CORPORATE LAW TEACHERS ASSOCIATION - BRIEFING PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES - 27 OCTOBER 2014

BRIEFING PAPERS

Re-assessment of the Statutory Business Judgment Rule in Australia - The Case for Law Reform

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Abstract

The perennial issue of directors' concern for exposure to personal liability has, once again, arisen in the Australian marketplace. The private sector has seized the law reform agenda and produced a set of law reform proposals to address such concerns. This briefing paper recognises that a key defence currently available to directors, the business judgment rule under s 180(2) of the *Corporations Act 2001* (Cth) is defective in many respects. Unsurprisingly, it forms the centrepiece of the law reform proposals advanced by the Australian Institute of Company Directors (AICD) and by Dr Bob Austin (former Supreme Court judge)/Minter Ellison. This briefing paper validates criticisms of the current operation of the statutory business judgement rules and calls for legislative reform.

INTRODUCTION

Over the past decades, there have been calls for,[1] and repeated government enquiries into[2], the need for greater protection to directors from personal liabilities in corporate law. Such concerns have arisen from the view that corporate sanctions, and exposure to personal liability, are adversely affecting the directors' willingness to engage in responsible risk taking[3] or to voluntarily participate in other aspects of decision making. Recent observations of the latter, for example, suggest that the voluntary uptake on the practice of Integrated Reporting in Australia is being hampered by directors' concerns about personal liability exposure, particularly for forward-looking statements that subsequently prove to be unfounded.[4]

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[1] See, for example, Baxt, R 'Do we Need a Business Judgment Rule for Company Directors?' (1995) 69 *Australian Law Journal* 571; 'The Duty of Care of Directors: Does it Depend on the Swing of the Pendulum?' in I Ramsay (ed), *Corporate Governance and Duties of Company Directors* (Centre for Corporate Law and Securities Regulation, University of Melbourne, 1997); Dr Austin, B 'Boards that Lead Need Better Protection' *Australian Financial Review* (21 March 2013).

[2] Senate Standing Committee on Legal and Constitutional Affairs, Company Directors' Duties , *Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989); House of Representatives Standing Committee on Legal and Constitutional Affairs, *Corporate Practices and the Rights of Shareholders* (1991); *Directors' Duties and Corporate Governance: Facilitating innovation and protecting investors*, Corporate Law Economic Reform Program, Proposals for Reform: Paper No. 3, (1997); *Review of Sanctions in Corporate Law* - Roundtable Paper 1 (2007), The Treasury, Commonwealth of Australia; *Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration* (2010), The Treasury, Commonwealth of Australia.

[3] See *Review of Sanctions in Corporate Law* - Roundtable Paper 1 (2007), The Treasury, Commonwealth of Australia.

[4] Drummond S, 'Integrated Reporting Brings Legal Worries', *Australian Financial Review* (17 April 2013) http://www.afr.com/f/free/markets/capital/cfo/integrated_reporting_brings_legal_RvN24L7rPruGI4M90qe4dI

The Treasury Paper (2007) explicitly recognised a 'fundamental issue'[5] of long standing within the area of corporate governance - namely the need to assess 'whether the current corporate regulatory framework strikes an appropriate balance between promoting good behaviour and ensuring directors are willing to take sensible commercial risks.'[6]

On this critical issue of balance, the Treasury Paper (2007) recognised the risks in failing to getting the balance right. Its observations bear repeating:[7]

> If corporate law is engendering an overly conservative approach to business decision making, this could discourage decisions that would advance the interests of the company. Risk- averse behaviour can increase agency costs and diminish return to shareholders. It may also reduce efficiency, productivity and economic growth.

Regrettably, there has been no follow up action to both sets of enquiries launched into by previous governments.

Recently, the void in the contest of ideas for striking the appropriate balance in corporate governance has been filled by two law reform proposals released by the private sector. Both sets of reform proposals address the need for a broader based general defence against breach of director duties,[8] considered and analysed below in Parts 2 and 3 of this briefing paper.

Viewed holistically, this briefing paper touches on the delicate question whether Australian corporate law has struck the right balance between discouraging undesirable director conduct and promoting responsible risk taking – a recurring theme in earlier government inquiries.

For purposes of this briefing paper, this base question, however, is examined in the specific context of the role played by the statutory business judgment rule defence in s 180(2) of the *Corporations Act 2001* (Cth) which operates upon the director's duty of care.

Although there 'is no single conception of what is meant by a business judgment rule,'[9] a learned commentator offers the following view which accords with its origins and application in the United States:[10]

> 'on the simplest level, the business judgment rule is an aspect of judicial doctrine that states that courts will not substitute their own opinion of the wisdom of a business

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viewed 9 October 2014; Drummond S and King A, 'Confusion just one of the Hurdles for Integrated Reporting', *Australian Financial Review* (27 November 2013); See further, Huggins, A, Simnett, R and Hargovan, A, 'Integrated Reporting and Directors' Concerns about Personal Liability Exposure: Law Reform Options' (2014) *Company and Securities Law Journal* (forthcoming); Du Plessis, J and Ruhmkorf, A 'New Trends Regarding Sustainability and Integrated Reporting for Companies: What Protections do Directors have? (2014) *The Company Lawyer*) (forthcoming).

5 *Review of Sanctions in Corporate Law* - Roundtable Paper 1 (2007), The Treasury, Commonwealth of Australia, [1.4].

6 Ibid.

7 Ibid.

8 See Australian Institute of Company Directors - A Proposal for Law Reform: *The Honest and Reasonable Director Defence* (AICD, Sydney, August 2014) - available at www.companydirectors.com.au ; See Dr Austin, B 'Boards that Lead Need Better Protection' Australian Financial Review (21 March 2013).

9 Redmond, P 'Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule' in Ian Ramsay (Ed), *Corporate Governance and the Duties of Company Directors* (1997) 185 at 190.

10 Ibid, 191.

> decision for that of the director who originally made it [subject to limited caveats]. Judges are not directors, should not try to be. At a more practical level, the rule is said to operate as a presumption, or a burden of proof issue.

This briefing paper arises from the legal tension that currently exists in this area of Australian corporate law. The tension can be attributed to the divergent manner in which the statutory judgment rule is applied in Australia, as compared to the original premise under which it was founded, described further in Part 2 of this briefing paper.

Moreover, the resultant tension is exacerbated by the divergent views expressed on the practical utility of the statutory business judgment rule in s 180(2) as an effective defence to allay director personal liability concerns.
A senior barrister has dismissed s 180(2) as mere window dressing.[11] A judge of the New South Wales Supreme Court, noting the 'profoundly ambiguous'[12] statutory language in s 180(2), nonetheless found (in a thousand page judgment) that that the statutory business judgement rule, in part, has some protective work to do.[13]

The polarising views, and critical judicial comment on major aspects of the statutory business judgment rule by Justice Austin in *ASIC v Rich*, arises from the fact that the law in s 180(2) represents a difficult transplant from the law in the United States.

Unsurprisingly, modification proposals to the current operation of the statutory business judgment rule lies at the heart of the twin reform proposals advanced by the private sector, discussed below in Parts 2 and 3.

This briefing paper is in four parts. The first looks at the operation of the current statutory business judgment rule. The second part provides an overview of recent law reform proposals designed, in part, to redress the shortcomings of the statutory business judgment rule. The third presents law reform options for parliament to reconsider. The paper concludes by offering a suggestion on the way forward.

Before commenting on these law reform proposals, it pays to first review the nature, scope and operation of the current statutory business judgment rule in Australia.

1. THE CURRENT STATUTORY BUSINESS JUDGEMENT RULE

The policy arguments and debates for and against the introduction of the statutory business judgment rule were ventilated[14] in the lead up to its introduction into the Corporations Act in 2000 as part of the *CLERP Act 1999* (Cth).[15]

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[11] Young, N, "Has Directors' Liability Gone Too Far or Not Far Enough? A Review of the Standard of Conduct Required of Directors under Sections 180-184 of the Corporations Act" (2008) 26 *Company and Securities Law Journal* 216.
[12] Austin J in *ASIC v Rich* (2009) 75 ACSR 1at [7264].
[13] Ibid at [7290].
[14] For collection of references, see *Review of Sanctions in Corporate Law* - Roundtable Paper 1 (2007), The Treasury, Commonwealth of Australia at [2.19]. See, in particular, Farrar, J 'Corporate Governance, Business Judgment and the Professionalism of Directors' (1993) 6 *Corporate and Business Law Journal* 1; Redmond, P 'Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule' in Ian Ramsay (Ed), *Corporate Governance and the Duties of Company Directors* (1997).
[15] For a summary of the various proposals preceding the introduction of the business judgment rule in 2000, see Du Plessis, J, 'Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules

It was designed as a safe harbor against breach of the directors duty of care and diligence (statutory, common law and in equity). It was intended to provide a powerful rebuttable presumption, in favour of directors, that they exercised their duty of care and diligence when making a business judgment. Academic commentary[16] and judicial authority[17] suggests this favourable interpretation of s 180(2) does not appear to be the case.[18]

Statutory Content: Business Judgment Rule

> **180 (2)** A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:
>
> (a) make the judgment in good faith for a proper purpose; and
>
> (b) do not have a material personal interest in the subject matter of the judgment; and
>
> (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
>
> (d) rationally believe that the judgment is in the best interests of the corporation.

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

Note: This subsection only operates in relation to duties under this section and their equivalent duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence)--it does not operate in relation to duties under any other provision of this Act or under any other laws.

> **(3)** In this section:
>
> "business judgment" means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

Operation

The statutory business judgment rule has not been considered in many cases, [19] although it received detailed examination by the New South Wales Supreme Court in *ASIC v Rich*[20]. In that case Justice Austin defined a 'business judgment' as involving a decision to take or not to take action in respect of

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Compared (Part 1)' (2011) 32 *Company Lawyer* 347 at 351; 'Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared (Part 2)' (2011) 32 *Company Lawyer* 377 at 377-380.

[16] DeMott, D, 'Legislating Business Judgment - A Comment from the United States' (1998) 16 *Company and Securities Law Journal* 575, commented on by Austin, R and I Ramsay, I *Ford's Principles of Corporations Law* (LexisNexis, 15th ed , 2013) at p.485[.8.310].

[17] *ASIC v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229.

[18] See also Santow G.F.K, 'Codification of Directors' Duties' (1999) 73 *The Australian Law Journal* 336, 348-349 and 350.

[19] *Review of Sanctions in Corporate Law* - Roundtable Paper 1 (2007), The Treasury, Commonwealth of Australia at [2.19] observed that the rule has received little judicial attention.

[20] (2009) 75 ACSR 1; [2009] NSWSC 1229. For a critical assessment of the business judgment rule, see Lumsden, A 'The Business Judgment Defence: Insights from *ASIC v Rich*' (2010) 28 *Company and Securities Law Journal* 164.

matters relevant to the business operations of the corporation (including matters of planning, budgeting and forecasting). His Honour also considered that the degree of information required by a director to satisfy (2)(c) would be influenced by:

- the importance of the business judgment to be made
- the time available for obtaining information
- the costs related to obtaining information
- the director's or officer's confidence in those exploring the matter
- the state of the company's business at that time and the nature of competing demands on the board's attention
- whether or not material information is reasonably available to the director.

Justice Austin explained that '[t]he qualifying words, "to the extent they reasonably believe to be appropriate", convey the idea that protection may be available even if the director was not aware of available information material to the decision, if he reasonably believed he had taken appropriate steps on the decision-making occasion to inform himself about the subject matter.'

His Honour also explained the meaning of the term 'rational belief' in s 180(2)(d) as follows: 'the director's or officer's belief would be a rational one if it was based on reason or reasoning (whether or not the reasoning was convincing to the judge and therefore "reasonable" in an objective sense) but it would not be a rational belief if there was no arguable reasoning process to support it.'

Noting the paucity of judicial authorities, the limited scope of the statutory business judgment rule and critical remarks on its operation by Justice Austin in *ASIC v Rich*,[21] there has recently been a concerted push for law reform.

2. CURRENT LAW REFORM PROPOSALS[22]

Two law reform proposals on director liability have been announced recently:

1. The AICD honest and reasonable director defence[23]
2. The proposed new statutory business judgment rule recommended by former corporate law judge Robert Austin and Minter Ellison

THE AICD PROPOSAL

The AICD has proposed a new broad based 'honest and reasonable director' defence that would be included into Ch 9 of the *Corporations Act 2001* (Cth). Chapter 9 contains provisions dealing with enforcement, remedies and court powers. The proposed defence is as follows:

Honest and reasonable director defence

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[21] (2009) 75 ACSR 1; [2009] NSWSC 1229 at [7262]-[7269].
[22] The following discussion and analysis of the law reform proposals draws from Harris J and Hargovan A, 'Business Judgment Rule Revisited' 2014 *Governance Directions* (forthcoming).
[23] See Australian Institute of Company Directors - A Proposal for Law Reform: *The Honest and Reasonable Director Defence* (AICD, Sydney, August 2014); available at www.companydirectors.com.au

> Notwithstanding any other provision of this Act or the ASIC Act, if a director acts (or does not act) and does so honestly, for a proper purpose and with the degree of care and diligence that the director rationally believes to be reasonable in all the circumstances, then the director will not be liable under or in connection with any provision (including any strict liability offence) of the Corporations Act or the ASIC Act (or any equivalent grounds of liability in common law or in equity) applying to the director in his or her capacity as a director.

Where these elements are satisfied the director will not be liable under or in connection with any provision of the:

- Corporations Act
- ASIC Act
- Any equivalent grounds under common law or equity so far as the liability applies to the person's capacity as a director.

Comment

The proposed defence contains a mix of subjective and objective assessments. The requirement to act honestly is a subjective assessment (which is consistent with the current s 181(1)(a)). The requirement to act properly has traditionally been assessed objectively under s 181(1)(b).

The requirement to act with the degree of care and diligence warrants further attention.

The current s 180(1) of the Corporations Act (the duty of care) requires a standard of conduct that a reasonable person would exercise in the same circumstances, which is an objective assessment.

This has been interpreted by the courts as meaning that directors have minimum standards of conduct, which are not changed by the actual knowledge or competency of the individual director. For example, as was illustrated by the *Centro* case,[24] a non-executive director cannot argue that they were not negligent for failing to read financial statements on the basis that they were not trained as an accountant. All directors must be able to monitor the financial performance of the company.

The AICD proposal would mean that directors would only need to perform at a standard of care and diligence that they rationally believed to be reasonable. This turns the current s 180(1) on its head and renders it a subjective assessment. This would take the law back to the time of *Re City Equitable Fire Insurance Co* [1925] Ch 407, where directors (particularly non-executive directors) were recognised as owing only intermittent obligations to the company. The AWA litigation in the early 1990s and the insolvent trading cases in the late 80s/early 90s fundamentally reset the assessment of director conduct in Australia based on community expectations.

Viewed in this context, this proposed defence, if adopted by parliament, would be a radical departure from the existing law for the following reasons.

Firstly, unlike the current statutory business judgment rule, this defence is not limited to business judgments. Therefore a decision not to participate at all in the oversight of management of the company (which has been held not to be a business judgment and therefore not amenable to the

[24] *ASIC v Healey* (2011) 83 ACSR 484. See Du Plessis, J and Meaney, I, 'Directors' liability for approving financial statements containing blatant incorrect items: Lessons from Australia for all directors in all jurisdictions' (2012) 33 *Company Lawyer* 273 ff.

statutory business judgment rule)[25] could be protected as long as the director was honest and the director rationally believed that the conduct was reasonable in the circumstances. It could be argued, however, that such a decision would not be carried out for a proper purpose.

Secondly, the defence seeks to override all existing obligations that give rise to liabilities, even if these existing provisions already have defences. For example, directors may be liable for defective disclosure in relation to prospectus offerings or in respect of continuous disclosure obligations, but both of these liabilities come are accompanied by due diligence defences.[26] It is questionable whether the new defence is needed where there is already a due diligence defence.

THE AUSTIN/MINTER ELLISON PROPOSAL

While the AICD proposal represents a change to the Corporations Act that will limit liability under that Act, the ASIC Act and equivalent common law and equitable liabilities, the proposal for a new statutory business judgment rule by Dr Robert Austin from Minter Ellison provides for a broader based defence that operates well beyond traditional corporate law statutes.[27]

This proposal addresses long-standing concerns about derivative liability where company directors are often made liable for the corporation's conduct by default. The proposed defence would be inserted into the interpretation statutes that operate federally and in each state and territory and therefore would be applicable to all statutes, not just the Corporations Act and the ASIC Act. The proposed defence is as follows:

Section XXX Protection for Directors of a Corporation where a Business Judgment is Made

(1) In this section, an **exposure to liability** includes exposure to:

criminal or civil liability under any Act or the general law;

a penalty of any kind; and

contravention of a provision of an Act.

(2) This section applies where:

(a) a section of an Act (the **Affected Section**):

(i) imposes a duty on a director of a corporation, or on a class (such as officers of the corporation) which includes a director of a corporation; or

(ii) exposes a director of a corporation, or a class which includes a director of a corporation, to liability (whether the exposure to liability arises only out of that section or out of that section together with some other provision or provisions to which that section is related); and

(b) a question arises as to the application of the Affected Section to an alleged act, conduct or omission by a director of a corporation, whether occurring in this jurisdiction or elsewhere.

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[25] *Gold Ribbon (Accountants) Pty Ltd (in liq) v Sheers* [2006] QCA 335.

[26] See *Corporations Act 2001* (Cth) ss 728, 729, 731 (prospectus liability); s 674(2A), (2B) (continuous disclosure).

[27] See Dr Austin, B 'Boards that Lead Need Better Protection' *Australian Financial Review* (21 March 2013).

(3) A director of a corporation, when acting in the capacity of director of that corporation, does not breach a duty imposed by an Affected Section, and is not exposed to liability by an Affected Section, unless it is proved by the party alleging the breach of duty or exposure to liability that:

(a) the act, conduct or omission that is alleged to constitute the breach of duty or exposure to liability was not, and did not arise out of, a business judgment made by the director in the capacity of director; or

(b) in respect of any act, conduct or omission that is, or arises out of, a business judgment made by the director in the capacity of director:

(i) the director was dishonest; or

(ii) the director had a material personal interest in the subject matter of the business judgment which has not been disclosed to the board; or

(iii) the business judgment made by the director was one that no reasonable person in that director's position could have made.

(4) In this section:

(a) **business judgment** means an exercise of judgment relating to taking or not taking action in connection with any business of the corporation;

(b) words and phrases used in this section that are given general definition in the *Corporations Act 2001* (Cth) have the meaning given to them by that Act; and

(c) **Act** includes a regulation or instrument made under an Act.

Comment

In contrast to the AICD proposal, this proposal moves beyond a mere defence by setting up a presumption of no liability for business judgments - this is similar to the way the business judgment rule operates in some parts of the United States, particularly the leading corporate law state of Delaware (where the majority of Fortune 500 companies are registered).

In Delaware, the business judgment rule involves a judicial presumption that ‘in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company’.[28] It should again be pointed out that the American business judgment rule provides considerable protection to directors. As Steinberg explains: [29]

> To attack successfully a board’s decision made under the rubric of the business judgment rule, a plaintiff must establish a culpable level of at least gross negligence. Ordinary negligence

[28] *Aronson v Lewis* (1984) 473 A 2d 805, 812 (Delaware Supreme Court).
[29] See Steinberg, M “The Corporate Law Reform Act 1992: A View from Abroad” (1993) 3 *Australian Journal of Corporate Law* 153, 161. Also see Priskich, V “A Statutory Business Judgment Rule in Australia: Proposals and Policy” (1999) 27 *ABLR* 38 at 39.

> which is the standard in a duty of care is not sufficient to impose liability when the board's decision comes within the scope of the business judgment rule.

As the Delaware Supreme Court said the 'board of directors enjoys presumption of sound business judgment; its decisions will not be disturbed by court if they can be attributed to any rational business purpose; and court will not substitute its own notions of sound business judgment.'[30] The presumption must be overcome by plaintiffs alleging breach of directors' duties, although it does not apply to decisions that are tainted by bad faith, self interest or gross negligence.[31]

The Austin / Minter Ellison Proposal is consistent with what the courts have been saying for more than a century - that it is not the role of the courts to pass judgment on honest business decisions.[32]

Indeed, the *ASIC v Rich* case in 2009,[33] the then Justice Austin (who has since retired from the bench) held that directors and officers are not liable under the duty of care for mere mistakes. The courts have consistently held that it is up to the directors to determine what is in the interests of the company, not the courts. If a business decision turns out to be the wrong decision and the company suffers loss, then unless the decision is affected by a negligent decision making process (to trigger the duty of care under s 180(1)), or the decision was tainted by bad faith or impropriety (see ss 181-183) then it is not reviewable by the courts.

This proposed reform would enshrine that principle (known as the common law business judgment rule) into statutes across the country and, unlike the current s 180(2), will clarify that the onus of proof is on the party challenging the presumption.

The elements of (3)(b) are consistent with the current s 181(1)(a) (the requirement to act in good faith) and s 191 (disclosure of material personal interests). The elements of (3)(b)(ii) are less stringent than the current statutory business judgment rule (s 180(2)(b)) which does not allow for any material personal interests, including those disclosed to the board. The elements of (3)(b)(iii) overlap with the current statutory business judgment rule in s 180(2), although the element of being reasonably informed (s 180(2)(c)) is absent. The proposed standard of reasonableness is tougher than the current s180(2)(d) which requires a rational belief that the judgment was in the best interests of the corporations.

3. OPTIONS

Both reform proposals strike at core corporate governance issues and raise basic questions - namely, what is the role of the board and what degree of latitude should the board be given to discourage an overly conservative approach to business decision making?

The two proposed defences, highlighted above, offer contrasting visions of how directors' actions should be regulated, and what they should be accountable for. This is an issue worthy of further discussion.

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[30] *Sinclair Oil Corp v Levien* (1971) 280 A 2d 717 (Delaware Supreme Court).

[31] See *Aronson v Lewis* (1984) 473 A 2d 805; *Smith v Van Gorkom* (1985) 88 A.2d 858 (Delaware Supreme Court). See further Schipani, C, "Defining Corporate Director's Duty of Care Standard in the United States and Australia" (1994) 4 *Australian Journal of Corporate Law* 152, 167.

[32] See for example, *Re Suburban Hotel Co* (1867) LR 2 Ch App 737; *Re Smith and Fawcett Ltd* [1942] Ch 304; *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483. See further, Hargovan A and Harris J, 'For Whom the Bell Tolls: Directors' Duties to Creditors after Bell' (2013) 35 *Sydney Law Review* 433 at 448-449.

[33] *ASIC v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229.

The AICD proposal appears to fundamentally alter the current enforcement and accountability framework underpinning the Corporations Act and the ASIC Act. It appears to significantly dilute the standard of conduct currently expected of directors in Australia.[34] In the context of corporate law, as noted by the Treasury Paper (2007),[35] the standard of conduct states how directors should conduct a given activity or make a decision. However, whether such a lowering of standards would be in line with community expectations and in the best interests of good and modern corporate governance principles, is questionable.

The Austin/Minter Ellison proposal, though broader because it would apply to all statutory obligations imposed on directors, appears to be relatively more modest in its impact on existing law.

Overall, it represents a slight watering down of the existing law but is an improvement on the current statutory business judgment rule by removing the current onus of proof on directors. In addition, it aims to overcome the issue of not only limiting the protection to 'business judgments', a concept that can hardly be defined with precision.

The fact that it applies to all statutory duties of directors may adequately address the concerns that have been circulating for the past 20 years regarding an overreaching of liability rules.

Both sets of proposals, however, have this much in common - they both advocate an expansion of the statutory judgment rule from its current limited sphere of operation which is confined to duty of care issues and the restrictive meaning of 'business judgments'.

Based on the discussions in the Treasury Papers (2007; 2010) and in light of the market led initiatives for law reform on directors' liabilities, we think it is appropriate for parliament to explore 2 main law reform options:

- reform of the limited operation of the business judgment rule in its current form under s 180;
- the introduction of a general defence applicable to all aspects of director liabilities under statute law.[36]

The necessity arises from the need to strike a balance between keeping directors accountable and allowing them to make risky decisions, which plainly the AICD believes is lacking. The competing models discussed above illustrate the challenges presented for law reform but these are not, in our view, insurmountable.

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[34] *Corporations Act 2001* (Cth), s 180(1)); *Daniels v Anderson* (1995) 37 NSWLR 438. The statutory duty of care and diligence imposes a standard essentially the same as that under common law: *ASIC v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229.

[35] *Review of Sanctions in Corporate Law* - Roundtable Paper 1 (2007), The Treasury, Commonwealth of Australia at [2.2].

[36] For examples of the wide exposure faced by directors for the companies breaches of law, based on derivative liability, see Bednall T and Hanrahan P, 'Officers' Liability for Mandatory Corporate Disclosure: Two Paths, Two Destinations?' (2013) 31 *Company & Securities Law Journal* 474; Herzberg A and Anderson H, 'Stepping Stones – From Corporate Fault to Directors' Personal Civil Liability' (2012) *Federal Law Review* 40, 181. For collection of judicial authorities adopting the stepping stone approach to director liability, see Australian Institute of Company Directors - A Proposal for Law Reform: *The Honest and Reasonable Director Defence* (AICD, Sydney, August 2014) at p 8. See references in note 4 for additional reasons in support of consideration for a general defence.

4. CONCLUSION

The critical issues raised in the Treasury Papers (2007; 2010), and in the law reform proposals highlighted above, provides compelling reasons for a closer look on the necessity, nature and scope of any reform in the area' of protection against director liabilities for breach of duties.

The necessity to do so has already been strongly signaled by the market in taking the lead to advance law reform proposals based on director liability concerns. Should this premise be accepted, it is reasonable to conclude that the debate has moved on and the focus should now lie on the nature and scope of reform.

At the least, Parliament is urged to consider a reassessment of the operation of the statutory business judgment rule. This task, ideally, should be undertaken as part of a broader consideration on the need for a general statutory defence to protect against director liability. It is trite to observe that such a move will not only potentially benefits those at the coalface, but the nation as well by discouraging risk-averse behaviour and stimulating economic growth.

CAMAC, with its body of expertise and excellent track record in delivery of influential and significant law reforms of benefit to the Australian economy, would be the ideal reference -except that the government, regrettably, has taken action to abolish it.[37] There is a valid and compelling case to be made for the government to rethink its proposed abolition.[38]

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[37] See Exposure Draft Bill, *Australian Securities and Investments Commission Amendment (Corporations and Markets Advisory Committee Abolition) Bill 2014* - available at http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2014/CAMAC/Key%20Documents/PDF/Exposure_Draft_CAMAC_Abolition.ashx

[38] See Georgia Wilkens, 'Abolishing of Corporations and Markets Advisory Committee' *Sydney Morning Herald* (14 June 2014) – available at http://www.smh.com.au/business/abolishing-of-corporations-and-markets-advisory-committee-20140613-3a2uc.html

CORPORATE LAW TEACHERS SUBMISSION ON INSOLVENCY LAW REFORM

Executive summary
We recommend that the Joint Committee review:

1. How Australia's corporate insolvency laws can better facilitate and support restructuring and corporate rescue, including:
    a. Review of Australia's insolvent trading laws (including the provision of a safe habour defence for genuine restructuring)
    b. Protecting businesses involved in restructuring from contractual termination clauses (ipso facto clauses)
2. Whether Australia needs a more nuanced set of insolvency procedures to deal with the different needs of large and small businesses in financial distress and insolvency
3. How illegal phoenix activity can be identified and addressed across government agencies

Insolvency Law Reform: Facilitating restructuring and corporate rescues

Corporate insolvency law has traditionally been focused on providing an efficient realization of an insolvent company's assets to provide for distributions to creditors. Most insolvent businesses operated within a domestic market and had large fixed asset bases of equipment that were subject to security provide by a single bank or a small group domestic banks. Modern business operates within a global market for capital, products and services. Corporate credit arrangements are a mix of several levels of secured creditors, often maintaining complex financial contracts involving a range of exotic derivatives and inter-creditor agreements. The decline of domestic manufacturing and the rise of the services sector (particularly professional advisory and financial services) has meant that the asset base of most businesses is not based on owning large pieces of equipment that are subject to bank mortgages. Businesses depend increasingly on human capital, intellectual property and intangible assets. Services and advisory businesses depend on maintaining key contracts with customers and suppliers for their viability. Traditional insolvency law is not suited to this environment as the appointment of an insolvency practitioner will result in the termination of contracts and the departure of key employees. Traditional insolvency law does not easily facilitate restructuring and corporate rescue attempts.

The debate about insolvency law has shifted around the world to focus on attempting to save businesses before they become terminally distressed and enter formal insolvency proceedings. Corporate rescue laws in most of Australia's major trading partners and neighbours in the Asia Pacific, including China, Hong Kong, Singapore, North America and the UK have recently revised their corporate insolvency laws, or are currently reviewing their laws, to facilitate restructuring rather than focusing mainly on dealing with insolvent companies. Australia has not undertaken a major revision of its corporate insolvency laws since the implementation of the Harmer Report in 1992.

Australia's corporate insolvency laws need an urgent review to focus on restructuring, turnaround and corporate rescue. Issues that require particular attention are insolvent trading for directors (which discourages participation in a workout/restructuring), a safe harbour for personal liability and the treatment of contractual terms that terminate on insolvency (so called ipso facto clauses) that rip value out of business upon formal insolvency. These issues have strong support for change from the insolvency profession and from the banking, credit and financial services industries. We note that the Australian Restructuring Insolvency and Turnaround Association (ARITA) and the Turnaround Management Association have been advocating these reforms for the past 4 years (since the

Treasury's aborted Safe Harbour for Insolvent Trading review in 2010), with ARITA releasing a major law reform discussion paper on 15 October 2014.

One-size fits all no longer works

Australia's insolvency laws are largely based on a one-size-fits all model under voluntary administration, liquidation and schemes of arrangement. The current insolvency mechanisms impose a substantial cost structure on insolvent companies. Liquidations typically cost at least $15,000 or more, and voluntary administrations typically cost at least $50,000 or more. This makes getting good insolvency advice very difficult for small and micro businesses.

There are a large number of liquidations that are assetless (driven by enforcement from government revenue authorities) with the amount of unfunded work done by insolvency practitioners estimated at $48 million per year (estimated by a report by the Insolvency Practitioners Association-now ARITA, in 2012). There are many businesses that literally cannot afford to enter insolvency proceedings if not pushed into proceedings by the ATO or ASIC. This results in an unknown number of assetless, non-functioning zombie companies sitting in the economy. There is widespread illegality that goes unreported due to the lack of scrutiny by liquidators or ASIC within this space. Concerns about the use of insolvent companies for money laundering, drug trafficking and other illegal activities are widespread within the insolvency practitioner community.

There is strong support within both the business and insolvency communities for a faster and more streamlined insolvency procedure that will allow for low asset/no asset liquidations. A streamlined procedure will also benefit insolvencies that are essentially single asset sale processes. This is provided for in other regimes, such as the judicial sale process in the United States and pre-pack procedures in the UK.

Finally, the voluntary administration regime that currently operates in Pt 5.3A of the Corporations Act 2001 (Cth) makes no distinction between small, medium, large and enormous insolvencies. This necessitates several court applications for larger and more complex matters, which drives up costs and slows down the process. It also means that smaller companies are subject to a range of procedural and reporting obligations that may not provide value for creditors. Other insolvency regimes such as Canada, the US and the UK provide a more nuanced approach with specific procedures for large and small insolvencies.

Curbing illegal phoenix activities

The current insolvency enforcement regime is based largely on private enforcement by liquidators and supervision of liquidators by ASIC. This system contains a fundamental flaw that liquidators typically have little funds to investigate or pursue delinquent directors so their role involves mostly superficial reporting, based on a checklist, tick a box procedure. ASIC receives thousands of reports from liquidators each year and yet very few actions are taken in respect of these reports. ASIC frequently requests further information, but there are no funds available to pursue further investigations. ASIC's enforcement role on directors of insolvent companies is focused mostly on compliance matters-have they completed the correct forms on time? This is demonstrated by the enforcement reports issued by ASIC that focus on 'small business compliance' matters where low level administrative and criminal sanctions (fines) apply. ASIC brings very few insolvent trading cases and rarely exercises its banning powers-at least based on what it reports to the public.

There is a clear need to see curbing illegal phoenix activity as more than a mere compliance issue. There is a need for a whole of government approach to address criminal phoenix activity across the economy, with the building and construction and labour hire industry particularly prominent in this area. This task is too big for ASIC alone, because it has a broad range of other responsibilities. A specialist team is needed that includes, ASIC, AFSA, ATO and Fair Work officers to address the problem.

We also advocate initiatives to harmonise insolvency laws by creating a single insolvency regulator whose sole focus is on insolvency reporting, investigations and enforcement rather than dispersing these functions throughout levels of government agencies.

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Parliamentary Joint Committee on Corporations and Financial Services
Rethinking national corporate regulatory systems in a global economy
Paul Redmond AM, Sir Gerard Brennan Professor, Faculty of Law, UTS

The regulatory challenge

1. In 1974 the Senate Select Committee on Securities and Exchange recommended that the national economy that had emerged required national regulation of corporations and securities markets. Labour, environmental and consumer standards now regulate business activity across Australia; however, their beneficial effect in preventing the externalization of social cost stops at its borders.

2. Over the past three decades, however, the economy has globalized—business, especially manufacturing, operations have moved offshore and trade, investment and currency flows have been thoroughly liberalized. Global production systems source components and locate stages of production to sites of lowest effective cost. Firms are part of supply chains operating as global networks crossing national boundaries. The components of these international production networks are highly mobile and relatively easily transferable. Price competition puts strong downward pressure on labour conditions and other social protections for workers and others affected by operations. The threat of investment flight to a more accommodating jurisdiction is a constant for developing countries. The mobility that globalisation gives to foreign direct investment, in the context of a competitive auction for investment capital, undermines host state capacity to enforce social protection and standards since these invariably impose costs for firms. Human rights problems are ubiquitous in the modern supply chains in which most levels of Australian business are engaged: few Australian companies today do not confront human rights problems.

3. There is no global regulatory mechanism for the new global economy; national regulation is all. Home states do not, with few exceptions, regulate the offshore operations and business relationships of their locally incorporated and headquartered firms; that responsibility is left to host states. The investment appeal of these host states—the relative poverty of their populations—is invariably matched by the poverty of their governance and social protection mechanisms, and perverse local incentives that militate against amelioration. The beneficial effects of our national regulatory are wholly absent from the production of the bulk of the consumer goods and many other products that Australians enjoy.

4. Investment liberalisation increases financial performance pressure upon managers. The threat of displacement by hostile takeover and pressure from institutional investors focused on financial return sharpens the profit focus. Institutionalization of investment adds a second level of fiduciary focus on financial return. It is fanciful to think that capital will protect labour and the environment—that is not its function; its incentives are otherwise.

5. Should this problem concern the committee? Consumers benefit from global supply chains even if at the cost of local jobs lost offshore. And offshore production is an undoubted boon to many of its workers, given the alternative of grinding poverty. Yet the considerations that ground our regulation of Australian firms—the freedom, dignity and social welfare of our citizens—do not end, as our regulation does, at national borders. They apply equally to all humanity. The challenge is to globalize our system of corporate responsibility and extend its beneficial effect to others affected by the operations and business relationships of our firms.

Options for globalizing corporate responsibility

6. Several options are available for doing so. I shall canvass some in what I judge to be the ascending order of feasibility and/or moral obligation.

7. There is currently a process in the UN Human Rights Council leading to consideration of a binding treaty on business and human rights. Support for the process is divided sharply along OECD membership lines: none of the 20 votes cast for the resolution in June 2014 came from OECD members and 12 of the 14 opposing the resolution were OECD adhering governments. Treaty ratification would, of course, be voluntary and a modest level of ratification might be anticipated from home states of major firms if the proposal led to a treaty. There are also formidable problems with such a treaty—the rigidity of its terms, effective implementation and enforcement.

8. The OECD might itself be the vehicle of collective action by developed states to extend the protection of their national systems. The OECD *Guidelines for Multinational Enterprises* are a voluntary standard of responsible conduct addressed to firms operating from and in these states; a mediation mechanism of uneven quality is provided through National Contact Points. Pressure from the United States, which had acted unilaterally in 1977 to criminalise corrupt corporate payments to foreign public officials, led to the OECD adopting a binding corruption convention in similar terms. There is no current movement in the OECD for prescriptive standards to replace the voluntary *Guidelines*.

9. Unilateral national action by a host state is another possibility. The US *Foreign Corrupt Practices Act* 1977 is the striking exception to the almost universal reluctance to regulate offshore corporate activity and relationships although in the UK the *Bribery Act 2010* and the *Modern Slavery Bill 2014* are recent further exceptions of specific application. In Australia, a predecessor committee to the PJC judged an Australian Democrats Bill to regulate offshore conduct of Australian firms to be “unnecessary and unwarranted”.[39]

10. The United Nations has endorsed non-binding corporate responsibility standards that are claimed to enjoy wide business support. The Human Rights Council’s ‘Protect, Respect and Remedy’ framework for business and human rights includes the pillar that all business enterprises have a responsibility to respect the human rights of those affected by their activities and business relationships (RtR). In 2011 the Council endorsed the *Guiding Principles on Business and Human Rights* (*Guiding Principles*) to operationalize the framework. A UN Working Group has been established to promote their implementation and the OECD *Guidelines* have been amended to include the responsibility to respect (RtR) standard.

11. The ‘Protect’ pillar of the *Guiding Principles* is directly relevant to legislators, regulators and oversight bodies of national corporate systems. Expressing international law principles, the pillar requires states to protect against human rights abuse within their territory by third parties, including business enterprises. It also requires states (and this obligation applies to home as well as host states) to set out clearly the expectation that all business enterprises domiciled in their territory respect human rights throughout their operations. In meeting their duty to protect, states should ensure that laws and policies governing the creation and ongoing

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[39] Parliamentary Joint Statutory Committee on Corporations and Securities, Parliament of Australia, *Report on the Corporate Code of Conduct Bill 2000* (2001), [3.3], [4.4]-[4.6].

operation of business enterprises, such as corporate law, do not constrain but enable business respect for human rights. They should also provide effective guidance to business enterprises on how to respect human rights throughout their operations and should encourage, and where appropriate, require, business enterprises to communicate how they address their human rights impacts (*Guiding Principles* 1-3).

12. The *Guiding Principles* stress the importance of national corporate and securities law to promote the RtR and the difficulties often presented by national systems:

    Laws and policies that govern the creation and ongoing operation of business enterprises, such as corporate and securities laws, directly shape business behaviour. Yet their implications for human rights remain poorly understood. For example, there is a lack of clarity in corporate and securities law regarding what companies and their officers are permitted, let alone required, to do regarding human rights. Laws and policies in this area should provide sufficient guidance to enable enterprises to respect human rights, with due regard to the role of the existing governance structures such as corporate boards.

    Guidance to business enterprises on respecting human rights should indicate expected outcomes and help share best practices. It should advise on appropriate methods, including human rights due diligence, and how to consider effectively issues of gender, vulnerability and/or marginalisation, recognising the specific challenges that may be faced by indigenous peoples, women, national or ethnic minorities, religious and linguistic minorities, children, persons with disabilities, and migrant workers and their families.

13. Australian corporate law needs be compatible with and, ideally, hospitable to the *Guiding Principles*, and not an impediment to their internalisation. Areas of significant concern include the following:
    - The scope of the licence under directors' duties to respond to the RtR when profit-sacrificing;
    - The separate legal entity principle and limited liability within corporate groups especially with respect to parent company responsibility for human rights abuses by subsidiaries and affiliates;
    - The entitlement of shareholders to raise RtR concerns at AGMs;
    - Clarification of financial reporting requirements concerning human rights impacts especially around standards of "materiality" or "significance" to the economic performance of the business enterprise; and
    - The corporate associations restrictions under takeovers law in exercise of the corporate responsibility to use leverage to prevent or mitigate adverse human rights impacts (cf Guiding Principle 19(b)(ii)).

    The writer hopes to canvass these concerns in discussion with the PJC.

14. A consensus resolution passed at the June 2014 session of the Human Rights Council specifically called on states to ‘take steps to implement the Guiding Principles, including by developing a national action plan or other such framework’. Australia was a signatory to this resolution. Denmark, the Netherlands and Britain have developed NAPs and draft plans are

in preparation in a number of other states. Australia has made no commitment to a plan and there appears no present appetite for one. That appears to be a lost opportunity.

Paul Redmond
15 October 2014

Parliamentary Joint Committee on Corporations and Financial Services: Briefing paper on Corporate Disclosure Regulation

Gill North – Associate Professor, Law School, University of Western Australia.

> *Great companies exist only because they are created and safeguarded by our institutions; and it is our right and our duty to see that they work in harmony with these institutions. The first requisite is knowledge, full and complete; knowledge which may be made public to the world.*[40]

The audience that public companies interact with today is extensive, including shareholders, analysts, creditors, employees, trade unions, industry associations, rating agencies, environmental groups, academics, researchers, public bodies, regulators and so forth. Hence company disclosure is no longer about merely sending an occasional report to shareholders. Companies must communicate with their many stakeholders in a clear, concise and effective manner. Comprehensive and timely disclosure is vital for the health of corporations and financial markets, and to maintain sustainable and competitive national and global economies. Most jurisdictions, including Australia, have established disclosure regimes applicable to listed companies, including periodic reporting obligations, and rules requiring timely disclosure of material information between reporting periods. The International Organization of Securities Commissions (IOSCO) indicates that the primary rationales for company disclosure regimes are protecting investors, ensuring that markets are fair, efficient and transparent, and reducing systemic risk.[41]

The quantity and quality of listed company disclosure in Australia is highly variable. The required regularity and mandated content of the periodic reports (beyond the financial statements) is significantly less than in other jurisdictions such as Canada and the United States (US). The mandated management discussion and analysis (MD&A) in the half year and preliminary final reports is general in nature, leaving companies with broad discretion around their content and tone. The MD&A is often poorly framed and disconnected from the financial statements and reported result. Substantive or adequate content is often lacking, particularly tailored risk disclosures and performance analysis and commentary on long-term trends. Yet as IOSCO notes, financial information in periodic reports is the core information around which related information, such as MD&A of the historical results and prospects, should be framed.[42] The form in which information is provided in periodic reports is discretionary and the timeliness of these reports is problematic. There is no quarterly reporting obligation and the final year reporting processes are not as efficient and equitable as they should be. At present, most listed companies report their fully year results on a preliminary basis with minimal financial notes and

[40] Theodore Roosevelt, State of the Union Message to Congress (3 December 1901).

41 International Organization of Securities Commissions, *Objectives and Principles of Securities Regulation* (June 2010) 3.

[42] Technical Committee of the International Organization of Securities Commission, *Principles For Periodic Disclosure By Listed Entitles* Final Report (February 2010) 4.

MD&A. The annual reports contain more comprehensive notes and some MD&A, but these reports are typically released a month later, by which time the report content is generally no longer materially price sensitive.

All modern governments should ensure there are efficient and fair mechanisms to enable individuals to manage their own savings and retirement plans when they elect to do so and can satisfy legal requirements. Many governments, including Australia, will not have sufficient capacity to provide pensions to all constituencies, and an increasing number of people will have to independently fund their retirement. Hence financial market structures and policies that facilitate and encourage individuals to engage and assume at least partial control over their personal savings and retirement plans are become increasingly important. However, investors and savers can only achieve a degree of control over their financial futures when meaningful information is provided at all levels of the savings chain. Notably, listed companies sit at the centre of financial markets and provide the richest and most important primary source of information, which is used by both financial intermediaries and direct investors.

The primary purposes of the Australian corporate disclosure regimes should be revisited, with a particular focus on the integrated framework, and the nature and scope of information publicly available. Company information needs to be released through non-discriminatory public channels in order to sustain broad market participation and vigorous competition. The most relevant and reliable information on publicly listed companies is provided in periodic reports and information released continuously between reporting periods, and these regimes are intended to be complementary. The integrated company disclosure framework only achieves its intended purpose when publicly available information is sufficiently regular and detailed to enable all persons with a warrantable interest to make well-informed decisions throughout a financial year.

Accordingly, I propose the following:

- A reconsideration of the role and purposes of the periodic reporting and continuous disclosure regimes in Australia;
- A reconsideration of how to effectively integrate the periodic and continuous disclosure regimes;
- An examination of the efficacy of the integrated disclosure framework from a user’s perspective;
- The introduction of unaudited quarterly reporting;
- The introduction of standard form periodic reporting;
- Enhanced MD&A reporting rules, which require mandatory tailored risk disclosures and long-term performance reviews within periodic reports;
- Clarity around the purpose and content of annual reports;
- A merger of the final year reporting processes (i.e. the preliminary final and annual reports), so that all participants are provided with complete information on a broadly equal basis.

BACKGROUND TO THE PROPOSALS

Comparative Research

My research has reviewed the national disclosure structures that apply to companies listed on major global exchanges in the United States (US), Canada, Germany, the United Kingdom (UK), Japan, Hong Kong, Australia, and Singapore. It has considered interdisciplinary empirical studies by finance, accounting, economics and legal scholars, disclosure review programs, and a sample of listed company reports, disclosures and websites across the selected countries. It uses the empirical studies to provide evidence on disclosure practices. It draws on disclosure reviews by regulators to identify common disclosure issues that arise and provide useful feedback and insight on processes and measures to improve company disclosure standards. It examines listed company reports, disclosures and websites to identify and discuss commendable reporting and communication practices for consideration when establishing a best practice company disclosure framework.

Why Are Mandatory Company Disclosure Frameworks Necessary?

Louis Brandeis famously stated more than a century ago that the potent force of publicity should be used as a continuous remedial measure in the impending struggle for real and useful disclosure within financial markets.[43] While it is easy to espouse the benefits of public transparency and accountability in financial markets, these goals have to be sought by every nation and community. Effective company disclosure frameworks are difficult to develop and maintain. Disclosure regimes are highly political, and power imbalances mean the strength and efficacy of disclosure regimes tend to be diluted over time.[44] Company disclosure policies and practices are generally determined as a result of political compromise.[45] Each constituency uses democratic processes to lobby for a regulatory environment that puts it in the best position.

Incentives are also a critical element of corporate disclosure frameworks. Disclosure issues generally arise when company managers and directors are reluctant to explain a company's position in plain terms to the world at large. Public company directors and managers naturally want to present company developments with which they are associated in the best possible light. Compelling monetary and personal incentives cause them to try to restrict or delay public dissemination of information when the content is negative, when public disclosures may reflect poorly on management, or when there are conflicts of interests. The largest institutions are clearly incentivised to obtain information privately in order to gain knowledge advantages vis-à-vis other participants. The groups in the most vulnerable position are small institutional or retail investors, and those in the community who are, or may be, adversely affected by corporate developments. These participants must generally rely on public disclosures and are the least likely to get timely access to all material information. It is difficult to overstate the importance of a continued presence of direct investors in financial markets. These participants assist to keep financial markets competitive, responsive and dispersed. They also form a critical segment of the

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[43] Louis Brandeis*, Other People's Money* (1914) Ch V.

[44] See Archon Fung, Mary Graham and David Weil, *Full Disclosure: The Perils & Promise of Transparency* (Cambridge University Press, New York, 2007) 125-126.

[45] Ibid 7.

market that competes with asset managers and other financial intermediaries, thereby ensuring that intermediaries provide options for end savers that are cost effective and valued.

What Do Effective Company Disclosure Frameworks Matter?

The primary purpose of financial exchanges and markets is to enable intermediation between listed entities seeking capital and savers with excess capital. Holistic analysis of disclosure regimes includes the costs and benefits of these regimes, and the comparative outcomes and costs that result from, or are associated with, disclosure omissions or deficiencies. It is important to understand the difference between who benefits from poor transparency and a lack of public scrutiny mechanisms in financial markets, and who bears the cost. The economic and social costs that arise in financial markets with ineffective disclosure regulation are too often forgotten.

Interdisciplinary scholarly research consistently suggests that superior corporate and economic outcomes are associated with enhanced company disclosure standards, high levels of transparency, broad and diverse market participation, effective legal protection for minority shareholders, investor confidence, and public trust.[46] As a whole, the empirical research points to compelling commercial, economic and social imperatives for effective corporate disclosure frameworks.

Tensions between Public and Private Disclosure Models

Company disclosure regimes in modern financial markets can essentially be characterised as emphasising, or giving preference to, either a public or private model. These models reflect the tensions between (a) financial market structures dominated by large financial institutions and intermediaries and (b) long-established aspirations for markets that are fair, efficient and transparent for all participants. Rapid increases in the absolute and relative levels of equity trading and ownership by large global institutions (with corresponding increases in institutional influence and power) feed into continued demands for a weakening of public communication models. However, when countries permit senior executives and asset managers to engage with selected participants behind closed doors on a regular basis, this promotes distinctly tiered disclosure channels and can result in weak public disclosure frameworks. Empirical research suggests that countries that allow listed companies to publicly disclose only limited and filtered information are unlikely to produce optimal long-term corporate or national outcomes.

Digital advances have radically changed modern communication models and the way that companies, investors, and stakeholders should interact and compete. Global communities and modern financial markets have embraced technological change, and entire populations are increasingly dependent on digital interfaces. To remain relevant and credible, corporate disclosure and the associated regulatory frameworks must reflect these momentous societal changes. The primary tests of effective company reporting and communication in contemporary markets include the ease with which information can be sourced and downloaded electronically, the quality and timeliness of publicly accessible company reports and disclosures, and the

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[46] See e.g., Gill North, *Corporate Communication in the 21st Century* (Kluwer Law International, The Hague, 2015) forthcoming. The book provides summary outlines of the many bodies of empirical research that examine company disclosure.

adequacy of online facilities and forums that allow interactive dialogue between companies, shareholders and other stakeholders.

What are the Elements of an Effective Disclosure Framework?

Company disclosure structures only achieve their intended purposes when publicly available information is sufficiently comprehensive and timely to enable well-informed decision making. As a spokesman for the Association for Investment Management and Research suggests, the 'voice of the investor has for too long been marginalized in the debates on financial reporting ... [Investors] need … regular, comprehensive reporting of financial information … They need it in accepted formats … based on generally accepted accounting standards …'[47] Listed companies have made large cost savings during recent decades from regulatory changes that permit electronic dissemination of reports. Some of these savings should be redirected to enhance the quality of publicly available company information, including the provision of information on a layered basis[48] to enable all interested persons to access the type and level of information they require.

My comparative research and analysis found that there are substantive differences between the periodic reporting rules and practices in the US and the rest of the world. The US was the first country to establish comprehensive company disclosure rules and standards in the 1930s. While its disclosure structure is not perfect, it has an admirable clarity of purpose. Section 2 of *Securities Exchange Act* of 1934 indicates that 'transactions in securities as commonly conducted upon securities exchanges … are effected with a national public interest, which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including … to require appropriate reports …'. In addition, s 2 of the New York Stock Exchange (NYSE) Listing Manual states that the disclosure rules are intended to '[e]nsure timely disclosure of information that may affect security values or influence investment decisions, and in which shareholders, the public and the Exchange have a warrantable interest.' Thus the explicit goal of securities regulation in the US is to enhance the national public interest. Further, the public sphere is the intended audience of disclosures made by NYSE listed companies. This is a sound framework for considering the effectiveness of existing disclosure law and practice.

Publicly available company information should be in a form that allows comparative analysis. The US has used periodic reporting templates for many decades; Form 10-K is used for preliminary full year reporting, and Form 10-Q is used for quarterly reporting. The financial statements in the 10-Ks and 10-Qs are supported by comprehensive MD&A and financial notes and all of the financial content must be reported in compliance with accounting standards. The MD&A includes a tailored outline of the company's strategies, performance, risks, and opportunities. These periodic reports are completed as standard forms that allow comparative company, sectoral and market analysis. Companies must complete all of the form sections

[47] Chartered Financial Analysts Institute, *European Investment Professionals Back Quarterly Reporting* (20 November 2003).

[48] Layered disclosure is disclosure in segments, with information presented in varying forms and detail to suit a broad audience with differing interests, time constraints, knowledge and ability.

(including commentary on the recurring and non-recurring elements of the reported result), thereby ensuring comprehensive information is presented on a consistent basis each reporting period. The content of these reports is well focused and uncluttered because the Securities and Exchange Commission (SEC) does not permit companies to include pictures, disconnected commentary, or marketing material. Relevant information is easily located because the reports contain an electronic table of contents and use standardised headings, and they are formatted in single online pages. All of these mandated reports can be readily accessed and downloaded from the SEC maintained Electronic Data Gathering, Analysis, and Retrieval System (commonly referred to as EDGAR).[49] This standardised reporting framework enables all participants and stakeholders to engage in comparative analysis of individual companies, sectors, and financial markets. Supervision of the company disclosure framework by the SEC is also consistent and comprehensive. The SEC seeks to promote public disclosure as the primary means of corporate communication in the US, and it unashamedly directs companies to provide comprehensive and timely information to enable all interested persons to assess a company's performance and value its securities. To summarise, periodic disclosure regulation in the US encompasses the following features:

- Preliminary full year reporting on Form 10-K and quarterly reporting on Form 10-Q;
- 10-Ks and 10-Qs that include a full set of financial statements, comprehensive MD&A, and detailed financial notes (all of which comply with accounting standards);
- Content in the 10-Ks and annual reports that is broadly consistent;
- Form 10-Ks that include five year financial performance tables; and
- Regular reviews of company reports and disclosures by the SEC.

While disclosure structures outside of the US reflect some of these features, no other national company disclosure framework is as integrated, comprehensive or transparent. Other jurisdictions have elected to take a "lighter touch" approach with respect to corporate disclosure regulation and practice. Moreover, the gap between disclosure standards and practices in the US and those in other jurisdictions, including Australia, continues to widen. While claims are made that transparency in financial markets has become a regulatory mantra and that investors are being overwhelmed by information,[50] reviews of periodic reports and continuous disclosures reveal that, in practice, available listed company information is often relatively sparse, sanitised and dated.[51] All jurisdictions are encouraged to follow the US disclosure model as global best practice.

Conclusion

In order to work effectively, company disclosure frameworks need to be driven by clear objectives and principles that are consistently applied. These frameworks work best when listed

[49] See SEC, *SEC Filings And Forms (EDGAR)* at http://www.sec.gov/edgar.shtml (last visited 14 June 2013).
[50] See, e.g., The Kay Review of UK Equity Markets and Long-Term Decision Making: *Final Report* (July 2012)(Final Report) 70 <http://lawcommission.justice.gov.uk/docs/kay-review-of-equity-markets-final-report.pdf> (last visited 14 June 2013).
[51] The author has reviewed company disclosure regimes in each of the jurisdictions discussed. She has also read and analysed company reports and disclosures from around the world for more than thirty years as a scholar, institutional analyst and retail investor.

companies adopt a normative culture of continuous public disclosure. Such cultures are only possible when directors and senior executives acknowledge the substantial benefits derived from timely and frank communication about company developments and performance. Long-term benefits are only derived from corporate disclosure regimes if there is broad participation, investor confidence and continued public trust in the integrity of financial markets. Such confidence is generated by giving legal weight to principles and rules that provide all participants with a right to comprehensive information on a timely basis, and that ensure minority shareholders rights are protected and market misconduct is enforced.

All nations should recommit to strong public disclosure frameworks as the primary means of listed company communication and engagement. Individual countries and the global community need to acknowledge that public scrutiny and accountability of large corporations is critical, and that disclosure structures serve long-term national interests. The Global Financial Crisis, and continuing economic and financial challenges in some parts of the world, serve as a stark reminder that the health of modern financial markets, real economies and people's lives are closely interconnected. Strong and concerted commitment to established disclosure frameworks is required so that aspirations and statements about financial market transparency and informed decision-making do not become mere platitudes.