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**CORPORATIONS LAW:
A CASE STUDY IN FEDERALISM**

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Introduction

Federalism, and its benefits and deficiencies, is likely to be the focus of much debate and discussion this year. Like most federal systems of government, ours is characterised by a formal distribution of legislative and executive power between the federal and state governments, under a written constitution, with an umpire, in the form of the High Court. Federalism has both its detractors and its supporters. It has been said that:

A properly working federation government is more adaptable to the preferences of the people, more open to experiment and its rational evaluation, more resistant to shock and misadventure, and more stable. Its decentralised, participatory structure is a buttress of liberty, a counterweight to elitism, and a seedbed of 'social capital'. It fosters the ... qualities of responsibility and self-reliance.¹

Very recently, The Hon Murray Gleeson AC, Chief Justice of the High Court, remarked that '[a] federation, it must be said, is not a model of efficiency ... If efficiency were the main objective, there would be better ways of running a country than by a federal representative democracy'.²

This paper considers the significant events in corporate regulation which have occurred over the past couple of years, reflecting briefly on how our federal system responded to those events.

In a globalised and highly competitive world, corporate regulation is a matter of national importance. An effective, responsive 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. Corporate regulation in the modern world thus presents a challenge to our federal system of government, a challenge which, it might be said, it has not met particularly well.

Our federal umpire, the High Court, confirmed in 1990 that comprehensive national corporate regulation is not something which under the constitutional distribution of powers between the different arms of the federation, falls within the powers of the national government. The Commonwealth's attempt in 1989 to enact national corporations legislation failed because of a lack of constitutional power over the incorporation of trading and financial corporations.³ Thus, corporate regulation in Australia has had to rely upon cooperation between the various elements of the federation.

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.⁴ It replaced the 1961 scheme which was based on uniform state and territory

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¹ Geoffrey de Q Walker, 'Ten Advantages of a Federal Constitution' (1999) 73 (9) *Australian Law Journal* 634, 653.

² The Hon Murray Gleeson AC, *Boyer Lectures 2000: The Rule of Law and the Constitution* (2000) 10.

³ In *NSW v Commonwealth* (1990) 169 CLR 482, 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.

⁴ The Commonwealth enacted the Companies Act 1981 and the Companies (Acquisition of Shares) Act 1980. Each state enacted application Acts applying the Commonwealth Acts.

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.⁵ However, these schemes were generally regarded as significantly flawed, leading to fragmented administration, ineffective use of resources and a lack of consistent and coherent regulation and enforcement. They were costly to business, and unresponsive to both the needs of business and changes in the global economic environment.

The current system of corporate regulation based on the Corporations Law came into operation on 1 January 1991. The scheme is an example of the 'cooperative federalism' which for many years seemed to provide a solution to some of the inadequacies of our federal system increasingly exposed by the economic and social pressures of the end of the twentieth century. The High Court appeared to be supportive of the notion of 'cooperative federalism', with, for example, in *Duncan's Case*, Chief Justice Gibbs remarking:

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 1914, apply in relation to the Corporations Law. The Corporations Agreement, to which the Commonwealth, all states and the Northern Territory became parties, imposed, 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 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 flaws, both statutory and constitutional, in the Corporations Law scheme. Gaps in the web of interlocking Commonwealth and state laws which comprise the present scheme were revealed in *Bond*⁸ and *Byrnes*.⁹ While these statutory deficiencies were within the power of parliaments to address legislatively,¹⁰ these two cases starkly illustrated the vulnerability inherent in a statutory network of the complexity of the Corporations Law scheme, which in reality comprises eight separate laws masquerading as one.¹¹ The

⁵ National Companies and Securities Commission Act 1979.

⁶ *R v Duncan* (1983) 158 CLR 535, 552.

⁷ *Ibid*, 589.

⁸ *Bond v R* (2000) 169 ALR 607.

⁹ *Byrnes v R* (1999) 164 ALR 520.

¹⁰ 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*.

¹¹ 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

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High Court also roundly criticised the complexity of the existing scheme. Unfortunately, other recent High Court decisions have revealed constitutional defects in the scheme which were not so easily remedied.

Re Wakim; ex parte McNally

The first constitutional blow to the scheme came with *Re Wakim*,¹² which, after the Court's decision in *Gould v Brown*,¹³ 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 at the zenith of the period of co-operative federalism to overcome another federal wrinkle, that is, uncertainties about the jurisdictional limits of the various courts in Australia's federal system. Under the schemes, one court could determine all matters in dispute between the parties, effectively creating an integrated court system and ensuring the efficient, convenient and 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 sections 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 was significant. The Federal Court lost most of its jurisdiction in relation to Corporations Law matters, a matter of regret for the Attorney-General, and the legal and business communities generally. As the Australian Law Reform Commission has noted, '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'.¹⁴ The Court is a national court, and had developed considerable co-ordinated expertise in the area of corporate law.¹⁵ 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 last year in *R v Hughes*.¹⁶ The Court had given 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

appeals against the sentences imposed, those sentences were increased. In *Byrnes*, the Court found that the relevant state law 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 under Commonwealth law were insufficient. Both appellants therefore were successful.

¹² *Re Wakim; ex parte McNally* (1999) 163 ALR 270.

¹³ (1998) 193 CLR 346.

¹⁴ ALRC, Report No 89, *Managing Justice*, 8.

¹⁵ 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.

¹⁶ (2000) 171 ALR 155.

functions in officers of another integer of the federation?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, and for schemes built on notions of 'cooperative federalism' more generally.

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 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 it has been suggested that 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. These decisions have engendered a 'pervasive uncertainty about the foundations of corporate regulation in Australia'.²⁰ Challenges based on *Hughes* to day-to-day regulatory and enforcement actions by ASIC and the DPP proliferated; in particular to the validity of company incorporations by ASIC.²¹

If the High Court were to find that ASIC's function of incorporation under the Corporations Law scheme is unconstitutional, approximately 660,000 companies incorporated by ASIC under the state Corporations Law since 1991 would 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 previous Chairman of ASIC, Mr Alan Cameron AM, summed up the present situation 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

¹⁷ *Bond*, at 608 and 610.

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.

²¹ Eg, *GPS First Mortgage v Lynch* and similar litigation. In *GPS First Mortgage v Lynch*, 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.

that to have a situation where there is any uncertainty at all is damaging.²²

Many other commentators, including business, professional, and shareholder representatives, have echoed these concerns.²³ In essence, the Corporations Law scheme has been 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 is ‘a fragile foundation for a highly important national law’ warned that ‘the next case may not present circumstances sufficient to attract the essential constitutional support’.²⁴ Remedial action was therefore imperative. Doing nothing would simply have ensured a long and very damaging period of uncertainty during which the courts examine, perhaps over a period of ten years or more, every aspect of the current law.

Various options were put forward for consideration, including:

- relying on state law, and returning to something like the old co-operative scheme;
- an amendment to the Constitution; and
- a unilateral Commonwealth law.

None of these offers a comprehensive solution. As I have already mentioned, the old co-operative model was generally regarded as significantly flawed.

Constitutional reform could obviously solve the present difficulties, if it could also be achieved in a timely manner. This, of course, is the problem. It would have taken too long to hold a referendum, and the chances of success at the ballot box would, at best, be uncertain. Of the 44 that have been put at 19 referendums, only eight 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 support, five others which had bipartisan support failed.²⁵ Amendments that would have had the effect of increasing Commonwealth constitutional power have a particularly poor record. In particular, none of the five attempts to extend the corporations power in section 51 of the Constitution was successful.²⁶

²² Alan Cameron, ‘The Law’s Condition is Critical, Warns Regulator’ *Australian Financial Review*, 7 April 2000, p 31.

²³ See, eg, 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.

²⁴ *Hughes*, 189.

²⁵ 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 *Melbourne University Law Review* 1, fn 29.

²⁶ 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

While there is some scope for the Commonwealth to unilaterally enact a corporations law, there are some disadvantages in this option. The most fundamental is that there are several significant areas which the Corporations Law presently regulates, including incorporation, where the Commonwealth may lack power. Consequently, to the extent that provisions of a unilateral Commonwealth law regulated these areas, their validity would inevitably be challenged.

A unilateral Commonwealth law would also have disadvantages from the perspective of the states, as it would presumably mean an end to the 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. In 1999 these payments totalled roughly \$135 million.

Referral of state 'corporate regulation' powers

The option of states referring appropriate power to the Commonwealth pursuant to section 51(xxxvii) of the Constitution is by far the preferable option. The Attorney-General, and the Minister for Financial Services and Regulation (and, more recently, the Prime Minister) have made it clear that this is the Commonwealth's preferred option. An appropriate referral has several advantages. It:

- can be achieved relatively quickly;
- would provide certainty and restore confidence, by placing the national system of corporate regulation on a new constitutional foundation and in so doing provide a secure basis for national economic development;
- would avoid the complexity of the current scheme, as it would enable the Commonwealth Parliament to enact a single Commonwealth corporations law applying in all referring states and in the ACT and Northern Territory;
- would enable the continued involvement of the states under a new Corporations Agreement; and
- would enable all the corporate law jurisdiction of the Federal Court to be restored.

Progress

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 last year to the referral option.

Under the 25 August agreement, the states were to refer the 'text' of the Corporations Law and the Australian Securities and Investments Commission Act, together with a power to amend that text in relation to the formation of companies, corporate regulation and the regulation of financial services and products. It was also agreed that the referral should terminate after five years, unless extended by proclamation. In the wake of the 25 August agreement, work progressed rapidly in five broad areas:

- state legislation required to refer the relevant 'matters' of state power to the Commonwealth was prepared;
- a new Corporations Act and Australian Securities and Investments Commission Act, to be enacted by the Commonwealth Parliament in reliance on the state referrals, was drafted;
- state legislation to ensure the validity of past actions of Commonwealth bodies such as ASIC and

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the DPP was drafted;

- preparation of consequential state legislation to ensure that references in state law will 'plug in' to the new Commonwealth law was commenced; and
- 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, was drafted.

However, unfortunately, in November last year that agreement was abandoned by the states. Notwithstanding public assurances to the contrary by the Prime Minister, and express safeguards in the revised draft Corporations Agreement, the states became concerned that the Commonwealth would use the referred power to regulate industrial relations. As a consequence they sought to include in their proposed referral legislation long and complex provisions excluding from the referral 'industrial relations' matters (and excluding sub-matters from that excluded matter). They also insisted on the states having the ability to unilaterally terminate the amendment mechanism, so that an individual state would be able to decide which amendments of the Corporations Law would apply in their jurisdiction. The Attorney-General and the Minister for Financial Services and Regulation rejected these demands, as it would not have given Australian business the necessary degree of legal certainty.

The Commonwealth, New South Wales and Victoria subsequently agreed at a meeting on 21 December 2000 to a package of measures refining the details of the earlier agreement so as to avoid these problems. It is, of course, the Commonwealth's hope that the other states will agree to refer power in the terms agreed on 21 December. The 21 December agreement is a significant step forward in overcoming the problems arising as a result of the High Court's *Hughes* decision. The referral would enable the Commonwealth to introduce a bill that will substantially re-enact the existing Corporations Law as a Commonwealth Act. That bill has been prepared, and is ready to be introduced into Parliament as soon as the legislative processes of the first referring state permit.

To allay state concerns about the scope of the referral, the agreement contains some significant concessions and safeguards. In order to address fears that the Commonwealth might make use of the referred powers to regulate workplace relations, it was agreed that the Corporations Agreement will specifically exclude the use of the referred power for the purpose of regulating workplace relations. In addition, an objects clause in the state referral legislation will indicate the referred powers are not intended to be used for this purpose. Importantly, this will not prevent the inclusion of provisions in the Corporations legislation necessary for corporate and securities regulation. Further, it was agreed that no state will be able to terminate the reference of the power to amend the Corporations Law and remain in the new scheme when all states terminate at the same time. This will achieve the Commonwealth's aim of ensuring consistent laws across all states and territories.

The Corporations Agreement will provide that if four states vote to terminate the amendment reference, all states will terminate the amendment reference. It was also agreed that, under the Corporations Agreement, three jurisdictions (including the Northern Territory) will be required to vote to approve amendments to the Corporations Law in areas where approval of the Ministerial Council is currently required.

The Commonwealth is confident that this agreement will meet its objective of overcoming the constitutional uncertainty in relation to the Corporations Law. In particular, the scheme is capable of a national and uniform application, and seamless enforcement. It would not allow corporate regulation to be held hostage to the demands of one referring state. At the same time, however, states will continue to play a role in shaping the policy behind the law. The new scheme, is at once a testament and the resilience to our federal system. The Commonwealth has urged the other states to come on board as soon as possible, to make it a truly national scheme. It is hoped that all states will have referral legislation in place by the time the Commonwealth legislation commences, and no later than 1 July 2001.

Once the new law is in operation, Australia will have in place a regulatory regime for commercial activity in which all elements of our federation have a significant stakeholding, but one which at the same time is certain, robust, adaptable, and efficient unhampered by jurisdictional difficulties, legal complexities and cumbersome administrative and regulatory structures.

Conclusion: working with federalism

So overall, how has our federal system of government served us in the field of corporate regulation? There can be no doubt that it has presented some obstacles. While almost everyone agrees that the national market and its corporate participants need to be regulated on a uniform comprehensive basis, the Constitution does not provide the Commonwealth with comprehensive power to regulate the national market. Furthermore, until now there has really been a failure to agree on an effective and robust co-operative approach, despite the identification of major constitutional problems in the field of corporate regulation. Even when agreement is reached, the costs for business, the delay and the costs for government are very considerable.

Despite these problems, Australia has managed to achieve substantial uniformity of corporations legislation for the past 40 years and has had a national regulator since 1990. Furthermore, it seems clear that an effective co-operative approach to corporations legislation will soon be put in place; an approach brokered within the existing constitutional framework. Business and professional groups have played an important role in making clear the priority that needs to be accorded to a timely replacement of the current scheme.

As challenges to this cooperative approach have emerged over the past 40 years, governments have responded within the constraints of our federal system. The path to the 21 December 2000 agreement between the Commonwealth, New South Wales and Victoria has not been straightforward. However, as my earlier quote from Chief Justice Gleeson rightly suggests, the success of a federal democratic government is not to be gauged by efficiency alone.

Whatever the shortcomings of our existing federal system, it cannot be denied that, at least for now, we need to make that system work, particularly if we are to achieve a fully effective national corporations law. A significant challenge will no doubt be to continue to achieve goals like these, and to respond to rapid change within the framework of our federal Constitution.