MEASURES TO ADDRESS WAKIM AND HUGHES:

HOW THE REFERRAL OF POWERS WILL WORK

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Introduction

The paper deals primarily with the measures that the Commonwealth and the States are taking to fix the problems which the High Court has identified over the last year or so with our present system of corporate regulation.

An effective and robust national regime of corporate regulation is fundamental to Australia's ability to generate wealth and employment, to attract investment, take a leading role in the global market place, and to position itself as a regional centre of excellence in financial markets and products.

In a globalised world, corporate regulation is a matter of national importance.

But Australia's governments have not always taken this view. The first 'co-operative' scheme of uniform Commonwealth and State companies and securities legislation was not established in Australia until 1981, with the enactment of the Commonwealth and State Companies Acts.[1] It replaced the 1961 scheme which was based on uniform State and Territory legislation. The 1981 scheme involved the application by the States of the Commonwealth Acts as State law and the establishment by the Commonwealth of a national administrative body, the National Companies and Securities Commission.[2]

Nor has the High Court seen comprehensive national corporate regulation as something within the powers of the national government. An attempt in 1989 by the Commonwealth to enact national corporations legislation foundered for want of constitutional power over incorporation of trading and financial corporations. In *NSW v Commonwealth*[3], a majority of the High Court held that the provisions of the Commonwealth's *Corporations Act 1989* enabling the incorporation of companies as trading and financial corporations were invalid. Many of you will recall that the majority in that case concluded that the word 'formed' in s.51(xx)

> is a past participle used adjectively, and the participial phrase 'formed within the limits of the Commonwealth' is used to describe corporations which have been, or shall have been created in Australia ... The subject of a valid law is restricted by that phrase to corporations which have undergone or shall have undergone the process of formation in the past, present or

[1] The Commonwealth enacted the *Companies Act 1981* and the *Companies (Acquisition of Shares) Act 1980*. Each State enacted application Acts applying the Commonwealth Acts.
[2] *National Companies and Securities Commission Act 1979*.
[3] (1990) 169 CLR 482.

> future. That is to say, the power is one with respect to 'formed corporations'.[4]

The contention that the expression 'formed within the limits of the Commonwealth' has no temporal significance[5] was rejected by the majority.

Following that decision, the current system of corporate regulation based on the Corporations Law was established, and came into operation on 1 January 1991.

The scheme is an example of the 'cooperative federalism' which the High Court had spoken about positively in the 1980s. For example, in *Duncans' case*, Chief Justice Gibbs remarked:

> There is no express provision in the Constitution, and no principle of constitutional law, that would prevent the Commonwealth and the States from acting in cooperation, so that each, acting in its own field, supplies the deficiencies in the power of the other ... [to achieve] a uniform and complete legislative scheme.[6]

In the same case, Deane J expressed the view that 'cooperation between the Parliaments of the Commonwealth and the States is in no way antithetic to the provisions of the Constitution: to the contrary, it is a positive objective of the Constitution'.[7]

The text of the Corporations Law is contained in a Commonwealth law enacted for the Australian Capital Territory. Laws of each State and the Northern Territory apply the Corporations Law of the ACT as a law of that jurisdiction. Commonwealth 'adjectival' laws, such as the Crimes Act, apply in relation to the Corporations Law.

The Corporations Agreement, to which the Commonwealth, all States and the Northern Territory are parties, imposes, as a political agreement, certain requirements on the Commonwealth in relation to amending the Corporations Law.

Responsibility for the administration and enforcement of the Corporations Law rests solely with Commonwealth bodies – the Australian Securities and

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[4] Ibid, 498.
[5] This view was expressed by Deane J, ibid, 506.
[6] *R v Duncan* (1983) 158 CLR 535, 552.
[7] *Ibid*, 589.

Investments Commission (ASIC), the Commonwealth Director of Public Prosecutions (DPP) and the Australian Federal Police (AFP).

Until recently, this combination of Commonwealth and State laws operated well and gave Australia – for the first time – an efficient and national approach to corporate regulation.

The problem: the unravelling of the Corporations Law

Recent decisions of the High Court, however, have revealed significant constitutional and statutory flaws in the Corporations Law scheme.

No constitutional flaws were at issue in the decisions in *Bond*[8] and *Byrnes*[9]; rather, the deficiencies revealed in those cases were gaps in the web of interlocking Commonwealth and State laws which comprise the present scheme. These two cases starkly illustrate the vulnerability inherent in a statutory network of the complexity of the Corporations Law scheme, which in reality comprises 8 separate laws masquerading as one.

In both cases, the appellants had been sentenced for offences against a State Companies Code (specifically the Codes of Western Australia and South Australia). As a result of the Commonwealth DPP's successful appeals against the sentences imposed, those sentences were increased.

In *Byrnes*, the Court found that the relevant State law[10] failed to confer necessary authority on the Commonwealth DPP to bring the appeal. Similarly, in *Bond,* the Court found that the necessary specific authorisation for the Commonwealth DPP to bring the appeal could not be found in Commonwealth law. The general conferrals of power Commonwealth law were insufficient. Both appellants therefore were successful.

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[8] *Bond v R* (2000) 169 ALR 607.
[9] *Byrnes v R* (1999) 164 ALR 520.
[10] That is, the transitional provisions in the *Corporations (South Australia) Act 1990* which sought to bring within the scope of the national scheme prosecutions for offences against the former co-operative scheme.

The High Court also took the opportunity to roundly criticise the complexity of the existing scheme, and gave some clue about what was to come in *Hughes*. In *Bond*, the Court said:

> [t]he appellant's arguments may appear to involve no more than dry and technical legal questions. Underlying those questions, however, are issues of considerable and general public and constitutional importance … which go beyond the construction of the particular statutory provisions which are involved. … Does the political responsibility for [a decision to appeal] lie with a Commonwealth or State Minister? Can one integer of the federation unilaterally vest functions in officers of another integer of the federation?[11]

Statutory deficiencies are, of course, within the power of parliaments to address legislatively. Thus, the *Commonwealth Director of Public Prosecutions Act 1983* was amended earlier this year by the *Jurisdiction of Courts Legislation Amendment Act 2000* to overcome the statutory deficiency exploited in the *Bond* case.[12]

However, the constitutional defects in the scheme which recent High Court decisions have revealed are not so easily remedied.

Re Wakim; ex parte McNally

The first constitutional blow to the scheme came with *Re Wakim*[13], which, after the Court's decision in *Gould v Brown*[14], was not entirely unexpected. The decision in *Re Wakim* invalidated significant aspects of the 'cross-vesting' provisions in the Corporations Law scheme, which, along with the general cross-vesting scheme, had been devised to remove uncertainties about the jurisdictional limits of the various federal, State, and Territory courts. Under the schemes, one court could determine all matters in dispute between the parties, effectively

[11] *Bond*, at [3] and [14].
[12] Most significantly, Schedule 5 of the JOCLA Act amended s.17 of the DPP Act.
[13] *Re Wakim; ex parte McNally* (1999) 163 ALR 270.

creating an integrated court system and ensuring the efficient, convenient, effective resolution of disputes.

In brief, the High Court in *Re Wakim* concluded that States cannot confer State jurisdiction on federal courts, as Chapter III of the Constitution constitutes an exhaustive statement of the manner in which the judicial power of the Commonwealth may be vested. Hence, Federal courts may hear and determine only matters falling within the terms of ss.75 or 76 of the Constitution. Matters arising under State laws do not fall into these categories.

The majority in *Re Wakim* also concluded that the Commonwealth cannot confer, or consent to the conferral of, State jurisdiction on federal courts.

The impact of the *Re Wakim* decision has been significant. The Federal Court has lost most of its jurisdiction in relation to Corporations Law matters.

The Attorney-General – as well as the legal and business communities more generally – expressed regret at the inability of the Federal Court to deal generally with Corporations Law matters. As the Australian Law Reform Commission noted recently, 'the Federal Court plays a pivotal role in relation to various sectors of economic activity – a role applauded and supported by corporations and corporate counsel'.[15] The Court is a national court, and has developed considerable co-ordinated expertise in the area of corporate law.[16] The fact that that specialist expertise is now unavailable to corporate litigants is a matter of concern to both the legal profession and the corporate world.

The Queen v Hughes

The constitutional validity of the Corporations Law scheme was again before the High Court earlier this year in *R v Hughes.*[17]

Mr Hughes challenged the conferral of State functions and powers on Commonwealth bodies and officials under the scheme. While the particular prosecution at issue in *Hughes* survived challenge, the Court's reasoning has serious ramifications for the Corporations Law scheme as a whole.

The Court appeared to confirm the general principle arising out of *Cram*[18] and *Duncan's case*[19] that Commonwealth authorities may perform State functions and

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[14] (1998) 193 CLR 346.
[15] ALRC, Report No. 89, *Managing Justice*, p.8.
[16] See remarks of Black CJ of the Federal Court, quoted in Towers, 'Black view of corporate regulation crisis', *Australian Financial Review*, 23 June 2000, p.34.

powers for the purposes of a co-operative Commonwealth/State scheme. But the Court indicated that the exercise by a Commonwealth authority or officer of State functions or powers coupled with a duty – particularly where the rights of an individual could be adversely affected - must be capable of being supported by a head of Commonwealth legislative power.

The Corporations Law covers a number of areas in respect of which the Commonwealth may lack legislative power. These include not only the incorporation of companies, but also the regulation of bodies corporate other than trading and financial corporations (for example, non operating holding companies) and their officers, and the regulation of managed investment schemes operated by individuals, including trusts and contractual arrangements.

As the Attorney-General has observed, in the wake of *Hughes*, and other recent decisions, there is a 'pervasive uncertainty about the foundations of corporate regulation in Australia'.[20] The recent decisions are compromising the ability of ASIC and the DPP to administer and enforce and the Corporations Law by rendering day to day regulatory processes vulnerable to challenge.

This is exemplified by the case of *GPS First Mortgage v Lynch*, in which Mr Lynch is challenging, on *Hughes* grounds, a company's ability to pursue bankruptcy proceedings against him. GPS is a Corporations Law company, incorporated by ASIC. Mr Lynch argues that ASIC was under a duty to perform the function of incorporation, but as there is no head of Commonwealth power to support this function, the incorporation by ASIC of GPS was invalid and void. Thus, it is argued that the company does not exist, and hence cannot maintain the bankruptcy proceedings against him. The Attorney-General has intervened to remove this case to the High Court.

A number of other similar cases have also been instituted and the High Court is likely to hear argument about this issue early next year.

If the High Court finds ASIC's function of incorporation under the Corporations Law scheme to be unconstitutional, approximately 660,000 companies incorporated by ASIC under the State Corporations Law since 1991 would

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[17] (2000) 171 ALR 155.
[18] (1987) 163 CLR 117
[19] (1983) 158 CLR 535
[20] The Hon Daryl Williams AM QC MP, Attorney-General, 'Action needed to end legal uncertainty for business', *Australian Financial Review*, 5 May 2000, p. 31.

essentially not exist. In addition, transactions entered into by these companies – for example, contractual arrangements – may be invalid.

I should indicate at this point that the Commonwealth believes that there are strong arguments in support of the validity of these incorporations. But to some extent, that is beside the point. The real point is that it is simply not acceptable for the system of corporate regulation – and the corporations which are the principle vehicle for conducting business – to be subject to continuing challenges to their validity.

The Chairman of ASIC, Alan Cameron, summed up the present situation earlier this year when he said:

> the impact [of these decisions] in terms of delay, disruption, uncertainty and sterile debate about technicalities has been all too real and expensive. Together the decisions show serious deficiencies in the arrangements underlying our system of corporate regulation. While the uncertainty remains, business and investor confidence must suffer... The Corporations Law is so critical to the way our economy and financial system works and the way companies work that to have a situation where there is any uncertainty at all is damaging.[21]

Many other commentators, including business, professional, and shareholder representatives, have echoed these concerns.[22]

In essence, the Corporations Law scheme is unravelling.

The solution: options

In *Hughes* Justice Kirby characterised the present scheme as beset by 'grotesque complications' and built on 'fiction piled upon fiction'.
He concluded that the Corporations Law scheme provides 'a fragile foundation for a highly important national law' and went on to warn that, although

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[21] Alan Cameron *The law's condition is critical, warns regulator* Australian Financial Review, 7 April 2000, p.31.

[22] See, for example, Professor Ian Ramsay, quoted in 'ASIC jurisdiction in jeopardy' *Australian Financial Review*, 4 May 2000, p.11; George Williams '*Hughes* decision heightens uncertainty' *Australian Financial Review*, 5 May 2000, p.33; 'No fix on the horizon for corporate law', *The Age*, 4 May 2000. p.C1; Professor Bob Baxt quoted in 'Questions unanswered', *Australian Financial Review*, 4 May 2000, p.10; Alan Cameron 'The law's condition is critical, warns regulator' *Australian Financial Review*, 7 April 2000, p.31; 'High Court may drive nail into Corporations Law coffin', *The Age*, 20 March 2000; Ian Dunlop, CEO, Australian Institute of Company Directors, 'Legal mess must be cleaned up as soon as possible', *Australian Financial Review*, 5 May 2000, p.57; 'Corporate Law fiasco must end', editorial, *Australian Financial Review*, 22 March 2000.

Mr Hughes's challenge was not successful, 'the next case may not present circumstances sufficient to attract the essential constitutional support'.[23]

Remedial action was therefore imperative. Doing nothing would simply ensure a long and very damaging period of uncertainty during which the courts examine, perhaps over a period of 10 years or more, every aspect of the current law.

Various options were put forward for consideration.

State law: the old NCSC model.

The option of relying on State law, and returning to something like the old co-operative scheme, was considered. The pre-1991 scheme involved 8 State/Territory corporate affairs commissions, responsible to the relevant State/Territory Minister, administering and enforcing the cooperative scheme legislation of their jurisdiction, coordinated by the National Companies and Securities Commission (NCSC).

That scheme was generally regarded as significantly flawed. It led to fragmented administration, ineffective use of resources and a lack of consistent and coherent regulation and enforcement.

Movement away from the current national system of corporate regulation under which the Commonwealth has full administrative responsibility and substantial policy responsibility would impose unnecessary costs on business and the wider community. It would also take us back to a legal framework which is not responsive to either the needs of business or changes in the global economic environment.

Constitutional reform

There has been a good deal of support for the constitutional amendment option. An amendment to the Constitution would obviously be a solution to the present difficulties, if it could be achieved in a timely manner. This, of course, is the problem. It would take too long to hold a referendum and the chances of success at the ballot box would, at best, be uncertain.

It is worth recalling that 44 proposals have been put at 19 referendums, but only 8 have been successful. Bipartisan support seems to be essential, but even this is no guarantee of success. While all of the successful referendums had bipartisan

[23] *Hughes*, 189.

support, 5 others which had bipartisan support failed.[24] Amendments that would have had the effect of increasing Commonwealth constitutional power have a particularly poor record. In particular, none of the 5 attempts to extend the corporations power in section 51 of the Constitution was successful.[25]

In any event, the practical difficulties in achieving an amendment quickly led the Attorney-General to rule out this option as a solution to the immediate problems we are facing.

Unilateral Commonwealth law

There is some scope for the Commonwealth to unilaterally enact a corporations law, particularly if the High Court were to reverse its view that the Commonwealth has no power to enact a general law for the incorporation of trading and financial corporations.[26] The High Court may have an opportunity to do this in *GPS First Mortgage v Lynch*, which, as already noted, is expected to be heard by the High Court early next year.

Unilateral Commonwealth legislation may also have been a more attractive option – and perhaps the only option – had all governments not agreed to an appropriate referral of corporate law and associated powers. But there are significant disadvantages in this option, the most fundamental of which is that there are several areas which the Corporations Law presently regulates, including incorporation, where the Commonwealth may lack power. As noted earlier, there are significant areas where this is the case.

Consequently, to the extent that provisions of a unilateral Commonwealth law regulated these areas, their validity would inevitably be challenged. Thus, this option may not have been any less vulnerable than the present scheme.

A unilateral Commonwealth law would also have disadvantages from the perspective of the States, as it would presumably have meant an end to the

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[24] These were Constitution Alteration (Legislative Powers) 1919, Constitution Alteration (Nationalisation of Monopolies) 1919, Constitution Alteration (Industry and Commerce) 1926. Constitution Alteration (Parliament) 1967, Constitution Alteration (Simultaneous Elections) 1977. In each case the Opposition party was the ALP. See Enid Campbell OBE, *Southern Memorial Lecture 1988: Changing the Constitution - Past and future*, 1989, 17 MULR 1, note 29.

[25] See proposals in relation to the following: 'legislative powers' (26 April 1911); 'corporations', 'industrial relations' (31 May 1913); 'legislative powers' (13 December 1919); 'industry and commerce' (4 September 1926); 'post-war reconstructions and democratic rights' (19 August 1944); 'industrial employment' (28 September 1946); in Select sources on constitutional change in Australia: 1901-1997, House of Representatives Standing Committee on Legal and Constitutional Affairs.

[26] *NSW v Commonwealth* (1990) 169 CLR 482.

current arrangements under the Corporations Agreement. At present, the States are consulted, and in relation to certain changes, including core company law matters, have a vote. They also receive CPI-indexed payments under the Agreement. Last year these payments totalled roughly $135 million.

Referral of State 'corporate regulation' powers

The option of States referring appropriate power to the Commonwealth pursuant to s.51(xxxvii) of the Constitution is by far the preferable option. The Attorney-General, and the Minister for Financial Services and Regulation, the Hon Joe Hockey MP, have made it clear for some time that this is the Commonwealth's preferred option.

An appropriate referral has several advantages. It:

- can be achieved relatively quickly;
- will provide certainty and restore confidence;
- will avoid the complexity of the current scheme;
- will enable the continued involvement of the States under a new Corporations Agreement; and
- will enable all the corporate law jurisdiction of the Federal Court to be restored.

There was also much support among business and legal communities for the referral option, and this support was no doubt influential in the decision of the State governments to pursue this option.

The agreement

Understandably, the States approached the suggestion that they refer power to the Commonwealth with caution. However, following intense discussion and negotiation over some months, at a joint meeting of the Standing Committee of Attorneys-General and the Ministerial Council for Corporations, the States unanimously agreed on 25 August this year to the referral option.

This agreement was an historic one, and one which was achieved in a remarkably short period following the *Hughes* decision. It will involve the most significant referral of 'power' by the States to the Commonwealth since federation.

Of course, there have been other referrals of State power. The referrals which enabled the Commonwealth to enact the Mutual Recognition Act in 1992 for the national recognition of standards in relation to goods and occupations were clearly significant, as were the somewhat less ambitious Commonwealth Powers (Meat Inspection) referral of 1983, and the Commonwealth Powers (Poultry Processing) referral of 1993. However, perhaps not surprisingly, none of these appears to have captured the headlines.

By contrast, the Corporations Law referral has become something of a cause celebre, at least for the business and legal communities. And for good reason. The referral will place the national system of corporate regulation on a new constitutional foundation and in so doing provide a secure basis for national economic development. It will enable the Commonwealth Parliament to enact a single Commonwealth Corporations law applying in all referring States and in the ACT and Northern Territory. The operation of the Corporations Law will no longer be dependent on State laws.

The agreed referral will provide constitutional certainty for, and restore robustness to, Australia's system of corporate regulation.

At their 25 August meeting Ministers agreed to a broad referral of the text of federalised versions of the existing Corporations Law and the *Australian Securities and Investments Commission Act 1989.*

The inclusion of an amendment power in the referral has always been seen as essential. If there were no power to amend the referred text, each State parliament would almost certainly need to make a new referral each time the new national law needed to be amended. The net result of a referral of a text without a power to amend it would be an inflexible and potentially non-uniform regulatory framework. A responsive amendment mechanism, producing uniform results across Australia, is therefore crucial to the success of the new scheme.

Consequently, the States also agreed at the 25 August meeting to a further referral of matters relating to the formation of companies, corporate regulation and the regulation of financial services and products. Constraints on the Commonwealth

Parliament's use of this referred matter will be built in to the referral legislation and the Corporations Agreement.

As the States consider that it is important to ensure that the referral is reviewed after a period, it was agreed that the referral would terminate after 5 years unless the States actually extend it.

Progress on the agreement

A huge amount of work has already been undertaken to enable the agreement to be put in place in the form of a new Commonwealth law. Work is now progressing in 5 broad areas.

First, there is the preparation of the State legislation required to refer the relevant 'matters' of State power to the Commonwealth.

Secondly, there is the preparation of the new Corporations Act and Australian Securities and Investments Commission Act, to be enacted by the Commonwealth Parliament in reliance on the State referrals. This includes the drafting of transitional provisions to ensure a smooth translation to the new regime.

Thirdly, there is the preparation of the State legislation required to ensure the validity of past actions of Commonwealth bodies such as ASIC and the DPP.

It will also be necessary for States to prepare consequential legislation to ensure that references in State law will 'plug in' to the new Commonwealth law.

Finally, there is the preparation of a replacement Corporations Agreement, to provide a political compact between the Commonwealth and State governments dealing with the arrangements underpinning the new constitutional basis of the Corporations Law.

After the 25 August meeting, the Attorney-General and Mr Hockey identified January 2001 as a target date for the commencement of the new national Corporations Law.

State and Commonwealth officers are now working on the detail of the many complex transitional and consequential matters that are thrown up in moving to the new national law.

Three main issues remain to be settled.

First, there is the issue of how to deal with State laws which will be inconsistent with the new Commonwealth law, and which, in light of s.109 of the Constitution, risk being rendered inoperative once the Commonwealth law comes into operation. There is also the question of the scope for States to enact future inconsistent laws.

Secondly, the States are concerned that the move to the new Commonwealth law may have implications for State revenue receipts arising from transactions relating to companies, such as stamp duty on transfers of securities. This is, of course, a matter for the States, but the Commonwealth has been assisting the States to seek a common, agreed position.

In relation to both these issues, as with the Corporations Law more generally, the Commonwealth's position has been to seek to preserve as far as possible, the status quo.

The third matter is the question of State and Territory voting rights under the Corporations Agreement in relation to amendments of the new Commonwealth law.

At the 25 August meeting, Mr Hockey and the Attorney-General accepted the State point of view that arrangements under the Agreement should be changed to enhance the position of States in relation to voting on amendments to the new national law.

However, it would be highly undesirable to risk creating difficulties of accountability and responsiveness as a result of alterations to the voting requirements in the Corporations Agreement. Australia's position in the global marketplace depends on an effective, responsive and flexible regulatory framework. The capacity to amend, and the uniformity of the new law, are crucial to the maintenance of a viable national law.

The timetable is very tight, but the Commonwealth is continuing to press for the States to enact their referral legislation in time to permit introduction of the Commonwealth legislation by the end of this year.

The challenge is to maintain the momentum that has already been achieved and to establish a single, national corporations law next year. It is worth emphasising that Commonwealth legislation cannot be enacted until the States agree on the precise form of the referral (including the proposed Commonwealth legislation), and referral legislation is passed by State Parliaments.

Once the new law is in operation, Australia will have in place a regulatory regime for commercial activity that is certain, robust, adaptable, efficient and swift, unhampered by jurisdictional difficulties, legal complexities and cumbersome administrative and regulatory structures.