falls upon futures brokers who must provide investors with certain specified information in relation to futures (s1210)
CONDUCT OF DEALERS' BUSINESS **Approval of Statements**	
There is no equivalent provision. The regulations complementing the Corporations Law (Securities and Futures) Act applied s1205 to share ratio contracts	The ASC may prohibit a person from publishing or broadcasting statements about futures contracts unless the form and content of the statements has been approved by the ASC (s1205)
Monthly Statements	
This obligation is addressed in the ASX Business Rules. The regulations complementing the Corporations Law (Securities and Futures) Act applied s1207 to share ratio contracts	A futures broker must send monthly statements of open positions and operations on discretionary accounts to clients (s1207)
Principal Trading	
A dealer must not deal in securities on its own account with a non-dealer without informing the non-dealer that the dealer is acting as principal (s843). The regulations complementing the Corporations Law (Securities and Futures) Act applied s1208 to share ratio contracts	A futures broker must maintain records of the broker's trading on its own account. A futures broker is prohibited from knowingly taking the other side of an order of a client without the client's consent (s1208)

Contract Notes	
Securities dealers must provide contract notes to: • the persons on whose behalf they are acting with certain exceptions; • the counterparty where the transaction is not in the ordinary course of business on the stock exchange, whether or not the dealer is acting as principal (s842)	Futures brokers must provide contract notes to the persons on whose behalf they are acting. There is no equivalent requirement concerning counterparties, but this requirement is foreign to futures as futures contracts must be entered into on market. Futures brokers need not give contract notes when the person on whose behalf they are acting is also a futures broker (s1206)
Securities contract notes are standard regardless of the type of securities involved	Futures contract notes differ depending upon whether they relate to futures options, eligible exchange-traded options or one of the other types of futures contract
The regulations complementing the Corporations Law (Securities and Futures) Act applied the contract note provisions of s1206 to share ratio contracts	A contract note relating to an option that is a futures contract will include the following information that need not appear on a contract note for a Chapter 7 option contract: • a description of the subject matter to which the option relates; • the date by which the purchaser of the option must declare an intention to exercise the option; • the option's exercise price
Know Your Client Provisions	
There are extensive investor protection provisions requiring securities dealers to: • disclose commissions and other pecuniary interests; • be aware of their clients' individual investment objectives and financial situations; • have a reasonable basis for making a securities recommendation (ss 849-853)	There are no equivalent provisions. In respect of futures, it is up to the client to satisfy itself that the contract is in the client's interest
Explanatory Document	
There is no equivalent provision. These obligations are, in relation to particular products, addressed in the ASX Business Rules. The regulations complementing the Corporations Law (Securities and Futures) Act applied s1210 to share ratio contracts.	A futures broker must give a document to each new client explaining futures contracts, obligations and risks (s1210)

Client Priority	
A securities dealer must give priority to clients orders. The provision extends to require priority of clients orders over orders from associates of the dealer (s844)	A futures broker must: • transmit instructions in sequence of receipt; • give priority to clients' orders. The client priority requirement applies to the brokers own account not to associates (s1266)
Dealings by Employees	
The following are prohibited: • Joint purchases by a dealer or an investment adviser and an employee; and • the giving of credit by a dealer or an investment adviser to an employee (or a person known to be associated with the employee) to enable the employee (or associate) to purchase or subscribe for securities (s845)	There are equivalent provisions (s1267)
Off-market Dealing	
There is no prohibition on off-market dealings in securities. However, ASX Business Rules limit the circumstances in which off-market dealings can be effected and require such dealings to be notified to the market. The regulations complementing the Corporations Law (Securities and Futures) Act applied s1258 to share ratio contracts	A futures broker is prohibited from off-market dealings in futures (s1258)
DEALERS ACCOUNTS AND AUDIT	
There are provisions with respect to the obligation to maintain accounts and the auditing of those accounts	There are similar provisions with respect to the obligation to maintain accounts and the auditing of those accounts
The provisions on property in the possession of the broker refer to scrip in the dealer's custody (s873). In the case of a stockbroker the 'property' received from the client is likely to be scrip or money and this is dealt with by s873 and the trust account provisions	The reference is to property in the custody of the futures broker
Trust Accounts	
The holder of a dealer's licence must maintain a trust account (s866)	A futures broker must maintain a clients' segregated account (which is, in some respects, less than a full-scale trust account, having regard to the provision made for margining requirements) (s1209). A futures broker is permitted to mix the funds of various clients in a global 'clients' segregated account'. It is not a series of trust accounts for individual clients. In one sense it is similar to a trust account as s1209(14) provides that money in the account and property invested out of the account are generally not available to meet the broker's liabilities
A stockbroker's obligation to pay money into a trust account is subject to some exclusions which enable brokers to manage funds for clients with reasonable efficiency (s867)	A futures broker's obligation to pay client money into the account is stated in more absolute terms (s1209(3))

Chapter 7 is more stringent with regard to the circumstances in which money can be withdrawn from the account. Stockbrokers need to obtain specific written instructions from their clients if they want to use client trust funds for paying margins or similar or to invest client funds	Chapter 8 authorises payment in connection with margins and withdrawals for various forms of investment (s1209(5)(b) and (d))
GENERAL OFFENCE PROVISIONS **Short Selling**	
There is a prohibition (with statutory exceptions) on selling securities in the absence of a presently exercisable and unconditional right to vest the securities in the buyer (s846). The provision has no relevance for derivatives	There is no equivalent provision
Insider Trading	
Provisions were extensively revised in 1991	Provisions based on older legislative precedent and are much less elaborate
Market Manipulation	
Transactions designed to increase or reduce or maintain the price of securities are prohibited (s997)	Transactions which create or maintain an "artificial" price are prohibited (s1259)
Market Rigging	
There is an elaborate provision containing deeming provisions which explain when a person will be held to have created a false or misleading appearance of active trading (s998)	The provision simply sets out the basic offence with no deeming provisions (s1260)
Misleading or Deceptive Conduct	
Misleading or deceptive conduct or conduct likely to mislead or deceive in connection with a dealing in securities is prohibited (s995)	There is no equivalent provision
False or Misleading Statement in or Omission from Prospectus	
A person must not cause the issue of a prospectus in relation to securities if that prospectus is required to be lodged under Part 7.12 and a material statement is false or misleading or there is a material omission (s996)	Futures contracts are not subject to prospectus-like disclosure obligation. There is thus no equivalent provision
Fraud	
There is no equivalent provision	There is a general provision concerning fraud in connection with dealings in futures contracts

False or Misleading Statements	
There is a prohibition on making a statement or disseminating information that is false in a material particular or materially misleading if the information is: • likely to induce subscription, sale or purchase of securities by others; or • likely to have the effect of increasing, reducing, maintaining or stabilising the market price of securities, when the person: • doesn't care whether the same is true or false; or • knows or ought reasonably to know the same is false in a material particular or materially misleading (s999)	There is an equivalent prohibition concerning dealings in futures contracts (s1261)
Fraudulent Inducements to Deal	
There is a prohibition on inducing or attempting to induce another person to deal in securities by various means (s1000)	There is an equivalent provision (s1262)
Dissemination of Information About Illegal Transactions	
There is a prohibition on dissemination of information to the effect that the price of securities is likely to rise or fall or be maintained by reason of transactions in contravention of ss997, 998, 999 or 1000 if the person or an associate: • entered into such transaction; • has or expects to receive any consideration or benefit in respect of the dissemination (s1001)	There is an equivalent provision (s1263)
REGISTER OF INTERESTS	
A register of relevant interests in securities must be maintained by: • licence holders; • proper authority holders; • financial journalists (Part 7.7) The provision has no relevance for derivatives	There is no equivalent provision
FIDELITY FUNDS	
ASX's markets are supported by the National Guarantee Fund. Claims can be made in respect of loss suffered including broker defalcation. However the Fund extends beyond this to cover loss arising in an insolvency situation whether or not there is an element of fraud. The Fund also provides a range of contract guarantees and a form of 'underwriting' of the net payment and delivery systems. (Part 7.10 Division 6B). In the context of options and share ratios, the relevant provisions are in s954N which allows a claim to be made if a broker defaults in meeting a net payment obligation in the settlement system	Part 8.6 sets up an old-style fidelity fund structure roughly corresponding with Part 7.10 Division 8. Essentially, claims are only available where loss is suffered through defalcation or fraud in respect of property entrusted to, or received by, the broker (s1239). There are no contract guarantees

MISCELLANEOUS	
The miscellaneous provisions of ss1114 and 1116-1119 are virtually identical to ss1268 and 1270-1273	Virtually identical provisions