CLERP INFORMATION REFORMS — TINKERING AT THE EDGES

JULIAN BLANCHARD†

I INTRODUCTION

As corporate lawyers and teachers we are immersed in and part of the information society. Our professional tasks centrally involve us in digesting, interpreting, generating and communicating information. To such an audience it seems unnecessary to persuade about the importance and power of information. However and more centrally in corporations, to quote from the Lavarch Committee:

> The examination of information released by a company is a principal means by which shareholders determine the performance of directors and hence ascertain if the directors are acting in the best interests of the Company. The availability of accurate and timely information on the financial position of companies is fundamental to informed judgement by shareholders about their investments.[1]

The current government's Corporate Law Economic Law Reform Program (CLERP) has not set aside corporate information as a discrete topic for its consideration. However within the extensive reforms promulgated or proposed as part of CLERP the information corporations must provide to shareholders in various situations is certainly tackled.

There are currently two phases of CLERP. The first was the enactment of the *Company Law Review Act 1998* (Cth) ('*Review Act*') which came into effect on 1 July 1998. The second is the Corporate Law Economic Reform Program Bill 1998 (Cth) (CLERP Bill) which was reintroduced into parliament on 3 December 1998.[2] The CLERP Bill has been referred to the Parliamentary Joint Committee on Corporations and Securities for inquiry and report by 22 April 1999. The *Review Act* altered and the CLERP Bill proposes to alter the information that corporations must provide to their shareholders. This paper examines those changes.

In this paper before examining the detail of the reforms I sketch a theoretical framework from which to analyse the merit or otherwise of the reforms. This framework establishes the information needs of shareholders and also enumerates quality criteria from which to assess the disclosures which are now required. Having established a theoretical framework the paper then outlines the current disclosure regime that operates in Australia which places the current reforms in

† LLB (Hons), GDLP, PhD, admitted as a practitioner of the Supreme Courts of South Australia and New South Wales and the High Court, formerly a Lecturer at Flinders University, currently a practising lawyer with Atanaskovic Hartnell: jrb@ah.com.au. The views expressed in this article are those of the author and not necessarily those of Flinders University or Atanaskovic Hartnell.

1 Lavarch Committee, *Corporate Practices and The Rights of Shareholders* (1991) para 4.1.2.

2 The previous Bill lapsed with the calling of the Federal Election during 1998.

their appropriate context. Only then and by using these frameworks and the broader context are the reforms explained and analysed.

II THEORETICAL DISCLOSURE FRAMEWORK

Besides pass-time chat, communication is mere noise unless it is purposive. The purpose of communication is only ascertainable by analysing the relationship between speaker and audience. In formalised and structured relationships, which directors and shareholders are a typical example of, the needs of the audience should dictate the information provided by the speaker.[3] Speakers in such contexts should not be free to choose whether and what information they provide to their audience, as is common with informal relationships. Therefore it is necessary to examine who shareholders are and what their role in corporations is.

Shareholders are investors, monitors and citizens. Investors are people and institutions with sufficient funds so that they are seeking to place those funds with someone else with the expectation of making a profit. Investors become shareholders when they choose to invest in corporate shares rather than placing their money in other types of investments such as bank deposit, mortgage finance, government bonds or real estate.[4] A particular investment decision is not irrevocable. One of the hallmarks of shares is that they are private property and generally freely transferable.[5] Shareholders therefore have a fluid investment. They are vitally concerned whether to hold, increase or reduce (or quit altogether) their investment in a particular company.[6] What decision shareholders make will be based on the same types of factors that influenced their initial decision. Some of those factors relate to the value of the shares (including their current market value compared with their initial purchase price), their expected rate of return (anticipated dividend stream)[7] and the relevant transaction costs.[8] Other factors include the shareholders current financial position, the then rate of return of other

3 The teacher/student relationship is another example of a formalised relationship and education literature states that teachers should focus on the information needs of their students (called 'student centred learning'); for example see Marlene LeBrun and Richard Johnstone, *The Quiet Revolution: Improving Student Learning in Law* (1994) particularly 89–91.

4 Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (1991) 4.

5 Robert Clark, *Corporate Law* (1986) 13–15. The *First Corporate Law Simplification Act* removed the requirement on proprietary companies to restrict the right to transfer its shares (previously set out in CL s 116(a)).

6 The ability of shareholders to quit their investment is commonly used by institutional investors who are dissatisfied with the performance of a company. This is commonly called the Wall Street Rule;. See Edward Rock, 'The Logic and (Uncertain) Influence of Institutional Shareholder Activism' (1991) 79 *The Georgetown Law Journal* 445, 462–63.

7 Information about future earnings is the most predominant method of valuing/pricing shares even though other methods exist (such as the capital value of the corporations underlying assets); see Ronald J Gilson and Reiner H Kraakmann, 'The Mechanisms of Market Efficiency' (1984) 70 *Virginia Law Review* 549–61.

8 The transactions costs in the sale and purchase of shares include brokers fees, stamp duty, capital gains taxes and the value of the shareholders own time in completing the transaction.

investments, taxation implications and the state of the economy generally.[9]

Companies incorporated under the *Corporations Law* are an appropriate vehicle for such investments because that is their very purpose; they exist to make money for shareholders. Put into classical legal terminology the residual goal of corporations is to maximise profit for shareholders.[10] Shareholders are principally concerned to make a profit and that is why they have chosen to invest in 'for profit' organisations rather than other types of organisations.[11] Corporations are not the only type of 'for profit' organisation; others include partnerships and joint ventures. But other key features of corporations, such as limited liability, perpetual succession and centralised management, make them a very suitable and common vehicle for business enterprises.

Shareholders as investors are principally concerned with the financial performance of corporations. They are therefore interested in receiving quality financial information about corporations.

Shareholders are monitors because they have delegated broad and exclusive[12] powers of management to directors[13] yet retain significant powers within the corporation. The principal residual powers retained by shareholders are the appointment and removal of the directors[14] and auditors,[15] to set the director's remuneration,[16] to alter the corporate constitution[17] and to wind up the corporation even if it is solvent.[18] Given this role it is incumbent upon the shareholders to monitor the directors to ensure they act in the interests of shareholders. That is, because of the separation between ownership and control[19] the issue of the accountability of the directors arises with the shareholders necessarily cast in the role of monitors. Accountability also arises under the citizenship model and therefore it is pursued further below.

---

9 It probably is not possible to list all the factors which motivate people to make particular investment decisions. Noise theorists, who criticise the efficient capital market hypothesis, claim that investors also often make irrational investment decisions. This seems at least partially correct. See Fischer Black, 'Noise' (1986) 41 *The Journal of Finance* 529.

10 Clark, above n 5, ch 16.

11 For example one defining feature of incorporated associations is that they are prohibited from passing on any profit to their members; see *Associations Incorporation Act 1985* (SA) ss 18(5), (6) and s 55.

12 *Clifton v Mount Morgan Ltd* (1940) 40 SR (NSW) 31, 44–45; *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* (1906) 2 Ch 34; *John Shaw & Sons (Salford) Ltd v Shaw* (1935) 2 KB 113; *NRMA v Parker* (1986) 11 ACLR 1; *Queensland Press Ltd v Academy Instruments No 3 Pty Ltd* (1987) 11 ACLR 419; Easterbrook and Fischel, above n 4, 2.

13 CL s 226A and (previously) Table A clause 66. As part of the reforms under the *Review Act* the model articles in Table A were repealed. However as the vast majority of companies were incorporated prior to this time, many of whom would have adopted Table A, Table A articles remain relevant and will be referred to in this paper.

14 CL ss 224C, 224D, 225, 227, 254 and 226E, Table A cll 58–62 and Listing Rules (LR) 14.4 and 14.5.

15 CL ss 327(3), 329.

16 CL s 236A, Table A cl 63 and LR 10.17.

17 CL s 136(2).

18 CL s 491.

19 Berle and Means, *The Modern Corporation And Private Property* (1940).

Shareholders can also be regarded as citizens in a corporate democracy. It is relevant to draw from the political arena since the internal governance of companies is patterned from the democratic model.[20] As mentioned above, shareholders vote for the election of their directors and a broad range of other matters. These elections occur on a regular basis. The usual position is for one third of the incumbents (other than the managing director) to retire each year but they can immediately offer themselves for re-election.[21] The elected directors are usually granted broad discretionary powers of management the exercise of which is generally not subject to review by the shareholders. Although directors are granted the power to manage, the modern reality is that the executives manage on a day to day basis.[22] At a shareholders meeting the shareholders usually have one vote for each issued share they hold.[23] The company's constitution is the primary document which governs the internal relationship between shareholders and their directors. This document can be amended by shareholders but only by a special resolution.[24]

The parallels with the style of representative democratic governments we enjoy in Australia are obvious.[25] Using the Federal Government as an example, politicians are elected on a regular basis.[26] The elected government then has broadly defined discretionary powers[27] with no provision for formal review of their decisions by the electorate. Once again, although Ministers have overall responsibility for their portfolios it is departments staffed by bureaucrats which do the day to day work.[28] However under the principle of responsible government

---

20 Many commentators consider that an analogy can be drawn between the governance structures of corporations and political democracies; for example see Buxbaum, 'Comparative Aspects of Institutional Investment and Corporate Governance', in Baums, Buxbaum and Hopt (eds), *Institutional Investors and Corporate Governance* (1993) 4 calls it the 'direct political analogy'. Stephen Bottomley, 'From Contractualism to Constitutionalism: A Framework for Corporate Governance' (1997) 19 *Sydney Law Review* 277, 296 thinks there is 'no strict analogy' although he regards the comparison as useful with democratic notions suitable to be 'adapted', but not 'adopted', to the corporate context. See also Andrew Fraser, *Reinventing Aristocracy: The Constitutional Reformation of Corporate Governance* (1998) who accepts the political analogy and uses this as the launching pad to argue in favour of imbuing civic virtues into corporations and their participants. Earl Latham, 'The Body Politic of the Corporation' in Edward Mason (ed), *The Corporation in Modern Society* (1960) 220 argues that the corporation exhibits the characteristics common to all bodies politic, namely:

> (1) an authoritative allocation of principal functions; (2) a symbolic system for the ratification of collective decisions; (3) an operating system of command; (4) a system of rewards and punishments; and (5) institutions for the enforcement of the common rules.

See also Mary Stokes, 'Company Law and Legal Theory' in William Twining (ed), *Legal Theory and Common Law* (1986) 26–31.

21 Table A, cll 58–61; Australian Stock Exchange, LR 14.4.

22 *AWA Ltd v Daniels* (1992) 7 ACSR 759, 832–33; Frederick Hilmer, *Strictly Boardroom* (1994) 26–31.

23 CL s 250E(1)(b) — replaceable rule; LR 6.9 — at least where a poll has been demanded.

24 CL s 136(2).

25 The similarities are made by Bottomley, above n 20, 296 and n 119.

26 *Commonwealth of Australia Constitution Act 1901* ('*CACA*') ss 13, 28.

27 *CACA*, s 51, although in the case of the Federal Government these are tied to specific heads of power.

28 Barry Jones, *Sleepers, Wake! Technology and the Future of Work* (2nd ed, 1990) 174–177.

Ministers remain politically accountable to Parliament for the actions of the departments in their portfolio.[29] Also the relationship between citizens and their elected representatives is governed by a written constitution[30] which can only be amended by a special majority vote of the electors.[31]

This division between the people and their elected representatives[32] introduces the problem of keeping the representatives accountable to those who elect them and for whom they act. One of the keys to accountability is the electorate receiving information about the activities and decisions of their representatives. For the power of information has long been recognised in both the political[33] and corporate contexts.[34] In the political arena in Australia the notion of democracy has evolved to mean open government.[35] Subject to some notable exceptions, such as security, defence and international relations,[36] generally citizens under notions of open government have access to information on any topic within the political spectrum. Citizens receive information by way of voluntary disclosures from or under the authorisation/command of the government, by means of the opposition and media and by pro-actively pursuing it under Freedom of Information legislation.[37] Similarly shareholders as corporate citizens should as a general principle be entitled to information on any topic concerning the corporation. This should be subject only to appropriately justified and closely constrained exceptions. The task then is to identify those exceptions. At the least commercial-in-confidence information and trade secrets should be excluded. Other potential exceptions are possible but are likely to be subject to debate (and is a debate that is not germane to this paper). The conclusion for the purposes of this paper is that shareholders as monitors and citizens need comprehensive information concerning the corporation in order to properly acquit themselves in these roles.

The financial information regularly published by corporations partially addresses the information needs of shareholders as monitors and citizens. For the

29 Stanley A de Smith, *Constitutional and Administrative Law* (5th ed, 1985) 199–200.

30 In Australia our constitution is written; *CACA*. A written constitution also exists in the United States of America but not in the United Kingdom.

31 *CACA* s128.

32 In corporate law commonly referred to as the separation of ownership and control. See Berle and Means, above n 19.

33 Jones, above n 28, 178 who states '[k]nowledge is power and access to information is analogous to access to power'. See also the Senate Standing Committee on Constitutional and Legal Affairs, *Freedom of Information* (1979) [3.4], [3.7]–[3.14].

34 'Sunlight is the best disinfectant, electric light the best policeman', Louis Brandeis, *Other Peoples Money and how the Bankers Use it* (1914) 92; Lois Loss, 'Disclosure as Preventive Enforcement' in Hopt and Teubner (eds), *Corporate Governance and Directors' Liabilities* (1984) ch IV; Lavarch Committee, above n 1.

35 *Commonwealth of Australia v John Fairfax & Sons Ltd* (1980) 32 ALR 485, 492–93 (Mason J); Australian Law Reform Commission and Administrative Law Council, *Open Government: A Review of the Federal Freedom of Information Act 1982* (1995) 11–13.

36 See, for example, the exceptions to disclosure under the *Freedom of Information Act 1982* ('*FOI*') (Cth) ss 33–36.

37 *FOI*. *Freedom of Information Acts* also exist in Vic (1982), NSW (1989), ACT (1989), SA (1991), Qld (1992) and WA (1992).

directors are appointed to successfully manage corporations and generate profits for shareholders and the financial statements record the financial performance and position of the corporation. Certainly the financial statements provide very pertinent information but within a very narrow range. They provide a historical snapshot of a company's financial performance and cash flows over a certain period and its assets and liabilities as at a certain date. Traditionally this was, and overall still is, regarded as the only information needed to assess the performance of the managers. However there is an increasing body of literature that questions this.[38] These authors argue for a broader range of information to be regularly published in order to better and more directly assess the performance of not just the company but of its managers. Certainly management performance can and is rightly linked to the financial performance of the company. After all as stated above it is the directors' role to maximise wealth for shareholders. This is particularly so when viewed from the perspective of shareholders interested in short term gains.[39] However there are a myriad of factors which influence the profitability of a company. Those factors include the number (if any) and quality of competitors in the same market, the state of the labour market, the government's taxation policy and the general health of the local and global economy. These factors can combine to produce either a good or a bad financial result for the company regardless of the quality of management performance. This gives poor managers the scope to be able to both take the credit for a good result and blame extraneous factors for a bad result. There is also anecdotal evidence of managers manipulating performance and information to ensure a steady increase in profitability over several years when greater increases were always available.[40] In addition, dividend payment rules entitle directors to pay dividends from profits retained from previous years.[41] Therefore even in years where there is not an adequate profit, or no profit at all, directors have the ability to nonetheless pay dividends from these reserves. To some extent this is in shareholders interests because they have a steady and predictable stream of income. Although a careful reading of the financial statements will reveal how such dividends are being funded, many unsophisticated investors would not necessarily pick up on this. On the other hand if it is appropriate to pay these dividends to shareholders why retain them in the first place? Certainly this practice is likely to deflect criticism of directors for a poor result in a year; shareholders with their normal dividend are less likely to complain than shareholders without a dividend. Also shareholders have an interest in more than just short term

38 For example see Carolyn Brancato, *New Corporate Performance Measures* (1995); Michael Sherer and David Kent, *Auditing And Accountability* (1983); Paul Kocourek, 'Board Performance Criteria — Who Defines It, Who Monitors It?' Paper presented at the conference 'Corporate Governance: Critical Board Issues' organised by the Australian Institute of Company Directors (AICD) in Sydney on 24 May 1993; AICD, *Measuring Board Performance* (1993); and Peter Drucker, 'Reckoning With The Pension Fund Revolution' (1991) 69 *Harvard Business Review* 106.

39 Kocourek, above n 38, 110.

40 Burrough and Helyar, *Barbarians at the Gate* (1990) 458–59.

41 Table A cl 89; *Marra Developments Ltd v B W Rofe Pty Ltd* [1977] 2 NSWLR 616; Phillip Lipton and Abraham Herzberg, *Understanding Company Law* (7th ed, 1998) 289.

profitability but also the ongoing viability and health of their corporations.[42] Hence there is a need for information that directly measures management performance.

Looked at from a slightly different perspective, the financial statements measure results but not how those results were achieved. This limits the ability to prospectively monitor the performance of management as results only reflect a historical position. An assessment of poor management can only be made after poor results have been published and any blame shifting to extraneous circumstances by management is no longer feasible or believable. Even if this point is reached investors may still be in the dark about how the losses arose. Therefore some commentators argue that shareholders should be told how the company and management operate so that effective monitoring can occur.[43] That is managers should explain how they manage their companies in order to maximise wealth. More specifically these commentators argue that to enhance wealth managers must have regard to such 'intangibles' as:

- quality of output;
- customer satisfaction/retention;[44]
- employee turnover and training;
- research and development investments and productivity;
- new product development;
- market growth/success;
- environmental competitiveness; and
- other measures specific to each company.[45]

These items do not traditionally appear in the financial statements but are relevant to how companies generate wealth and therefore information on these topics should be provided to shareholders.

In addition there should be disclosures about the conformance by the corporation's directors and executives with their legal responsibilities (primarily

42 Kocourek, above n 38, 111. There is empirical evidence which supports the view that shareholders take a long term view of the corporation and do not just have a short term investment horizon, see Ray Anderson and Marc Epstein, 'The Usefulness of Annual Reports' (1995) 65 *Australian Accountant* 25, 26.

43 Sherer and Kent, above n 38, 118.

44 This item is the focus of a form of business analysis described in Harry and Lawson, *Six Sigma Productibility Analysis And Process Characterisation* (1992). This was the business system used by Motorola Inc to turn their declining fortunes around in the 1980s, which culminated in Motorola receiving a United States national quality award in 1988.

45 Brancato, above n 38, 10. See also Drucker, above n 38, 113–114. Similar measures exist in the public sector, see Sharp, Stanwick and Baulderstone, 'An Organisational Culture Consistency Meter in Evaluation of Organisational Learning' Paper presented at a conference 'Evaluation: Equipping Communities and Government' conducted by the Australasian Evaluation Society, Adelaide, Australia, 1–3 October 1997.

fiduciary duties).[46] Given the extraordinary breadth of the power of management delegated to directors but the very potent powers retained by shareholders and their ultimate powers over the company, directors should be accountable for all of their functions. Given that pertinent information is a linchpin of accountability then shareholders should receive information on the conformance by directors with the very duties put in place in recognition of the relative positions of directors and shareholders.[47] There is scant recognition of this as a matter of principle. In a different context (medical negligence), two justices of the High Court support this kind of logic. Justices Gaudron and McHugh in *Breen v Williams* stated:

> If there was a general fiduciary duty to act in the best interests of the patient, it would necessarily follow that a doctor has a duty to inform the patient that he or she has breached their contract or has been guilty of negligence in dealings with their patient.[48]

In the corporate context there is a duty on directors to act in the best interests of the company/shareholders and therefore the necessary implication of reporting a breach of duty logically follows. Also Australia law and practice embraces a modestly idealistic view of corporations (corporate managers should cause their corporations to comply with applicable laws and regulations even when non-compliance would increase the corporation's net present value).[49] As a result shareholders as monitors are necessarily interested in the directors and executives' compliance with the relevant laws which effect them. Such disclosures would add to the complete package of information provided to shareholders.

Finally there should be disclosure about the corporation's social performance (eg its work safety, product liability and environmental record). Under a strict dualist view of the company[50] where profit maximisation is the sole residual goal of the company then corporate social reporting (CSR) is unnecessary. In fact voluntarily incurring the costs of CSR would be contrary to the purposes of a strict profit maximisation regime.[51] However Australian law does not embrace a strict dualist approach. First, since monism is embraced then voluntary, seemingly altruistic expenditures are acceptable so long as they can be justified according to

46 A matter close to this is currently under the active consideration of the Parliamentary Joint Committee on Corporations and Securities. This Committee is considering whether 'companies should be obliged to report any proceedings instituted against the company for any material breach by the company of the Corporations Law, or trade practices law, and, if so, a summary of the alleged breach and the company's positions in relation to it'.

47 Also given the broad powers of management which directors are entrusted with they should be accountable for the exercise of these powers. Direct information on this topic would assist the operation of the takeover market which relies on bidders being able to identify poorly managed companies. This also justifies the business management audit, discussed earlier.

48 (1995–1996) 186 CLR 71, 113.

49 Clark, above n 5, 684–85.

50 Ibid 677–78.

51 Scott Henderson and Graham Peirson, *Issues In Financial Accounting* (6th ed, 1994) 873.

the long term profitability of the company.[52] Arguably if directors choose to depart from a strict profit maximising position they should report this information to shareholders and justify the expenditure, otherwise such expenditure is funds taken from the bottom line profit shareholders are entitled to.[53] This will catch some forms of social information, notably positive acts that benefit constituencies other than shareholders. However disclosure under this justification will not catch negative social impacts a company has in the normal course of conducting its business.

Second, as mentioned above Australian law embraces a modestly idealistic view of the corporation under which companies are compelled to comply with the law even if corporate profits are thereby reduced. Therefore this justifies disclosure to shareholders as monitors of corporations' compliance with social oriented laws.[54] Disclosure by corporations of their compliance with the vast array of social laws would go a long way to providing adequate CSR to shareholders.

From a less theoretical perspective there are arguments that shareholders are interested in social information from their perspective as investors. Various authors argue this, including:

- Bowman and Haire who argue that a balanced degree of corporate social responsibility is a sign of a flexible, sensitive and responsive management style that results in higher profitability.[55] They rely on empirical research to support their argument.[56] They also find that companies which actively

52 Julia Tolmie, 'Corporate Social Responsibility' (1992) 15 *University of New South Wales Law Journal* 268, 270 and 286. However note the influential American Law Institute (ALI), *Principles of Corporate Governance: Analysis and Recommendations* (1994) has divorced social responsibility behaviour from the profit maximisation norm. ALI, 2.01, 55 of its report provides:

> (a) a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.
>
> (b) Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business:
>
> (1) is obliged, to the same extent as a natural person, to act within the boundaries set by law;
>
> (2) may take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business; and
>
> (3) may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.

53 *Hutton v West Cork Railway Co* (1882) 23 Ch D 654, 673 (Bowen LJ) 'the law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except as are required for the benefit of the company'.

54 Henderson and Peirson, above n 51, 880; Tolmie, above n 52, 269–70.

55 Bowman and Haire, 'A Strategic Posture Toward Corporate Social Responsibility' (1975) 18 *California Management Review* 49, 54–57; see also Walter F Abbott and R Joseph Monsen, 'On the Measurement of Corporate Social Responsibility: Self Reported Disclosures as a Method of Measuring Corporate Social Involvement' (1979) 22 *Academy of Management Journal* 501, 513–14.

56 Bowman and Haire, above n 55, 51–54. See also Sally Wheeler, 'Inclusive Communities and Dialogical Stakeholders: A Methodology for an Authentic Corporate Citizenship?' (1998) 9 *Australian Journal of Corporate Law* 1, 14.

engaged in socially responsible behaviour reflected this in their annual report compared with companies which were less active;[57]

- Trotman and Bradley similarly see a link between social responsibility and long term planning.[58] They argue:

  Therefore, it can be expected that companies which place strong emphasis on the long term in making decisions would be more likely to disclose social responsibility information than companies which concentrate on the immediate future in making decisions. By disclosing social responsibility information the company may be improving its public image and increasing its chances of long run survival and growth.[59]

  A view to the long term is generally viewed as a sign of good management.[60] This is supported by the material concerning management performance (discussed above) which listed 'environmental competitiveness' as one of the intangibles managers must consider to enhance long term profitability; and

- Spicer argues:

  The sanctions that have been applied increasingly to corporate activities which have been judged to be socially undesirable include legislative enactments, government regulation, judicial decisions and consumer retaliation. Clearly, when severe and costly sanctions are invoked, the expected economic impact on the affected corporation may be sufficient to induce a direct relationship between its social performance on key issues (eg., pollution control) and the worth of its securities. Under these conditions, it would not be surprising to find knowledgable investors considering a corporation's social performance in making their investment decisions;[61]

  Spicer's empirical study supported his argument.[62] Support for Spicer's thesis is available from other studies based on empirical evidence drawn from

57 Bowman and Haire, above n 55, 51.

58 Trotman and Bradley, 'Associations Between Social Responsibility Disclosure and Characteristics of Companies' (1981) 6 *Accounting, Organisations and Society* 355.

59 Ibid 358, 361.

60 AICD, above n 38, 3. Managers often criticise institutional investors of not being long term investors which hinders managers abilities to implement policies which is for the long term benefit to the company. See for example Black, 'Agents Watching Agents: The Promise of Institutional Investor Voice' (1992) 39 *UCLA Law Review* 811, 862–64; John Coffee Jnr, 'Liquidity Versus Control: The Institutional Investor As Corporate Monitor' (1991) 91 *Columbia Law Review* 1277, 1324–326.

61 Barry H Spicer, 'Investors, Corporate Social Performance and Information Disclosure: An Empirical Study' (1978) 53 *The Accounting Review* 94, 96. See also Barry H Spicer, 'Market Risk, Accounting Data and Companies Pollution Control Records' [1978] *Journal of Business Finance and Accounting* 67 quoted in Trotman and Bradley, above n 58, 358; Abbott and Monsen, above n 55, 506.

62 Spicer, 'Investors, Corporate Social Performance and Information Disclosure: An Empirical Study', above n 61. So did a subsequent empirical study, see Philip Shane and Barry H Spicer, 'Market Responses to Environmental Information Produced Outside the Firm' (1983) 58 *The Accounting Review* 521.

institutional investors.[63] This dovetails into another argument. There are a considerable number of socially oriented laws currently in existence. The costs to companies of complying with these laws can be significant as are the monetary and other sanctions if a corporation breaches these laws. Therefore any disclosure that corporations are not complying with the law will indicate to investors that the company will have to incur significant compliance costs and may be subject to significant penalties.[64] These costs obviously detract from the future cash flows that are available to shareholders.

So the need for CSR can be linked to shareholders as investors.[65] There is also empirical evidence which supports the desire by shareholders for CSR.[66]

The need for CSR can also be linked to shareholders as citizens. As concluded above, shareholders as corporate citizens should as a general principle be entitled to information on any topic concerning the corporation. This is only subject to an exception for commercial-in-confidence information and trade secrets. Social information is certainly a topic of information concerning the corporation and therefore a legitimate topic for disclosure to shareholders.

Besides the need for various types of information, there is concern about the quality of any information provided. There is clearly the inherent risk that directors in reporting on their own performance will at the least be biased and at the worst deliberately manipulative (either by withholding information or by issuing inaccurate information). In the political arena there is a recognised strong danger of abuse of the communication process.[67] But there are structural mechanisms in place in a political democracy to curb this danger and endeavour to ensure the quality of the information citizens receive. These mechanisms

63 Longstreeth and Rosenbloom, *Corporate Social Responsibility and the Institutional Investor* (1973) (which is quoted in Spicer, 'Investors, Corporate Social Performance and Information Disclosure: An Empirical Study' above n 61, 96); Martin Freedman, 'Accounting and the Reporting of Pollution Information' (1993) 5 *Advances in Public Interest Accounting* 31, 33–34 where the author discusses three previous studies, two of which support Spicer's thesis and one which contradicts it but has itself been subjected to subsequent criticism.

64 Shane and Spicer, ''Market Responses to Environmental Information Produced Outside the Firm' above n 62, 524. See also Carol Tilt, 'Environmental Policies of Major Companies: Australian Evidence' (1997) 29 *British Accounting Review* 367, 388 where she concludes from the result of her study that 'environmental law (or the threat of environmental law) appears to be a major influence on companies' policy development and environmental activities'. However she also concludes that most companies do not disclose their corporate environment policies to the public.

65 Other reasons have been posited for CSR. For example Abbott and Monsen, above n 55, 508–509 note the decline in public confidence in business and view CSR as an attempt to bolster this sagging confidence and legitimise business actions. Alternatively Marc Epstein, Flamholtz and McDonough, 'Corporate Social Accounting in the United States of America: State of the Art and Future Prospects' [1976] *Accounting, Organisations and Society* 23 argue that CSR is voluntarily undertaken by companies out of fear of and in the hope of averting mandatory government regulation.

66 Anderson and Epstein, above n 42; Kirsty Simpson, 'Annual Reports: Glossy, Expensive and Useless?' (September 1997) 67 *Australian Accountant* 16; Rankin, *Corporate Reporting — The Green Gap* (Institute of Chartered Accountants in Australia, Queensland, 1996) 11–13; Marc Epstein and Martin Freedman, 'Social Disclosure and the Individual Investor' (1994) 7 *Accounting, Auditing and Accountability Journal* 94, 105.

67 Tom Campbell, 'Rationales for Freedom of Communication' in Campbell and Sadurski, *Freedom of Communication* (1994) 18, 37.

principally are an active opposition coupled with an effective media. The role of the opposition is to criticise government policy and to suggest viable alternatives.[68] The media's role in the political context is to report information (including the views of the opposition) so the electorate has full information and thereby facilitate debate. The media's role is not simply to report information; its role is also to criticise government policy and engage in investigative journalism.[69] These mechanisms are either generally absent from or less effective in the corporate context. This difference highlights the need for other mechanisms in the corporate context to ensure the quality of corporate information. For financial information this is addressed by the requirement for this information to be independently audited by an accounting expert. For other types of information there is generally no such independent scrutiny or quality control other than the deterrent effect of liability rules.

More generally the quality of information can be gauged according to the criteria of accuracy, credibility, relevance, comparability (including international comparability), understandability, accessibility and timeliness compared with its cost and legitimate concerns for confidentiality of certain types of information. In the corporate context understandability of information is a particularly acute issue given the nature of many types of corporate information and the identity of those who invest in shares. Much corporate information, in particular the financial information, is by its nature sophisticated and complex. This is no problem for professional investors. However there are many retail, unsophisticated investors that have only little, if any, commercial or accounting background who have difficulty in understanding financial information.[70] These unsophisticated investors are in a difficult position. A pragmatic approach is to recognise that there is a limit to how simple some information can be made whilst ensuring that where it is possible to make complex information more understandable at a reasonable cost then such steps are desirable and warranted.

III REGULATORY DISCLOSURE FRAMEWORK

Australia has a framework of periodic and episodic reporting by corporations to their shareholders. The principal periodic report is the annual report which comprises the:

68 Graham Maddox, *The Hawke Government and Labour Tradition* (1989) 101; Henry Mayo, *An Introduction to Democratic Theory* (1960) 147–50; Graham Maddox, *Australian Democracy in Theory and Practice* (3rd ed, 1996) ch 8.

69 Judith Lichtenberg, *Democracy and the Mass Media* (1990) 70, 91, 110; Department Of Science, *A National Information Policy For Australia* (1985) 27; MacPhee, 'Freedom of Speech' (1988) 4 Civil Liberty 5; Campbell, above n 67, 37–41.

70 Anderson and Epstein, above n 42.

- directors' report;[71]
- financial statements comprising a profit and loss statement, balance sheet, statement of cash flows[72] and notes to them.[73] The financial statements must comply with the accounting standards and present a true and fair view;[74]
- directors' declaration;[75] and
- auditor's report (except for small proprietary companies).[76]

The annual report is supplemented by the half-year report which is a pared back version of the annual report. The financial statements and directors' declaration are the same[77] but the directors' report is 'a review of the entity's operations during the year and the results of those operations'.[78] Similarly the auditor may undertake a full audit or simply review the half-year financial statements.[79]

As discussed above, the annual and half yearly reports which are principally comprised of the financial statements address shareholders' information needs as investors. Indirectly this same information, in particular the directors' report, partially addresses shareholders needs as monitors and citizens.

The episodic reports arise either when shareholders are being asked to do something or when something significant occurs concerning the corporation. The episodic reports arise when:

- shareholders (or others) are asked to inject capital into the company. Generally the issuing corporation must issue a prospectus. This information is addressing shareholders information needs as investors as this is the very type of decision they are then confronted with;
- a bidder is attempting to acquire a majority of a corporation's shares. Generally both the bidder and the takeover target must issue information to the existing shareholders. Once again this information is principally addressing existing shareholders as investors who are being asked to quit their investment (although shareholders will be considering the price they are being offered compared with their assessment of the respective quality of the existing managers with those of the bidder);
- a matter is within the competency of shareholders and requires their approval in general meeting. Fiduciary principle requires the directors to provide full and accurate information concerning the resolutions to be voted upon. What information is provided depends on the power they are being asked to exercise

71 CL ss 298–300A.
72 CL s 295(2).
73 CL s 295(3).
74 CL ss 296, 297.
75 CL s 295(4).
76 CL ss 301, 307–308, 314(1)(a)(iii).
77 CL s 303.
78 CL s 306.
79 CL ss 302(b), 309.

and this determines whether it is addressing shareholders as investors, monitors and/or citizens. However as shareholders are being asked to exercise their residual powers most often they will be acting as monitors and citizens;[80]

- for listed companies the happening of a variety of triggering events, the principal one being the continuous disclosure regime.[81] This requires the listed corporation, subject to some exceptions, to immediately notify the market of any information concerning the corporation that 'a reasonable person would expect to have a material effect on the price or value of the [corporation's] securities'. As the linchpin of the test is concerned with the price or value of securities then clearly once again it is principally concerned with shareholders as investors.

In these situations shareholders are essentially passive in the information generation process,[82] either when others decide to act or when significant events dictate. However shareholders can be more pro-active in their search for information. Any shareholder can request to inspect corporate documents, but directors do not have to accede to such requests.[83] Alternatively the holders of five per cent of the issued share capital can apply to court for access to corporate documents so long as they are acting in good faith and for a proper purposes.[84] In these situations shareholders can be acting as investors, monitors and/or citizens depending on their ability to convince a court they are acting for a proper purpose.[85]

---

80 *Deveraux Holdings Pty Ltd v Pelsart Resources NL (No 2)* (1985) 9 ACLR 956; *Advance Bank of Australia Ltd v FAI Insurance* (1987) 5 ACLC 725; *Chequepoint Securities Ltd v Claremont Petroleum NL* (1986) 4 ACLC 711; *Re Marra Developments Ltd* (1976) 1 ACLR 470.

81 See generally Australian Stock Exchange, *Official Listing Rules*, ch 3. The continuous disclosure rule is LR 3.1. Note that one of the amendments introduced by the *Review Act* was to require disclosure to the Australian Stock Exchange of any information disclosed by the corporation to the Securities and Exchange Commission of the United States of America, the New York stock exchange or other prescribed foreign exchanges (see new CL s 323DA). This is designed to provide parity of information between investors in different countries and recognises the increasingly global nature of securities markets. This new section was inserted into the *Review Act* in the Senate at the instance of the Labour Party and the Democrats. Although passed, the government has since opposed this amendment and referred it to the Parliamentary Joint Committee on Corporations and Securities.

82 Shareholders can requisition (CL s 249D) or convene (CL s 249F) meetings of themselves and include items of business in the notice of the general meeting (CL ss 249L to O) but this is quite rare; usually the directors dictate the business to be conducted at shareholders meetings and therefore control the agenda and information released. Shareholders also have the right to ask questions on the management of the company (CL s 250S) and of the auditors (CL s 250T) at the annual general meeting. However the directors and the auditor are not legally obliged to answer these questions.

83 Either generally as part of their management discretion or pursuant to CL s 247D (replaceable rule). Section 247D also allows the shareholders in general meeting to authorise inspection.

84 CL s 247A, formerly s 319.

85 The bona fides and purposes of applicant shareholders has been disputed territory; see *Re Augold NL* (1987) 5 ACLC 286; and *Grants Patch Mining Ltd v Barrack Mines Ltd* (1988) 6 ACLC 101.

IV REFORMS

This part of the paper examines the reforms to the disclosure requirements introduced by the *Review Act* and proposed to be introduced by the CLERP Bill. The theoretical framework outlined above is the analytical tool to assess the adequacy of these reforms. The reforms are explained and analysed in the context of the current disclosure framework, starting with the periodic reports.

A *Periodic Reporting*

1 *Directors' Report*

The *Review Act* has reordered, simplified and tinkered with some of the content requirements of the directors' report. However there were two significant changes. First, the *Review Act* was amended in the Senate at the instance of the Labour party and the Democrats to provide for the first time some direct social reporting.[86] The amendment alters the *Corporations Law* by obliging directors to provide in their annual report:

> if the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory-details of the entity's performance in relation to environmental regulation.[87]

This amendment does not apply to financial years ending on or before 1 July 1998.[88] Therefore the first disclosures will occur for the 1998/99 financial year with annual reports usually appearing in October and November (although some corporations with a year end later than June have already reported). This delay is

86 Note that the Whitlam government of the early 1970s introduced a Bill to require some social disclosure by companies. When the Whitlam government was removed from office the Bill, which had been passed in the House of Representatives, never passed through the Senate. Schedule 3, cll 3(z) to (zc) of the Corporations and Securities Industry Bill (1976) No 225 required the following items to be included in the annual report of a company:

> (z) the prescribed particulars in respect of the conduct during the financial year of relations between the corporations in the group and persons employed by any of them and in respect of the personnel and employment policies of the corporations in the group;
>
> (za) particulars of any arrangements made by the corporations in the group during the financial year for protecting the safety and health of their employees;
>
> (zb) particulars of any arrangements made by the corporations in the group during the financial year for protecting the safety and health of the public in relation to the activities of those corporations and for protecting the environment; and
>
> (zc) particulars of any arrangements made by the corporations in the group during the financial year for the protection of consumers of goods or services supplied by those corporations.

The contents of this Bill is reproduced and commented on in Trotman, 'Social Responsibility Disclosures by Australian Companies' (March 1979) *The Chartered Accountant in Australia* 24, 28.

87 CL s 299(1)(f).

88 Ibid ss 1431, 1412.

frustrating but is appropriate as many companies will have to implement environmental compliance programs in order to be able to comply with this legislation. It will be interesting to see which environmental regulations will be regarded as 'significant' and which as insignificant! (Is there such a thing as an insignificant environmental regulation?) Compared with the range of topics CSR can cover, then this amendment must be regarded as a very piecemeal approach to CSR. It is certainly very limited compared to the CSR corporations in the United States are required to make.[89] Also there is no audit requirement applying to this disclosure and therefore the accuracy and credibility of such information is doubtful. The amendment is welcomed as a first step but hopefully one down a long path that will be fully trod. This information recognises shareholders interests for information as monitors and citizens (and to some extent investors) who are interested in receiving information beyond that of traditional financial information.

However this topic remains a political football. Despite agreeing to the amendments to ensure the *Review Act* was passed and passed on time, the government has since announced that it opposed this amendment (and some others).[90] The government has referred these matters to the Parliamentary Joint Committee on Corporations and Securities. The very real prospect is that this new provision may be repealed prior to them being fully operative!

Secondly, a new s 300A was inserted which provides:

> The directors' report for a financial year for a company must also include:
>
> (a) discussion of broad policy for determining the nature and amount of emoluments of board members and senior executives of the company;
>
> (b) discussion of the relationship between such policy and the company's performance; and
>
> (c) details of the nature and amount of each element of the emolument of each director and each of the 5 named officers of the company receiving the highest emolument.

Section 300A was also an amendment to the *Review Act* introduced in the Senate. Whilst the government does not now necessarily oppose this amendment it has referred it to the Parliamentary Joint Committee for them to generally examine it.

A long-standing criticism of the usual disclosures on directors' remuneration related to performance based remuneration. Performance based remuneration is seen as a way to align the interests of shareholders and directors. This type of remuneration structure is a key indicator in the corporate governance puzzle.[91] Therefore shareholders have a legitimate interest in receiving information on the components of remuneration and details on any that is performance based.[92]

---

89 See, in particular, *Securities Exchange Act 1934* (US) Regulation S-K Item 101(c)(xii) and item 103. See also Securities Exchange Commission Release No 33-6130, 34-16224.

90 Letter from the Treasurer to the chairperson of the Parliamentary Joint Committee on Corporations and Securities dated 10 July 1998.

91 Jensen and Murphy, 'CEO Incentives — It's Not How Much You Pay, But How' (1990) *May Harvard Business Review* 3.

92 Jennifer Hill, *Remuneration Disclosure in Australia* (1996) 9–11.

Traditionally whether any or if so, how[93] and what proportion of the remuneration package was performance based was not disclosed to shareholders at all. This was seen as a glaring omission.[94] This has now been addressed by this new requirement in the directors' report. Such disclosures by all companies will enable comparability between the level and type of remuneration in different companies.[95] This information is pertinent to shareholders as investors and monitors.

The government removed from the proposed *Review Act* before it was passed the requirement that a management discussion and analysis (MD&A) be included in the directors' report.[96] The government removed the MD&A requirement preferring to leave this to voluntary action by corporations rather than mandatory legislation.[97] Its removal was controversial and criticised.[98] The reason to have a MD&A is to address the problem of the complexity of the financial statements.[99] In particular many less sophisticated investors have difficultly in understanding these documents. The MD&A addresses this by forcing management by way of narrative to explain and analyse the financial performance and position of the corporation. However the concern, supported by empirical evidence, is that if corporations are free as to whether, how and what they disclose then usually poor quality disclosures results.[100] This is a situation where the government has shown a lack of commitment to improve the understandability of financial information for the benefit of unsophisticated investors. It also shows an unwillingness to make Australian law consistent with international law, principally the United States where MD&A's are an established part of their periodic reporting requirements.[101] An MD&A would assist shareholders understanding as investors.

93 It is possible to, and some companies do, structure performance based remuneration on non financial measures; see Brancato, above n 38, 46–49.

94 Australian Investment Managers Group, 'Newsletter No 2', July 1994, 6; Hill, above n 92, 18.

95 Hill, above n 92, 12, 18–19.

96 See the Second Corporate Law Simplification Bill (1996) s 299.

97 Parliamentary Joint Committee on Corporations and Securities, *Report on the Company Law Review Act 1997* (AGPS, Australia, 1998) para 1.39 (available at http://www.aph.gov.au/senate/committee/corp_sec_ctte/companylaw/section1.htm).

98 Ibid para 1.38–1.43.

99 *Securities Exchange Act 1934* (US) Regulation S-K 229.303, Instruction 1.

100 Above n 97, para 1.43. This is the universal conclusion of commentators who have looked at voluntary social reporting; see Guthrie and Parker, 'Corporate Social Disclosure Practice: A Comparative International Analysis' (1990) 3 *Advances in Public Interest Accounting* 159, 171; see also David Hackston and Marcus Milne, 'Some Determinants of Social and Environmental Disclosures in New Zealand Companies' (1996) 9 *Accounting, Auditing and Accountability Journal* 77, 100; Deegan, 'Environmental Reporting for Australian Corporations: An Analysis of Contemporary Australian and Overseas Environmental Reporting Practices' (1996) *Environmental and Planning Law Journal* 120, 122 gives a vivid example of an apparent non-disclosure by BHP of a contingent environmental liability but disclosure of two environmental performance awards. See also Henderson and Peirson, above n 51, 880; Mark Blair and Ian M Ramsay, 'Mandatory Corporate Disclosure Rules and Securities Regulation' in Walker and Fisse (eds), *Securities Regulation in Australia and New Zealand* (1994) 271; Seligman, *Corporations: Cases and Commentary* (1995) 258.

101 *Securities Exchange Act 1934* (US) Form 10-K, pt II, General Instructions, Item 7 which requires compliance with Regulation S-K Item 303. See also Parliamentary Joint Committee on Corporations and Securities, above n 97, para 1.40.

2 *Financial Statements*

The *Review Act* amended the financial reporting requirements. However nearly all of the amendments merely streamlined the law rather than effecting substantive changes. For example the requirement for a statement of cash flows is now located directly in the *Corporations Law*[102] rather than as part of compliance with the accounting standards[103] and the 'deadline' has been simplified.[104] The biggest change is to allow corporations to provide concise financial reports rather than full reports.[105] Members by request can ensure they receive a full report (or no report at all).[106] The ability to prepare a concise report is driven by the desire to provide more meaningful, essential information to shareholders because many annual reports were regarded as 'unhelpful and even confusing'.[107] The success of this reform will unfold over time depending on practices adopted by publishing corporations. It is at least consistent with the simpler documents that can be used when corporations are raising funds (discussed below).

The CLERP Bill proposes to change the regulatory framework in place for the formulation of the Accounting Standards. The main changes are to:

- establish a Financial Reporting Council to supervise the Australian Accounting Standards Board;[108]
- explicitly state a purposive interpretation of the standards,[109] including providing what the general objects of the standards are.[110] These objects include developing accounting standards that require the provision of financial information that is relevant, reliable, comparable and understandable;[111]
- attempt to harmonise the Australian standards with international standards;[112] and
- mandating that before making or formulating an accounting standard a cost/benefit analysis must be undertaken.[113] These changes will not have any immediate, direct impact on the disclosures made to shareholders so are not pursued any further.

102 CL s 295(2)(c).
103 Formerly CL s 298 and AASB 1026 'Statement of Cash Flows'.
104 CL s 315; cf former ss 283D, 58C, 245.
105 CL s 314, supported by AASB 1039 'Concise Financial Reports' which is effective for financial years ending on or after 31 December 1998.
106 CL s 316(1).
107 Corporate Law Simplification Program, *Accounts and Audit* (1994) 2.
108 Corporate Law Economic Reform Program Bill (1998) (CLERP Bill) sch 12, pt 12 div 1, s 225.
109 CLERP Bill s 228.
110 CLERP Bill s 224.
111 CLERP Bill s 224(a) (iv) (v) and (vi).
112 CLERP Bill s 233, 225(2)(f).
113 CLERP Bill s 231.

3 *Directors' Declaration*

Under the *Review Act* the directors' statement was changed to a directors' declaration. Besides the change in nomenclature, the directors' declaration is now comprehensive. The directors must opine concerning compliance with accounting standards (not previously there), whether the financial statements give a true and fair view and solvency.[114] This removed the anomaly under the old law whereby compliance with the accounting standards in the financial statements was paramount but in the directors' statement the directors did not have to give their opinion concerning such compliance!

4 *Auditor's Report*

The audit requirements were streamlined under the *Review Act.* Two minor changes of note were made. First, the auditors must audit the director's declaration which includes the declaration of solvency.[115] It seems appropriate that the auditors opine as to solvency as this is a key piece of financial information. Second the auditor must report to the Australian Securities and Investments Commission (ASIC) if during the course of the audit he or she has reasonable grounds to suspect that a contravention of the *Corporations Law* has occurred.[116] Previously the auditor had to be satisfied that such a breach had occurred.[117] The old section had been criticised by the auditing profession on the basis that 'satisfied' of a breach imposes too high a standard of proof.[118] As the section imposes on auditors a kind of policing function then the 'reasonable cause to suspect' standard is consistent with the standard usually imposed on the police in conducting their investigations.[119]

B *Takeovers*

Part of the *CLERP Act* involves substantive changes to the takeovers provisions.[120] Part of these changes involves streamlining the information provided during takeovers.[121] There will be one disclosure document issued by each of the bidder and target regardless of whether the takeover is done on or off market.[122] Under the current law there are separate statements for the bidder (Part A or C statement) and the target (Part B or Part D statement) depending on the type of takeover, even

114 CL s 295(4).
115 CL s 307(a), 295(1)(c); cf former s 331A.
116 CL s 311.
117 Former CL s 332(10).
118 Lavarch Committee, above n 1, para 4.7.34. The Lavarch Committee agreed with this criticism and recommended the change at para 4.7.59.
119 Alan Leaver, *Investigating Crime* (1997) 78–79, 96–98.
120 See CLERP, *Takeovers: Reform Paper No 4* (1997) ('CLERP, *Takeovers*') and CLERP Bill.
121 Although no mention of changing the information rules was made in CLERP, *Takeovers*. Some, but certainly not all, of the new proposals derive from Corporate Law Simplification Program, *Takeovers: Proposals for Simplification* (1996) 6.
122 CLERP Bill sch 1, ch 6, pt 6.5, ss 636 (bidder's statement), 638 (target's response).

though the content of the statements (A and C; B and D) are substantially the same.[123] This streamlining is welcome and sensible.

In addition, the information content of these statements provided by the bidder and target to shareholders has been simplified. Generally in this context simplification means deletion of explicit disclosure requirements. The information that bidders will no longer have to provide is information concerning the offeror's principal activities,[124] trading in the past four months by the offeror or its associates in the offeror,[125] the terms of the purchase of other securities in the target (in certain circumstances),[126] any pre-emption clause in the target's constitution,[127] benefits or other agreements with officers of the target,[128] changes in the target's financial affairs,[129] any agreement to transfer shares acquired by the offeror,[130] escalation clauses,[131] and additional information required by the regulations.[132]

Another major change to the bidders statement compared to the current disclosures arises where part of the purchase price involves shares in the offeror or another body corporate. Under existing law the Part A statement must only provide specified information about those other shares, notably their price.[133] Under the new proposals the bidder statement must include all the information that would be required for a prospectus.[134]

The general disclosure test for the target's response is similar to the general disclosure test for prospectuses.[135] The statement must include 'all information that holders of bid class securities and their professional advisers would reasonably require to make an informed assessment whether to accept the offer under the bid'.[136] Only information actually known to the directors of the target need be included;[137] there is no longer a requirement that they undertake reasonable

123 CL s 750.

124 CL s 750 pt A cll 2(b) and (c) (corporate offerors) and 7(b) and(c) (natural person offerors) and pt C cll 2 (b) and (c) and 4(b) and (c) respectively.

125 CL s 750 pt A cl 5 and pt C cl 6.

126 CL s 750 pt A cll 8, 9 and pt C cl 7.

127 CL s 750 pt A cl 10.

128 CL s 750 pt A cll 12, 13 and pt C cll 9, 10.

129 CL s 750 pt A cl 14 and pt C cl 11.

130 CL s 750 pt A cl 15 and pt C cl 12.

131 CL s 750 pt A cl 16 and pt C cl 13.

132 CL s 750 pt A cl 18.

133 CL s 750 pt A cll 6 (alterations in share capital of offeror in past 5 years), 19 (information about shares in other body corporate), 21 (price of such shares).

134 CLERP Bill s 636(1)(h); Corporate Law Simplification Program, *Takeovers: Proposals for Simplification* (1996) s 13(c).

135 CLERP Bill s 638(1).

136 CLERP Bill s 638(1); Corporate Law Simplification Program, above n 134, s 13(a) proposed such a test for all takeover statements.

137 CLERP Bill s 638(1)(b).

enquiries before completing the statement.[138] The only other separate disclosure requirement is to disclose a statement by each of the target directors whether they recommend acceptance of the offer or not and their reasons.[139] The information target corporations are not explicitly and specifically required to provide is information concerning each target directors' shareholding in the target,[140] any target directors who did not approve the terms of the Part B or D statement and their reasons,[141] the shareholding by target directors in the offeror,[142] share transactions in the offeror by the target or its associates in the past four months,[143] share transactions in the target by its associates in the last four months,[144] proposed benefits to officers of the target,[145] any other agreement with directors of the target in connection with the takeover,[146] any interest a director of the target has in a contract with the offeror,[147] sales of shares in the target (including price) in the previous six months[148] and any material changes in the target's financial position since the date of the last balance sheet.[149] The proposed CLERP Bill clearly intends to move to a 'fuzzy law' approach to target statements. It is not clear whether the information that currently has to be provided will be caught by the proposed fuzzy law test. However the checklist approach that used to apply to prospectuses changed to the fuzzy law approach without sustained or universal calls for a return to the checklist approach.

C *Fundraising*

Part of the CLERP Bill proposes substantial amendments to the regime whereby corporations raise funds in Australia. From an information perspective the most pertinent changes are to the types of disclosure documents and the specialist liability rules.

Under the CLERP Bill corporations are able to issue either a prospectus, short-form prospectus, profile statement or offer information statement.[150] A prospectus remains as the standard full-disclosure document. Both the general

138 The draft legislation released for public comment had such a requirement, see New Takeovers Provisions Bill (1998) (Cth) s 37(1)(b)(ii). The proposals for prospectuses includes such a requirement; See CLERP Bill sch 1, ch 6D, s 710(1)(b)(ii). Certainly a target is acting in a more pressured context and has time constraints but surely this would constrain what could properly be regarded as reasonable enquiries.

139 CLERP Bill s 638(3). Currently CL s 750 pt B cl 1 and pt D cl 1.

140 CL s 750 pt B cl 2 and pt D cl 2.

141 CL s 750 pt B cl 4 and pt D cl 4.

142 CL s 750 pt B cl 5 and pt D cl 5.

143 CL s 750 pt B cl 6 and pt D cl 6.

144 CL s 750 pt B cl 7 and pt D cl 7.

145 CL s 750 pt B cl 8 and pt D cl 8.

146 CL s 750 pt B cl 9 and pt D cl 9.

147 CL s 750 pt B cl 10 and pt D cl 10.

148 CL s 750 pt B cl 11.

149 CL s 750 pt B cl 12 and pt D cl 11.

150 CLERP Bill s 705.

test[151] and specific requirements[152] for the content of the prospectuses remains substantially the same (although certainly not identical).

A short form prospectus can be used when the issuing body has lodged documents with the ASIC and does not wish to duplicate that information in the prospectus.[153] The short form prospectus must describe the information that is omitted. Given all public corporations are required to lodge their financial statements with the ASIC each year this can potentially save a significant amount of duplication. The *Corporations Law* already allows incorporation by reference[154] for documents required to be lodged with the ASIC so long as the documents are summarised in the prospectus. The difference in the proposed laws is to allow the issuing corporation to lodge non-mandated documents with the ASIC and only having to describe them in the short form prospectus. Thus the existing rules have been streamlined in favour of shorter prospectuses, principally for the benefit of retail investors.[155]

A profile statement may be used if the ASIC has approved the making of offers of that kind by way of a profile statement.[156] A prospectus must still be prepared and sent to the recipient of the profile statement if that person requests.[157] The ASIC is expected to exercise its discretion in industry specific segments, with the managed investment industry already having tested the waters with a pilot scheme conducted in association with the ASIC.[158] The content of the profile statement is as follows:

(a) identify the body and the nature of the securities; and

(b) state the nature of the risks involved in investing in the securities; and

(c) give details of all amounts payable in respect of the securities (including any amounts by way of fee, commission or charge); and

(d) state that the person given the profile statement is entitled to a copy of the prospectus free of charge;

(e) state that:

  (i) a copy of the statement has been lodged with ASIC; and

  (ii) ASIC takes no responsibility for the content of the statement; and

(f) give any other information required by the regulations or by the ASIC approval given under subsection 709(3).[159]

151 CLERP Bill s 710 and CL s 1022. There is some variation in the drafting but substantially the same test is adopted. The general test was explicitly re-endorsed in CLERP, *Fundraising; Proposals For Reform: Paper No 2* (1997) ('*Fundraising*') 14–15.

152 Compare CLERP Bill s 711 and CL s 1021.

153 CLERP Bill s 705(2), 712.

154 CL s 1024F.

155 CLERP, *Fundraising*, above n 151, 15–18.

156 CLERP Bill ss 705(3), 709(2), (3), 721(2).

157 CLERP Bill ss 714(1)(d), 721(3).

158 CLERP, *Fundraising*, above n 151, 18–22.

159 CLERP Bill s 714(1). Subsection (2) requires the standard expiry date statement to be included.

The profile statement is designed to provide concise and comparable financial information.[160]

An offer information statement can be used when the issuing corporation is only seeking to raise $5 million (including amounts raised previously under an information statement).[161] The policy behind the information statement is to reduce the significant costs associated with preparing a full prospectus incurred by smaller businesses.[162] The information statement includes the same information as for a profile statement plus must:

(b) describe the body's business; and

(c) describe what the funds raised by the offers are to be used for; and

(g) state that the statement is not a prospectus and that it has a lower level of disclosure requirements than a prospectus; and

(h) state that investors should obtain professional investment advice before accepting the offer; and

(i) include a copy of a financial report for the body.[163]

Also a much more limited disclosure document can be used for corporations that have their securities listed and are subject to the continuous disclosure regime.[164] Once again this is a measure to avoid duplicitous disclosures; ie not requiring disclosure of information the market is already aware of (although on request shareholders can receive the documents that have previously been disclosed).

There are a variety of offers that do not require any disclosures. Two are worth mentioning. The first is personal offers made to not more than 20 people where the issuing corporation is not seeking to raise more than $2 million per year.[165] This modifies a previous 'excluded issue'.[166] The second is offers made to the big end of town where the assumption is that these people can look after themselves and do not require the benefit of mandated disclosures. The big end of town is measured according either to the size of the offer or the identity of those offered the securities. So offers seeking to raise at least $500,000 from each investor is exempted,[167] as is currently the case.[168] So are offers to 'sophisticated investors'. Sophisticated investors are either those an authorised dealer considers the person to be experienced in securities investments because of their previous experience or the wealthy (net assets of $2.5 million or income of $250,000 for the last two years).[169] Some of these are rough rules of thumb and are somewhat arbitrary. Arguably even a liberal government is not concerned to protect those

160 CLERP, *Fundraising*, above n 151, 18–22.

161 CLERP Bill ss 705(4), 709(4), (5).

162 CLERP, *Fundraising*, above n 151, 50–57.

163 CLERP Bill s 715. A requirement that the body disclose 'any other information known to the body' has been deleted (see New Fundraising Provisions Bill (1998) (Cth) s 16(1)(k)).

164 CLERP Bill 138, s 713.

165 CLERP Bill s 708(1)–(7).

166 CL s 66(2)(d).

167 CLERP Bill s 708(8)(a), (b).

168 CL s 66(2)(a).

169 CLERP Bill s 708(8)(c), (d).

who are wealthy but ignorant. Similarly exempted are offers to 'professional investors', who are those traditionally regarded as institutional investors.[170]

The government in formulating these reforms recognised the technical and incomprehensible nature of many prospectuses.[171] However they refused to propose a mandatory comprehensibility test. Rather the government has faith in market forces and the shorter disclosure document options to address this.[172] This is out of step with existing or proposed rules in the United States and the United Kingdom[173] and seems to place undue deference to market forces, which presumably have been operating for many years yet the problem of comprehensibility remains. Time will tell about the effectiveness of the shorter disclosure documents.

The government in the CLERP Bill and other legislation proposes to simplify and clarify the liability rules.[174] The principal test of liability remains whether the statement was misleading or deceptive[175] but the due diligence defence clearly applies to all alleged breaches of this rule by all those who are potentially liable (which extends beyond the issuing corporation to directors and others).[176] This clarifies an ambiguity within the *Corporations Law*[177] and removes the overlapping and strict liability under the *Trade Practices Act 1974* (Cth).[178] The policy underlying these changes is principally to reassert that fault based liability (rather than strict liability) is appropriate for an investment decision which inherently involves risk taking (and is therefore different to a consumption decision).[179] The changes are also motivated by a desire to reduce transaction costs.[180]

Neither under existing law or under the CLERP Bill are issuing corporations required to make forecasts. However many issuers make forecasts[181] and they are regulated. Indeed the current government recognises that investors are interested in forward looking information,[182] which is supported by commentators and

170 CLERP Bill s 708(10).

171 CLERP, *Fundraising*, above n 151, 22–24.

172 Ibid.

173 As recognised by the government itself, see ibid 22–23.

174 CLERP, *Fundraising*, above n 151, 37–50.

175 CLERP Bill s 728(1).

176 CLERP Bill s 731; CLERP, *Fundraising*, above n 151, 50.

177 It is not perfectly clear whether the existing due diligence defences in CL ss 1008A(2) and 1011 apply to the general liability rule in CL s 995 in addition to the liability rule in CL s 996; see Donna Croker, *Prospectus Liability Under the Corporations Law* (1998) ch 7.

178 CLERP, *Fundraising*, above n 151, 40–43. See also Corporations Law Simplification Program, *Fundraising: Trade Practices Act*, s 52 and *Securities Dealings* (1995). The principal case where s 52 of the *Trade Practices Act 1974* (Cth) was applied to a prospectus is *Fraser v NRMA* (1995) 15 ACSR 590; although see Croker, above n 177, ch 8.

179 CLERP, *Fundraising*, above n 151, 41; Croker, above n 177, 10–11.

180 Ibid 39–40.

181 Ibid 48.

182 Ibid 26–28.

empirical evidence.[183] Under the existing law issuing corporations must have reasonable grounds for any forecast they make[184] (which requirement is to be retained).[185] Under an ASIC practice note the ASIC's view is that the assumptions under which the forecast is made and how it was calculated must be published in the prospectus.[186] In addition under existing law issuers are presumed not to have reasonable grounds unless they produce evidence to the contrary.[187] However the current government regards the reverse onus as a disincentive to provide forward looking information and therefore seek its repeal.[188] This is certainly pro-business[189] but can be criticised on the basis that given the information disparity between issuing corporations and investors it will be virtually impossible for investors to successfully prove that the forecast was not made on reasonable grounds.[190] Others dispute this on the basis that because the assumptions on which the forecast is based must be published then this is sufficient evidence for anyone to test their reasonableness.[191]

D *Inspection of Documents*

Under the *Review Act* the statutory right of shareholders to inspect documents has been renumbered and altered slightly. The right is now located in s 247A, formerly s 319. There are minor differences between s 247A and s 319. Under s 247A the applicant can personally inspect the company's books, whereas under s 319 only the applicant's lawyer or auditor could inspect. However the principal structure of the sections, an application to a court and shareholders having to satisfy the court that they acting in good faith and for a proper purpose, are the same. Given that I conceive of shareholders as investors, monitors and citizens with very broad rights to information in my opinion these requirements of a court application and proof of bona fides and proper purpose seem unwarranted hurdles; they certainly compare very unfavourably to Freedom of Information legislation.[192]

183 See Chartered Accountants in England and Wales, *The Corporate Report* (1975) 6.32–6.39; and Jones, 'Whatever Happened to the Corporate Report?' (July/August 1995) Management Accounting 52; Anderson and Epstein, above n 42, 27–28. This view is supported by recent empirical evidence, see Yap, 'Cash Flow Statements: How Useful?' (December 1996) *Australian Accountant* 36, 37.

184 CL s 765(1).

185 CLERP Bill s 728(2); CLERP, *Fundraising*, above n 151, 27.

186 Australian Securities and Investments Commission (ASIC), *Practice Note 67: Financial Forecasts in Prospectuses*. This is also the view of the current government; see CLERP, *Fundraising*, above n 151, 28.

187 CL s 765(2).

188 CLERP, *Fundraising*, above n 151, 28.

189 The policy underlying these reform proposals are explicitly pro-business, see CLERP, *Fundraising*, above n 151, 9 (the government endorses an economic framework for fundraising 'which is pro-business and underpins investor confidence in market integrity').

190 See various submissions made to CLERP, summarised in Croker, above n 177, 76–77.

191 Croker, above n 177, 28, 76–77.

192 Julian Blanchard, 'Public Law Accountability Measures for Corporations' (1997) 1 *The Flinders Journal of Law Reform* 181.

V CONCLUSION

The CLERP reforms concerning corporate information and within the purview of the areas they tackle are largely sensible and designed to simplify the relevant disclosure requirements and thus the actual disclosures that have to be made. For this the government is to be congratulated, even though it is possible to disagree with the detail of some of the amendments.

However of greater concern is the narrow focus of the CLERP reforms. They are almost entirely focused on the information needs of shareholders as investors. There are only two amendments that explicitly address shareholders information needs as monitors and citizens. They are the disclosure in the directors' report by corporations of their performance in relation to environmental laws and about director and executive remuneration. In fact neither of these are part of CLERP itself, being amendments politically forced on the government in the Senate and which the government is now actively opposing or reviewing. The government is continuing the traditional myopic view that shareholders are exclusively investors interested about money. At least the government is up front about this; it is an <u>economic</u> reform program and if it is not about investment and money the government is not too interested. However this paper has demonstrated that such a myopic view is not theoretically justified.

Parts of CLERP are contradictory as a matter of policy on at least two issues, namely understandability and internationalisation (which from a global perspective raises the quality of comparability). Concerning the understandability of corporate information the government has introduced as choices available to corporations the ability to publish simpler and shorter annual reports and disclosure documents when raising funds. That these remain choices in the hands of issuing corporations points to a lack of resolve in this area and certainly seems to place the corporation's convenience and costs as a higher policy goal than assisting unsophisticated investors in understanding these complex documents. Nonetheless these shorter documents if embraced by the corporate community will assist unsophisticated investors. In contrast the government refused to force corporations to publish a MD&A and also refused to have a mandatory comprehensibility test apply to prospectuses (let alone any other document). The reasons advanced to support these refusals are unconvincing. Both would have significantly assisted unsophisticated investors. The lesson seems to be that the government will embrace simplicity and hence hopefully improve understandability when it requires corporations to do less than they have been required to do in the past but will not impose any additional burdens on business to further this end.

The other contradictory policy thread concerns internationalisation. Part of the review of the accounting standards explicitly require the Australian standards to be harmonised with international standards. Subject to the need to recognise any legitimate Australian peculiarities, this is a commendable goal and reflects the increased globalisation of business and the securities market. However the government's opposition to the new s 323DA (information disclosed to foreign stock markets must also be disclosed to the Australian market), refusal to implement a mandatory MD&A and also to have a comprehensibility test apply to prospectuses all go against international trends in this area and are indefensible from this perspective. Once again the government lacks the resolve to force corporations to undertake additional reporting (or how reports are prepared) in order to ensure international harmonisation.

It is unfortunate that the government did not separately and comprehensively attempt to reform the topic of corporate information. Without such an attempt using a sound theoretical framework and consistently applying prioritised policy the result inevitably has been piecemeal and contradictory reform.