The high cost of company law

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IF it was "indigestible" in 1992, as former high court judge Anthony Mason opined, it must be poisonous by now.

Australian company law, embodied in the 1500-odd page Corporations Act 2001 and the 400-plus pages of ASIC regulations and class orders, may well edge out the Income Tax Act for first prize in legislative absurdity.

At least the tax code, however clunky, performs a necessary function - raising revenue to pay for public services. Sudden abolition of company law would not send society into a tailspin. Common law, self-regulation, and a heightened community awareness of caveat emptor would soon fill the void.

The brevity, coherence and consistency of Australian corporate law has deteriorated almost continually since the first attempt at uniform national corporate law in 1961, with little prospect for improvement.

Singling out the most superfluous parts of Corporate Law is a challenge.

Part 2M stipulates every conceivable facet of company financial reporting, including the removal, remuneration, rotation and appointment of auditor.

Surely the stock exchange, tax office or voluntary investor organisations could insist on minimum standards, reveal those who don’t comply, and leave the rest to the market.

Audit firms already have a strong interest in maintaining the perception they are rigorous and unbiased. And the Accounting Standards Board already sets out guidelines for company reporting.

"The quorum for a directors’ meeting is two directors and the quorum must be present at all times during the meeting," the law also says. Why not three instead, and are they allowed to go to the bathroom?

One wonders who the baroque provisions surrounding takeover bids in Part 6 are designed to protect. The parties to such transactions, typically educated, relatively wealthy and informed, can look after themselves. The existing rules frustrate a more efficient allocation of capital by making it harder for takeovers to occur and increasing uncertainty.

The same can be asked of the vague if noble requirement for "continuous disclosure", which mandates directors to tell the market everything that a reasonable person would deem relevant to the share price.

The sacred cow of the "minority shareholder" is held out as justification for such ornate "protections", but without them whatever damage might arise to third parties from mutually beneficial agreements among any combination of first and second parties would be dealt with, much more efficiently, in the price and supply and demand of the equity or bonds in question.

The prescriptive impulse reaches its zenith in financial services, where chapter 7 mandates prolix reams of "product disclosure statements", "financial services guides" and "statements of advice" that so bamboozle investors and bank customers. Insurer QBE has recently put the cost of excessive financial regulation at around $100 per policy, or about 12 per cent.

The Corporations Act in effect is a tax on business, with its severity set by the volume and complexity of legislation. In NSW alone more than 5100 lawyers - almost 20 per cent, more than double the share a decade ago - are in-house, toiling away to ensure compliance with the box-ticking minutiae of company law. With an average salary of $160,000 a year, that alone amounts to an $836 million a year tax on business.

The only point of corporate law is to provide investors and businesses with an "off the shelf" set of contracts that save having to negotiate terms and conditions every time people want to conduct a different type of transaction.

The spread of futures and derivatives markets since the 1990s explains some of the growth in regulation (although it doesn't justify it: remember the global financial crisis emerged in the regulated, not unregulated, financial sector). But the bulk of it pertains to misguided attempts to protect consumers from poor decisions.

From the Poseidon bubble in 1970s to the collapse of Storm Financial, aggrieved investors have put pressure on legislators to ratchet up consumer protection laws, but as the latest Commonwealth Bank financial planning scandal indicates, it is impossible to stamp out losses. Such protections can even exacerbate losses, lulling investors into ever greater false senses of security.

Fraud is already rightly a punishable offence, but stupidity and greed rightly aren't. The loss and risk of loss of money is essential to the free market system. Caveat emptor was the best defence against it in advanced countries, especially in the financial services arena; its erosion has created a costly morass of potentially ineffective regulation.

The outlook isn't inspiring. The Howard government in the late 1990s shifted the task of simplification from the Attorney-General's department to the Treasury, whose economists typically look down on lawyers and have neither the interest nor knowledge to improve the efficiency of the security and company law.

The Coalition this year short-sightedly abolished the Corporations and Market Advisory Committee, perhaps the only objective voice calling for better company law, to save only $1m a year (while keeping open the $25m a year Human Rights Commission, a cherry on a cake of publicly funded activism).

In the wake of the GFC, legislators everywhere, epitomised by the sledgehammer Dodd-Frank reforms in the US, have preferred to paper over chasms in the existing financial architecture with yet more feckless black letter law rather than contend with the underlying economic disease of moral hazard.

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