HOW FAR CAN LEGISLATION PROVIDE FOR CORPORATE GOVERNANCE IN THE CONTEXT OF INTERLINKED ENTITIES?

THE STANDING COMMITTEE ON COMPANY LAW REFORM WAS ASKED BY THE THEN FINANCIAL SECRETARY, WHO IS NOW THE CHIEF EXECUTIVE, DONALD TSANG WHO OPENED THIS CONFERENCE ON TUESDAY TO LOOK AT CORPORATE GOVERNANCE. BEING RATHER NAÏVE, I THOUGHT IT WOULD BE ALL ABOUT HOW TO MAKE A COMPANY RUN BETTER, SOMETHING I WAS PARTICULARLY ILL EQUIPPED TO ADVISE ON SEEING AS I HAD BEEN A BARRISTER SPECIALISING IN PATENTS AND TRADE MARKS AND THEN A JUDGE ALL MY WORKING LIFE. ANYWAY IT SOON BECAME CLEAR THAT WE HAD TO LOOK AT THE LAW AND AT THE REGULATIONS BECAUSE AT LEAST PART OF CORPORATE GOVERNANCE MEANT "HOW TO CATCH THE CROOKS". I THOUGHT THEN, AND STILL FEEL, OTHERS ARE MUCH BETTER EQUIPPED TO CONSIDER. SO FOR 4 YEARS WE CONSIDERED CORPORATE GOVERNANCE EW MADE PROPOSALS, HAD 2 PUBLIC CONSULTATIONS AND MADE OUR RECOMMENDATIONS. THIS MORNING I THOUGHT I WOULD TALK ABOUT A FEW THINGS THAT HAVE COME OUT OF OUR WORK. IF I STRAY FROM THE TITLE OF THE TALK I HOPE YOU WILL EXCUSE ME.

AS YOU WILL HAVE SEEN I HAVE CHOSEN AS THE TITLE TO MY TALK *HOW FAR CAN LEGISLATION PROVIDE FOR CORPORATE GOVERNANCE IN THE CONTEXT OF INTERLINKED ENTITIES?* THERE IS NO EMPIRICAL ANSWER TO THAT QUESTION. MY ANSWER TO THE FIRST PART OF THE QUESTION IS THAT LEGISLATION IS NECESSARY, PARTICULARLY IN RESPECT OF PUBLICLY LISTED COMPANIES BUT ALSO IN RESPECT OF PRIVATE COMPANIES. THAT CONCLUSION IS, PERHAPS, REGRETTABLE BUT IS NEVERTHELESS QUITE CLEAR. NOR IS THERE AN EMPIRICALANSWER TO THE, PERHAPS, BETTER PHRASED QUESTION *HOW FAR IS IT DESIRABLE FOR LEGISLATION TO PROVIDE FOR CORPORATE GOVERNANCE IN THE CONTEXT OF INTERLINKED COMPANIES.* I WOULD SUGGEST THAT LEGISLATION IS A MEANS TO AN END, BUT CANNOT OF ITSELF PROVIDE THE ANSWER. TO MY MIND THE STARTING POINT SHOULD BE ADEQUATE DISCLOSURE IN APPROPRIATE CIRCUMSTANCES. THE END RESULT HAS TO BE EFFECTIVE POWERS OF ENFORCEMENT.

REGULATION OF CORPORATE AFFAIRS MUST BE PREMISED UPON THE OBJECTIVE THAT BUSINESS MUST BE ALLOWED TO PROSPER. OVER REGULATION LEADING TO RESTRICTIONS WHICH HAMPER LEGITIMATE BUSINESS WILL HAVE A NUMBER OF CONSEQUENCES. OTHER SPEAKERS HAVE ALREADY MENTIONED THEM. THEY CANNOT BE DISCOUNTED AS BEING MERELY SIDE-EFFECTS. THEY CAN BE COUNTER-PRODUCTIVE AND AGAINST THE GOOD OF THE COMPANY, THE SHAREHOLDERS AND EVEN THE CREDITORS. AMONGST THE MOST OBVIOUS HAZARDS ARE THAT OVER-ZEALOUS REGULATIONS MAY IMPOSE RESTRICTIONS DETER COMPANIES FROM BUSINESS WHICH COULD OTHERWISE RIGHTFULLY BE CARRIED OUT; THEY ARE ALSO LIKELY TO CAUSE AN UNNECESSARY AMOUNT OF COSTS TO BE INCURRED BY THOSE WHO SEEK TO OBSERVE THE REGULATIONS. A SMALL RESEARCH COMPANY IN THE UNITED STATES THAT

REINVESTS ALL PROFITS BACK INTO RESEARCH ESTIMATES THAT HIRING THE EXTRA ACCOUNTING SERVICES COSTS THEM 3 RESEARCH SCIENTISTS. ONE HAS TO FACE IT THAT THE HONEST GUYS ARE GOING TO COMPLY AND IT WILL COST THEM AND THE CROOKS ARE ALWAYS GOING TO BE CROOKS.

QUITE APART FROM ALL THAT, THERE IS THE ILL WHICH I HAVE ALWAYS CONSIDERED TO BE PROBABLY THE MOST SERIOUS, OVER REGULATION SPAWNS AN ATTENTION TO DETAIL THAT LEADS TO THOSE RESPONSIBLE FOR CORPORATE CONDUCT TO CONCENTRATE ON THE MINUTIAE AND TO FORGET THE IMPORTANT PRINCIPLES. LISTENING TO THE TALK WE HAD ON THE ENRON SAGA THAT SEEMS TO ME WHAT HAPPENED THERE. AND YESTERDAY MORNING WE HAD A DISCUSSOIN ON **PRINCIPLES** AND **REGULATIONS**. BOTH ARE NECESSARY, BUT I SUGGEST THAT THE ULTIMATE GOAL MUST BE TO GET THE PRINCIPLES RIGHT AND UNDERSTOOD. THE REGULATIONS CAN ONLY BE A MEANS TO THAT END. THE TROUBLE IS THAT A CONCENTRATION ON DETAILED RULES LEADS TO ONE LOSING SIGHT OF THE BIG PICTURE. FOR EXAMPLE WITH ACCOUNTS THE BIG PICTURE IS "DO THEY SHOW A TRUE AND FAIR VALUE OF THE COMPANY?" LOSE SIGHT OF THAT AND TROUBLE STARTS. IT'S THE SAME PROBLEM NIXON HAD. YOU GET A LOT OF BRIGHT YOUNG PEOPLE TOGETHER AND THEY THINK THEY FIND A WAY ROUND THE RULES. YOU HAVE GOT TO HAVE PEOPLE WITH EXPERIENCE AND INTEGRITY TO SAY "THIS IS WRONG – BLOW THE WAY SECTION 205 SUBSECTION 2(A) OR WHATEVER SAYS."

THE SIGNIFICANCE OF RELATED OR INTERLINKED ENTITIES IS THAT THEY SEEMINGLY PRESENT VERY DIFFICULT PROBLEMS. IN FACT THE REASON I PICKED THIS AS THE TITLE OF THIS TALK WAS THAT WHEN THE STANDING COMMITTEE WAS DOING ITS WORK ON CORPORATE GOVERNANCE THIS WAS BY FAR THE MOST DIFFICULT ASPECT. THERE IS PERHAPS LITTLE NECESSITY TO EXAMINE TO ANY GREAT DEPTH WHAT CONSISTS OF A RELATED OR INTERLINKED COMPANY. PRIMARILY ONE IS CONSIDERING THOSE WHERE A SINGLE SHAREHOLDER HAS SHAREHOLDINGS IN BOTH COMPANIES AND, OF COURSE, WHERE THAT SHAREHOLDING IS SUBSTANTIAL THIS IS ALL MORE IMPORTANT. ONE ALSO HAS TO CONSIDER THE POSITION OF DIRECTORSHIPS. MULTIPLE DIRECTORSHIPS, OFTEN THE RESULT OF SUBSTANTIAL SHAREHOLDINGS, CREATE EVEN MORE ACUTE PROBLEMS. WHAT MAY BE RELEVANT HERE ARE DEALINGS BETWEEN THE COMPANY AND EITHER THE DIRECTOR HIMSELF OR MORE USUALLY, ANOTHER COMPANY IN WHICH THE DIRECTOR HAS A SUBSTANTIAL INTEREST, OR, INDEED, DEALINGS BETWEEN ONE COMPANY AND AN ASSOCIATED COMPANY.

HONG KONG HAS A LARGE NUMBER OF LISTED COMPANIES WHERE THERE IS ONE SUBSTANTIAL SHAREHOLDER. THAT PERSON IS USUALLY THE FOUNDER OF THE COMPANY OR HAS OTHERWISE ACQUIRED A CONTROLLING INTEREST. YESTERDAY ESTELLA NG TOLD US OF HANG LUNG WITH THE FAMILY BEING THE MAJOR SHAREHOLDER. THAT IS BY NO MEANS UNUSUAL. READING THE NEWSPAPERS ONE GATHERS THAT HONG KONG IS NOT ALONE IN THIS REGARD. IT IS NOT AN

EXAGGERATION TO SAY THAT IT IS QUITE COMMON THROUGHOUT THE REGION AND A FREQUENT OCCURRENCE IN OTHER PARTS OF THE WORLD THAT LISTED ENTITIES HAVE A MAJOR IF NOT CONTROLLING SHAREHOLDER. BECAUSE OF THAT, ONE MIGHT SUPPOSE THAT IT IS NECESSARY ALWAYS TO BE ON THE LOOKOUT FOR THE CONTROLLING SHAREHOLDER ATTEMPTING TO TAKE AN UNFAIR ADVANTAGE IF NOT TO APPROPRIATE ASSETS OF THE COMPANY TO HIMSELF. BUT THAT IS PROBABLY BASED ON AN INACCURATE PERCEPTION. ACCORDING TO AN ACADEMIC SURVEY COMMISSIONED BY THE STANDING COMMITTEE A COUPLE OF YEARS AGO, CLOSELY HELD COMPANIES FAIRED NO WORSE THAN, AND OFTEN BETTER THAN, COMPANIES WHERE THE SHAREHOLDING WAS DIVERSE. I SHOULD SAY THAT THE APPARENT INCIDENCE OF WHAT MIGHT BE TERMED GENERALLY AS "MISCONDUCT BY CONTROLLING SHAREHOLDERS" IS, THANKFULLY, LOW. INDEED, ONE CAN SAY THE CONTROLLING SHAREHOLDERS ARE MORE LIKELY TO HAVE THE BEST INTERESTS OF THEIR COMPANY AT HEART THAN ARE THE MINORITY SHAREHOLDERS. AND NO ONE HAS YET EXPLAINED TO ME WHY ONE SHOULD ASSUME THAT ALL MINORITY SHAREHOLDERS ARE THINKING IN TERMS OF THE COMPANY RATHER THAN OF THEMSELVES. THERE IS NO REASON WHY A MINORITY SHAREHOLDER SHOULD NOT HAVE INVESTMENTS, IF NOT A CONTROLLING INTEREST, IN COMPETITORS. A SMALL SHAREHOLDER IS POSSIBLY MORE LIKELY TO BE LOOKING AT THE SHORT TERM RATHER THAN THE LONG TERM.

WHY LEGISLATION?

IT IS, PERHAPS, LOGICAL, IF NOT HELPFUL, TO SEE WHY LEGISLATION MIGHT BE NECESSARY IN THE FIRST PLACE. THE ANSWER TO MY MIND IS QUITE SIMPLE. THE ONLY THING THAT CAN ULTIMATELY CONTROL A PERSON'S ACTIONS IS THE LAW AND THE THREAT OF SOME MEANINGFUL SANCTIONS IF THE LAW IS BROKEN. THE LAW THAT HAS BEEN DEVELOPED BY THE COURTS, MOSTLY IN THE 19TH CENTURY, HAS PROVED INADEQUATE TO ADDRESS ALL ASPECTS OF CORPORATE MANIPULATION. FURTHERMORE, THE VARIOUS REMEDIES ARE IN REALITY INADEQUATE FOR PROPER PROTECTION PARTICULARLY OF SHAREHOLDERS, NOT TO SAY CREDITORS, OF LISTED COMPANIES.

BRIEFLY THE LAW DEVELOPED BY THE COURTS IS THAT A SHAREHOLDER IS NOT ENTITLED TO VOTE IN RESPECT OF RESOLUTIONS AUTHORISING HIS OR HER ACQUISITION OF COMPANY PROPERTY, EVEN AT WHAT MIGHT BE CONSIDERED AN ACCEPTABLE PRICE. THIS HAS BEEN ANALYSED AS BEING A RULE AGAINST APPROPRIATION. THE DEVELOPMENT OF THE LAW HAS NOT PROPERLY ADDRESSED THE ISSUE OF SHAREHOLDERS DEALING WITH THE COMPANY GENERALLY AND IN PARTICULAR HAVING AN INTEREST IN COMPANY CONTRACTS. THE COURTS HAVE NOT TAKEN AN ADVERSE REACTION TO SHAREHOLDERS VOTING IN FAVOUR OF APPROVING CONTRACTS WHERE THEY HAD, EITHER DIRECTLY OR INDIRECTLY, AN INTEREST IN THE PROVISION OF ITEMS OR SERVICES THAT WERE BEING ACQUIRED BY THE COMPANY. THIS COMMON LAW APPROACH MANIFESTED ITSELF IN A NUMBER OF CASES. I REGRET TO SAY THAT IT

MANIFESTS ITSELF EVEN TODAY IN ONE OR TWO RATHER BLATANT INSTANCES. YESTERDAY WE HEARD ABOUT NAMING AND SHAMING. WELL I CAN TELL YOU THAT THE NEWSPAPERS HAVE DONE THAT ON SIME NOTABLE OCCASIONS, BUT IT DOES NOT SEEM TO HAVE MADE MUCH DIFFERENCE NOR STOPPED THE INDIVIDUALS CONCERENED GOING AROUND TOWN AS BOLD AS BRASS.

THE REMEDIES. THERE IS THE DERIVATIVE ACTION, WHETHER UNDER THE NEW STATUTORY SCHEME RECENTLY ENACTED IN HONG KONG OR UNDER THE PREVIOUS SCHEME, REALLY ONLY EMPHASISED THE EXISTENCE OF MAJORITY RULE. BRIEFLY A DERIVATIVE ACTION IS BROUGHT BY A SHAREHOLDER OF THE COMPANY IN RESPECT OF A WRONG DONE TO THE COMPANY. IT IS AN ACTION TAKEN BY THE SHAREHOLDER FOR THE BENEFIT OF THE COMPANY AND NOT FOR HIMSELF. THE CASE LAW WAS NOT PARTICULARLY CLEAR NOR WAS IT ENTIRELY PREDICTABLE. A DERIVATIVE ACTION IS EXPENSIVE. UNFORTUNATELY IT HAS BEEN MADE MORE EXPENSIVE BY THE INTRODUCTION OF NEW RULES OF COURT REQUIRING EVEN MORE DIFFICULTIES TO BE SURMOUNTED BY THOSE WHO WISH TO BRING SUCH AN ACTION. AS AN ASIDE, I WOULD MENTION THAT MY PERSONAL VIEW IS THAT THESE NEW RULES ARE UNNECESSARY AND IN THEMSELVES ADD TO THE COSTS BY ADDING TO THE STEPS THAT MUST BE TAKEN BY A PROSPECTIVE LITIGANT. THEY HAVE BEEN BROUGHT ABOUT, IN MY VIEW, BECAUSE SOME JUDGES, I HAVE TO SAY IN OTHER JURISDICTIONS, HAD BEEN UNABLE TO CONTROL THEIR OWN COURT. OFTEN, THE COSTS OF A DERIVATIVE ACTION HAVE ULTIMATELY TO BE BORNE BY THE COMPANY. THE FUNDING OF A DERIVATIVE ACTION THUS BECOMES PROBLEMATIC. IF THE COURT IS TO AUTHORISE THE PERSON BRINGING THE ACTION ON BEHALF OF THE COMPANY TO BE REIMBURSED DURING THE COURSE OF THE ACTION IT INVOLVES THE COURT TAKING A PRELIMINARY VIEW ON THE CASE. IF THE PERSON BRINGING THE ACTION IS NOT FUNDED BY THE COMPANY THEN, INEVITABLY, THAT PERSON HAS TO FINANCE THE ACTION OUT OF HIS OWN RESOURCES. SINCE, AT BEST, SUCCESS IN THE ACTION WOULD BE OF VERY LIMITED INDIRECT PERSONAL BENEFIT THERE IS LITTLE INCENTIVE FOR A MINORITY SHAREHOLDER TO PURSUE A DERIVATIVE ACTION. IF THE MAJORITY OF THE MEMBERS ARE NOT IN FAVOUR OF THE ACTION THERE IS GOOD REASON THAT IT SHOULD NOT PROCEED BECAUSE, AS HAS BEEN SAID, THE ACTION CAN HAVE THE EFFECT OF KILLING THE COMPANY WITH KINDNESS

REMEDIES SUCH AS THE UNFAIR PREJUDICE ACTION MAY PERHAPS BRING SOME RELIEF TO THE MORE WELL-HEELED SHAREHOLDERS OF PRIVATE COMPANIES BUT SHAREHOLDERS OF LISTED COMPANIES ARE RARELY, IF EVER, LIKELY TO BE ABLE TO USE THAT REMEDY.

HONG KONG HAS NOT YET PROVIDED FOR CLASS ACTIONS. THERE IS A GREAT DEAL OF PRESSURE FOR THE INTRODUCTION OF CLASS ACTIONS AND IT IS THOUGHT THAT, IF ADOPTED, THEY WOULD BE EFFECTIVE AS A TOOL FOR CORPORATE GOVERNANCE. WHETHER THAT WOULD BE SO IS, AT PRESENT, A MATTER OF

CONJECTURE BUT LIKELY TO BE DETERMINED IN THE FUTURE. ONE OF THE DIFFICULTIES OF CLASS ACTIONS IS THAT THEY CAN EASILY BECOME MORE OF A MEANS OF OBTAINING AN UNMERITORIOUS RESULT BY REASON OF THE THREAT OF HEAVY DAMAGES THAT MIGHT RESULT FROM IT. I WOULD HESITATE TO USE THE WORD BLACKMAIL, BUT, AT TIMES, THEY CAN BE LITTLE MORE THAN THAT. SPEAKING FROM PERSONAL EXPERIENCE, HAVING BEEN THE BENEFICIARY OF TWO CLASS ACTIONS, I CAN ONLY SAY THAT I HAVE HAD NOTHING TO DO WITH THE COMMENCEMENT OF THEM, WAS DUBIOUS, TO SAY THE LEAST, ABOUT THE MERITS OF THEM, BUT, WITHOUT DOING ANYTHING MYSELF, I HAVE BENEFITED FROM SETTLEMENTS WHICH I CONSIDER HAD NO LEGAL MERIT ON THE PART OF THE PLAINTIFFS.

I TURN THEN TO CONSIDER THE MAJOR CONTROL THAT HAS SO FAR BEEN DEVELOPED IN HONG KONG. IT IS THE USE OF THE LISTING RULES.

THE LISTING RULES, BEING RULES OF THE STOCK EXCHANGE, CAN, AT THE MOMENT, PROVIDE HALF AN ANSWER AND, UNFORTUNATELY THAT HALF IS UNSATISFACTORY. THE PRIMARY POINT IS THAT THE LISTING RULES DO NOT AS MARTIN WHEATLEY WAS SAYING YESTERDAY HAVE THE FORCE OF LAW. THE EFFECT IS, THEREFORE, THAT A BREACH OF THE LISTING RULES DOES NOT CARRY WITH IT ANY CONSEQUENCES OTHER THAN THOSE THAT THE STOCK EXCHANGE CAN ITSELF IMPOSE. THOSE PENALTIES RANGE FROM PUBLIC CENSURE, ULTIMATELY, TO DELISTING. NONE OF THESE PENALTIES BENEFIT THE SHAREHOLDERS OTHER THAN IN A RATHER HYPOTHETICAL WAY AND IT CAN HARDLY BE SUPPOSED THAT MOST SHAREHOLDERS WOULD BE SO ALTRUISTIC AS TO BE SATISFIED WITH SUCH PENALTIES AS REMEDIES OR TO RELISH THE PROSPECT OF THE COMPANY HE HAS INVESTED IN BEING DELISTED. IMPORTANTLY THERE IS A PROBLEM THAT WHATEVER SANCTIONS THE STOCK EXCHANGE CAN IMPOSE, THEY DO NOT, IN REALITY, PROVIDE A DETERRENT.

THERE IS ALSO THE DEFECT THAT THE STOCK EXCHANGE BEING A TRADING ENTITY CANNOT BE GIVEN POWERS OF INVESTIGATION.

I WOULD NOT LIKE TO PUT FORWARD A LIST OF WHAT MIGHT BE CONSIDERED THE CARDINAL SINS OF CORPORATE GOVERNANCE BUT HIGH AMONGST THOSE PECCADILLOES MUST BE INACTION. AS IS SO OFTEN OBSERVED NOTHING STANDS STILL AND, CERTAINLY IN THE CORPORATE SECTOR, MATTERS MOVE ON AT AN EVER INCREASING PACE. WE HEARD YESTERDAY ABOUT HOW MARKET REGUALTION IN ALMOST EVERY COUNTRY USED TO BE IN THE HANDS OF THE STOCK EXCHANGE, WHICH OPERATED A SELF REGULATING ORGANISATION, MUCH LIKE THE PROFESSIONS USED TO. NEVERTHELESS, NEARLY 4 YEARS AGO THE GOVERNMENT OF HONG KONG APPOINTED AN EXPERT PANEL TO ADVISE IT AS TO HOW THE MATTER CAN BE TAKEN FORWARD. THEIR REPORT CAME OUT MORE THAN THREE YEARS AGO. IT WAS CLEAR. IT WAS ALSO LOGICAL. IT STARTED ON THE FOOTING THAT THERE WAS NOTHING WRONG IN RELYING

ON THE LISTING RULES OR SOMETHING SIMILAR AS A MEANS FOR ENFORCING ESSENTIAL CORPORATE GOVERNANCE RULES. BUT IF THOSE RULES WERE TO HAVE ANY FORCE THE SANCTIONS FOR NON-OBSERVANCE MUST BE SUCH THAT THEY HAVE A DETERRENT EFFECT. SOMETHING MORE THAN A PUBLIC REPRIMAND WAS NECESSARY. MAYBE IT MIGHT BE A FINE. POSSIBLY DISQUALIFICATION AS A DIRECTOR WOULD BE A GREATER PENALTY. ONE CAN THINK OF OTHERS. BUT THOSE PENALTIES CANNOT BE LEFT IN THE HANDS OF A TRADING ENTITY AND THE STOCK EXCHANGE IS A TRADING ENTITY. GONE ARE THE DAYS OF THE EAST INDIA COMPANY, WHERE THE COMPANY COULD RULE AS IF IT WERE ITS OWN STATE.

HENCE THE PROPOSALS WERE, AMONGST OTHER THINGS, THAT THE MAKING AND ADMINISTERING RULES ON LISTING-RELATED MATTERS SHOULD BE PERFORMED BY A NEW LISTING AUTHORITY TO BE ESTABLISHED WITHIN THE SFC. THE SFC WOULD BE ENTITLED TO MAKE RULES UNDER THE SECURITIES LEGISLATION. DECISIONS OF THE LISTING AUTHORITY WOULD BE SUBJECT TO APPEAL TO A LISTING PANEL. THE VARIOUS ARGUMENTS AND COUNTERARGUMENTS THAT WERE PUT FORWARD BY THOSE OPPOSING SUCH A PROPOSAL, AND BY THOSE IN FAVOUR, WERE ALL DEALT WITH IN THAT REPORT WHICH WAS PUBLISHED IN MARCH 2003. ALTHOUGH THE IMMEDIATE OFFICIAL REACTION TO THE EXPERT REPORT WAS FAVOURABLE AND INDEED IT WAS ANNOUNCED THAT THE RECOMMENDATIONS WOULD BE IMPLEMENTED THERE WAS ALMOST AN IMMEDIATE RETRACTION OF THAT COMMITMENT. THIS HAS BEEN FOLLOWED BY A SERIES OF REPORTS AND RECOMMENDATIONS WHICH APPEAR TO BE LEADING NOWHERE AT PRESENT.

THE QUESTION THEN ARISES AS TO HOW A LEGISLATIVE FRAMEWORK CAN PROVIDE FOR THIS, PARTICULARLY IN CIRCUMSTANCES WHERE ALTERATIONS TO THE RULES MAY BE NECESSARY. EVEN IF SUBSIDIARY LEGISLATION IS VIEWED AS THE MOST DESIRABLE OPTION, A DIFFICULTY ARISES BECAUSE SUBSIDIARY LEGISLATION INEVITABLY REQUIRES VETTING. THAT VETTING HAS TO BE DONE BY THE LEGISLATURE. IT CAN BE EITHER POSITIVE VETTING IN WHICH CASE THE SUBSIDIARY LEGISLATION HAS TO BE PUT BEFORE THE LEGISLATURE AND SPECIFICALLY APPROVED, OR, IT CAN BE WHAT IS TERMED NEGATIVE VETTING, NAMELY THE SUBSIDIARY LEGISLATION IS LAID BEFORE THE LEGISLATURE BUT NOT DISCUSSED UNLESS A SPECIFIC REQUEST IS MADE. THE CUMBERSOME PROCESS OF HAVING TO WAIT FOR SUBSIDIARY LEGISLATION TO BE VETTED MAY PROVE HARMFUL TO THE OVERALL OPERATION OF SUCH A SYSTEM.

THERE WERE VARIOUS OPTIONS PUT FORWARD AS TO HOW THE LISTING RULES COULD BE DEALT WITH. THE MOST FAVOURED WAS THAT THE GENERAL PRINCIPLES WOULD BE LAID DOWN IN LEGISLATION. AFTER THAT, THE ALTERNATIVES WOULD SEEM TO BE THAT EITHER THE MORE DETAILED ASPECTS OF THE LISTING RULES WOULD BE SUBSIDIARY LEGISLATION OR THE DETAILED CODE WOULD BE NON-STATUTORY THAT REPRESENTED A GUIDE AS TO HOW THE RELEVANT STATUTORY PROVISIONS WOULD BE INTERPRETED AND HAD TO BE COMPLIED WITH.

THE MECHANICS OF IT WOULD DOUBTLESS HAVE TO BE WORKED OUT IN PRACTICE BUT THE FUNDAMENTAL POINT THAT FOR EFFECTIVE CORPORATE GOVERNANCE THE IMPORTANT RULES AS TO HOW COMPANIES SHOULD BE OPERATED SHOULD HAVE STATUTORY BACKING WAS ENDORSED NOT LONG AFTER THAT BY THE STANDING COMMITTEE ON COMPANY LAW REFORM IN THE SECOND PHASE OF ITS WORK ON CORPORATE GOVERNANCE. THE STANDING COMMITTEE WENT FURTHER IN RECOMMENDING THAT THE COMPANIES REGISTRY'S CAPABILITY AS A CORPORATE REGULATOR SHOULD BE INCREASED ON AN INCREMENTAL BASIS IN RESPECT OF UNLISTED COMPANIES.

IT IS WITH LITTLE SATISFACTION THAT ONE OBSERVES THAT DESPITE THE PASSAGE OF TIME NOTHING VERY MUCH HAS BEEN DONE. I TRUST THE INACTION IS NOT A REFLECTION OF THE SAME GENERAL ATTITUDE EXPRESSED IN MY FAVOURITE QUOTE FROM JOHN HOWARD, AUSTRALIAN PRIME MINISTER

CORPORATE GOVERNANCE IS IMPORTANT, ITS NOT AS IMPORTANT AS THE MONTHLY MORTGAGE, ITS NOT AS IMPORTANT AS THE COMMONWEALTH GAMES BUT ITS VERY IMPORTANT

I AM GLAD TO HEAR IN MR WHEATLEY'S TALK THAT STATUTORY BACKING IS ON THE WAY, THE QUESTION I ASK IS CAN I HOLD MY BREATH?

ONE TURNS BACK TO THE QUESTION OF THE SHAREHOLDER WHO HAS A CONFLICTING INTEREST AND THE DIRECTOR WHO HAS AN INTEREST BY REASON OF THE DIRECTORSHIP IN ANOTHER COMPANY WITH WHICH THERE IS SOME RELATED TRANSACTION. IF ONE EXAMINES THE BASICS IN RELATION, FOR EXAMPLE, TO SHAREHOLDERS, ONE IS PROBABLY CONSIDERING TRANSACTIONS IN WHICH THE MAJOR SHAREHOLDERS HAVE AN INTEREST DIFFERENT FROM, OR AT LEAST ADDITIONAL TO, THAT OF OTHER SHAREHOLDERS. FOR THESE PURPOSES NO DISTINCTION SHOULD BE DRAWN BETWEEN THE VARIOUS TYPES OF INTEREST THAT THE CONTROLLING OR MAJORITY SHAREHOLDER MAY HAVE. IT IS ASSUMED, ALTHOUGH THIS MAY NOT ALWAYS BE THE CASE, THAT THE INTEREST WOULD BE A LEGITIMATE COMMERCIAL INTEREST. AS A RESULT OF PERHAPS CONCERTED PRESSURE OR, POSSIBLY, SIMPLY A REALISATION THAT SOMETHING HAD TO BE DONE, THERE HAVE BEEN MAJOR CHANGES IN THE LISTING RULES ADMINISTERED BY THE STOCK EXCHANGE REQUIRING DIRECTORS AND MAJOR SHAREHOLDERS TO DISCLOSE RELATED TRANSACTIONS AND ABSTAIN FROM VOTING IN FAVOUR OF RESOLUTIONS AUTHORISING THE COMPANY TO ENTER SUCH TRANSACTIONS. FOR THE MOST PART, THAT IS HIGHLY DESIRABLE, BUT IT CAN GO TOO FAR. PERFECTLY LEGITIMATE BUSINESS MAY BE CONDUCTED BETWEEN COMPANIES WITH COMMON DIRECTORSHIPS, OR, INDEED, BETWEEN COMPANIES WHERE THERE IS SOME COMMONALITY IN THE SHAREHOLDING. DEALINGS MAY HAVE SYNERGISTIC RESULTS AND BE WHOLLY DESIRABLE BUT IT NO DOUBT MAKES IT DIFFICULT FOR THE BUSINESS TO BE CONDUCTED IF THE RULES ARE ABSOLUTE. FOR

EXAMPLE EXCEPTIONS HAVE TO BE MADE FOR TRANSACTIONS WHERE THE SUMS INVOLVED ARE MINIMAL, BUT THE LIMITS OF WHAT IS MINIMAL HAVE TO FIXED IN RELATION TO THE PARTICULAR CIRCUMSTANCES OF THE COMPANIES INVOLVED. CARE HAS TO BE TAKEN WHEN ASSESSING WHAT IS MINIMAL IN RELATION TO ANY PARTICULAR COMPANY. IT IS IMPORTANT THAT IF THAT IS TO BE ASSESSED IN RELATION TO THE ASSETS, INAPPROPRIATE ITEMS SHOULD NOT HAVE BEEN INCLUDED INTO THE QUANTIFICATION OF THE ASSETS.

IT IS NOT, OF COURSE, ONLY THE SHAREHOLDER OR DIRECTOR HIMSELF WHO MUST TAKE CARE; SPOUSES AND TRUSTEES OF TRUSTS IN WHICH THE SHAREHOLDER OR DIRECTOR IS INTERESTED WOULD ALSO BE EXCLUDED. AND ANY CORPORATION WHICH IS ASSOCIATED WITH THE DIRECTOR OR CONTROLLING SHAREHOLDER WOULD ALSO HAVE TO COME WITHIN THE PROHIBITION

ONE AREA OF DIFFICULTY LIES IN RELATION TO WHAT ARE TERMED ASSOCIATED COMPANIES. IT CAN BE HIGHLY DETRIMENTAL IF THE DIRECTOR OF A LISTED COMPANY OR A MAJOR SHAREHOLDER SHOULD DEAL WITH AN ASSOCIATED COMPANY OF A LISTED COMPANY. THE QUESTION ARISES AS TO WHAT THE TEST SHOULD BE AS TO WHETHER A COMPANY IS AN ASSOCIATED COMPANY. ONE OF THE PROPOSALS WHICH HAS BEEN PUT FORWARD AS A TEST FOR THE PURPOSES OF DECIDING WHAT IS AN ASSOCIATED COMPANY, IS WHETHER THERE IS SIGNIFICANT INFLUENCE

IT WOULD BE ALL TOO EASY TO ENACT RULES THAT PREVENT ANY DEALING – THAT AS I HAVE SAID WOULD BE COUNTERPRODUCTIVE. WHAT IS PERHAPS ALSO IMPORTANT IS THAT THE PASSING OF A RESOLUTION APPROVING A SELF-DEALING TRANSACTION IN WHICH A DIRECTOR OR SUBSTANTIAL SHAREHOLDER OR OTHER CONNECTED PERSON HAS AN INTEREST, SHOULD BIND ALL THE SHAREHOLDERS INDIVIDUALLY.

I DO NOT INTEND TO LABOUR THE AUDIENCE WITH AN ANALYSIS OF THE LISTING RULES IN RELATION TO RELATED PARTY AND CONNECTED TRANSACTIONS. IT SUFFICES TO SAY THAT NEW RULES WERE INTRODUCED IN MARCH 2004. TO A LARGE EXTENT THEY MIRROR THE RECOMMENDATIONS OF THE STANDING COMMITTEE ON COMPANY LAW REFORM WHICH HAD PREVIOUSLY BEEN MADE. THEY PROVIDE REQUIREMENTS FOR DISCLOSURE AND THE VOTING BY INDEPENDENT SHAREHOLDERS TO AUTHORISE CONNECTED PARTY TRANSACTIONS. NATURALLY THE BROAD DEFINITIONS OF RELATED PARTY TRANSACTIONS ENCOMPASS SUCH MATTERS AS STANDARD CONTRACTS FOR THE PURCHASE OF NORMAL CONSUMER GOODS OR CONSUMER SERVICES. THEY ALSO ENCOMPASS CONTRACTS FOR THE SHARING OF ADMINISTRATIVE SERVICES AND THE DEALINGS BETWEEN ASSOCIATED COMPANIES.

INEVITABLY THE RULES HAD TO PROVIDE FOR THE EXEMPTION OF VARIOUS CONTRACTS FROM THE REQUIREMENT OF REPORTING AND INDEPENDENT SHAREHOLDER

APPROVAL. INDEED, THE STARTING THRESHOLDS, EVEN FOR DISCLOSURE OF ALL TRANSACTIONS IS, IN MY VIEW, SIGNIFICANTLY HIGH. ALTHOUGH THERE IS A DISTINCTION DRAWN BETWEEN THOSE WHICH REQUIRE TO BE REPORTED AND THOSE WHICH REQUIRE AUTHORISATION BY A VOTE BY THE INDEPENDENT SHAREHOLDERS FOR APPROVAL, THE CATEGORIES OF CONTRACTS WHICH DO NOT REQUIRE TO BE APPROVED, OR EVEN DISCLOSED, IS EXTENSIVE. AGAIN, WHATEVER VIEWS MAY BE TAKEN IN RESPECT OF THEM PROBABLY WOULD BE SUBJECT TO CHANGE AS TIME WENT ON.

PERHAPS MOST DIFFICULT, FROM THE POINT OF VIEW OF CONSIDERATION OF THE LISTING RULES IN A STATUTORY ENVIRONMENT, IS THE INCLUSION IN THE LISTING RULES OF THE ABILITY OF THE STOCK EXCHANGE TO GIVE WAIVERS FROM ALL OR ANY OF THE REQUIREMENTS. THE ALL ENCOMPASSING PROVISION WHICH ALLOWS THE STOCK EXCHANGE TO DO THAT WOULD CAUSE DIFFICULTIES IN A STATUTORY CONTEXT PARTICULARLY IF IT WERE ENVISAGED THAT MEANINGFUL SANCTIONS COULD FOLLOW A BREACH OF THE RULES. WHILST ONE CANNOT SAY THAT IT IS WRONG FOR THE STOCK EXCHANGE TO RESERVE TO ITSELF THE POWER OF GRANTING EXEMPTIONS, THE NEED FOR THE POWER DEMONSTRATES THE DIFFICULTY OF PHRASING RULES WHICH ARE ADEQUATE BUT NOT OPPRESSIVE. I CANNOT PRETEND THE SAME PROBLEM WILL NOT EXIST WHEN STATUTORY BACKING IS GIVEN TO THE LISTING RULES BUT THAT IS SOMETHING THAT MUST HAPPEN.

HAVING SPENT THE LAST 30 MINUTES OR SO TELLING YOU THAT I DO NOT CONSIDER THAT A TRADING ENTITY CAN BE AN EFFECTIVE REGULATOR, I WILL NOW PASS THE FLOOR TO SOMEONE WHO IS GOING TO TELL YOU THAT IT CAN.