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UNLOVELY AND UNLOVED: CORPORATE LAW REFORM'S PROGENY

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ABSTRACT

"*Oscar Wilde would have regarded our modern Corporations Law not only as uneatable, but also indigestible and incomprehensible" (Sir Anthony Mason, 1992)*

There is no dispute; it is unlovely and unloved. Complex, ungainly, internally inconsistent, conceptually troubled; the Corporations Act 2001(CA 2001) is a mishmash of old law, ad hoc amendments, provisions pulled willy-nilly from different legal systems, statements which are not law at all, ideological posturing, and drafting styles that swing wildly from the colloquial to the technical. Despite massive efforts at law reform in the last fifteen years, and continuous tweaking, the CA 2001 remains, as Sir Anthony Mason found it, indigestible and incomprehensible.

The state of the legislation, at odds with the dynamism of the Australian economy over this same period, raises some intriguing questions. Is corporations law not just "trivial", as Bernard Black provocatively suggested a few years ago, but completely irrelevant? In this case, does law not *matter, not a whit? Is corporate law reform not worth the economic candle? Why is consistency and coherency in business law not valued in Australia? Is this an atavistic response of an old common law system, a deep-rooted aversion to "codification"?*

This paper looks at some of the consequences of this state of affairs, arguing that a better corporations law would be of benefit to Australia. The paper identifies some points of departure: a separate business corporations statute, elimination of the bifurcation of directors duties (as between the statute and the general law), substitution of a comprehensive personal property security regime for the troublesome insolvent trading provisions and reconceptualisation of the complexities of capital maintenance rules.

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"Oscar Wilde would have regarded our modern Corporations Law not only as uneatable, but also indigestible and incomprehensible" (Sir Anthony Mason, 1992)

"[E]very significant amendment to the corporations legislation since [1998]…has added substantially to complexity and, it has to be said, has created obfuscation" (Justice R.P .Austin, October 24, 2007).

INTRODUCTION

There is no dispute. The Corporations Act, 2001 (CA 2001)[1] is unlovely and unloved[2]. Complex, ungainly, badly drafted, internally inconsistent, conceptually troubled; it is a mishmash of old law, ad hoc amendments, provisions pulled willy-nilly from different legal systems, statements which are not law at all, ideological posturing, drafting styles that swing wildly from the colloquial to the technical, and as one of my compatriots once quipped in a different context, resembles no less than a rider galloping "madly off in all directions".[3] Despite massive efforts at law reform in the last fifteen years, [4]and continuous tweaking[5], the CA 2001 remains, as Sir Anthony Mason found it, indigestible and incomprehensible.

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[1] Corporations Act 2001 (Cth), Act No 50 of 2001.

[2] The Corporations Act 2001 (Cth) comprises over 2200 sections, divided into 26 chapters. Roman Tomasic opines in 'The Modernisation of Corporations Law: Corporate Law Reform in Australia and Beyond' (2006) 19 *AJCL* 2 at 22 and 33 respectively that the Act has "a haphazard chapter structure" and is "economically burdensome"; John Farrar notes in his book, *Corporate Governance in Australia and New Zealand* (2001) at page 6 that Australians "have a tendency to over-legislate [in the area of corporations law] and the result is obese and user-unfriendly legislation"; and D Goddard describes the Australian approach as an example of how *not* to reform companies law in 'Company Law Reform – Lessons from the New Zealand Experience' (1998) 16 *Company and Securities Law Journal* 236 at 254.

[3] With apologies to Stephen Leacock, "Gertrude the Governess, or Simple Seventeen", in *Nonsense Novels* (1911).

[4] As the result of a corporations law 'simplification task force' established by the Commonwealth Attorney-General in the 1980s, the First Corporate Law Simplification Act (Cth) was passed to amend the corporations legislation in force at the time. When the responsibility for reform of corporations law was shifted from the Attorney-General's office to the Commonwealth Treasury, the Corporate Law Economic Reform Program (CLERP) was instituted with the aim of reviewing corporations legislation. In 1998, the Company Law Review Act 1998 (Cth) was passed – some of the changes wrought by this Act survive in the modern Corporations Act 2001 (Cth), for example, the Small Business Guide contained in Part 1.5. Further changes were effected to Australian corporations law by the first wave of CLERP reforms, the Corporate Law Economic Reform Program Act 1999 (Cth). Finally, after significant constitutional strife (further explained at n [ ] below), the Corporations Act 2001 (Cth) was passed, the result of the states agreeing to refer their constitutional powers in respect of corporations to the Commonwealth. Between 2001 and 2007, significant changes were made to the Corporations Act 2001 (Cth) as a result of the passing of the Financial Services Reform Act 2001 (Cth) and the Commonwealth Criminal Code – these reforms affected the financial services and markets and criminal offence provisions of the Act respectively. Further CLERP reforms (known as CLERP 7, 8 and 9) also took effect during this time. In 2005, the Corporations Amendment Bill (No 1) 2005 (Cth) was passed,

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What is there to like about the CA 2001? It seems that its main virtue, in the eyes of the business community, is the one-stop shopping it provides,[6] obviating the necessity for multistate filings. Constitutionally, this was a hard won advantage, and one which arguably would not necessarily have had to be such a costly, time-consuming battle, had the courts demonstrated a greater inclination to reconsider questionable precedent.[7] Administrative convenience though may have come at a high price.

Secondly, the hard work of the Corporations Law Simplification Task Force[8], although perhaps now taken for granted, should not be underestimated. According to one member of the Simplification Task Force, "the First Corporate Law Simplification Act…rewrote company law, drastically simplified the text and

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clarifying the personal liability of directors of corporate trustees, in addition to regulations designed to support the reforms made the Corporations Act 2001 (Cth) by the Financial Servies Reform Act 2001 (Cth). See Elizabeth Boros and John Duns, *Corporate Law* (2007) 12-22; and *Ford's Principles of Corporations Law*, Chapter 2.

[5] Since its inception in 2001, the Corporations Act 2001 (Cth) has been amended by 32 different pieces of legislation.

[6] Elizabeth Boros and John Duns, *Corporate Law* (2007) 16.

[7] Historically, Australian corporations law existed in the form of state legislation, a state of affairs that was eventually concluded to be undesirable and an impediment to national consistency. In 1989, the Hawke Government passed the Corporations Act 1989, a national piece of corporate law legislation. The power relied upon to pass this legislation was the 'corporations power' contained in s 51(xx) of the Australian Constitution. The power conferred upon the Commonwealth by this section allows legislation to be passed "with respect to foreign corporations and trading and financial corporations formed within the limits of the Commonwealth". However, at the time of the passing of the Corporations Act 1989, there existed conflicting interpretations of what the word 'formed' within section 51(xx) meant. The narrow interpretation of the word was that the power bestowed on the Commonwealth was confined to companies *already* formed, thereby rendering the Commonwealth incapable of legislating with regards to the registration of new companies. The broader view was that the power extended to *all* companies formed within the Commonwealth, to the obvious exclusion of foreign corporations. The Corporations Act 1989 was based on the broader interpretation of s 51(xx) – however, challenges by the states prevented proclamation of the act, and ultimately the High Court of Australia in *NSW v Commonwealth* (1990) 169 CLR 482 held that 'formed' meant 'already formed' and so the Corporations Act 1989 was constitutionally invalid. The Commonwealth and the states then attempted to collaborate on corporations law issues – a 'cross-vesting scheme' was instituted, such that for the purposes of administration and enforcement, state law was treated as if it was federal law. Jurisdiction was 'vested' in both the Federal Court and the state courts to hear matters under the legislation. However, a series of High Court decisions including *Re Wakim; Ex parte McNally* (1999) 198 CLR 511 held that this scheme was constitutionally invalid, a conclusion which also rendered invalid all previous decisions of the Federal Court on point (therefore requiring legislation to be passed to retrospectively validate them). Ultimately, the states and territories agreed to refer their constitutional powers over corporations to the Commonwealth Parliament for the purpose of a national legislative scheme – the Corporations Act 2001 (Cth). See also Suzanne Corcoran, 'Corporate Law and the Australian Corporation: A History of section 51(xx) of the Australian Constitution' (1994) 15 *Journal of Legal History* 131.

[8] [dates]

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substance of the law of proprietary companies (incidentally killing off the unnecessary complication of a separate Close Corporations Act by meeting all of its objectives within company law), and materially simplified the law of public companies, with surprisingly little litigation going to the superior courts to resolve the meaning of the new provisions. The Task Force's remit was to simplify the drafting, keeping the substance intact, except where there was a consensus for incremental change, but they marshalled support so effectively that they carried through a wholesale reform within that remit." [9]

Thirdly, there has been innovation[10], some uniquely Australian responses to local circumstances. In some instances though (the approach to statutory directors' duties[11] for example), the case for Australian exceptionalism is not persuasive.

The problems with the reforms though are not the result of a lack of either good ideas or understanding of the issues at the forefront of modern corporate practice. There were lots of good models and studies around, the Canada Business Corporations Act[12], the New Zealand Companies Act[13], the Revised Model Business Corporations Act in the United States[14], the efforts of the American Law Institute on Corporate Governance[15], the Review of the Hong Kong Companies Ordinance[16] and, beginning in 1998, the extensive studies of U.K companies law undertaken by the Department of Trade and Industry in London[17], which culminated in the Companies Act 2006 (UK)[18]. Traces from these various sources can be detected throughout the CA 2001, albeit occasionally to untoward or surprising effect.

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[9] Email to the author from George Durbridge, dated April 20, 2008.

[10] E.g., the inclusion of a new Part 1.5 in the statute, a non-statutory "Small business guide". In the spirit of the plain English drafting of the Simplification Task Force, the Small business guide, sets out the basic features of a proprietary company and its operation. However, as noted *infra* at page [ ], the inclusion of this non-statutory material in the statute itself may cause some confusion as to its import and its normative force.

[11] Discussed *infra* at page [12].

[12] RSC 1985, c C-44.

[13] 1993 (NZ).

[14] (2005).

[15] American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations – Volumes 1 & 2* (1994).

[16] See, for example, *Consultancy Report of the Review of the Hong Kong Companies Ordinance* (1997).

[17] Now known as the Department for Business Enterprise and Regulatory Reform: see, for example, Company Law: Flexibility and Accessibility (2004) 04/994; Company Law Reform: Small Business Summary (2005) 05/1780; Company Law Reform Bill: Regulatory Impact Assessment (2005) 05/2081.

[18] *Companies Act 2006* (UK) c 46.

Undoubtedly, the process of the law reform efforts during this fifteen year period provides some explanation of the results. The initial efforts, perhaps in response to Sir Anthony Mason's stinging comments, [19] were focussed on form not substance: simplification and the use of plain English drafting.[20] Not surprisingly, it proved devilishly difficult to disentangle form from substance. In the process, major changes were made in approach, in effect constituting a major shift in the conceptual underpinnings of parts, but not all, of the legislation.

Then ideology intervened, with the renaming of the reform efforts, the Corporate Law Economic Reform Program (CLERP), and their repackaging as part of an economic agenda of a newly ensconced government. The reform efforts themselves were shifted from the Attorney General's Office to the Treasury, although the enactments that immediately followed were largely unchanged from those proposed (but not enacted) by the Simplification Task Force. [21] And corporate law reform ever since has remained in the Treasury.[22] Unfortunately, the work of the Simplification Task Force was arrested in mid-flight; planned restructuring of the legislation was left undone.[23]

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[19] Anthony Mason, 'Corporate Law: The Challenge of Complexity' (1992) 2 *Australian Journal of Corporate Law* 1, 1.

[20] See the comments of George Durbridge, *supra* [ ]. See also, Roman Tomasic, 'The Modernisation of Corporations Law: Corporate Law Reform in Australia and Beyond' (2006) 19 *AJCL* 2; Ford's Principles of Corporations Law, Chapter 2.

[21] The Corporations Law 1989 (Cth) came into force on 1 January 1991. The previous legislation had established the Companies and Securities Advisory Committee (post-2001, this body is known as CAMAC, the Corporations and Markets Advisory Committee), a body charged with advising the relevant Commonwealth minister on proposed law reform and other matters pertaining to corporations law. It was responsible for publishing discussion papers for community consultation, and ultimately reports tendered to the Minister. However, during the 1990s some corporations law reform projects were pursued independently of CAMAC – the Commonwealth Attorney-General's deparment established a Simplification Task Force that operated between 1993-1996. The recommendations of this body were enacted in corporate law simplification acts. However, a change of government in 1996 led to the shifting of the responsibility for corporations law from the Attorney-General's department to the Treasury, where a Corporate Law Economic Reform Program (CLERP) was established. Under the CLERP initiative, many of the reform proposals developed by the Simplification Task Force were enacted. For further details, see Ford's Principles of Corporations Law at 3.360-3.380; Roman Tomasic 'The Modernisation of Corporations Law: Corporate Law Reform in Australia and Beyond' (2006) 19 *AJCL* 2 at 27.

[22] Some concerns were raised, anecdotally, with the author as to corporate legislation being drafted in Treasury: inadequate legislative drafting skills, insufficient institutional memory, seeming ad hocery and ideologically driven reforms. On the other hand, another commentator vigorously denied this as "mischievous nonsense"; email to the author, *supra* n. 9.

[23] The "patchwork appearance" of the CA 2001 "is a result of the simplification programme having been interrupted half-way. The CLERP programme did enact the Bills left to it by the simplification programme, but the remaining simplification work was never taken in hand, relevantly including the

On the other hand, corporate activity is the motor of a free market economy, and until the very recent financial shocks reverberating around the world, the Australian economy has experienced impressive, unprecedented and uninterrupted growth over the entire period of the legislative imbroglio. Does this mean that corporations law doesn't matter?[24] Is corporate legislation as "trivial" as Bernard Black argued so disingenuously in 1990?[25] Are efforts expended on improving the state of corporate legislation in Australia simply not worth the economic candle?

Such a response would be disheartening.[26] There are compelling arguments to be made in support of addressing the statutory morass of the CA 2001.

Economic efficiency is one argument. A better statute would reduce compliance costs (primarily in the form of legal fees) associated with the statute. The cynical might cite the immediate impact on legal fees as a motivating factor in the toleration of the status quo evidenced by the legal profession. More likely though, it is simply a manifestation of the well-documented phenomenon of path dependency and interest group politics in corporate law?[27]

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tidy-up act which would have completed the restructuring and re-numbering of the Act." Email to the author, *supra* n.9.

[24] One of the arguments posited in the influential "law and finance" literature has been that "law matters, and may even be a determinative of economic development. See one of the latest in this series of papers, La Porta, Rafael, Lopez de Silanes, Florencio and Shleifer, Andrei, "The Economic Consequences of Legal Origins", Journal of Economic Literature, forthcoming available at SSRN: http://ssrn.com/abstract=1028081.

[25] Bernard Black, 'Is Corporate Law Trivial? A Political and Economic Analysis' (1990) 84 *Northwestern University Law Review* 542. Black asserts what he himself acknowledges to be an 'extreme hypothesis', namely that state corporate law is trivial. Black's approach is to examine mandatory corporate law and assess its triviality with reference to four considerations. These considerations are: whether the rules are 'market mimicking', i.e. mandatory but with no 'bite'; whether the rules can be avoided by 'advance planning'; whether a rule that has started out as irrelevant has now become relevant, and thus subject to change by 'the political forces that [lead] to the trivialization of corporate law'; and finally, whether the rule covers such rarely occurring situations that it remains unchanged by the relevant political forces in corporate law. In the course of his article, Black considers the common themes present in academic discourse on corporate law, as well as exceptions to triviality. Finally, he looks at the implications of triviality of corporate law, for both the legislature and the judiciary.

[26] Something that is also acknowledged in Anthony Mason, 'Corporate Law: The Challenge of Complexity' (1992) 2 *Australian Journal of Corporate Law* 1.

[27] See Lucian Bebchuk and Mark Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) 52 *Stanford Law Review* 127.

A better statute might also promote a culture of compliance. Where the statute makes no sense, either because it is confusing or commercially unrealistic, it risks losing its normative force. There may be token compliance at the margins or in highly visible situations, but otherwise the law becomes a dead letter. Are there areas of the CA 2001 which might fall into this category, the capital maintenance requirements, for example?[28]

Arguably, a better statute could also reduce the volume of litigation generated by a difficult statute. Given the size of the economy, is there a disproportionately large number of corporate law issues which find their way to the courts, and in many cases all the way to the High Court, for judicial consideration? [29] In this area of the law, although the judiciary will ably resolve the dispute, judicial principles so laid down in response to highly specific factual situations, may not be optimal as a general matter.[30] And, to judge by the comments of Sir Anthony Mason and Justice R.P. Austin, the judiciary may be justifiably exasperated with the demands which such a difficult statute places upon them.

Then there is the facilitation of international transactions. The state of Australia's corporations law statute is no longer a purely domestic matter. Australian exceptionalism, intended or not, also has a cost internationally. To the extent that the CA 2001 does not meet the usual expectations of international business partners, it adds an additional layer of cost and complexity to international transactions. When international transactions are derailed or delayed by arcane processes, ghosts from another century, the first reaction of international participants is to look for an alternative route around an annoying local impediment. Somewhat incredulous encounters with the CA 2001 by international business people also detract from the enviable reputation of Australia as a place of innovative, effective regulation (which it is in some areas[31]) and a dynamic, modern business community.

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[28] *Corporations Act 2001* (Cth) Part 2J.1, 'Share capital reductions and share buy-backs'. This proposition has not been tested empirically and is merely anecdotal. It may be a fruitful avenue for further investigation.

[29] Statistics on the number of corporations law decisions in the High Court were not readily available; again, this may be an area of fruitful future research.

[30] See *Gambotto v WCP Ltd* (1995) 182 CLR 432.

[31] The "Aussie model" of dual financial regulators, the "twin peaks" approach, is currently of interest to US regulators; see, e.g., "Sharks circle Paulson's Aussie plan", *(London) Financial Times*, April 2, 2008, 11. The idea of the 'twin peaks' model of financial regulation is that there are two financial

A second, and somewhat tangential, consideration in the international realm is the significance of Australian legislation and regulation as a model for emerging and transitional economies in the Asia-Pacific region. A controversial but widely accepted view in the world of international development is that the origins and nature of a legal system may determine the level of development of a country's financial system.[32] Argued the other way around, the existence of a vibrant financial system would indicate, as a precondition, a well-functioning system of commercial and financial legislation, worthy of emulation in the search for similarly stellar economic results.

With its large number of foreign students and visiting scholars, Australia is exporting its legal system; the visitors take it home with them, often in an uncritical fashion, both the good and the less good. Thus the outdated and less than optimal aspects of the CA 2001 receive an undeserved validation (by virtue of unrelated desirable economic activity) and are propagated throughout the region.

Such an outcome may not directly impact the Australian business community. On the other hand, Australia is an active participant in international development in the Asia Pacific, and has an interest at various levels in the economic development of its neighbours. Australian legal practitioners and business people are present throughout the region. Legislation can be viewed as another potential high value export, intangible though it may be.

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regulators: in line with recommendations made by consultative Committees, the Australian government created the Australian Securities and Investment Commission (ASIC) and the Australian Prudential Regulation Authority (APRA). APRA was intended to be responsible for prudential regulation, whereas ASIC's responsibilities were specified to be market and disclosure regulation. The 'twin peaks' model therefore depends upon creating two highly specialised agencies, each with clearly demarcated and comprehensive roles in the regulation of financial services. This model is thought to be better than a model which depends upon one single "mega-regulator", as a single regulator with all functions may become too powerful, and may not realise maximum efficiency in carrying out all of these functions. For more information, see Cooper, J, et al, ASIC paper, 'The Integration of Financial Regulatory Authorities – the Australian Experience' (2006), a paper presented to the Securities and Exchange Commission of Brazil, 30th Anniversary Conference.

[32] See the latest in the long series of "law and finance" papers, La Porta, Rafael, Lopez de Silanes, Florencio and Shleifer, Andrei, "The Economic Consequences of Legal Origins", Journal of Economic Literature, forthcoming available at SSRN: http://ssrn.com/abstract=1028081, pp 4, 12.

At a more fundamental level though, the state of the CA 2001 raises the question of the place of legislation generally in the Australian legal system. What is the point of legislation? What should a statute do? How does a statute interact with case law, past and future? Why would consistency and coherency in statutory drafting not be valued? To the contrary, why would such characteristics be sniffily dismissed as efforts at "codification", and we don't do that here?

A suspicion of "codification", and statutory law generally, runs deep in old English law traditions, an atavistic response perhaps associated with political trauma such as the French Revolution or an ancient preference for authority residing in the judiciary as opposed to the legislature. Of course, these predilections in the modern UK itself have been turned on their head since the entry of the UK into the European Union (EU). The significant structural changes to UK companies law that took place in the 30 or so years following the UK's accession to the EU where driven, both for better and for worse, by continental codified law as manifested in European Commission Directives. Mostly for the better for companies law, according to Gower, who welcomed as a positive influence the structural analysis and intellectual rigour of these systems.[33]

Such a view might explain an otherwise inexplicable phenomenon. How is it that Canadian and US corporate legislation is so much better drafted, and is accorded greater stature and deference, than the CA 2001? Even where provisions of the latter are directly derived from the former? The legislatures, the business communities, the legal communities make it so. Legislation is perceived to be preferable to, and to oust automatically, case law for business law solutions.[34] For example, the creation of a statutory derivative action is assumed to override the application of the

[33] See, e.g., the discussion on Impact of Community Law in Paul L Davies, *Gower's Principles of Modern Company Law* (1997, 6th ed), 54ff; also, Cally Jordan, 'Towards a Commonwealth Model of Companies Law' in F M Patfield (ed) *Perspectives on Company Law: 2* (1997).

[34] For a more detailed analysis of this phenomenon, see Cally Jordan, 'The Conundrum of Corporate Governance' (2005) 30 *Brooklyn Journal of International Law* 983. Delaware may be an important exception to this proposition, where both the judiciary and the legislature appear to be equally significant in the development and interpretation of business law precepts. But few jurisdictions can boast of the experienced and specialised judiciary which Delaware has created.

exceptions to the rule in Foss v. Harbottle[35]. No need for a statutory signpost to that effect.[36]

An explanatory factor here may be the comfort level of both US and Canadian legislators with the concept of "codification", in the sense of systematic, structured and principles-based legislation. There are, of course, glaring exceptions to this proposition, but, again on the other hand, some fine examples too: the Canada Business Corporations Act (CBCA) and the Revised Model Business Corporations Act (US) among them. Canada is a true civil code jurisdiction (thanks to Quebec), and the beneficent civil code influences of clarity, consistency and organisation have permeated the traditional English common law approach to statutory drafting, and a more European acceptance of the primacy of legislation. In fact, the drafting and organisational style of the old Quebec civil code[37], of Napoleonic origins, was a direct influence on the 1975 CBCA.

Codification is also an accepted part of the US legislative landscape. There are many US codes, although they may bear only a remote resemblance to their European cousins. But related they are. An often ignored aspect of the US legal system is the strong French (and codal) influences in the 19th C, influences which continue to be perceptible, to this day.[38]

[35] *Foss v Harbottle* (1843) 67 ER 189. The Canadian Dickerson Committee said about the Canadian statutory derivative action contained in the *Canada Business Corporations Act* RSC 1985 c 44, that "[i]n effect, [the] provision abrogates the notorious rule in *Foss v Harbottle* and substitutes for that rule a new regime to govern the conduct of derivative actions... [W]e have relegated the rule to legal limbo without compunction, convinced that the alternative system recommended is preferable to the uncertainties – and obvious injustices – engendered by that infamous doctrine" – 'Proposals for a New Business Corporations Law for Canada (1971), Vol. 1, para 482, as cited in Pearlie Koh Ming Choo, 'The Statutory Derivative Action in Singapore: A Critical and Comparative Examination' (2001) 13(1) *Bond Law Review* 64 at 66.

[36] Corporations Act 2001 (Cth) s 236(3).

[37] The Civil Code of Lower Canada (1866), largely inspired by the Napoleonic code of 1804, was replaced in its entirety by the Civil Code of Quebec in 1994.

[38] See H Patrick Glenn, *Legal Traditions of the World* (3rd ed, 2007): "Law in the United states is generally seen as adhering to a common law 'family', but today this is far from obvious. In many respects U.S. law represents a deliberate rejection of common law principle, with preference being given to more affirmative ideas clearly derived from civil law. These were not somehow reinvented in the United states but take over directly form civilian sources in a massive process of change in adherence to legal information in the nineteenth century" (at 249).

In terms of reconceptualising Australian corporations law, the fundamental question is where to start. The lessons of the Simplification Task Force of the 1990s must be taken to heart; form and substance must both be addressed.

FORM AND STRUCTURE

The CA 2001 continues to be built on the chassis of old UK companies law, with now disparate elements "bolted together" (as one of the author's colleagues put it[39]) into a fantastical multipurpose vehicle. The *Mad Max* approach to corporate law. [40]

But, of course, this is no longer 19thC companies law at all. It is a compendium of modern capital markets regulation, insolvency law, secured transactions. It goes on.[41] As difficult as it may be to untwist all these strands, it would be a gargantuan task to recreate a coherent whole, in effect an Australian corporate commercial code.[42] The most persuasive argument for one comprehensive piece of legislation dealing with virtually all of the aspects of corporate activity, would be that it is comprehensive. But to be useful, it must also be coherent. However, neither comprehensiveness nor coherency was the motivating factor in this approach; rather, the "amalgamation" of

[39] Associate Professor Paul Ali, University of Melbourne Law School.

[40] The story behind the comprehensive approach to the CA 2001 is a fascinating mixture of constitutional drama and publisher-drive expediency. "Until 1991, we had four principal codes, and the original Corporations Law represented little more than a bundling of those into one Act….Those of us who lived by the Codes used to carry about with us both Vol 1 (the Companies Code) and Vol 2 (the Takeovers, Securities, Futures and Interpretation Codes). The two volumes were easier to pack into a briefcase than one big volume, but that was about all: the provisions so often interlock that you needed to have both. The bolting together brought about some economy in definitions, and some gain in uniformity, both because one definition of 'association' etc replaced four, but no great change. The Simplification Task Force looked at whether the Corporations Law could be split into a companies volume and a markets volume, by re-enacting it as two statutes, or just restructuring one statute in such a way as to facilitate printing it in two volumes. The idea did not fit the political rhetoric of the day: the Commonwealth had just brought us out of a archaic welter of separate statutes into a modern and convenient unitary statute. …In the end, the publishers killed off the idea, by indicating that they would put it all in one volume, however it was structured." Email to the author from George Durbridge, dated April 20, 2008.

[41] The impact of the Financial Services Reform Act 2001 on the CA 2001 has been castigated in particular, as "the outstanding, vastly expensive and ghastly failure of the last few years. Logical and rigorous it may have seemed but in the end it has been a policy and political failure which has been partly fixed by a patchwork of hasty regulations and exemptions, and which has burnt all of the capital which reformers had accumulated through cautious and well-prepared reforms in the 1990s." Email to the author from George Durbridge, dated April 20, 2008.

[42] Mind you, Napoleon did it in a few years, but the result was primarily a compilation of commercial practices developed over several centuries, whereas the Germans took their time (some 75 years) to produce a rigorously consistent, theoretically "perfect" commercial code.

the disparate rules served to prop up the Commonwealth's constitutional claim to regulatory authority.[43]

Sadly, coherency was the victim. The CA 2001 is clutter and complexity rife with inconsistencies and anachronisms. New provisions, often thumb in the dyke "fixes", are wedged in alphanumerically (s. 50AAA, for example, or s. 601AI).[44] At least the complexity of the alphanumeric provisions may provide a clue to their vintage and how they may need to be interpreted in light of older provisions.

The definitional section 9 is a minefield. There are the usual, inoffensive if inelegant, shortcuts: "**unfair loan** has the meaning given by section 588FD". Later definitions sometimes cause confusion with earlier statutory provisions. An "officer" is defined to include a "director", which is also defined. The key statutory provisions on directors' and officers' duties (ss. 180, 181, 182) refer to "directors and other officers". Is this a deliberate distinction, or redundant drafting? Other "definitions", are in fact substantive provisions: see the new s. 9A(3), the meaning of rights issue with its detailed conditionalities.

Then there are the anachronisms, provisions derived from the very earliest of companies statutes in the UK, which no longer serve their original or any other useful purpose. Take s.115 of the CA 2001:

> A person must not participate in the formation of a partnership or association that: (a) has as an object gain for itself or for any of its members; and (b) has more than 20 members unless the partnership or association is incorporated or formed under an Australian law.

Compare this provision to section 4 of the *Companies Act 1862* (UK), the consolidation of the original *Joint Stock Companies Registration and Regulation Act 1844* (UK):

> …no Company, Association, or Partnership consisting of more than Twenty Persons shall be formed…for the Purpose of carrying on any other Business that has for its Object the Acquisition of Gain by the Company, Association, or Partnership or by the individual Members thereof, unless it is registered as a Company under this Act or is formed in pursuance of some other Act of Parliament, or of Letters Patent…

[43] Email to the author from Claire Grose, dated April 22, 2008.
[44] Renumbering of the statute was on the agenda of the Simplification Task Force, but never carried through by its successor, CLERP. Email to the author from George Durbridge, dated April 20, 2008.

Now the derivation of s.115 of the CA 2001 is pretty clear; apart from modernising the capitalisation of nouns (a hangover from the 18thC) and a bit of rephrasing, the provisions are more or less identical.

But what is the point of s. 115? The original UK provision marked the beginning of modern UK companies legislation and was an early form of investor protection, by requiring public registration of entities offering subscriptions to the public.[45] The CA 2001 has an entire regulatory framework comprised of hundreds of statutory provisions, based on modern securities regulatory regimes elsewhere, designed to promote investor protection. Section 115 serves no modern purpose.

Worse, it is not as though s. 115 has been inadvertently overlooked, tucked away for a century or so, unnoticed in the statutory attic, so to speak. It has been amended in modern times[46] to permit exceptions to the statutory limit of 20 members (for law firms, no less); it is commented upon in leading textbooks. [47] But no one has asked the fundamental questions: why do we have it and why don't we get rid of it. [48]

Then there is the non-law. Part 1.5 –Small Business Guide is not legislation at all. It is a useful summary of legislative provisions, but certainly that could be provided outside the statute (and avoid the confusion its inclusion creates). It is unlikely that small businesspeople will be found trolling the statute for this information, especially given the state of the current statute.

It would be of much greater utility to have a modern, well-drafted *business* corporations act of the Canadian or New Zealand variety, that would be accessible to business people (if they were inclined, as few are, to consult statutory sources). Leave behind the old statute to deal with all of the marginal varieties of company that may

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[45] The US securities regulation regime, beginning with the *Securities Act of 1933,* looked back to the 19thC UK statutes as its inspiration; offers to the public require the filing of "registration statements".
[46] The Corporations Regulations 2001 contain the regulation 2A.1.01, which specifies the exact number of partners in a partnership as permitted by exceptions to the principle contained in s 115. The maximum number of members permitted under these exceptions was increased by virtue of the amending Corporations Amendment Regulations 2006 (Cth). These regulations took effect as of 17 February 2006.
[47] See *Ford's Principles of Corporations Law*, 1.240.
[48] To be fair, the comparable provision in the UK was only repealed in 2002 (Statutory Instrument 2002/3202, 21 December 2002); available at http://www.opsi.gov.uk/si/si2002/uksi_20023203_en.pdf.

continue to exist. And encourage the preparation of a comprehensive annotations and official commentaries for the use of practitioners and the judiciary.

Twenty years ago, looking to Canada and the United States, the New Zealanders coined the term "core companies law" and began the process of unpacking old UK-style companies law into discrete statutes. This process had itself been prompted, although imperfectly executed, in the UK under pressure from EC companies law directives. Here in Australia, Ralph Simmonds (then Dean of Law at Murdoch University) urged the reformers of the 1990s to do the same.[49] His advice went unheeded, now making the task even more difficult.

Does it matter? Is it worth the effort? As one practitioner commented to the author (and the author, to test the theory, did it), it is possible to, literally, tear the statute apart and clip together the useful bits on "core companies law" into a fairly readable package.

On the other hand, if it is possible to do this so readily, why not do it, legislatively. Of course, it is not quite so simple. And a lot of the "useful bits" are themselves open to question. But the exercise would offer more than just satisfaction to those with tidy minds. It would aid in the reinvigoration and reconceptualisation of business corporations law in Australia. The CA 2001 is becoming an oddity in the modern common law world. More and more, recourse is had to Canadian and US approaches to business law. In future, no doubt, the new Companies Act 2006 (UK) will also serve as a touchstone. The debates invoked by Sons of Gwalia[50], that perfect storm of old companies law principles, modern securities regulation and insolvency, could perhaps be resolved without recourse to the highest court of the land. Unpacking the

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[49] Ralph Simmonds in his article 'Dismembering the Corporations Law and Other Law Reform: Should Something More be Added to the Law Reform Agenda?' (1995) 13 *Company and Securities Law Journal* 57, argued that "separation into distinct statutes in this country should be on the local reform agenda for the law of the new millennium" (at 57). He felt that the success of the New Zealand approach came from "the attention the New Zealand reformers paid to the question of what belong[s] in a corporations law, and what did *not*" (at 59; emphasis his). Ultimately, Simmonds advised the would-be reformers of Australian corporations law that "[m]odernisation and simplification… are not enough. Modernisation – addressing the out-of-date, the technically inapt or the policy-poor in the corporations law – is rightly considered to be important. So too is simplification – getting the statute into a more intelligible form of communication – shorter if possible, clearer at least. However, these are not enough because we are doing too much in one statute… we need to [divide the Corporations Act] up into different statutes" (at 63).

[50] [2007] HCA 1.

CA 2001 into separate statutes would promote a more obvious, and conceptually sound, characterisation of principles and issues.

SUBSTANCE

The reforms of the 1990s were marked, and marred, by too little real change and too much compromise in the face of clear choices. As noted above, it is a futile exercise to attempt to change form without consideration of substance. This may be one of the factors militating against rationalisation of the CA 2001. It is not a simple exercise and reform fatigue has set in.

But assuming that such an obstacle could be overcome, what areas of companies law are worth reconsideration, particularly in light of recent developments in the UK and now habitual recourse by counsel and the courts to Canadian and US approaches for guidance? Here are some first impressions.

Officers and Directors' Duties

The statutory treatment of directors duties[51], is perhaps the most surprising aspect of the CA 2001. Somewhat similar statutory statements of directors duties are found in other Commonwealth statutes (in Canada and New Zealand, for example) and in most US state legislation (following the RMBCA, or its predecessor).

There are some differences in wording and import in the statutory statements of directors duties in the CA 2001. "Skill", for example, has been dropped from the duty of care in s. 180(1) and the "proper purpose" doctrine (scathingly rejected in Canada although not in New Zealand or the UK) is perpetuated in the duty of good faith provisions of s. 181. In addition, there is a statutory statement of the "business judgment rule" (s.180(2)). There is no statutory formulation of the business judgment rule in the United States, where the rule originated. There, it remains a judicial doctrine.

[51] Ch. 2D extends beyond directors duties strictly speaking, to include officers and in some cases employees.

The creation of statutory directors duties was controversial in the UK, as it was in Hong Kong and Australia. The reticence appeared to stem from concerns that a statutory statement could narrow or dilute the duties developed over decades by the courts. The courts would be deprived of their ability to inject nuance and discernment into their decisions, particularly in hard cases. Some support for this view could be found in the fact that one of the most important commercial jurisdictions in the United States, Delaware,[52] does not have a statutory statement of directors duties (whereas nearly every other state does). However, the Delaware story is a unique one.[53] To this author, the hesitations over a statutory statement of directors duties smack more of the generalised suspicion of statutes that permeates older common law jurisdictions.[54]

The Australian approach in the CA 2001 evidences this tension between legislative and judicial solutions. It appears to be a fudge, a nod of the head to both sides of the debate, resulting in an unusual and surprising result. There is a statutory statement of directors duties. However, it has been interpreted as solely creating a civil penalty enforceable only by the regulator[55]. The general law, the common law, continues to provide the source of traditional directors duties in Australia.

This bifurcation of directors duties is perplexing, and adds unwarranted complexity to an already complex area. The courts themselves have pragmatically tried to resolve the issue by stating that the content of the statutory and the general law duties is one and the same. [56] If so, what purpose is served by the bifurcation? Why have the statutory statement at all? Certainly civil penalties or standing for the regulator could be provided for in a more usual way.

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[52] The Southern District of New York (physically found in the Wall Street area) is the other.

[53] Delaware ferociously protects the discretion of its judiciary. Three points must be noted though. The Delaware statute is famous for its management friendly bias. The Delaware courts are highly specialised, sophisticated, commercial courts; complex commercial litigation is one of the major industries in Delaware. And thirdly, as Mark Roe has so intriguingly suggested in ‘Delaware’s Competition’ (2003) 117 *Harvard Law Review* 588, the Delaware legislature and its judiciary deliberately provide scope for great flexibility of interpretation of Delaware corporate law so as to pre-empt, if necessary, recourse to federal legislation in this area.

[54] See *supra [ ]*.

[55] There is a separate criminal offence created in section 184 of the Corporations Act 2001 (Cth) for breach of the statutory duties of good faith, use of position and use of information.

[56] See *ASIC v Adler* (2002) 41 ACSR 72 at 166; *Sheahan v Verco* (2001) 79 SASR 109; *Daniels v Anderson* (1995) 37 NSWLR 438.

Then there is the anomaly of the statutory business judgment rule. No generalised statutory directors duty of care, but a statutory exculpation, applicable to both the statutory duty of care and "their equivalent duties at common law and in equity" (s. 180(2)). The language is somewhat difficult. Does s. 180(1) create multiple duties? Does the duty of care sound in equity? It would appear that the exculpatory statutory business judgment rule (as proposed at a time when a comprehensive form of statutory directors duties was contemplated) survived whereas the proposal for the underlying statutory duties did not. Was there an ideological spin to this? Was it seen as a "pro-management" gesture, clumsy, but in the great Delaware tradition?

Be that as it may, the situation is now even more anomalous. After long debate, the UK has adopted statutory statements of directors duties[57] and made it very clear that these statutory duties, although informed by the general law, displace and take precedence over it.

Insolvent Trading

Given the hesitations concerning the creation of a statutory statement of directors duties, it is somewhat ironic that s. 588G (and its predecessor provisions) creates a statutory director's duty, in this case, to prevent insolvent trading.

It is important though to situate this duty in its context. The provisions relating to a director's duty to prevent insolvent trading appear in Chapter 5 of the CA 2001, "External administration", and more precisely, Part 5.7B, "Recovering property or compensation for the benefit of creditors of insolvent company". Division 3 of Part 5.7B is entitled "Director's duty to prevent insolvent trading".

So, conceptually, ss. 588G and following, are primarily insolvency provisions, which elsewhere would be found in separate insolvency legislation. That s. 588G is characterised as a director's duty at all is a misconception. Parallel provisions, in ss 588V and following, impose liability on holding companies in certain circumstances for insolvent trading of subsidiaries; statutory veil piercing.

[57] *Companies Act 2006* (UK) c 46, Chapter 2, ss 170-181.

The statutory scheme provided for in Division 3 of Part 5.7B is complex, unwieldy, and arguably of little real benefit to unsecured creditors. There is a little chart included in s. 588G (1A) as an aid to sorting through the provisions.

This is also relatively old law of UK derivation and has been the object of a fair amount of judicial and academic scrutiny. Opinion is divided on the utility of the provisions. Certainly there is some sympathy for the plight of unsecured creditors (possibly, although not conclusively, the ultimate beneficiaries of the regime). On the other hand, the direct and indirect costs associated with the regime appear unjustifiable.

First of all, the regime runs counter to one of the sacred tenets of corporations law, limited liability. In effect, together with s. 588V (liability of holding company for insolvent trading by subsidiary), the provisions create a statutory form of piercing the corporate veil, to reach both corporate controllers (the holding company) and, exceptionally even for veil piercing dogma, directors.

Supporters of the provisions maintain that, despite relatively little litigation involving the provisions, they serve to promote consensual settlements among creditors, companies and corporate directors. However, as a commercial matter, in the context of conducting business as an ongoing concern, the provisions are a director's nightmare. Corporations, like the rest of us, may be going into and out of insolvency on a daily basis. As Boros and Duns put it: "The Australian approach, which is to take a relatively hard line against directors, is in a number of respects a crude one both in terms of policy and practice".[58]

Detractors of the regime point out that no comparable provisions exist in US or Canadian corporate law. Mind you, provisions comparable to 588G and 588V, were they to exist in either the US or Canada, would not be found in corporations law at all, but rather in separate bankruptcy and insolvency statutes.

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[58] Elizabeth Boros and John Duns, *Corporate Law* (2007) 58.

But the absence of comparable “director’s duties for insolvent trading” in Canada and the United States may be a clue to the underlying problem in the Australian (and UK) statutes. The insolvent trading regime is designed to protect unsecured creditors by promoting their chances of collection in the face of the insolvency of the corporate debtor. One of the main commercial law differences between Canada and the United States on the one hand, and Australia and the UK, on the other, is the absence in the latter of a satisfactory, comprehensive, personal property security regime. [59] In North America (and New Zealand), it is very easy for a creditor, virtually any creditor, to *become* a secured creditor. And because of the comprehensive nature of the registration system for security interests, it is also relatively simple to ascertain the extent to which a potential debtor’s property may already be encumbered.

Thus, arguably, implementation of a comprehensive personal property security regime (along Canadian or New Zealand lines), in addition to the other benefits it would bring to the commercial community, would permit the elimination of a troublesome and complex area of the CA 2001. Happily, the Attorney-General’s office in Canberra is currently working on reforms to create an Australian personal property security regime which would be much closer to the New Zealand and Canadian models.[60] In implementing a separate personal property security statute, the trick would be not to forget to revisit, with a view to eliminating, the insolvent trading provisions in the CA 2001.

Share Capital Rules

The share capital rules contained in Chapters 2H (“Shares”) and 2J (“Transactions Affecting Share Capital”) also merit reconsideration. There have been numerous and welcome adjustments to these rules[61] in attempts to modernise them and keep up with

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[59] Here again, New Zealand has followed the North American model: see the *Personal Property Securities Act 1999* (NZ).

[60] “An exposure draft of an Australian PPS Bill is being prepared which I hope will be released publicly in the next month or so. The Bill takes a functional approach to personal property securities and be underpinned by a new PPS register. As you can imagine, we’re working very closely with the States and Territories. We’ve also had excellent support form the business community, including the banks, who recognise the efficiencies to be gained through a national PPS system.” Email to the author from Ian Govey, Attorney-General’s Office, Canberra, dated April 11, 2008.

[61]Chapter 2H comprises the sections 254A – 254Y, and Chapter 2J comprises the sections 256A – 260E. Each Chapter has been amended by four acts. Chapter 2H has been amended by the *Treasury*

rapidly evolving capital raising practices. However, the provisions jostle somewhat uneasily together. For example, if you eliminate the concept of par value (s. 254C), have the conceptual underpinnings for bonus shares (s.254A) been knocked out.

In other respects, the amendments to the capital maintenance rules in Chapter 2J may continue to generate unjustifiable impediments to legitimate capital raising and restructuring. Unlike the insolvent trading rules, which may be worrisome in theory but relatively marginal in practice, the share capital rules are at the very heart of corporate law. The complexity of Chapter 2J creates ample fodder for corporate law examination questions, but headaches for the corporate world.

Shareholders certainly deserve protection from dilution and other manipulative machinations involving the capital structure of the corporations in which they are invested. As for creditors, their interests may be protected in other ways. The share capital transactions chapter begins with a laudable statement of principle in terms of balancing the interests of shareholders and creditors when engaging in what would be characterised as a reduction of capital (not otherwise specifically permitted by the statute). But it is well understood that the old "impairment of capital" rules have never served creditors particularly well.

Given the breadth and complexity of the capital maintenance rules in Chapter 2J, the question should be asked: are they more honoured in the breach. That is to say, are they more or less ignored except in highly visible transactions? Such a situation would do little to promote a corporate culture of compliance. In international transactions, the provisions provoke consternation and frustration as they are at odds with the expectations of international practice.

The Revised Model Business Corporations Act in the US provides a very elegant alternative. Any "distribution" (a defined term which makes no distinction between

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Legislation Amendment (Application of Criminal Code) Act (No. 3) 2001 No. 117 (COM), the Corporations (Change of Incorporation) Regulations 2002 No. 168 (COM), the *Corporations Legislation Amendment Act 2003 No. 24* (COM) and the *Financial Sector Legislation Amendment Act (No. 1) 2003 No. 116* (COM). Chapter 2J has been amended by the *Treasury Legislation Amendment (Application of Criminal Code) Act (No. 3) 2001 No. 117* (COM), the *Financial Services Reform Act 2001 No. 122* (COM), the *Corporations Legislation Amendment Act 2003 No. 24* (COM) and the *Corporations Amendment (Insolvency) Act 2007 No. 132* (COM).

capital distributions or distributions out of profits, encompassing dividend payments, share buybacks, reductions in capital, etc) is subject to a solvency test comprised of both a balance sheet and a cash flow test. Directors are subject to personal liability if they get it wrong and shareholders may be required to disgorge unlawful distributions.[62]

CONCLUSIONS

Despite the massive amounts of legislative change in the 1990s and beyond, the CA 2001 remains a troubled and unsatisfactory piece of legislation. Unlovely and unloved. It is hard to escape the conclusion that the legislative reforms of the 1990s represented a missed opportunity, one that was seized in neighbouring New Zealand. If anything, addressing the difficulties now, may be more difficult than it was fifteen years ago. There are the usual constitutional difficulties that dog major change in the commercial law area (a problem which the UK and New Zealand do not share with Australia); the usual issues of path dependency and interest group pressures; reform fatigue.

Reconceptualisation of the overall framework of corporations legislation involves disentangling a matted complex of legislative stands reaching far into the commercial world. Many issues remain difficult ones and do not present easy answers. At the least though, there is a compelling argument for liberating the basic business corporation rules from the confines of the CA 2001. If at the same time it were possible to rationalise and reconceptualise some of the more problematic areas such as the treatment of directors duties or share capital transactions, all the better.

But in terms of ending this discussion with some food for thought, perhaps it is time to take a page from the book of regulatory competition. Do Canada and the United States have such well regarded business corporations statutes in part because there are so many of them (over 60 in all). Lots of room for experimentation, variety and choice? Should Victoria or New South Wales provide a sleek, modern business

[62] See the *Revised Model Business Corporation Act* (2002, 3rd ed): § 1.40 for a definition of 'distribution'; § 6.40 for 'Distribution to Shareholders'; § 8.30 for 'Director Standards of Conduct'; and § 8.23 for 'Liability for Unlawful Distributions'.

corporations vehicle to give the bloated old CA 2001 a run for its money? After all, there are no constitutional difficulties in doing so.