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5 December 2014

The Hon. Josh Frydenberg MP
Parliamentary Secretary to the Prime Minister
PO Box 6022
House of Representatives
Parliament House
Canberra ACT 2600

Email: officeofderegulation@pmc.gov.au

Dear Josh,

Deregulatory initiatives

The Australian Institute of Company Directors welcomes the opportunity to provide comments to the Government on areas where it can remove further unnecessary red tape.

The Australian Institute of Company Directors (Company Directors) is one of the two largest member-based director associations worldwide, with individual members from a wide range of corporations, including publicly-listed companies, private companies, not-for-profit organisations, charities and government and semi-government bodies. As the principal Australian professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

Company Directors is pleased that the Government is continuing its deregulatory agenda and considering ways to further reduce red tape and to deliver compliance cost savings for businesses. Creating a system of efficient regulation is a key element for boosting national productivity. We have long called for a reduction in red tape and reform of the whole system of creating, reviewing and removing regulation, most recently in our policy paper, "Towards Better Regulation".[1]

1. Summary

In summary, the comments of the Company Directors are as follows:

(a) In addition to the specific initiatives set out below, there are a number of broader issues that the Government must tackle if it is to achieve real change to the level of red tape currently impeding Australian businesses.

(b) To ensure that the regulation of corporations and directors remains efficient, effective and contributes to national productivity, we recommend the Government undertake the following specific deregulation initiatives:

(i) Insert an Honest and Reasonable Director Defence for directors into the Corporations Act.

[1] Australian Institute of Company Directors, "Towards Better Regulation" (July 2013). Available on our website http://www.companydirectors.com.au

(ii) Reinstate the Corporations and Markets Advisory Committee (CAMAC).

(iii) Reconsider the current thresholds for financial reporting.

(iv) Accommodate greater flexibility for entities trying to change their financial year end.

(v) Amend all provisions under various Commonwealth legislation that allow for the reversal of the onus of proof or the evidentiary onus of proof.

(vi) Insert a tailored licensing regime for litigation funders into the Corporations Act that is enforceable by ASIC.

(vii) Retain the Australian Charities and Not-for-profit Commission (ACNC), or at least core components of it.

(viii) Simplify and streamline the remuneration reporting requirements for listed companies under section 300A of the Corporations Act.

(ix) Remove potential liability for directors to indemnify the Commissioner of Taxation for specific taxes recovered in liquidation under section 588F of the Corporations Act.

2. Broad areas requiring attention

The growth of regulation and red tape imposes direct and indirect costs on Australian business, plays a role in hindering good business decisions and can prevent the growth of investment and job creation. Approaches to regulation and levels of red tape must be continuously monitored. If not, governments and regulators will cease to operate as effectively as they could due to complexity and the overlap of the legislation and regulations they are required to administer. While it is possible to identify specific issues that can be easily addressed through the amendment or repeal of certain provisions (and we have provided examples of such issues later in this paper), creating meaningful change to red tape is likely to also require more holistic, structural reforms.

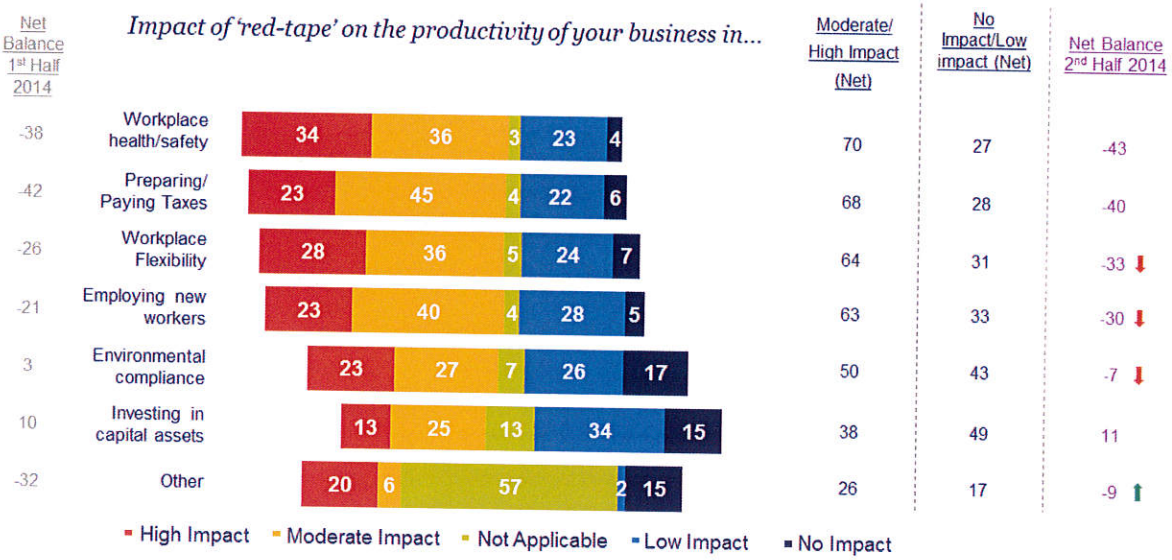
Twice a year, Company Directors surveys its membership to ascertain directors' views, current priorities and future intentions. The results are published in our "Director Sentiment Index" (DSI), which is Australia's only index of director views and sentiments on business, regulation, governance and public policy. Through the DSI, directors have consistently highlighted that the red tape that creates the greatest compliance burden for the businesses are the broader, complex and long term-issues, such as occupational health and safety, taxation and industrial relations.

In the most recent DSI covering the second half of 2014[2], directors identified a number of key areas where they feel their businesses are most affected by red tape (see diagram below).

[2] Australian Institute of Company Directors, "Director Sentiment Index: Research Findings Second Half 2014" (November 2014). Available on our website http://www.companydirectors.com.au

Impact of 'red-tape' on business productivity

Around 70 per cent of directors identify workplace health/safety and preparing/paying taxes as the aspects of their business most affected by 'red-tape'. These are followed by workplace flexibility and employing new workers.



If substantive reform is made in these areas, it may be that director sentiment regarding the level of red tape in Australia will move in a positive direction.

Improvement to the overall level of red tape facing corporations and directors in Australia could also be achieved through the amendment and simplification of the corporations and taxation laws. The sheer complexity and volume of these pieces of legislation significantly adds to the compliance burden faced by Australian businesses. For example, in its current form, the Corporations Act 2001 is in excess of 1800 pages in length. In addition to its length, the Corporations Act (and the obligations it imposes) are unnecessarily complex and cannot properly be understood by those trying to work within it. Similarly, the legislation relating to tax is virtually incomprehensible and excessively voluminous. Indeed, Chief Justice Patrick Keane of the Federal Court of Australia was quoted in 2011 as saying: "Opening the Tax Act is like entering the door to a parallel universe".[3]

3. Specific suggestions for regulatory change

While reform in the broader areas identified above are critical, we are encouraged that the Government is seeking further specific examples of where it can remove unnecessary red tape for business. To this end, we are of the view that the following areas provide scope for change and are suggestions of where significant improvements could be made to reduce the compliance burden on business, while providing a net regulatory benefit or a minimal regulatory detriment.

3.1 Insert a broad based director defence into the Corporations Act

We are firmly of the view that Australia needs to actively create an environment where directors that act with integrity and commitment are free to pursue and

[3] Eyers, James, "Top Judge hits out at federal laws", *The Australian Financial Review* (21 January 2011)

harness new opportunities, take calculated risks, drive performance and create jobs without being overly focussed on personal liability concerns.

Company Directors has long stated that the current business judgment rule does not provide directors with appropriate protection in the performance of their roles. The business judgment rule has very narrow operation. It only applies to one contravention of the Corporations Act, being the statutory duty of care and diligence in section 180(1) of the Act and its equivalent duties at common law and in equity. The business judgment rule is not available as a defence to any other alleged contravention of the Corporations Act (including for example, alleged breaches of disclosure provisions, corporate reporting requirements or the insolvent trading provisions).

We are concerned that requiring directors who perform their roles honestly and diligently, to operate in a regulatory environment where there is a lack of an effective business judgment rule defence and a high risk of personal liability is detrimental to Australia's economy and prosperity. We are of the view that the current approach to the regulation of directors deters good directors from accepting board positions, stifles innovation and entrepreneurialism, slows decision-making and dampens productivity.

The impact of stringent regulation causing directors to be overly concerned about personal liability manifests itself on numerous fronts. One example is Australia's insolvent trading regime. In Company Directors' view the insolvent trading regime, amongst other things:

- not only encourages, but effectively mandates directors to move to external administration as soon as a company encounters financial difficulties in order to avoid personal liability and consequent reputational damage;
- discourages directors from taking sensible risks when considering other kinds of informal corporate reconstructions or "work-outs" to deal with a company's financial problems; and
- can lead to losses by shareholders, creditors, employees and, in many cases, may have downstream impacts on the broader community through loss of the value of their investments, retirement savings and jobs.

Irrespective of any further insolvency reform approaches that may have merit, we consider that a critical element to addressing the problems created by the insolvent trading regime and numerous other corporate law issues is for directors to have access to a broad based defence in the Corporations Act.

We are of the view that the insertion of an overarching and broad-based defence into the Corporations Act is now required to protect directors that act honestly and with an appropriate level of commitment, but who now work in an increasingly complex and compliance focussed regulatory environment.

Company Directors has developed a proposed defence that would be available to directors in circumstances where he or she has conducted him or herself honestly, for a proper purpose and with the degree of care and diligence that the director rationally believes to be reasonable in the circumstances (the "Honest and Reasonable Director Defence")[4]. The defence would be available to all directors of companies regulated by

[4] Australian Institute of Company Directors, "The Honest and Reasonable Director Defence: A proposal for reform" (August 2014). Available on our website http://www.companydirectors.com.au

the Corporations Act (from small business owners to directors of large, public listed entities). Importantly, the defence does not lower standards for directors.

3.2 Reinstate CAMAC

Company Directors was very disappointed to learn of the Government's decision to disband CAMAC. CAMAC has played an important role in the development of the corporations law since it was created in 1989. As noted in our recent submission to the Government[5], it is our strong recommendation that CAMAC be reinstated.

While in the short term the abolition of CAMAC and streamlining its functions into Treasury may appear to be an effective cost saving measure, we are of the view that such a decision is short sighted and has the potential to increase red tape in the longer term. This is because there will no longer be a cost effective, highly experienced and independent body considering improvements to the corporate law in Australia.

As stated above, the hallmark of any solid deregulatory agenda is not just removing regulation but ensuring that the regulation which remains, is working as effectively as possible. One of the key elements in achieving effective regulation is to first determine whether a problem exists and if so, to appropriately define that problem. It is only then that analysis can be undertaken as to whether regulation or another option provides an appropriate solution. Regardless of one's views as to the recommendations proposed by CAMAC on particular issues, CAMAC has played a critical role in identifying, explaining and analysing corporate law and market related problems. CAMAC has also played an important educational role by preparing high quality and well researched reports which effectively set out technical issues in a clear and highly readable manner.

The level of consultation conducted by CAMAC with stakeholders is also noteworthy. CAMAC's expertise in the corporations and markets area ensures that there is a great understanding within CAMAC of the issues and laws being canvassed by stakeholders when consultation occurs. This has ensured high quality communication and debate on matters being considered by CAMAC.

3.3 Thresholds in financial reporting

Section 45A of the Corporations Act sets out the thresholds that proprietary companies must meet in order to be classified as either large or small for the purposes of the Act. Companies that satisfy two or more the criteria in section 45A(2) will be small proprietary companies and companies that satisfy two or more of the criteria in section 45A(3) will be large proprietary companies. This classification determines the nature and extent of financial reporting for such companies.

Company Directors recommends that the Government increase elements of these thresholds and reduce the financial reporting burden on smaller entities. We also recommend that the revenue threshold be increased to $100 million and the gross assets threshold be increased to $50 million in the relevant subsections.

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[5] Submission to Federal Treasury dated 24 October 2014. Available on our website http://www.companydirectors.com.au

3.4 Extend the period of a financial year for entities that are changing a subsequent financial year end

Section 323D(2A) of the Corporations Act limits how entities can change their subsequent financial year to a financial year that has a minimum duration of six months and a maximum duration of 12 months.

Company Directors would encourage amendment of this section to allow entities to change their year end and to have a subsequent financial year up to a maximum duration of 18 months when they have met the requirements set out in section 323D(2A). This amendment would increase the flexibility available to entities to change their year ends.

3.5 Amend legislation reversing the onus of proof applying to directors under various legislation

Any instances where Commonwealth laws reverse the usual onus of proof so that directors are deemed liable irrespective of whether or not they were to blame (unless they could prove the availability of a statutory defence) or where the evidentiary onus of proof is reversed should be amended. While the Government has already amended a number of these provisions, some still remain.

Examples of these include:

a) Section 12BB of the ASIC Act

The Corporations Act and the Australian Securities and Investment Commission Act 2001 (ASIC Act) contain various provisions that are relevant to statements or representations about future matters. Aside from provisions which require the corporation to disclose information about a future matter, corporations and directors must ensure that statements or representations do not contravene the prohibitions against misleading or deceptive conduct in both Acts. These provisions generally require that statements as to future matters be made on reasonable grounds.

In summary, section 12BB of the ASIC Act provides that a representation as to a future matter must be made on reasonable grounds. However, unlike section 769C of the Corporations Act section 12BB of the ASIC Act reverses the evidentiary burden of proof and assumes that the director and/or the corporation did not have reasonable grounds for making the representation with respect to the future matter unless the company or director can adduce evidence to the contrary.

We see no sound policy reason why the evidentiary onus of proof in the ASIC Act should be reversed when the equivalent provision in the Corporations Act does not reverse the evidentiary burden in this manner. We recommend that section 12BB of the ASIC Act be amended. The retention of this provision is just one of the reasons why there is hesitance on the part of directors to provide statements as to future matters.

b) Section 8Y of the Taxation Administration Act 1953

As noted in our submission to the Federal Treasury[6], section 8Y of the Taxation Administration Act 1953 provides that, if a corporation commits a taxation offence, a director of the corporation will be deemed to be guilty of the same offence. In other words, the provision reverses the fundamental legal principle that a person is innocent until proven guilty. It also fails to recognise that the corporation is a legal entity distinct from its directors by holding the directors liable for the corporation's offence, without the need for the directors to be involved in the offence.

Section 8Y should be re-drafted so that it becomes an accessorial liability provision which requires the prosecution to prove a director's involvement as an accessory to a corporation's taxation offence.

c) Division 269 of Schedule 1 of the Taxation Administration Act 1953

In 2012, the previous federal government passed the Tax Laws Amendment (2012 Measures No. 2) Bill 2012 which introduced Division 269 into Schedule 1 of the Taxation Administration Act. This Division makes directors personally liable for the company's unpaid superannuation guarantee amounts regardless of the directors' culpability. The measures apply to all directors of Australian companies registered under the Corporations Act, makes new directors personally liable for the actions of the company even when the person was not a director at the time of the company's breach. This provision offends against the rule of law as it amounts to a reversal of the onus of proof and the short notice periods set out in the Division to respond to ATO inquiries is burdensome.

We are of the view that these measures should be wound back, as noted in our previous submissions on this issue.[7]

3.6 Discourage the proliferation of shareholder class actions and support efforts to regulate litigation funders

Company Directors has consistently raised concerns about major litigation against corporations being instigated, promoted and funded by professional litigation funders. We continue to be concerned about the practice of litigation being commenced for the dominant purpose of profit-making by third parties that have no genuine interest in the issues being litigated.

Company Directors considers that the fundamental objective of the court system is to facilitate justice and to resolve real disputes between aggrieved persons. We are of the view that a regulatory regime which encourages the proliferation of class actions for third party profit is not in the best interests of the Australian economy or community.

Despite the deregulatory agenda of the Government, we are of the view that litigation funding is one area that needs to be subject to increased regulation. We have also

[6] Submission to Federal Treasury dated 3 September 2012. Available on our website http://www.companydirectors.com.au

[7] Submission to House of Representatives Standing Committee on Economics dated 26 October 2011, Submission to Federal Treasury dated 2 May 2012. Both submissions are available on our website http://www.companydirectors.com.au

consistently stated that our preference is for litigation funders to be subject to a tailored licensing regime contained in the Corporations Act which is capable of being enforced by ASIC.[8] We note that recommendation 18.2 in the Productivity Commission's recent draft report, "Access to Justice Arrangements" is broadly consistent with our recommended approach.

We are of the view that the increase in funded shareholder class actions is creating an environment where litigation funders and some lawyers are acting primarily as entrepreneurs and promoters of litigation. This may occur, for example, where a lawyer scans the ASX announcements platform for a corporate profit downgrade announcement and a subsequent share price fall, prepares a claim and then actively seeks out a plaintiff and group members who may wish to be involved in a class action against the corporation.

Company Directors remains of the view that class actions brought against corporations are highly complex pieces of litigation that have the potential to impose significant burdens on the companies and directors involved. This type of litigation due to its size and scale can impose costs on the public in the form of higher consumer prices, the diminution of share value (reflected in superannuation account balances) and decreased tax revenue (as corporate profits decline). While the government and commentators have focused on the access to justice arguments which support litigation funding for major class actions, little attention has been paid to the actual returns received by investors in these actions or the impact of such actions on Australian markets, productivity and the economy as a whole.

Accordingly, we recommend that the Government introduce effective regulation of litigation funders by way of a tailored licensing regime set out in the Corporations Act and enforceable by ASIC.

3.7 Reinstate ACNC (or at least core components of it)

Since the commencement of the not-for profit (NFP) reform in 2010/2011 and through a range of submissions, Company Directors has consistently repeated its view that the charity sector (and the broader NFP sector) would benefit from:

- an independent national regulator;
- reduction of red-tape;
- harmonisation of Federal, State and Territory regulations; and
- a "one-stop-shop" for reporting to government(s).

We do not believe that the abolition of the ACNC, or any of the options outlined in the paper "Options for Replacement Arrangements following the abolition of the Australian Charities and Not-for-profits Commission" (Options Paper), will assist in achieving the outcomes above. As noted in our submission to the Department of Social Services in response to the Options Paper[9], while we acknowledge that the ACNC had also not yet achieved those outcomes, we believe that it was at least on a path to achieving them.

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[8] Submission to Federal Treasury dated 17 August 2011, Submission to Treasury dated 27 January 2012, Submission to Federal Treasury dated 7 November 2012, Submission to ASIC dated 13 March 2013 and Submission to Productivity Commission dated 4 November 2013. All submissions are available at www.companydirectors.com.au.

[9] Submission to Department of Social Services dated 24 October 2014. Available on our website http://www.companydirectors.com.au

We understand the Government has made a commitment to abolish the ACNC. While we do not agree with this approach, we strongly encourage the Government to at least maintain elements of the ACNC that were delivering improved outcomes for the sector.

We believe the Government could achieve its commitment to abolish the ACNC and still improve outcomes for the sector if features of the current regime are maintained. Specifically:

- Directors' duties and governance standards in the ACNC Act 2012 that offer protections for volunteer directors are retained.
- A central reporting mechanism to government is established.
- A charities register that provides valuable information for a range of stakeholders is developed. It should be recognised that data collected on the charities register is a valuable source for research and policy development in the NFP sector.
- A firm commitment is made and upheld to create an agency/organisation tasked with harmonising, across jurisdictions all laws impacting the NFP and charity sector.

3.8 Streamline remuneration reporting requirements

Company Directors has long advocated for the need to reform remuneration reporting under the Corporations Act. Remuneration reports are becoming longer and more detailed and consume a significant amount of time for those organisations that are required to prepare them, particularly at the board level. The remuneration report is also not achieving the objectives for which it was originally introduced as it does not provide useful and easily-digestible information to shareholders.

As such, Company Directors believe that there is an urgent need to revisit all the requirements of section 300A to ensure that companies are able to report the remuneration outcomes of their key management personnel in a way that accurately reflect the company's remuneration philosophies and the actual pay received by these individuals.

3.9 Remove potential liability for directors to indemnify the Commissioner of Taxation for specific taxes recovered in liquidation

Under section 588FF of the Corporations Act, a liquidator of a company can seek a Court order to recover a payment of specific taxes (particularly PAYG and superannuation guarantee charge contributions) that the company made to the Commissioner of Taxation on the basis that the payment was an "unfair preference". If the Court makes such an order, section 588FGA (2) provides that: "Each person who was a director of the company when the payment was made is liable to indemnify the Commissioner in respect of any loss or damage resulting from the order".

The effect of section 588FGA is to place the Commissioner of Taxation in the unique position of being able to recover any amounts the Court orders the Commissioner to pay back to the liquidator from the company's directors. No other creditor is afforded this right.

We are of the view that section 588FGA should be repealed, as noted in our submission dated 27 November 2013.[10]

[10] Submission to Federal Treasury dated 27 November 2013. Available on our website http://www.companydirectors.com.au

We hope that our comments will assist the Government as it pursues deregulatory agenda. If you would like to discuss any of our views, please contact me or Senior Policy Advisor, Gemma Morgan, on (02) 8248 6600.

Yours sincerely,

John H C Colvin
Chief Executive Officer &
Managing Director