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|  | |  |  |  |  |  | | --- | --- | --- | --- | --- | | |  |  | | --- | --- | | **Bulletin No. 127**  Editor: [Professor Ian Ramsay](mailto:i.ramsay@unimelb.edu.au" \t "_new), Director, Centre for Corporate Law and Securities Regulation  Published by Lawlex on behalf of [Centre for Corporate Law and Securities Regulation](http://cclsr.law.unimelb.edu.au/" \t "_new), Faculty of Law, the University of Melbourne with the support of the [Australian Securities and Investments Commission](http://www.asic.gov.au/" \t "_new), the [Australian Securities Exchange](http://www.asx.com.au/" \t "_new) and the leading law firms: [Blake Dawson](http://www.bdw.com.au/" \t "_new), [Clayton Utz](http://www.claytonutz.com/" \t "_new), [Corrs Chambers Westgarth](http://www.corrs.com.au/" \t "_new), [DLA Phillips Fox](http://www.dlaphillipsfox.com/" \t "_new), [Freehills](http://www.freehills.com/" \t "_new), [Mallesons Stephen Jaques](http://www.mallesons.com/" \t "_new).   1. 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The Commission contemplates taking the following actions:   * Exploring initial agreements with one or more foreign regulatory counterparts, which would be based upon a comparability assessment by the SEC and by the foreign authority of one another's regulatory regimes. * Considering adoption of a formal process for engaging other national regulators on the subject of mutual recognition. This process could be accomplished through rulemaking or other appropriate mechanisms, possibly informed by one or more initial agreements with other regulators. * Developing a framework for mutual recognition discussions with jurisdictions comprising multiple securities regulators tied together by a common legal framework, including Canada (which has no national securities regulator, but rather provincial regulators) and the European Union (whose national securities regulators are subject to supranational legislation and directives). * Proposing reforms to Rule 15a-6 in order to improve the process by which US investors have access to foreign broker-dealers.   Further information is available on the [SEC](http://www.sec.gov/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.2 Post-SOX audit quality has improved say audit committee members**  More than three-quarters of audit committee members of US companies who took part in a recent survey commissioned by the Center for Audit Quality (CAQ) rate overall audit quality "very good" or "excellent", and 82 percent say it has improved in recent years, according to a report published on 18 March 2008.  About 53 percent of the audit committee members agreed that overall audit quality is "very good", while 25 percent described it as "excellent". About 87 percent said the risk of inaccuracies in financial statements due to fraud is "not very high", and 60 percent agreed that the risk declined after the passage of the Sarbanes-Oxley Act of 2002 (SOX). Audit committee members indicate they believe the risk of fraud and materially inaccurate statements is low due to tightened internal controls and increased external auditor scrutiny.  Nearly two-thirds (65 percent) agreed that investors should have more confidence in the markets as a result of the 2002 law.  Participants in the audit committee survey represented a broad range of publicly traded companies. All served on at least one audit committee in 2007. Six in 10 served on two or more audit committees, and half were committee chairs. About 56 percent began their service as audit committee members prior to enactment of SOX.  Overall, 58 percent of the audit committee members said changes resulting from SOX had a positive impact. They offered several reasons for the improvement, among them:   * Increased audit committee oversight - 92 percent * Requirements regarding internal controls - 87 percent * Better communication within audit committees - 85 percent * CEO/CFO sign-off on financial statements - 81 percent * Increased emphasis on quality by auditors - 77 percent * More rigorous audits - 76 percent * Audit committee oversight of auditors -76 percent   Nearly all of the audit committee members (99 percent) said they devote more time to their committee work as a result of SOX. About 90 percent said they work more closely with external auditors.  The audit committee members expressed mixed views on the efficacy of audited financial statements filed with the U.S. Securities and Exchange Commission (SEC). Although most described financial statements as "easily accessible" (81 percent) and "relevant to investors" (87 percent), 78 percent said they are too complicated.  The Internet survey of 253 audit committee members was conducted between January 7 and February 20, 2008, by The Glover Park Group.  The report is available on the [CAQ](http://www.thecaq.org/newsroom/pdfs/auditsurvey.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.3 US President's working group issues policy statement to improve future state of financial markets**  On 13 March 2008, the US President's Working Group on Financial Markets (PWG) issued a policy statement with recommendations to improve the future state of US and global financial markets. The statement offers the group's insight on causes of recent market issues and next steps for mitigating systemic risk, restoring investor confidence, and facilitating stable economic growth.  The PWG, working with the Office of the Comptroller of the Currency and the Federal Reserve Bank of New York, issued the statement to help enable market participants and regulators to better deal with the complexity that has resulted from market innovation. The recommendations offer steps to improve market transparency and disclosure, risk awareness and risk management, capital management and regulatory policies and market infrastructure for products such as over-the-counter derivatives. The statement focuses on changes needed from financial regulators and all market participants, including mortgage originators and brokers, financial institutions, issuers of securitized products, credit rating agencies and investors. The statement also discusses the challenges presented by securitization and over-the-counter derivatives.  The PWG will work with foreign regulators, finance ministries, and central banks through the international Financial Stability Forum and other venues to address these challenges globally. The PWG is committed to progress toward implementation of the recommendations. Members will issue a progress statement in the fourth quarter of 2008 and consider whether further steps are needed to address weaknesses in financial markets, institutions and related supervisory policies.   In general, the recommendations include measures to be implemented by government authorities or market participants that will:   * reform key parts of the mortgage origination process in the United States; * enhance disclosure and improve the practices of sponsors, underwriters, and investors with respect to securitized credits, thereby imposing more effective market discipline; * reform the credit rating agencies processes for and practices regarding rating structured credit products to ensure integrity and transparency; * ensure that global financial institutions take appropriate steps to address the weaknesses in risk management and reporting practices that the market turmoil has exposed; and * ensure that prudential regulatory policies applicable to banks and securities firms, including capital and disclosure requirements, provide strong incentives for effective risk management practices.   The report is available on the [US Treasury](http://www.treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.4 Canadian regulators adopt harmonized prospectus rule**  The Canadian Securities Administrators (CSA) have announced that National Instrument 41-101 "General Prospectus Requirements" (NI 41-101) and related amendments came into force on 17 March 2008.    NI 41-101 creates a comprehensive and transparent set of national prospectus requirements for all issuers including certain investment funds.    The new rule is based on three general principles:   * Harmonization and consolidation of the general prospectus requirements among Canadian jurisdictions. * Harmonization of the general prospectus requirements with the continuous disclosure and short form prospectus disclosure regimes. * Amendments to the principles underlying the general prospectus requirements identified as a result of regulatory reviews, applications for exemptive relief, or public comment and consultation.   NI 41-101 is coming into force at the same time as Multilateral Instrument 11-102 "Passport System" and new national policies that streamline Canadian regulatory processes for prospectuses and exemptive relief applications.  NI 41-101 and related amendments are available on several CSA members' websites.   The CSA, the council of the securities regulators of Canada's provinces and territories, co-ordinates and harmonizes regulation for the Canadian capital markets.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.5 FRC publishes discussion paper on cost-effective regulation**  On 10 March 2008, the UK Financial Reporting Council (FRC), the UK's independent regulator responsible for promoting confidence in corporate reporting and governance, published a discussion paper which aims to stimulate an on-going dialogue with its stakeholders about ways to improve the cost-effectiveness of FRC regulation without compromising the achievement of high standards of corporate reporting and governance.   In line with its commitment to the principles of good regulation, the FRC has in the past few years taken or proposed a range of actions to reduce the costs to market participants of the regulation for which it has responsibility. This document highlights some of the most significant of these actions and invites stakeholders to comment on further opportunities to reduce regulatory costs whilst preserving confidence in corporate reporting and governance.   The main focus of the discussion paper is on opportunities to reduce the costs associated with FRC regulation rather than on its internal costs.   Proposals highlighted in the paper include:   * a major project to review the relevance and complexity of corporate reporting; and * the FRC's continuing work to promote cost-effectiveness in the development of international accounting and auditing standards.   The paper also identifies further initiatives on which it might consult in the future, including a proposal to provide a summary of FRC regulatory requirements which apply to SMEs.   The FRC invites feedback by 31 May 2008 from interested parties on the questions set out in the discussion paper and any other aspects of the cost-effectiveness of FRC regulation.   The discussion paper is available on the [FRC](http://www.frc.org.uk/about" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.6 Institutional investors criticise share trading by directors and executives**  On 9 March 2008, ten leading Australian institutional investors called for dramatic improvement to the governance of director and executive share trading, after commissioned research found an increasing number of company directors failing to exercise effective governance.    The investigation into 3,255 share trades by S&P/ASX200 company directors during the 12 months ended 30 September 2007 revealed declining governance standards for director and executive share trading at many of Australia's largest listed companies.    The research found that active director share trading in the weeks prior to profit announcements and upgrades increased from a previous study released in 2005. Also rising was the number of directors actively trading company shares in the period after books-close and prior to public release of financial results.   Key findings of the research are:   * More than a third of Australia's 200 largest listed companies failed to comply with the [Corporations Act](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) - notifying changes in directors' interests more than 14 calendar days after the event. * Nearly half of Australia's 200 largest listed companies breached the Listing Rules of the Australian Securities Exchange (ASX) - notifying the market of director trades more than five business days after the event. * Directors of 32 of Australia's 200 largest listed companies actively purchased shares within eight weeks prior to a material earnings upgrade or takeover announcement - a 40% increase from 2004. * Directors of 23 of Australia's 200 largest listed companies actively traded shares during the period between books-close and results-release - a 15% increase from the 2005 study.   In a detailed Position Paper, the ten institutional investors have outlined their concerns and called upon company directors and regulators to ensure a transparent and honest market for securities. These investors together account for some A$65 billion of listed security investments, or nearly one in six dollars invested by institutions in listed entities.  The full report is available at: [http://www.regnan.com.au](http://www.regnan.com.au/" \t "_new)  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.7 FRC consults on changes to audit committee guidance relating to audit choice project**  On 7 March 2008, the UK Financial Reporting Council (FRC) began consultation on proposed changes to the Smith Guidance on Audit Committees as part of the implementation phase of its Choice in the UK Audit Market project.  **(a) Background**  The Guidance on Audit Committees (The Smith Guidance) was first published in 2003. It is intended to assist company boards when implementing the sections of the Combined Code on Corporate Governance dealing with audit committees and to assist directors serving on audit committees in carrying out their role. The FRC is responsible for keeping the Combined Code on Corporate Governance under review together with associated guidance including the Smith Guidance.  The Market Participants Group (MPG) was established in October 2006 to provide advice to the Financial Reporting Council on market-led actions to mitigate the risks that could arise in the event of one or more of the Big Four audit firms leaving the market. The Group's final report, containing 15 recommendations to enhance the efficiency of the UK audit market, was published last October.  **(b) Changes to audit committee guidance**   A number of the MPG's recommendations were targeted at companies. Four of these have particular relevance to audit committees and, therefore, the Smith Guidance. The recommendations called for:   * Company boards to provide information to shareholders relevant to their auditor selection decision. * Company boards to disclose any contractual obligations (such as loan agreements) to appoint certain types of audit firms. * Large companies to consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning. * Sections of the Smith Guidance dealing with auditor independence to be reviewed for consistency with the relevant ethical standards for auditors.   The consultation document is available on the [FRC](http://www.frc.org.uk/about/auditchoice.cfm" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.8 Retail investor guide on MiFID**  On 7 March 2008, the Committee of European Securities Regulators (CESR) published a guide for retail investors on the new European Directive for Financial Markets, the Markets in Financial Instruments Directive (MiFID). The purpose of the guide is to explain, in clear and straightforward language, the new protections retail consumers will experience in buying financial services, following the introduction of this legislation across Europe.    One of the main purposes of the MiFID Directive is to harmonise investor protection throughout Europe and increase consumers' confidence that the products they are being sold are actually appropriate for their needs.  The MiFID Directive, which came into effect on 1 November 2007, establishes how investment firms and the services they provide are regulated. One of its core principles is that firms wishing to provide services to retail investors must act professionally, provide fair information on financial products, and they must take into account the individual circumstances of each consumer.  Further information is available on the [CESR](http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/439&format=HTML&a" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.9 SEC proposes naked short selling anti-fraud rule**  On 7 March 2008, the US Securities and Exchange Commission (SEC) announced additional steps to better safeguard investors and protect the integrity of the markets during short selling transactions by proposing a rule that would specify that abusive "naked" short selling is a fraud.   In a naked short sale, the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period for trades. As a result, the seller fails to deliver stock to the buyer when delivery is due. This is known as a "failure to deliver". Sellers sometimes intentionally fail to deliver securities to the buyer as part of a scheme to manipulate the price of a security, or possibly to avoid borrowing costs associated with short sales.   The Commission voted unanimously to propose a new rule, Rule 10b-21, that would highlight the specific liability of parties who deceive others, such as broker-dealers and purchasers, about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date.   The comment period for the proposal will end 60 days from the date of publication of the proposed rule in the Federal Register.   Further information is available on the [SEC](http://sec.gov/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.10 Supervisory agencies issue joint report assessing risk management practices**  On 6 March 2008, the senior financial supervisors from five countries issued a report that assesses a range of risk management practices among a sample of major global financial services organizations.   This report - [Observations on Risk Management Practices during the Recent Market Turbulence](http://www.sec.gov/news/press/2008/report030608.pdf" \t "_new) - summarizes a joint review that supervisors initiated. The seven supervisory agencies participating in this project are the French Banking Commission, the German Federal Financial Supervisory Authority, the Swiss Federal Banking Commission, the U.K. Financial Services Authority, and, in the United States, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, and the Federal Reserve.   Supervisors undertook this effort to evaluate the effectiveness of current risk management practices during this period of stress. These observations could then be used in supervising individual firms and in assessing potential future changes in supervisory requirements, guidance and expectations.   This work was also undertaken in response to a request from the Financial Stability Forum, whose mission is to promote international financial stability, improve the functioning of markets, and reduce systemic risk. The Financial Stability Forum has established a Working Group on Market and Institutional Resilience that is preparing a separate report to the Finance Ministers and Central Bank Governors of the G-7 countries on the underlying causes of recent financial market turmoil and will make appropriate recommendations.   The report's key observations and proposed supervisory responses are summarized in a [transmittal letter](http://www.sec.gov/news/press/2008/letter030608.pdf" \t "_new) to the chairman of the Financial Stability Forum.   The report is available on the [SEC](http://www.sec.gov/news/press/2008/report030608.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.11 Global CEO turnover rises 10 percent in past 12 months**   A study published on 3 March 2008 concludes that CEO departures at the world's 500 largest revenue-producing companies jumped 10 percent from 2006 to 2007. The study was conducted by public relations firm, Weber Shandwick.   |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | | **Global CEO Turnover by Region: 2005** *-* **2007** | | | | | | | |  | **2005** | | **2006** | | **2007** | | | **Region** | **Total (#)** | **Percent** | **Total (#)** | **Percent** | **Total (#)** | **Percent** | | North America | 34 | 18% | 18 | 10% | 27 | 15% | | Europe | 28 | 15% | 33 | 18% | 28 | 15% | | Asia Pacific | 18 | 15% | 20 | 16% | 25 | 21% | | Latin America | 2 | \* | 3 | \* | 1 | \* | | **Total** | **82** | **16.4%** | **74** | **15.0%** | **81** | **16.2%** |   Source: Weber Shandwick's CEO DeparturesT \*Due to very small sample sizes in Latin America, the percentages are not shown.  **(a) Regional CEO turnover highest in Asia Pacific and trending up**  Proportionally, Asia Pacific companies experienced the highest turnover in 2007 compared to other regions, losing over one in five of their largest company chief executives. CEO turnover within Asia Pacific's most elite companies also climbed 25 percent from 2006 to 2007. This increase is partially due to unusually high turnover in Australia, which lost four CEOs in 2007, compared to none in 2006. However, Asia Pacific CEO turnover is primarily due to retirement and normal succession planning.   North American CEO departures increased a large 50 percent from 2006 to 2007, although failed to reach its 2005 high. This is attributable not only to a 33 percent increase in US turnover, but also the retirement of three Canadian chief executives, up from zero in 2006.   In contrast to its regional counterparts, CEO turnover among Europe's largest global companies decreased 15 percent from its peak in 2006. This reduced departure rate augurs well for the region.  **(b) Trends**  Weber Shandwick's analysis identified several other significant changes related to CEO turnover:   * More CEOs Exited for "non-traditional" reasons - Over the past three years, the world's largest company CEOs continued leaving office primarily due to "traditional" reasons such as retirement, succession planning, or reaching the mandatory age for retirement. Since CEO departures for traditional reasons declined a large 22 percent from 2006 to 2007, it is possible that broader factors could be impacting CEO tenure worldwide. The past 12 months saw an increase in non-traditional reasons for CEO departures such as mergers, private equity buyouts, interim term completions, and corporate governance restructuring. In addition, there was a slight rise in CEOs departing against their will in 2007 over the previous year (28 percent, 2006 vs 32 percent, 2007).  |  |  |  |  | | --- | --- | --- | --- | | **Global CEO Turnover 2005 - 2007: Reasons for Departure** | | | | |  | **Normal/Traditional Departure** | **Against Their Will** | **Other** | | 2005 | 48% | 35% | 17% | | 2006 | 59% | 28% | 12% | | 2007 | 46% | 32% | 22% |   Source: Weber Shandwick's CEO DeparturesT   * North American CEOs most likely to be ousted in 2007- Among CEOs of the world's largest companies that left against their will in 2007, North American CEOs departed at the highest rate compared to their regional counterparts (37 percent, North America vs 32 percent, Europe vs 24 percent, Asia Pacific). This sizeable ouster rate is a dramatic change from 2006 where North American CEOs benefitted from having the lowest regional involuntary turnover rate. In contrast, European CEOs' involuntary turnover rate remained fairly consistent over time and Asia Pacific's involuntary turnover rate declined dramatically from 2006 to 2007.  |  |  |  |  | | --- | --- | --- | --- | | **2007 Ousted "Against Their Will" Global CEOs by Region** | | | | |  | **2005** | **2006** | **2007** | | North America | 41% | 17% | 37% | | Europe | 29% | 30% | 32% | | Asia Pacific | 37% | 43% | 24% |   Source: Weber Shandwick's CEO DeparturesT   * Insider CEOs still preferred over outsider CEOs - Board preference for insider over outsider CEO replacements continues essentially unchanged year over year. In 2007, nearly seven out of 10 newly named CEOs were insider executives.  |  |  |  |  | | --- | --- | --- | --- | | **Insider vs. Outsider Global CEOs: 2005 - 2007** | | | | |  | **2005** | **2006** | **2007** | | Insiders/Outsiders (%) | 68%/32% | 65%/35% | 68%/32% |   Source: Weber Shandwick's CEO DeparturesT   * North American CEO tenure on the decline - The average tenure of global chief executives who exited office in 2007 was six years, down from 6 years, five months in 2006. North American CEOs' average tenure dramatically shortened in 2007, dropping nearly two years from 2006 (8 years, 6 months in 2006 down to 6 years, 8 months in 2007). In contrast, the average duration of Asia Pacific CEO terms lengthened from 4 years, 3 months in 2006 up to 5 years, 7 months in 2007. European CEO tenure has remained relatively stable year over year.  |  |  |  |  | | --- | --- | --- | --- | | **Average Global CEO Tenure: 2005- 2007** | | | | |  | **2005** | **2006** | **2007** | | North America | 6 years, 10 months | 8 years, 6 months | 6 years, 8 months | | Europe | 7 years | 6 years, 10 months | 6 years, 10 months | | Asia Pacific | 5 years, 2 months | 4 years, 3 months | 5 years, 7 months | | **Total** | **6 years, 5 months** | **6 years, 5 months** | **6 years** |   Source: Weber Shandwick's CEO DeparturesT  Weber Shandwick's CEO departures study is based on an analysis of the global Fortune 500 companies. For purposes of the study:   * Insider CEOs are defined as executives who have worked for the company for three or more years before being announced as the new CEO. * Outsider CEOs are defined as executives who either have never worked for the company or been employed by the company for less than three years before being announced as the new CEO.   Further information is available on the [Weber Shandwick](http://www.webershandwick.com/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.12 Treasury Committee calls for enhanced framework to ensure markets heed warnings about financial risk**   On 3 March 2008, the UK Treasury Committee published its report "Financial Stability and Transparency", which concludes that the framework by which the public authorities issue warnings of potential problems in financial markets is deficient and recommends that in future the Bank of England and the FSA should clearly highlight the two or three most important risks in a short covering letter to financial institutions, for discussion at Board level. The Bank and FSA should also seek confirmation from those institutions that these warnings have been properly considered and publish commentaries on the responses received.   **(a) The causes of the market turbulence of August 2007 onwards**   The Committee investigated the underlying causes of the unfolding turbulence which has gripped financial markets since mid-2007. The Committee concluded that the benign macro-economic and low interest rate environment of the last few years spawned the growth of complex new financial instruments as well as new types of institutional investors. The search for yield in this environment encouraged many investors to invest in products which, it emerged, they did not always fully understand. Complex products have introduced increased opacity into the financial system, as is demonstrated by continuing uncertainty over the scale and distribution of losses in the banking sector resulting from exposure to sub-prime mortgages.     **(b) Investors**   The report expresses concern that some investors did not exercise sufficient due diligence on the products they bought and appear to have been overly-reliant on the credit rating agencies, often using ratings as a "green light" to invest. The Committee therefore calls on investors to exercise greater responsibility for the decisions they make in the future.  **(c) The credit rating agencies**   The report concludes that the problems affecting financial markets since early August 2007 have highlighted inherent and multiple conflicts of interest in the credit rating agencies' business model, as well as flaws in their rating methods. The Committee calls for the credit rating agencies to tackle these perceived conflicts of interest as a matter of urgency if they are to regain trust and confidence.    **(d) The Committee's overall approach and future work**  The Committee states that detailed regulation of products is one response to the problem of product complexity, although not one that the Committee instinctively favours. However, the Committee warns that if the market and, in particular, the investment banks prove unable to address the problem of overly complex products, then regulation will need to be examined in the future.   The report is available from the [UK Parliament](http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/371/371.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.13 Hong Kong Exchange reports on implementation of code on corporate governance practices**  On 29 February 2008, the Stock Exchange of Hong Kong Limited (the Exchange), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx), published a report on the findings from its second annual review of listed issuers' corporate governance practices.   The review, which analysed the practices disclosed in 1,114 listed issuers' 2006 annual reports, was aimed at determining how effectively the Code on Corporate Governance Practices (the Code) is being implemented.    The Code became effective, with one exception, for accounting periods commencing on or after 1 January 2005. The exception, the code provision on internal controls, became effective for accounting periods commencing on or after 1 July 2005.   The Code includes two levels of recommendations: (1) code provisions; and (2) recommended best practices. Code provisions are not mandatory but issuers must disclose in their interim and annual reports whether they have complied with each code provision; where issuers deviate from a code provision, the issuer must give reasons for the deviation. The recommended best practices are for guidance only i.e. issuers are encouraged, but not required, to state whether they have complied and give reasons for any deviation.   The review's findings included the following:   * All 1,114 issuers met the requirement to comply or explain i.e. all issuers either said in their annual reports that they had complied with the 45 code provisions or explained their deviation from one or more code provisions; * About 96 per cent of the issuers complied with at least 41 of the 45 code provisions; and * Larger issuers complied with more code provisions than smaller issuers (based on market capitalisation).   The report is available on the [HKEx](http://www.hkexnews.hk/reports/corpgovpract/CG%20report.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.14 Proposed reform of notification of top 20 interest holders in managed investment schemes**  On 28 February 2008, the Australian Treasury published draft regulations that will amend the [Corporations Regulations 2001](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56758" \t "Default) to remove the requirement for managed investment schemes (registered schemes) to notify the Australian Securities and Investments Commission of the top 20 interest holders each year as part of a scheme's annual review.   The draft regulations will align the treatment of registered schemes with the treatment of public companies in relation to the member reporting requirements amendments introduced in the [Corporations Amendment Regulations 2007 (No. 5)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=97318" \t "Default).   The [Draft Explanatory Statement](http://www.treasury.gov.au/documents/1348/PDF/Draft%20Explanatory%20Statement.pdf" \t "_new) and the [Draft Regulations](http://www.treasury.gov.au/documents/1348/PDF/Draft%20Regulations.pdf" \t "_new) are available on the Treasury's website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.15 ABI research: Corporate governance 'pays' for shareholders and company performance**   New research from the Association of British Insurers (ABI) shows that companies with the best corporate governance records have produced returns 18 percent higher than those with poor governance according to a media release published by the ABI on 27 February 2008.     It was also revealed that a breach of governance best practice (known as a red top in the ABI's guidance) reduces a company's industry-adjusted return on assets (ROA) by an average of 1 percentage point a year. For even the best performing companies (those within the top quartile of ROA performance) that equates to an actual fall of 8.6 percent in returns per year.   The research also shows that shareholders investing in a poorly governed company suffer from low returns. £100 invested in a company with no corporate governance problems leads to an average return of £120 but if invested in the worst governed companies the return would have been just £102.   Other key findings include:   * The worst offending companies, which breached guidelines in every year examined, underperformed the average industry-adjusted return on assets by 3- 5 percentage points a year.  There was also found to be a time lag of two to three years between any breach and the impact on performance * The volatility of share returns is 9 percent lower for well-governed companies than poorly governed companies. * The balance of the board is crucial.  More non-executive directors (NEDs) on a board improve performance, though too great a number is linked to a fall in profitability. * Companies that receive a red top for pre-emption rights issues see a large negative impact on performance, with an annual decrease of 3 percentage points of industry-adjusted ROA (Pre-emption is the right of existing shareholders to be offered shares at a time of new share issues, to prevent them having their holdings diluted).   The research examined 654 UK FTSE All-Share companies from 2003 to 2007 using governance data from the ABI's Institutional Voting and Information Service (IVIS).  The service issues colour coded guidance to highlight breaches of governance best practice, with red being the most serious.    The report is available on the [ABI](http://www.abi.org.uk/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.16 Proposals on sovereign wealth funds and financial stability**  On 27 February 2008, the European Commission adopted communications on sovereign wealth funds and on adapting European and global financial systems to better promote financial stability. These communications are the Commission contribution to EU leaders' discussions on these subjects at the Spring European Council on March 13-14 2008. On sovereign wealth funds (SWFs), the Commission is proposing that EU leaders endorse a common EU approach to increasing the transparency, predictability and accountability of SWFs. This common approach will strengthen Europe's voice in international discussions aiming to establish a code of conduct including standards in areas of transparency and governance. On financial stability, the Commission wants the European Council to confirm the principles which will guide the EU's efforts to improve financial market transparency and reinforce prudential control and risk management, and to set out the broad lines of the action to be taken.   **(a) Sovereign wealth funds**   The Commission's communication on sovereign wealth funds proposes to EU leaders what it refers to as a balanced and proportionate common EU approach.  The overall aim is to maintain an open investment environment while enhancing the transparency, predictability and accountability of SWFs' investments. This requires obtaining greater clarity and insight into the governance of SWFs and improving the quality of information they provide to markets on their size, investment objectives, strategies and source of resources.   The communication sets out five principles:   * commitment to an open investment environment both in the EU and elsewhere, including in third countries that operate SWFs; * support of multilateral work, in international organisations such as the IMF and OECD; * use of existing instruments at EU and Member State level; * respect of EC Treaty obligations and international commitments, for example in the WTO framework; and * proportionality and transparency.   The Communication goes on to spell out some basic governance and transparency standards that should be included in a voluntary code of conduct for SWFs to be agreed at international level, building on the current work done by the IMF. An internationally agreed voluntary code of conduct is the most effective and proportionate way to address concerns over possible risks that the cross-border operations of some SWFs could interfere with the normal functioning of market economies.   Among the main concerns are that some SWFs operate in an opaque manner without disclosing for example, the value of their assets, investment objectives and the nature of their risk management systems. There are also concerns that SWF owners may use them to further strategic interests, rather than normal commercial interests, thus both distorting markets and posing potential security problems for the EU and its Member States.   The common approach the Commission is putting forward will avoid an uncoordinated series of national responses that would fragment the internal market and damage the European economy as a whole. It will also help advance the EU's trade goal of opening third country markets to EU investors. This would be more difficult if the EU was seen as imposing unjustified barriers within Europe. The Commission asks the European Council to endorse this approach and make it the basis to encourage recipient countries to keep their market open and provide clear guidelines towards access to investment and SWF owners to reach agreement on a code of conduct, preferably by end 2008.   **(b) Financial stability**  The ECOFIN Council agreed in October 2007 a road map for reinforcing European and global financial regulation and supervision to fill the gaps revealed by recent financial turmoil in the wake of the US sub-prime crisis. The road map is based on four key areas of work: improving transparency; valuation of financial products, strengthening prudential requirements and making markets function better.   The Commission communication on financial stability asks EU leaders at the Spring European Council to build on this road map and "go one step further" by confirming at head of state and government level the principles which will guide the EU internally and in international fora.   Those principles should include: primary responsibility for managing risk rests with individual financial institutions and investors; national regulatory and supervisory frameworks must be equal to the task of coping with rapid change and innovation in financial products; cooperation between regulatory authorities in the EU and globally must be stepped up.   The Commission also wants the European Council to endorse a series of lines of action both in terms of internal policy and in international fora. These include:   * improving information provided by credit ratings agencies, by taking regulatory measures if the agencies do not act voluntarily; * updating accounting and valuation rules, so that full information on the exposure of banks and other financial institutions to off-balance sheet vehicles is made available; * encouraging prompt and full disclosure of losses by financial institutions; * improving early warning systems on financial stability; * fostering the effectiveness of EU networks of financial supervisors and ensuring strong and effective supervision of cross-border groups; and * working on a common framework for assessing the systemic implications of a potential crisis.   The Commission wants a political agreement with the Council and the European Parliament to deliver the necessary legislative changes before April 2009.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.17 CEIOPS publishes two consultation papers for the framework directive proposal related to insurance groups' supervision and proportionality**   On 25 February 2008, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) published two Consultation Papers of Draft Advice to the European Commission for the Solvency II project, on Aspects of the Framework Directive Proposal related to Proportionality and on Insurance Groups.   The Draft Advice on Proportionality addresses how to gear the new risk-based regime to the nature, scale and complexity of an insurer's or reinsurer's risks, including small and medium-sized undertakings. Appropriate treatment of all undertakings is to be achieved through the application of the proportionality principle. CEIOPS has proposed principles in its Draft Advice under all three Pillars, also on aspects of internal models, and group supervision.   CEIOPS' Draft Advice on Insurance Groups concerns measures to facilitate their effective supervision. Part I relates to the group support regime. It addresses the detailed content of the criteria to be satisfied for the application of the Regime. According to the Framework Directive Proposal, insurance and reinsurance undertakings within an insurance group can be authorized to cover their Solvency Capital Requirement with group support declared by their parent undertaking when certain criteria are satisfied. In its Draft Advice, CEIOPS advises the European Commission on the legal and economic criteria that need to be satisfied and verified, and on the specific requirements regarding public disclosure when the Group Support Regime is applied within an insurance group.   Part II relates to the rights and duties of the Group Supervisor and Colleges of Supervisors. CEIOPS covers 30 proposals for implementing measures that relate to the cooperation, coordination and information exchange in the Colleges of Supervisors.   The consultation papers are available on the [CEIOPS](http://www.ceiops.eu/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.18 IPO activity in Australia**   IPO activity in Australia increased to 91 listings in 2007, raising $8.9 billion. This represents a 28 percent jump from 71 listings in the prior year, raising $6.9 billion, according to a media release published by PricewaterhouseCoopers on 25 February 2008.  Despite being in the midst of the US-led sub-prime credit crisis, close to a quarter of the 2007 listings (23 IPOs) occurred in the month of December - the highest monthly activity in 7 years.  This analysis is part of PricewaterhouseCoopers' 16th Annual Survey of Sharemarket Floats report. The report charts the performance of IPOs in the year to 31 December 2007 (excluding compliance listings, 'backdoor' listings, demutualisations and resource sector floats).  Aggressive IPO pricing was a feature of the year as evidenced by the majority of 2007 floats (53 per cent) trading at a discount to their issue price as at 31 December 2007. Also, increased market volatility in the last four months of the year and in January / February 2008 has invariably impacted the listing plans for a number of companies.   2007 saw the listing of seven private equity backed companies, with all but one of these listing prior to the capital market turbulence which began in August. Boart Longyear was the largest private equity exit in 2007 via an IPO, raising $2.3 billion from investors in April 2007.   **(a) Small and large cap float performance**  Of the 91 companies which floated in 2007, the majority (56) had a market capitalisation on listing of less than $100 million. Consistent with previous years, most IPO activity involved relatively small to moderate fund raisings, with 56 per cent of IPOs (51 floats) raising less than $20 million and 40 per cent of IPOs (36 floats) raising $10 million or less.  In 2007, Large Cap floats continued to achieve significant pricing premiums of around 26 per cent over Small Cap floats.  Post float performance of Small Caps was down in 2007. Over the course of the calendar year, Small Cap floats returned a negative 5 per cent to investors, whilst the S&P/ASX 300 Industrials Index rose by 3.5 per cent.   This investor outcome is consistent with the fact that forecast P/Es (Year 1) for Small Cap floats rose slightly in 2007 to 10.3 times, as compared with 9.1 times in the previous year. Large Cap forecast P/Es (Year 1) remained unchanged from the prior year at 13 times.  Large Cap floats provided healthy 'stag' profits on listing of 20 per cent in 2007, which largely held up over the course of the year, and generated solid share price returns to investors of 17 per cent to 31 December 2007, thereby outperforming the overall market rise of 3.5 per cent for the same period.  **(b)  Sector performance**  The Investment & Financial Services sector was the largest source of IPOs in 2007 (22 floats), being responsible for close to a quarter of total listings. Of the five largest floats in 2007 which collectively raised $4.6 billion, four were in Investment & Financial Services. The largest listing in this sector, by market capitalisation, was Platinum Asset Management.  The Industrials sector also featured highly with 16 listings followed by the Health & Biotechnology sector with 12 listings. The Health & Biotechnology sector is traditionally a relatively strong source of IPOs year on year.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.19 Australian auditor independence framework evaluation**  The Australian auditor independence framework continues to operate effectively, according to the annual report on auditor independence released on 25 February 2008 by the Australian Financial Reporting Council (FRC).   The report indicates that audit firms have made significant progress in the adoption and refinement of the systems and processes they use to ensure compliance with auditor independence requirements. However, the FRC noted that some small to medium-size audit firms, which were reviewed under the Australian Securities and Investments Commission's (ASIC's) audit inspection program for the first time, had not taken a proactive approach to planning and implementing effective policies, systems and processes to ensure compliance with legislative requirements for audit independence.   The report also notes that the professional bodies already have in place continuing professional development programs to ensure members are adequately informed about and are conscious of the auditor independence requirements.   The FRC is required, by subsection 235BA(1) of the [Australian Securities and Investments Commission Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56481" \t "Default), to prepare an annual report on the performance of its auditor independence functions, the findings and conclusions reached by the FRC in performing those functions, and the actions (if any) taken by the FRC.    The report is available on the [FRC](http://www.frc.gov.au/reports/default.asp" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.20 Executive contracts and severance: Guidelines from ABI and NAPF**  On 22 February 2008, the ABI (Association of British Insurers) and NAPF (National Association of Pension Funds) published their updated joint statement on executive contracts and severance.  The statement, first published in 2002, assists companies with the design and application of contracts for when senior staff depart. It is also used by shareholders when assessing whether a situation exists where failure is being rewarded.   The new statement contains eight principles, including:   **Notice periods** - encouragement is now given to boards to consider making directors' contracts with a shorter notice period than the standard 12 months.   **Severance payments** - responsibility is outlined for Remuneration Committees to justify severance payments and the importance of not rewarding failure.   **Contract** terms - Remuneration Committees should ensure that policy and objectives on directors' contracts are clearly stated in the Remuneration Report.   **Pensions** - the importance of regular reviews by the Remuneration Committees is outlined to ensure that these do not lead to unmerited payments in the event of severance.  **Executive commitment** - Boards should ensure that executives show leadership by aligning their financial interests with those of the company.    The full guidance is available on the [NAPF](https://www.napf.co.uk/DocumentArchive/Policy/Corporate%20Governance/20080218_ABI%20NAPF%20Statement-feb%202008.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.21 FSA proposes further simplification of investment advice disclosure**   On 19 February 2008, the UK Financial Services Authority (FSA) published a consultation paper containing proposals which aim to further help investment advisers provide consumers with clear and simple information about services and costs.    The FSA's new regime for the conduct of investment business - Conduct of Business Sourcebook (COBS) - came into force on 1 November 2007. This introduced a principles-based approach to disclosure, giving investment advisers flexibility over how they give information to consumers on their services and costs.  Following consumer research, the FSA is proposing to build on COBS by introducing a single disclosure document, also in guidance, to combine the information contained in the Menu and Initial Disclosure Document (IDD). This would simplify investment disclosure and continue to give firms discretion over how the information is presented while maintaining their responsibility to consumers. The regulator is also seeking views on whether it would be appropriate for the industry to develop guidance in this area.  The FSA invites views on the questions set out in the consultation paper by 19 May 2008.  In placing this simplified document in guidance, the FSA is providing firms with an effective way of complying with a number of European Union disclosure requirements. In line with European requirements, for firms that wish to use this document, it may further reduce the number of documents investment advisers provide at the point of sale and give firms greater flexibility in achieving clarity for consumers.  The consultation paper is available on the [FSA](http://www.fsa.gov.uk/pages/Library/Policy/CP/2008/08_03.shtml" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1)  **1.22 Report on hedge funds**   The United States Government Accountability Office (GAO) has published a report on hedge funds. The report is titled "Regulators and Market Participants Are Taking Steps to Strengthen Market Discipline, but Continued Attention Is Needed".   According to the report, since the 1998 near collapse of Long-Term Capital Management (LTCM), a large hedge fund - a pooled investment vehicle that is privately managed and often engages in active trading of various types of securities and commodity futures and options - the number of hedge funds has grown, and they have attracted investments from institutional investors such as pension plans. Hedge funds generally are recognized as important sources of liquidity and as holders and managers of risks in the capital markets. Although the market impacts of recent hedge fund near collapses were less severe than that of LTCM, they recalled concerns about risks associated with hedge funds and they highlighted the continuing relevance of questions raised over LTCM.    This report (1) describes how US federal financial regulators oversee hedge fund-related activities under their existing authorities; (2) examines what measures investors, creditors, and counterparties have taken to impose market discipline on hedge funds; and (3) explores the potential for systemic risk from hedge fund-related activities and describes actions regulators have taken to address this risk. In conducting this study, GAO reviewed regulators' policy documents and industry reports and interviewed regulatory and industry officials, and academics.  The report is available on the [GAO](http://www.gao.gov/new.items/d08200.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h1) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **2. Recent ASIC Developments** |  |  | | |  | | |  | | --- | | **2.1 ASIC grants relief for share and interest sale facilities**  On 18 March 2008, the Australian Securities and Investments Commission (ASIC) announced class order relief from provisions of the [Corporations Act](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) (the Act) to facilitate the operation of certain share and interest sale facilities. This relief is provided in ASIC Class Order CO 08/10 "Share and interest sale facilities".  ASIC has also released Regulatory Guide 161 "Share and interest sale facilities" (RG 161), which explains the relief given in CO 08/10 and ASIC's approach for sale facilities not covered by the class order.  Share and interest sale facilities are facilities that some companies and issuers of interests in managed investment schemes offer to their members from time to time. These sale facilities can provide an easy and cheap way for their members, especially those with small holdings, to dispose of their holdings at or near their current market value.   CO 08/10 provides relief from a range of provisions of the Act. This will allow companies and product issuers to offer certain sale facilities and related facilities for the purchase of shares or interests, and reduce costs for those companies and product issuers by removing the need for them to apply to ASIC for individual relief before offering such facilities to their members.  The relief only applies to facilities where the shares or interests are sold in the ordinary course of trading on a licensed market or approved foreign market. The relief is also subject to other limitations and conditions. The details are set out in RG 161 and the class order.  The class order will commence after it has been gazetted and recorded on the Federal Register of Legislative Instruments (FRLI) in electronic form.  Over the past few years, ASIC has granted individual relief to facilitate the operation of some sale facilities and related purchase facilities. In July 2007, ASIC issued Consultation Paper 85 "Share and unit sale facilities" (CP85) in which ASIC proposed class order relief and sought comments on that proposal.  [Regulatory Guide 161 "Share and interest sale facilities"](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg161.pdf/$file/rg161.pdf" \t "_new), the [Class Order](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/co08-10_pre-registered.pdf/$file/co08-10_pre-registered.pdf" \t "_new) and the [Explanatory Statement](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ES_co08-10.pdf/$file/ES_co08-10.pdf" \t "_new) are available from ASIC.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h2)  **2.2 Refinancing in response to financial stress**   On 13 March 2008, the Australian Securities and Investments Commission (ASIC) released a report that examines the risks for homeowners of inappropriate refinancing in response to mortgage stress.  The report, 'Protecting wealth in the family home' (REP 119) examines the experience of a small number of borrowers to obtain an understanding of how borrowers can make poor refinancing choices and the costs and consequences of those choices.   The ASIC report found that:   * two fringe brokers reviewed in detail charged fees to borrowers of more than 20 per cent of the existing equity in their homes, with a highest fee of more than $24,000; * these fringe brokers refinance borrowers into interest only loans for one or two years with high upfront costs. These loans provide, at best, a short term solution. In some cases borrowers cannot afford the repayments on the loans, and are sold up by the lender before the loan term finishes; * ASIC analysed three of these inappropriate loan transactions in detail. ASIC found that these refinances cost the borrowers a minimum of $20,120, through the brokerage fees and lender costs associated with these loans; and * borrowers may enter into a series of refinances until the equity in their home has been exhausted and is insufficient to support a further loan.   ASIC undertook the research to assist brokers, lenders and borrowers to make better decisions. The report includes a checklist for borrowers on the costs they should consider when they are looking to refinance to see if it is worth it, and a series of questions for their broker.  In November 2007, the states and territories released a draft bill to introduce national uniform broker legislation.   The full report is available on the [ASIC](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_119_Protecting_wealth_in_family_home.pdf/$file/REP_119_Protecting_wealth_in_family_home.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h2)  **2.3 APRA and ASIC release new online reporting system for dual-regulated institutions**  On 11 March 2008, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) released a new online breach reporting system for dual-regulated institutions.  The online system simplifies the process for regulated institutions to report breaches, and prospective breaches, of a legal provision of an APRA-administered or ASIC-administered Act, standard or rule, as well as other matters that are required to be reported. It also reduces duplication faced by institutions regulated by both APRA and ASIC. The superannuation industry is already using an online system to report breaches to APRA.  The new system:   1. enables all APRA-regulated institutions - authorised deposit-taking institutions, general insurers, life insurance companies, friendly societies and superannuation licensees - to report breaches to APRA online; and 2. enables those institutions regulated by both APRA and ASIC to report breach notifications required to be lodged with both regulators through a single electronic breach report to APRA, thereby eliminating the requirement for dual-regulated institutions to provide separate breach reports for the same incident to both regulators.   This initiative follows the passage through Parliament, in late 2007, of the [Financial Sector Legislation Amendment (Simplifying Regulation and Review) Act 2007](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=98576" \t "Default). The Act introduces a consistent definition of reportable breaches across all institutions in APRA-regulated industries and all ASIC-regulated Australian Financial Services licensees.  Further details are available on the [APRA](http://www.apra.gov.au/breach" \t "_new) website and the [ASIC](http://www.asic.gov.au/" \t "_new) website.  The agreement between ASIC and APRA is available on the [ASIC](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/APRA_ASIC_legal_agreement.pdf/$file/APRA_ASIC_legal_agreement.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h2)  **2.4 ASIC releases market assessment reports**  On 6 March 2008, the Australian Securities and Investments Commission (ASIC) released the findings of the following eight annual assessments:   1. Australian Pacific Exchange Limited (APX) 2. Bloomberg Tradebook Australia Pty Ltd (BTA) 3. Board of Trade of the City of Chicago Inc (CBOT) 4. Chicago Mercantile Exchange Inc (CME) 5. Golden Circle Limited (GCL) 6. National Stock Exchange of Australia Limited (NSX) 7. Reuters Transaction Services Limited (RTSL) and 8. Yieldbroker Pty Limited (Yieldbroker).   ASIC has concluded that each market has adequate arrangements for the supervision of its market in accordance with the obligations under section 792A(c) of the [Corporations Act](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) (the Act).  **Background**  A financial market is defined as a facility through which offers to buy and sell financial products are regularly made. Anyone who operates a financial market in Australia must obtain a licence to do so, or otherwise be exempted by the Minister.  As part of the conditions of granting a licence to operate a financial market, the licensee must supervise the market in accordance with Part 7.2 of the Act.  Under the Act, ASIC is required to conduct an assessment of the extent to which licensed financial markets are complying with their obligations to supervise their markets. ASIC must do this at least once per year in relation to each licensee. ASIC can also assess how well a licensee is complying with its other obligations under the Act.  The reports are available on the [ASIC](http://www.asic.gov.au/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h2)  **2.5 Market warned about stock lending, short selling obligations and false or misleading rumours**   On 6 March 2008, the Australian Securities and Investments Commission (ASIC) and the Australian Securities Exchange (ASX) issued three statements to clarify and reinforce existing obligations in relation to share lending and short selling.    The three statements are:    **(a) ASIC reminds market participants about stock lending disclosure obligations**   ASIC has noted market commentary in relation to the practices of stock lending and short selling being associated with current market volatility.  ASIC considers it is timely to remind market participants of some important disclosure obligations. ASIC is of the view that persons engaged in stock lending or stock borrowing should carefully examine their obligations to lodge substantial holding notices in a timely manner.   It is very likely the acquisition of a substantial holding of securities as part of a stock lending arrangement will give rise to a duty to disclose the substantial holding to the listed company (or registered scheme) and the market operator. This is because the borrower of the securities will acquire a "relevant interest" in the securities at the time it agrees to borrow it. When the securities are sold, there will be a corresponding notifiable disposal.  A person is obliged to lodge a substantial holding notice:   * within two business days of becoming aware of their substantial holding; or * if a takeover is on foot, by 9.30 am on the next trading day of the financial market after becoming aware of their substantial holding.   **Stock lending and the takeovers and substantial holding provisions of the Corporations Act 2001**  Stock lending describes the practice by which securities are transferred from one party (the "lender") to another (the "borrower"), with the borrower obliged to return them (or equivalent securities) either on demand or at the end of any agreed term. Stock borrowing is often undertaken to "cover" what would otherwise be regulated short selling transactions under the [Corporations Act](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) and ASX Market Rules.  Stock lending activity requires consideration of the relevant interest and substantial holding provisions of the Corporations Act. Under section 608 of the Corporations Act, a person has a relevant interest in securities if (among other things) they:   1. hold the securities; or 2. can vote (or control the voting) of a security; or 3. can dispose (or control the disposal) of a security.   Section 608 provides it "does not matter how remote the relevant interest is or how it arises" (section 608(1)), or that the power or control is "indirect", is "subject to restraint", or even "cannot be related to particular security" (section 608(2)). Further, section 608(8) accelerates the acquisition of interests for the purposes of section 606 by anticipating the performance of agreements.   The holdings of a party's "associates" (defined in Part 2 Division 1.2 of the Corporations Act) are also taken into account in determining relevant interests.   Under section 671B of the Corporations Act, an obligation to make initial substantial holding notice disclosure will arise if a person has a relevant interest in more than 5 percent of a listed company or registered scheme. The person is also obliged to notify of a movement of 1 percent in that holding.  It is ASIC's view that entry into a stock lending agreement and/or the allocation of securities by the lender to the borrower engages the relevant interest provisions of the Corporations Act. That must be the case where a borrower holds a presently exercisable and unconditional right to vest borrowed securities. Accordingly, stock lending may give rise to substantial holding notice implications for the lenders, the parties who manage stock lending arrangements, and borrowers.   Stock borrowed will also be subject to the 20% control threshold in section 606 of the Corporations Act. Section 606 of the Corporations Act prohibits persons from acquiring relevant interests in the voting shares of a public/listed company if that person or someone else's voting power increases from a figure at or below 20 percent to a figure above 20 percent (or from a figure above 20 percent to a higher figure above 20 percent but below 90 percent) unless acquired in one the circumstances set out at section 611.  ASIC expects strict compliance with the substantial holding and control threshold obligations by all holders, and will be monitoring trading and related disclosures to ensure this occurs.  ASIC is aware that some market participants may find strict observance of these obligations administratively burdensome, but ASIC believes this disclosure is important particularly in current market conditions. ASIC's Regulatory Guide 159.267 describes some circumstances where parties to stock lending arrangements may lodge joint holding notices and ASIC proposes to issue a consultation paper to consider means of streamlining notification procedures.    **(b) ASX on short selling**    The Australian Securities Exchange (ASX) is addressing transparency and settlement risk issues associated with short selling of listed securities in several ways. These issues are more acute in times of market volatility. In the current environment, ASX reminds market Participants of the requirements existing under a combination of current legislative provisions and ASX market rules.    Short selling plays a useful role in contributing to market efficiency in a developed financial economy. Any obligations placed on brokers need to contribute to that efficiency or otherwise address clearly identifiable regulatory objectives.    Transparency of the amount of what is commonly referred to in the market as "naked" and "covered" short selling activity is important for market users to inform their trading decisions. A "naked short sale" for this purpose is where the Participant, either proprietary or on behalf of a client, enters an order in the market and does not have in place arrangements for delivery of the securities. A "covered short sale" for this purpose is where the Participant, either proprietary or on behalf of a client, enters an order in the market and does have in place arrangements for delivery of the securities, typically, by borrowing the relevant securities.    ASX achieves transparency by imposing obligations on brokers to ensure reporting to them by their clients of "naked" and "covered" short selling, and the on-forwarding of that information to ASX for dissemination to the market. To the extent that legislative amendments are needed to remove the scope for differing interpretations of key obligations under the law, and to support the obligations that ASX imposes directly on brokers and indirectly via brokers on other market users, appropriate representations have been made by ASX to Government. ASX will consult with industry on any consequential changes to its operating rules.    For the purposes of transparency of "naked" and "covered" short selling, a combination of legislative provisions and ASX rules require that:   * When asking a broker to execute a short sale, a client must inform the broker that the sale is a short sale. * A broker must advise their client of the obligation to notify the broker of short sales. * A broker must inform its clearer that the sale is a short sale, and must ensure that the clearer has secured a minimum 20% initial margin over the short position. * A broker must advise ASX as soon as practicable that it is executing a short sale. * A broker must report to ASX their unsettled net short sale position as at 7:00pm by no later than 9:00am on the next trading day.   Where a broker has reason to believe that a client is placing an order for a "naked" or "covered" short sale, ASX expects that the broker will make appropriate enquiries of the client to ascertain the nature of that sale in order to satisfy the broker's obligations to provide its daily net short sale position to ASX.    Because short selling activity has the potential to give rise to settlement risks, ASX limits the class of listed securities in which "naked" short selling can occur (an "approved list" comprising approximately 20% of the stocks listed on ASX, based on liquidity and capitalisation criteria).    ASX consolidates the net short sale data provided by brokers and publishes the information in the form of a daily short sale list. The list provides details of aggregate net short sale positions (including "covered" short sales) in respect of approved short sale securities.    ASX recognises the importance of proactively addressing settlement risks arising from "naked" short selling. ASX is reviewing the scale of its late fees for delayed settlement (against a background of comparatively few delayed settlements as a proportion of total market activity relative to other markets). ASX is also reviewing the removal of particular stocks from the approved short sale list if settlement failures increase for any security on the list.   Failure by brokers to comply with ASX rules could result in disciplinary action before the ASX Disciplinary Tribunal.    If ASX identifies a person not in compliance with their short selling obligations under the Act (in particular section 1020B(5)), ASX will refer the matter to ASIC.    If, in the course of any ASX monitoring of trading practices by brokers and/or their clients, ASX identifies the making or spreading of false or misleading statements (especially if in conjunction with short selling), ASX will refer the matter to ASIC for further investigation.    ASX will work with relevant market Participants to ensure their understanding is consistent with the requirements and intentions of the market rules.    The approved short sale list is available from the [ASX](http://www.asx.com.au/data/shortsell.txt" \t "_new) website.   **(c) False or misleading rumours**  ASIC has been approached by a number of market participants concerned that some individuals are deliberately spreading false or misleading information about listed securities.  There are concerns that this is being done to artificially provoke sales of securities and to reduce their market price.  Conduct of this type can be a criminal offence and ASIC, in conjunction with the Australian Securities Exchange, will be vigilant in monitoring the market to ensure this type of behaviour is detected and prosecuted.  Section 1041E of the Corporations Act states that a person must not make a statement or disseminate information if (relevantly):   * it is false in a material particular or is materially misleading; and * is likely to induce persons to dispose of or acquire financial products or to have the effect of reducing the price for securities; and * if the person does not care whether the statement or information is true or false, or knows or ought reasonably to have known it is false or misleading.   If a person spreads a false rumour without properly investigating its truth then the person risks breaching this section. ASIC will investigate the conduct of persons who spread false information or rumours if they cannot substantiate that they did concern themselves as to the truth or falsity of the rumour.   The maximum penalty for an individual breaching section 1041E is five years imprisonment and/or a fine of $220,000.  Section 1041E is part of a suite of provisions in the Corporations Act which prohibit market manipulation (section 1041A), false trading (section 1041B) and market rigging (section 1041C). There is also a provision that prohibits inducing a person to deal in financial product using false or misleading information (section 1041F).  Financial market participants must not engage in dishonest conduct in relation to a financial product or service (section 1041G) when carrying out a financial services business. Dishonest is defined by reference to the standards of ordinary people.  ASIC believes that these provisions, together with the laws prohibiting trading in securities by persons who have confidential price sensitive information (whether or not the information is sourced from an "insider") are sufficient to ensure fair market trading practices.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h2)  **2.6 ASIC consults on new insurance requirements for registered liquidators**  On 29 February 2008, the Australian Securities and Investments Commission (ASIC) released 'Consultation Paper: Insurance requirements for registered liquidators' (CP 96), seeking feedback on its proposals about the new insurance requirements for registered liquidators in section 1284 of the [Corporations Act 2001](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default).  The new insurance requirements were introduced by the [Corporations Amendment (Insolvency) Act 2007](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=98069" \t "Default) and require registered liquidators to have adequate and appropriate professional indemnity (PI) and fidelity insurance. These requirements already apply for new liquidators, and they come into force for liquidators with existing registrations from 1 July 2008.  The new insurance requirements replace the previous requirement for registered liquidators to lodge and maintain a security / performance bond with ASIC, or alternatively to rely on the no-action position described in ASIC 'Regulatory Guide 33 Security Deposits' (RG 33) by holding both PI insurance and a public practice certificate from one of the professional accounting bodies.   Registered liquidators will be responsible for assessing their insurance needs in complying with their obligation to maintain adequate and appropriate PI and fidelity insurance.   The consultation paper seeks feedback on ASIC's proposed:   * transitional arrangements for registered liquidators previously relying on RG 33; * insurance assessment processes; * guidance on what is an adequate amount of cover; and * guidance on what are appropriate terms and conditions in an insurance policy.   The consultation period for the paper closes on 14 April 2008.  The consultation paper is available from the [ASIC](http://www.asic.gov.au/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h2) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **3. Recent ASX Developments** |  |  | | |  | | |  | | --- | | **3.1 Companies Update 02/08: Listing Rule 3.1- financing arrangements of listed entities and margin loans held by company directors**    On 29 February 2008, the Australian Securities Exchange (ASX) published Companies Update 02/08. ASX is concerned to ensure that all listed entities are aware of, and in compliance with, their continuous disclosure obligations in the current environment of high market volatility.    This is particularly so with respect to the disclosure of material information relating to the:   * financing arrangements of entities; and * existence and terms of any finance arrangements that may be in place in relation to directors' shareholdings (for example, margin loans).   Listing rule 3.1 requires an entity to disclose immediately to ASX any information that it is aware of concerning itself that a reasonable person would expect to have a material effect on the price or value of its securities. The exceptions to this requirement are set out in listing rule 3.1A. The expectations of the reasonable person evolve over time and ASX is committed to administering listing rule 3.1 in a way that reflects these evolving standards.    **(a) Finance arrangements**   Where a listed entity has in place or enters into new material financing arrangements or alters existing material financing arrangements which include terms that may be activated upon the occurrence of certain events (particularly those beyond the control of the entity, such as market events), disclosure may be required under listing rule 3.1 at the time that any such term is activated or becomes likely to be activated. The disclosure required may include the nature and terms of the arrangements, the trigger event, and any other material information such as any impact that triggering of the term may have on the entity's relationship with its bankers, or financial position or financial performance. It may also be appropriate in some circumstances for the entity to request a trading halt if the entity is unable to immediately release the information.    **(b) Margin loans**   Listing rules 3.19A and 3.19B require an entity to disclose the notifiable interests of a director within five business days of the appointment or resignation of the director or of a change to the notifiable interests occurring.   Information about shareholders and their shareholdings can be material under listing rule 3.1 and require immediate disclosure (see, for example, bullet point 11 in the note to listing rule 3.1 which deals with information about the beneficial ownership of securities obtained under Part 6C.2 of the Corporations Act). Where a director has entered into a margin loan or similar funding arrangement for a material number of securities, ASX advises that listing rule 3.1, in appropriate circumstances, may operate to require the entity to disclose the key terms of the arrangements, including the number of securities involved, the trigger points, the right of the lender to sell unilaterally and any other material details. Whether a margin loan arrangement is material under listing rule 3.1 is a matter which the company must decide having regard to the nature of its operations and the particular circumstances of the company. Attention is drawn to paragraphs 16 to 19 of Guidance Note 8 - Continuous Disclosure which discusses when an entity becomes aware of information. Listing rule 3.1B applies where ASX considers that there is or is likely to be a false market, and in such circumstances an entity must disclose information necessary to correct or prevent a false market. This requirement may arise even though the entity is not aware of any information that would be required to be disclosed under listing rule 3.1.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h3)  **3.2 Companies Update 01/08: Trading halts and suspensions**  On 27 February 2008, ASX published Companies Update 01/08. Keeping the market informed is a key priority of ASX. It is the obligation of every listed entity to keep the market informed, and this obligation continues when an entity has requested a trading halt or suspension from quotation of its securities.    The listing rules permit entities to request interruptions to trading in their securities.   Listing rule 17.1 enables ASX to grant a trading halt at the request of the entity, and listing rule 17.2 enables ASX to suspend an entity's securities from quotation at the entity's request. Both rules state that ASX may decide not to grant the trading halt or suspension despite the request of the entity. (Trading halts and voluntary suspensions from quotation under either of these rules are to be distinguished from suspensions of securities imposed by ASX under listing rule 17.3 without a request having been made by a listed entity).   Listing rules 17.1 and 17.2 both state that ASX may require the request to be in writing. Guidance Note 16 - Trading Halts stipulates in relation to trading halts that the request must be confirmed in writing and must include the information required by the listing rules (paragraph 10), and that the request will in most cases be released to the market (paragraph 11). ASX advises it will insist that requests for suspension under listing rule 17.2, as well as requests for trading halts under listing rule 17.1, be made in writing for release to the market.    The information provided in the written request must include the matters set out in those listing rules, namely:   * reasons for the suspension or trading halt; ASX expects that the reasons provided would be more specific than "pending an announcement". By way of example, acceptable reasons may include a proposed acquisition/disposal, significant capital raising, merger discussion, and/or finalising accounts. * how long the entity expects the suspension or trading halt (for trading halts less than two days); * the event that the entity expects to happen that will end the suspension or halt in trading; * a statement that the entity is not aware of any reason why its securities should not be suspended or halted; and * any other information necessary to inform the market about the suspension, or other information that ASX asks for.   ASX notes that in some circumstances it may not be appropriate for ASX to suspend or halt trading in an entity's securities. ASX draws listed entities' attention to paragraph 9 of Guidance Note 16, where ASX notes that expectation of a takeover being made for the entity or acquisition of a substantial shareholding may be relevant in deciding whether to grant a trading halt or suspension, and paragraph 12 of Guidance Note 16, which concerns the inappropriateness of an interruption in trading to facilitate the administrative or marketing convenience of an entity.    Where a listed entity is not able or willing to provide a written request to ASX for suspension of its securities, including the information required in listing rule 17.2, ASX may consider whether the entity's securities should more appropriately be suspended, without the entity's request, by ASX under listing rule 17.3.   Listing rule 3.1 applies to entities while their securities are subject to a suspension or a trading halt, and if the entity becomes aware of information that would require disclosure under listing rule 3.1 the entity must release that information immediately notwithstanding that the entity's securities are suspended or halted from trading (listing rule 18.6).   **Back to back trading halts**   ASX refers to paragraph 14 of the Guidance Note which encourages entities to consider a voluntary suspension where the entity cannot manage a disclosure issue within the two day trading halt period. ASX also refers to paragraph 15 in the Guidance Note, which states that the back to back trading halt will only be granted in exceptional circumstances and that a delay in finalizing information to be announced to the market would not be considered to be "exceptional" circumstances.    Entities should seek guidance from their home branch if they are contemplating requesting a back to back trading halt.    **Reinstatement**   ASX may at any time reinstate an entity's securities to quotation (listing rule 17.7). Prior to reinstatement ASX will ensure that the market has the information referred to in the request for suspension or trading halt as well as any other information ASX asks for. Occasionally ASX may require additional time to satisfy itself that an entity continues to comply with the listing rules (in particular the on-going requirements of listing rules 12.1, 12.2, and 12.5) prior to reinstating trading in the entity's securities.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h3)  **3.3 Amendment to SFE Clearing Rules - Increase in financial commitment by participants to support SFE Clearing**   SFE Clearing Rule 5 (Commitment to Support Obligations of SFE Clearing) forms part of the SFE Clearing guarantee fund. Clearing Participants are required to contribute a specified amount, called the First Level Commitment (comprising a fixed component and a variable component up to a specified total). The amendment increases the total aggregate First Level Commitment from $60 million to $120 million.  Regulatory approval has been completed and the changes took effect on 1 March 2008.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h3) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **4. Recent Takeovers Panel Developments** |  |  | | |  | | |  | | --- | | **4.1 Allegiance Mining NL - Declaration of unacceptable circumstances and orders**   On 22 February 2008, the Takeovers Panel advised that it had made a declaration of unacceptable circumstances and final orders in relation to an application dated 11 February 2008 by Allegiance Mining NL (Allegiance) in relation to the affairs of Allegiance (TP07-76).   **(a) Background**   Zinifex Australia Limited (Zinifex) made an off-market takeover bid for all the ordinary shares in Allegiance dated 3 January 2008 (Offer). The Offer was scheduled to close at 7.00pm on Friday 8 February 2008.  At 4.55pm on 8 February 2008 Zinifex lodged with ASIC a notice of variation to extend the closing date of the Offer until 7.00pm on Friday 22 February 2008 (Notice of Variation).  A letter advising each Allegiance shareholder that the Offer was extended was collected by Australia Post at around 5.00pm on 8 February 2008. Zinifex emailed the Notice of Variation to Allegiance at 6.56pm on 8 February 2008.  At 7.18pm on 8 February 2008, Zinifex emailed an announcement containing the Notice of Variation to ASX. At 7.30pm on 8 February 2008 the Notice of Variation appeared on the ASX website.  **(b) Declaration**  The Panel considered that any acquisition of control over voting shares in Allegiance should take, and in this case should have taken, place in an informed market and shareholders should have enough information to consider the merits of the extension of the Offer and reasonable time to consider it.   The Panel considered that Zinifex was committed to the extension at 5.00pm on 8 February 2008 by the collection by Australia Post, a step which could not be retracted and which could have resulted in significant confusion if the extension did not proceed for any reason. Thus, at 5.00pm on 8 February 2008 Zinifex should have informed Allegiance so that Allegiance could notify its shareholders.  By not doing so, some shareholders, who otherwise might not have accepted the offer when they did, accepted in the mistaken belief that the Offer had not been extended.  Therefore, it appeared to the Panel that the circumstances are unacceptable having regard to the effect of the circumstances and the purposes of section 602.   **(c) Orders**  The Panel has made orders to the effect that Allegiance shareholders who accepted the offer after 5.00pm (Melbourne time) but before 7.30pm on 8 February 2008 have a right to apply to Zinifex to cancel their acceptance of the offer.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h4) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **5. Recent Corporate Law Decisions** |  |  | | |  | | |  | | --- | | **5.1 Use of a director's loan to argue solvency in opposition to a winding up application**   (By Mark Cessario and Nicole Parrish, Corrs Chambers Westgarth)   Leveraged Equities Limited v Hilldale Australia Pty Limited [2008] NSWSC 190, New South Wales Supreme Court, Hammerschlag J, 7 March 2008   The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/march/2008nswsc190.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/march/2008nswsc190.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   Leveraged Equities Limited ("LE") applied to the court for the winding up of Hilldale Australia Pty Limited ("Hilldale") under section 459P of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) ("Act") following Hilldale's failure to comply with a statutory demand by LE. Hilldale sought to oppose the application by proving its solvency. For this purpose, Hilldale relied primarily on the availability of funds from a loan by one of its two directors and shareholders, Mr Mackellar.   His Honour considered that the loan from Mr Mackellar to Hilldale represented a resource available to Hilldale to pay its debts as and when they fell due. Therefore, even though it was probable that Mr Mackellar controlled Hilldale, the funds he loaned to the company could still be taken into account when assessing Hilldale's solvency.     This was because the funds were loaned pursuant to a binding agreement between Mr Mackellar and Hilldale, and because some protection was afforded by the duties imposed on Mr Mackellar as a director not to use his position to gain an advantage for himself or to cause detriment to Hilldale.   His Honour confirmed that the predominant test of solvency is a cash flow test, with regard also to be had to the company's assets and credit resources.   Although Mr Mackellar's loan fund was considered an available resource relevant to Hilldale's financial position, there were deficiencies in the evidence that made it difficult to properly assess the company's overall financial position. On its best estimate, the court did not consider that Hilldale realistically had sufficient resources to meet all of its debts as and when they became due.     Hammerschlag J therefore considered that Hilldale had not discharged its onus of establishing solvency and granted the winding up order.   **(b) Facts**   Hilldale is a civil construction business for mining, rail and road infrastructure. On 13 April 2007 LE served a statutory demand on Hilldale recalling funds provided under a lending facility agreement. Hilldale failed to satisfy the demand and LE moved to wind it up by originating process on 21 August 2007.   One of the two directors and sole shareholders, Mr Mackellar, had sworn affidavits in November 2007 and January 2008 that he had funds personally available to him that he was prepared to lend Hilldale to meet its debts if required. It was clear on the facts that without this financial support, Hilldale was insolvent.   In February 2008, Mr Mackellar entered a formal deed of loan with Hilldale.   It was apparent from Mr Mackellar's evidence that he disputed the debt claimed in the statutory demand and did not intend to pay the debt out of the loan funds.   **(c) Decision**   As an initial consideration, Hammerschlag J referred to the following principles in determining whether a company is solvent:   * under section 459C the court must presume a company is insolvent in an application for winding up if it has failed to comply with a statutory demand; * the predominant test for determining solvency is a cash flow one, although the state of a company's balance sheet is still relevant; * it is the inability, utilising such resources as are available through the use of assets or which may otherwise realistically be raised, to meet debts as they fall due which indicates insolvency; * the question of solvency must be assessed at the date of the hearing, however this does not mean that future events are to be ignored; * applying a cash flow test for solvency does not mean that the extent of the company's assets is irrelevant to the inquiry.  The credit resources available must also be taken into account; and * the defendant bears the onus of demonstrating its solvency by leading the "fullest and best" evidence of the company's financial position. Proper verification of assets and liabilities is critical to rebut the presumption of insolvency. Unaudited accounts and unverified claims of ownership or valuation are not ordinarily probative of solvency.   **(i) The loan as a resource**   Hammerschlag J considered that the 'statements of preparedness' in the affidavits by Mr Mackellar did not translate to a resource realistically available to Hilldale. This was because they were non-binding expressions of intent, and Mr Mackellar indicated that he did not intend to use the funds he was willing to provide Hilldale to pay LE.   However, his Honour held that the loan advanced under the formal deed could be considered a resource of the company relevant to its solvency.     Whilst LE argued that Mr Mackellar was so closely involved with Hilldale that the loan might be considered a sham, Hammerschlag J considered that some protection was afforded to LE by the duties imposed on Mr Mackellar as a director not to use his position to gain an advantage for himself or to cause detriment to Hilldale.   Further, the non-binding nature of the statements of preparedness could be contrasted with the binding terms of the deed.     Therefore, his Honour held that account should be taken of the loaned funds when assessing Hilldale's solvency.   In obiter, Hammerschlag J expressed the view that contractual subordinations (whereby a creditor undertakes to not seek payment or to subordinate their claims in relation to a debt owed by a related company) are not sufficient grounds to combat an application for winding up. This is because they are open to consensual rescission and therefore cannot be considered a reliable improvement to a company's financial position.  **(ii) Proving solvency**   Hammerschlag J found that there were several significant evidentiary deficiencies in the balance sheet provided by Hilldale. There was some controversy over the valuation of certain items of equipment and a general lack of supporting documentation for various non-current assets and liabilities. Taking into account necessary adjustments for errors and unsubstantiated items, upon the balance sheet his Honour found that if Hilldale met all of its current obligations it would have less than $15,000 cash and no other realistically available resources.   Further, Hilldale did not provide a cash flow statement and did not present any evidence as to its liabilities with respect to wages, loan repayments and costs to complete projects in progress. The evidence demonstrated that Hilldale had made a loss in its general earthmoving business in the previous year, with no immediate prospects for an improved financial forecast.     Hammerschlag J found that the evidence did not establish:   * the sources and extent of Hilldale's present or prospective income; or * the nature and extent of Hilldale's due or near due or ongoing obligations, and therefore it had not presented its "fullest and best" evidence as to its financial position.   Even with the benefit of Mr Mackellar's loan funds as a resource, Hilldale could not be considered able to meet all of its debts as and when they fall due. His Honour held that Hilldale had failed to discharge the onus of proving its solvency; therefore the presumption of insolvency remained and Hilldale was placed under a winding up order.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.2 Liquidator has standing to seek order to distribute surplus funds of wound up incorporated association**   (By Eliza Blandford, Blake Dawson)   Re Bankstown Community Child Care Incorporated [2008] NSWSC 173, New South Wales Supreme Court - Equity Division, Barrett J, 5 March 2008   The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/march/2008nswsc173.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/march/2008nswsc173.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   An incorporated association had been wound up by the court and a surplus existed after the payment of debts. No special resolution of the association existed that specified where the surplus funds should be distributed and no members remained to pass a new special resolution. While it is unresolved whether an association with no members still exists for the purposes of seeking an order, Barrett J found that the liquidator had standing as a person aggrieved under section 53(3) of the [Associations Incorporation Act 1984 (NSW)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=3727" \t "Default) (the Act). An order was made to distribute the funds to similar community organisations.   **(b) Facts**   In June 2007, an order was made under section 51(1)(j) of the Act that Bankstown Community Child Care Centre Incorporated ("Bankstown Association") be wound up and a liquidator appointed.   After the Bankstown Association's creditors had been paid in full, a surplus of $600,000 remained. The liquidator approached the court seeking relief in order to properly dispose of the funds. It was proposed that the surplus be distributed to two similar community organisations.    **(c) Decision**  Section 53 of the Act makes specific provision regarding distribution of surplus property of an incorporated association. Section 53(2) specifies that, generally, surplus property is to be distributed "in accordance with a special resolution of the association".     The Bankstown Association, however, did not have any special resolution of the kind contemplated by section 53(2). While evidence was put forward that it had passed two resolutions nominating separate organisations that were to receive surplus funds, neither of these were special resolutions. The Bankstown Association was also unable to pass a new special resolution, as it no longer had any members. To be a member of the Bankstown Association, a person was required to have a "child/children in . attendance at the child care centre of the association". As the child care centre no longer operated, no person who could be considered a member existed.   Therefore, Barrett J needed to determine whether section 53(3) allowed the court to make an order that the surplus funds be distributed elsewhere, in the absence of a special resolution.   In the analogous circumstances of Re Bankstown Students Association Inc [2005] NSWSC 700, Campbell J found that an incorporated association had standing to seek an order regarding distribution of surplus funds as a person aggrieved by section 53. The state of aggrievement arose due to the fact that section 53 does not provide a mechanism for the distribution of surplus funds in the absence of a special resolution.   Barrett J agreed that the Bankstown Association was relevantly aggrieved by the absence of any determined destination for surplus property in its winding up. But before an order could be made, a metaphysical question had to be addressed - without any members, does the Bankstown Association even exist, let alone have standing?   An incorporated association is a means of "clothing a fluctuating body of persons with corporate personality so that those persons are bound together by the bond of incorporation". Barrett J, however, was not aware of any decided cases dealing with whether a corporation aggregate still exists if no members form part of that aggregate.     Barrett J concluded that there was no need in the present case, however, to conclude whether Bankstown Association still existed. This was because the liquidator could be considered a person aggrieved in terms of section 53(3), whether or not the Bankstown Association existed. The liquidator was charged with the task of distributing the Bankstown Association's surplus in the way required by law. Since the law identified no destination for the surplus, the liquidator had "a clear interest of his own in seeking the intervention of the court so that appropriate specification may be made to enable him to discharge his duty of winding up the affairs of the body".   Therefore Barrett J concluded that an order could be made directing disposal of surplus assets to the two organisations that the Bankstown Association had previously nominated in its resolutions. These organisations operated with similar objects and purposes as the Bankstown Association and their constitutional arrangements also precluded distribution of property to members.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.3 Mortgagees' rights and obligations when exercising their power of sale**  (By Matt Bernardo, Mallesons Stephen Jaques)  Fortson Pty Ltd v Commonwealth Bank of Australia [2008] SASC 49, Supreme Court of South Australia (Full Court), Doyle CJ, Debelle and Bleby JJ, 4 March 2008  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/sa/2008/march/2008sasc49.htm](http://cclsr.law.unimelb.edu.au/judgments/states/sa/2008/march/2008sasc49.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  Fortson Pty Ltd (Fortson) claimed that the Commonwealth Bank of Australia (CBA) failed to discharge its duty under section 420A(1)(a) of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) (the Act) when selling property after Fortson defaulted on loan repayments. In rejecting Fortson's claim, the Full Court held that:   * Fortson did not in fact suffer any loss; and * the fact that Mr Burton (an expert valuer) was employed by CBA during the time of the re-hearing did not preclude him from being called as an expert.   **(b) Facts** Fortson borrowed from CBA to purchase a hotel property. The borrowings were secured by a mortgage, a charge over the business and a guarantee by Mr and Mrs Jovanovic (the directors of Fortson). Fortson defaulted, and CBA exercised its power as mortgagee and sold the property. The sale occurred via a private tender process, without the property being publicly advertised or placed on the open market.  The market value of the property was assessed at $660,000 by Mr Burton, who was instructed by CBA but was an independent valuer at the time.  CBA sold the property for $800,000.  CBA commenced action to recover the amount due under the guarantee. Mr and Mrs Javonovic counterclaimed, arguing CBA breached section 420A of the Act (failing to take reasonable care to sell the property for the best price that was reasonably obtainable).  At the time of the re-hearing (there had already been a hearing in the District Court, an appeal to the Full Court, a re-hearing in the District Court and then this further appeal to the Full Court), Mr Burton was an employee of CBA. He worked in a department which had no connection with CBA's debt collection processes. Counsel for CBA advised Burton that he need not disclose this.  The main questions the Full Court considered on appeal were:   * Did the judge err in assessing the market value of the property? * The consequences of CBA failing to disclose that Mr Burton was an employee of CBA when he gave his evidence at the re-hearing. * What orders should be made as to the costs of the actions.   **(c) Decision**   At first instance, the central issue was the price which would have been obtained had CBA taken all reasonable care. This would have been met by CBA appointing an agent, conducting proper marketing campaigns and placing the property on the market. During the re-hearing, Lee J found the price to be $870,000. Fortson contended it to be at least $1.5 million.  **(i) Did the judge err in assessing the market value of the property?** Since the property had market value, section 420A(1)(a) of the Act applied, and all that had to be determined was the market value of the property. The Full Court defined market value to be the price that a willing purchaser would have to pay a vendor willing but not anxious to sell in order to obtain the land (Commonwealth v Arklay (1952) 87 CLR 159 at 170).  The Full Court held that Lee J had fallen into error in drawing a distinction between market value and the price obtained after appointing an agent, conducting a proper marketing campaign and putting the title of the property to the open market. Lee J had not determined market value. Rather, he sought to determine the "best price" which could have been achieved, but this is not what section 420A(1)(a) required.  Lee J relied on the expert evidence of Mr Burton (a valuer) and Mr Williamson (a sales agent for hotel properties). Both agreed the market value should be assessed by capitalising the rental of the hotel.  Both based their calculations of the imputed rental upon their estimate of the revenue of the hotel (determined by applying an occupancy rate to an average rate per room).  Williamson contended the hotel should have been able to achieve an occupancy rate higher than 50%. His findings were based on a hotel market commentary report which was not tendered in evidence. Lee J allowed Mr Williamson to give evidence of the report, and the Full Court held this evidence should not have been admitted because it was hearsay.  Mr Burton provided a detailed analysis of capitalisations rates, whereas Mr Williamson conducted a mathematical exercise without using the skill and expertise expected of a valuer. However, in determining the capitalisation rate to be applied, Lee J simply averaged the value of these two figures, an approach held to be invalid by the Full Court. This is so because the capitalisation rate adopted by a valuer represents their assessment of the likely purchaser and the risk inherent in the intended use of the land by that specific purchaser.  After taking into account several errors in Mr Burton's and Mr Williamson's market value calculations, the Full Court adopted their own figure of $722,352, which was less than the price for which the hotel was sold ($800,000). Accordingly, Fortson did not suffer loss as the hotel was sold for more than its market value.  **(ii) The consequences of CBA failing to disclose that Mr Burton was an employee of CBA when he gave his evidence before Judge Lee**  The Full Court reiterated that expert evidence should be entirely objective and dispassionate, and the expert should not have any kind of relationship with the party by whom they are called (so that their evidence is not influenced by them).  It was essential for an expert witness to disclose any relationship they had with the party calling them. Regardless of the fact that Burton had not been employed by CBA when he prepared the initial valuation, it should have been disclosed from the outset (as it goes to the weight of the evidence which Burton was to give). Counsel for CBA therefore erred in advising Burton that he need not disclose this.  However, the non-disclosure did not lead to the Full Court to order a re-hearing.  Burton prepared his valuation long before taking up employment with CBA, when he worked as an independent valuer. During the re-hearing, he was merely repeating that evidence and defending the opinions he earlier expressed in the report. The fact that Burton was employed by CBA at the time he gave his evidence was a material fact concerning the weight to be given to his evidence, but, on the facts, the Full Court held that its disclosure would have made no difference to the weight to be attached to his evidence. Accordingly, the failure to make the disclosure did not require a re-hearing.  **(d) Orders**  Lee J's judgment was set aside because Fortson did not suffer loss.  Judgment was made in favour of CBA for $77,643.93 plus interest from 3 March 2003 (the amount due under the guarantee).  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.4 Determining whether circumstances arising from a failed property development venture justified the appointment of a receiver and manager over the trust assets of a trustee company**   (By James Williams, DLA Phillips Fox)   Ciccarello, in the matter of Adelaide Property Development Pty Ltd ACN 118023868 v Cubelic [2008] FCA 141, Federal Court of Australia, Mansfield J, 22 February 2008   The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2008/february/2008fca141.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2008/february/2008fca141.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)   **(a) Summary**   The case arose from the breakdown of a relationship between three individuals involved in a failed property development venture which was in the process of being wound up, and centred around the question of who should control that process. Orders were sought by one of the parties that a receiver and manager be appointed under section 233 of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) ('Act') over assets held on trust by the relevant trustee company, and alternatively, that the proceeds of a property sale be held on trust by the selling real estate agent.    Mansfield J proposed orders that a receiver and manager be appointed over one particular property held on trust by the trustee company and that certain restrictions relating to the provision of notice be placed on the trustee company in relation to selling or offering for sale other trust assets.  **(b) Facts**   Mr Ciccarello, the first plaintiff, Mr Steve Cubelic, the first defendant and Mr Tony Cubelic, the second defendant entered into a property development venture ('Venture') in late 2005 or early 2006.   The structure of the Venture consisted of the third defendant, Adelaide Property Development Pty Ltd ('APD'), acting as trustee of the Adelaide Property Unit Trust ('APUT'). Mr Ciccarello, Mr Steve Cubelic and Mr Tony Cubelic were the directors and equal shareholders of APD, and also, the three equal unit holders of the APUT.   APD, in its capacity as trustee of APUT, acquired three properties situated in Brighton, North Brighton and Wingfield with a view to developing and ultimately selling them.   The relationship between Mr Ciccarello, Mr Steve Cubelic and Mr Tony Cubelic had broken down by about July 2006 and since that time, the business and affairs of APD had been conducted by Mr Steve Cubelic and Mr Tony Cubelic (together the 'Cubelics') to the exclusion of Mr Ciccarello. The Cubelics made significant decisions on behalf of APD as to how the business was to operate, including in relation to the disposition of assets and as to the appropriation of funds resulting from the disposition of assets. In particular, the Cubelics were responsible for APD's decision to sell the North Brighton property and transfer the available settlement funds from the sale to SA Prawns Pty Ltd, a company of which the Cubelics were directors.   The plaintiffs sought orders that a receiver and manager be appointed under section 233 of the Act over the assets held on trust by APD for the APUT, and alternatively, that the proceeds of the sale of the Brighton property sale be held on trust by the selling real estate agent. The orders were then refined to include an order that the receiver and manager appointed was to provide a report within twenty-one days of the appointment as to the assets and liabilities of APD and what should be done to preserve its business.   In seeking the orders, the plaintiffs cited the fact that Mr Ciccarello had been excluded from the management of APD and that the proceeds from the sale of the North Brighton property had been transferred to SA Prawns Pty Ltd when they should have been applied to reduce the overdraft or facilities granted to APD by Westpac Banking Corporation so as to reduce the imposition of penalty interest.   The defendants argued that the appointment of a receiver and manager would disqualify APD from continuing to act as the trustee of the APUT by virtue of a clause of the APUT trust deed, which stated that a trustee would be disqualified if a receiver and manager was appointed to any of its assets or undertaking, meaning the unit holders by special resolution or the court under the Trustee Act would have to appoint a replacement trustee. Further, it was argued that the appointment of a receiver and manager over the trust assets would add to the costs of realising the remaining trust assets.    **(c) Decision**   Mansfield J initially established that the court possessed the requisite power to appoint a receiver and manager over the assets of a trust by virtue of section 57 of the [Federal Court of Australia Act 1976 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6941" \t "Default) ('FCA Act') and that the basis upon which a court appoints a receiver and manager is ultimately for the protection or preservation of property for the benefit of persons who have an interest in it.   His Honour accepted that Mr Ciccarello had been excluded by the Cubelics from participating in any decision making of APD and that the transfer of the available proceeds from the North Brighton property sale to SA Prawns Pty Ltd was not a decision made in the best interests as trustee of the APUT.   His Honour noted that the appointment of a receiver and manager would not disqualify APD from continuing to act as the trustee of APUT, as the appointment would only relate to assets held by APD as a bare trustee of the APUT rather than the assets or undertaking of APD itself.   Mansfield J proposed to make an order appointing a receiver and manager over the Brighton property pursuant to section 57 of the FCA Act and restraining APD from selling or offering for sale the Wingfield property or the other assets of APD without giving notice in writing of seven days to the plaintiffs' solicitors.   His Honour explained that in limiting the appointment of the receiver and manager to the Brighton property, he had accommodated the costs concerns shared by the defendants.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.5 Securities exchanges: public regulators immune from private law duties?**  (By Jonathan Mackie, Mallesons Stephen Jaques)  Bank of New Zealand v New Zealand Exchange Limited [2008] NZCA 25, Court of Appeal of New Zealand, Robertson, Arnold and Ellen France JJ, 22 February 2008  The full text of this judgment is available at:  [http://www.nzlii.org/nz/cases/NZCA/2008/25.html](http://www.nzlii.org/nz/cases/NZCA/2008/25.html" \t "_new)  **(a) Summary**  This case raised the issue of whether a securities exchange is considered a public regulator immune from private law duties.  The Court of Appeal decision indicates that exchanges may owe such duties where:   * the exchange is primarily a commercial body, notwithstanding that it may have some regulatory functions; or * an important purpose of the exchange's rules and inspection function is to protect a broker's clients.   **(b) Facts**  Access Brokerage Limited (Access) was a stockbroker and member of the New Zealand Exchange Limited (NZX). Under NZX rules, Access was required to hold on trust clients' assets and maintain limited levels of liquidity. Compliance was monitored by NZX through their inspection function.  Between 1996 and 2000, Deloitte Touche Tohmatsu (Deloitte) was engaged to carry out this function. However, from 1 January 2003, NZX undertook the inspection duties themselves and charged fees for conducting the work.  In the course of its annual inspection of Access in 2003, NZX identified various breaches of the rules. Access was advised and NZX set out a timetable for the rectification of these matters. However, matters did not come to a head until Access was placed into liquidation in September 2004 after its directors advised NZX that it was unable to meet obligations to clients of over $4.5 million.  The Bank of New Zealand (BNZ), Access' banker, settled the indebtedness and took assignment of Access' clients' right of action. BNZ and Access issued proceedings against NZX and Deloitte.  The focus of the claims was on NZX's performance of its statutory functions of inspection of the financial information provided by Access in the year leading to its failure.  **(i) BNZ's claim**  BNZ alleged that NZX breached a duty of care in negligence in carrying out the annual inspection in August 2003 and in its subsequent conduct.  The two aspects of the claim were:   * NZX failed to conduct the annual inspection with reasonable professional skill, care and competence; and * NZX, having identified serious issues and breaches of the rules, failed to take satisfactory steps to require Access to correct the situation or, if that was not possible, to suspend Access' designation as an NZX firm.   BNZ submitted that NZX should owe duties in private law because:   * NZX was a commercial body, listed on a stock exchange and operating a securities market for profit; * NZX was not a statutory regulatory body representing the general public interest - this role was fulfilled by the Securities Commission; and * the immediate purpose of the imposition, via the conduct rules, of terms requiring trust funds and minimum liquidity levels was to protect brokers' clients.   **(ii) Access' claim**  Access claimed that NZX breached the term of the contract contained in the NZX rules, requiring that in carrying out his or her duties, an inspector should exercise "normal professional care and skill". Access submitted that NZX did not adequately inspect, test or review the various records.  **(iii) NZX's reply**  NZX submitted that it was the regulator of the stock market, and that the principal purpose of NZX and the inspection regime was to ensure orderly conduct of the market. The fact that it happened to be a listed company did not alter its regulatory nature. NZX relied on authorities to submit that regulatory bodies are not subject to private law duties and, indeed, that such a duty would be inconsistent with the statutory scheme.  **(iv) Approach in the NZ High Court**  **BNZ's claim**  In the NZ High Court, Harrison J granted NZX's application to strike out the claims against it by BNZ and Access. Importantly, Harrison J saw the inspector's predominant function as giving NZX the information needed to fulfil its statutory duty of oversight of the market as a whole. The judge rejected BNZ's submission that a critical purpose of the inspection provisions was to protect clients from loss through misappropriation or a broker's insolvency.  Harrison J saw the purpose of the inspection function as related to protection of the market as a whole. It followed that the judge saw as analogous cases where it was held that there was no duty of care, in particular Yuen Kun Yeu v Attorney-General of Hong Kong [1988] 1 AC 175 (PC(HK)) and Davis v Radcliffe [1990] 2 All ER 536 (PC(IoM)). The Judge rejected any analogy with cases involving auditors of solicitors' nominee company accounts, viewing the distinction between audit and inspection functions in NZX's rule as an important one.  Harrison J also concluded there was no special relationship between NZX and Access as:   * neither the inspector nor NZX had the power to control the day to day activities of Access; and * there was an absence of any relationship between the clients of Access and NZX prior to the point when clients invested.   Further, the Judge did not consider that the necessary degree of proximity and relationship or reliance were present. Harrison J was satisfied that even if there were proximity, policy factors were determinative of BNZ's claim. Additionally, Harrison J was not satisfied that it would be just and reasonable to impose a duty.  **Access' claim**  Harrison J took the view that the scope of the inspector's duties did not extend far enough for Access to rely on NZX's proper performance of its contractual duties to protect it from the loss as:   * Access effectively sought to sue NZX for the adverse financial consequences of its own failure; * NZX had no role in relation to Access' management or control and was not responsible for the failure to establish and maintain internal controls; * it was outside the scope of an inspector's duties to protect a broker from its own failure to perform or remedy breaches; * the inspector was bound to report to NZX rather than to the broker and only dealt with the broker when he or she became aware of an "unsatisfactory feature" possibly giving rise to a claim on the fidelity fund; and * the inspection function was not like the audit function, providing a "true and fair view" of the company's accounts.   **(c) Decision on appeal**   The case on appeal turned on the characterisation of the role of NZX and of the purpose of the inspection regime.   In order to ascertain whether or not NZX was subject to private law duties, the court first examined the relevant statutory framework and rules, particularly those relating to the inspection function. The court considered the framework for NZX provided by the Securities Market Act 1988 and NZX Participant Rules and the role of the Securities Commission under the Securities Act 1978.  **(i) Role of NZX**  The legislative environment suggested that NZX may have had some regulatory functions. However, it was necessary for the court to ascertain whether NZX was the regulator of the stock market and thus immune from private law duties.  The court sought to ascertain where on the spectrum of regulation NZX fell. It noted that:   * NZX focussed on commercial success of a listed company, in contrast to a regulator acting solely on the basis of their view of the public interest and common good; * NZX's corporate structure could not be completely ignored; * NZX's commercial focus was evidenced by their decision to move the inspectorate in-house, in order to cut reliance on external advisors, build intellectual property and benefit financially; * the extent of ministerial involvement with NZX rules was fairly limited; * the public interest factors, relevant to the Minister's approval process of a proposed conduct rule, were set at a reasonably high level; * while possessing some regulatory functions, NZX was not in the same category as the Securities Commission; and * the Securities Commission was the primary regulator - this was supported by the interaction between NZX and the Commission and the Commission's functions and associated powers (i.e. to hear evidence and summons people).   The court contrasted NZX's role with that of a traditional regulator and examined the cases of Yuen Kun Yeu and Davis v Radcliffe in which no duty of care had been found. In Yuen Kun Yeu, the Privy Council emphasised that an important characteristic of a traditional regulator was that some of its functions were quasi-judicial in character. The Court of Appeal noted that although the NZX had some regulatory functions, those functions on their face did not come within the category of "quasi-judicial" activity.  In Davis v Radcliffe, Lord Goff emphasised that a characteristic task of a modern regulatory agency is carefully weighing and balancing competing considerations in the public interest. His Lordship was of the view that the very nature of the task, with its emphasis on the broader public interest, militated strongly against imposing a duty of care on such an agency. In this case the Court of Appeal was of the view that while aspects of NZX's role necessitated consideration of the public interest, its commercial focus put it in a different category from organisations such as those.  Instead of finding the cases analogous with the facts before the court, as Harrison J had done, the court took the view that the commercial focus of NZX put it in a different category from the organisations considered in those cases.  **(ii) Nature of the inspection regime**  Although the view taken of NZX's role was sufficient to deal with the appeal in relation to BNZ's claim, the court went on to consider BNZ's contention that an important purpose of the rules and the inspection function was to protect the broker's clients. The court accepted this approach and opined that it was at least arguable that NZX owed some private duties.  Notwithstanding that an orderly market was one of the objectives of the rules and inspection regime; it was not the overriding objective. There were a number of aspects of the rules that could only be interpreted as having the purpose of protecting the interests of the clients of brokers. These features included:   * requirements to hold clients' money and securities in trust and maintain high levels of liquidity; and * obligations to keep accounting records.   Further, the inspection function must be seen as corresponding to the purpose of protecting clients' interest:   * While the rules are published, apart from inspection, it would be difficult for clients to be satisfied as to compliance. * Although the functions of the inspector were not to be regarded as an audit and did not provide a "fit for" warranty, it did not follow that the inspector was not obliged to exercise due care and skill. * The inspector's associated powers suggested some parallels with an audit. * The requirement to report unsatisfactory situations to the Commission was consistent with this conception of the inspector's role. * A provision in the Securities Market Act indicated the possibility of liability for the exchange where reasonable care was lacking.   The court considered that the better analogy was with cases involving auditors of solicitors' trust accounts and nominee companies. In such cases it had been accepted that there may be a duty of care.  **(iii) Conclusion**  NZX was primarily a commercial body, albeit with some regulatory functions and an important purpose of the inspection regime was to protect the interests of the broker's clients. As the matter was argued there was sufficient to allow the appeal in relation to the claim by BNZ. While there might have been issues about causation the matter was at least arguable and so should not be struck out on that basis.  **(iv) Access' contractual claim**  The court also considered Access' breach of contract claim. The claim was based on the term of the contract (provided in NZX rules) that in carrying out his or her duties, an inspector should exercise normal professional care and skill. Access alleged that NZX did not adequately inspect, test or review the various records.  The court took the view that after the analysis in BNZ's claim, NZX's primary argument, that the alleged duties were inconsistent with the regulatory regime, fell away. Further arguments raised by NZX could only be resolved at trial on the basis of evidence as to the inspection function. Although Access' claim could well face difficulties at trial, it was premature to strike it out.  **(v) Result**  The appeal was allowed and the claims by BNZ and Access against NZX were reinstated. The claims against Deloitte were reinstated by consent.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.6 Determining whether the purported dismissal of a member of an incorporated association was valid**  (By James Williams, DLA Phillips Fox)   Goodwin v VVMC Club Australia (NSW Chapter) [2008] NSWSC 154, New South Wales Supreme Court, White J, 15 February 2008  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/february/2008nswsc154.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/february/2008nswsc154.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   John Arthur Goodwin ('Plaintiff') challenged his dismissal as a member of the Vietnam Veterans Motor Cycle Club Australia NSW Chapter Incorporated ('Defendant'), an association registered under the [Associations Incorporation Act 1984 (NSW)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=3727" \t "Default) ('Act'), on the basis that the dismissal was not effected in accordance with the rules contained in the Defendant's constitution ('Rules'), nor the by-laws purportedly adopted by the Defendant ('By-laws') at a later date. The Plaintiff sought a declaration that the expulsion was invalid and that he remain as a member of the Defendant. After establishing the justiciability of the Plaintiff's claim, White J held that the Plaintiff was entitled to the declaration sought and an award of damages.    **(b) Facts**   The Defendant was established to provide war veterans with an environment in which they could share their experiences, assist each other in assimilating into the community and access services available to war veterans.   The Rules were registered with the New South Wales Department of Fair Trading on 11 May 1999. The expulsion of members of the Defendant was governed by rules 11 and 12 of the Rules, which provided for a two-stage process to be followed in disciplining members.    First, a complaint was to be determined by the Defendant's Management Committee ('Committee'), which involved receiving the complaint, providing the subject of the complaint with an opportunity to respond and then deciding whether or not to expel the particular member by resolution of the Committee.    Secondly, in the event that the Committee resolved to expel the member, the member was to be afforded the right to appeal to the Defendant in general meeting, where the Committee and the member were able to present their respective cases, following which the members were to vote by secret ballot as to whether the resolution should be revoked or confirmed, the latter of which required the passing of a special resolution.   An alteration of the Rules could only be effected if the alteration was approved by a special resolution and lodged with the Director-General. On 13 November 2004, members of the Defendant voted to accept the By-laws, however the vote did not amount to a special resolution and the By-laws were not registered. Therefore, the By-laws did not alter or replace the Rules and in the event of any inconsistency between the two constituent documents, the Rules were to prevail.   In so far as the dismissal of members was concerned, by-law 1023 provided for a one-stage process, involving a disciplinary proceeding being conducted before the members of the Defendant, at which the subject of the complaint was to be given the opportunity to present their case and then the proceeding to be decided by a majority vote of the members.   After the Plaintiff criticised the President of the Defendant ('President') and accused the President of defaming him and labelling him an informant to another club at the annual general meeting held on 23 July 2005, the Secretary of the Defendant ('Secretary') on behalf of the Committee, asked the Plaintiff to state his intentions towards the Defendant in writing within 14 days. The Plaintiff responded by calling on the Committee to take disciplinary action against the President.   Following further correspondence between the Committee and the Plaintiff, the Secretary wrote to the Plaintiff on 9 January 2006 offering retirement in light of the Plaintiff having previously informed the Committee of his medical condition and his inability to attend social functions or work at shows.   A general meeting of the Defendant was then scheduled for 3 February 2006 and the Plaintiff advised that he was not able to attend due to ill-health.   On 3 February 2006, a special general meeting was held prior to the general meeting at which the business set out in the agenda was dealt with. Then at the general meeting which followed, a resolution, which proposed to offer the Plaintiff a final offer of retirement and to dismiss the Plaintiff in the event that he did not accept the offer, was passed twenty-eight to zero with one member abstaining.   The Plaintiff rejected the offer and the Secretary then wrote to the Plaintiff advising him of his dismissal as a member of the Defendant.   The Plaintiff sought a declaration that he remained a member of the Defendant and that his purported expulsion from the Defendant was invalid.   (**c) Decision**   White J initially considered whether the Plaintiff's expulsion as a member of the Defendant was justiciable. His Honour cited a number of relevant authorities and concluded that if a contractual relationship existed between the Plaintiff and the Defendant or its members, then the matter was justiciable. His Honour then referred to section 11(2) of the Act, which provides that the rules of an incorporated association bind the association and the members of the association to the same extent as if the rules had been signed and sealed by each member and contained covenants on the part of each member to observe all the provisions of the rules. His Honour held that the effect of the subsection was that a contract did exist between the Plaintiff and the Defendant, and between all the members of the Defendant, and that therefore, the matter at hand was justiciable.   White J noted that it was not in dispute that the Defendant failed to comply with the Rules and the By-laws in effecting the Plaintiff's dismissal.   However, despite the fact that the Defendant's failure to comply with the Rules or By-laws was not in question, White J considered the validity of by-law 1023. His Honour held that by-law 1023 was inconsistent with rules 11 and 12, which governed the dismissal of a member, by virtue of, amongst other things, the fact that it removed a member's right to appeal, and therefore, would not have been relevant to the matter even in the event that the Defendant had complied with the by-law.   His Honour also held that the Plaintiff was not afforded the requisite standard of natural justice in relation to the dismissal. In reaching this decision, his Honour cited the fact that the Plaintiff was not given notice of any charge of improper conduct or any proper opportunity to respond to either the Committee or to members in general meeting prior to the decision to dismiss the Plaintiff being made.   White J therefore granted the declaration that the Plaintiff remain as a member of the Defendant and that his purported dismissal was invalid. White J cited Brereton J's finding in Rose v Boxing NSW Inc [2007] NSWSC 20 that damages may be awarded for a breach of natural justice or for purported actions in excess of power by an incorporated association on the basis of damages for breach of the contract between the members and the club founded on the constitution. His Honour referred to the fact that the Plaintiff had lost a great deal of his social life and ties as a result of his dismissal as a member of the Defendant, and awarded the Plaintiff contractual damages of $1000.   Finally, his Honour ordered that the Defendant pay the Plaintiff's costs based on his Honour's view that the Defendant, properly advised, ought to have perceived it did not have reasonable prospects of successfully defending the claim.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.7 No indemnifying directors against insolvent trading claims and misleading and deceptive conduct on a due diligence committee**   (By Phoebe Berridge, Clayton Utz)   New Cap Reinsurance Corporation Ltd v Daya [2008] NSWSC 64, Supreme Court of New South Wales, Barrett J, 13 February 2008    The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/february/2008nswsc64.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/february/2008nswsc64.htm" \t "_new)  or   [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   A provision in a company's constitution indemnifying its directors for loss or damage properly incurred in the discharge of the directors' duties would not operate to indemnify a director against an order under section 588M(2) of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default).     The phrase "in trade or commerce" for the purposes of section 52 of the [Trade Practices Act 1974 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6426" \t "Default), section 42 of the [Fair Trading Act 1987 (NSW)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=3955" \t "Default) and section 12DA of the [Australian Securities and Investments Commission Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56481" \t "Default) does not encompass representations made by directors at board meetings, but may extend to misleading and deceptive conduct engaged in on a due diligence committee.     **(b) Facts**   Mr Williams was a director of New Cap Reinsurance Corporation Ltd (New Cap). New Cap's liquidators brought a recovery action against Mr Williams, Mr Ghose and Mr Peck (each a director of New Cap) for allegedly allowing New Cap to incur insolvent trading debts in breach of section 588G(2) of the Corporations Act. Two debts were involved. The first was a US$30 million loan from another company.     The decision to enter into the loan agreement was made at a meeting of New Cap's board on 31 December 1998. The second involved certain "contingent liabilities" under reinsurance contracts entered into by New Cap (the "inwards reinsurance debts").   Mr Williams brought a cross claim against New Cap, Mr Ghose, Mr Peck, Mr Daya (also a director of New Cap) and Mr Aroney (New Cap's chief financial officer and company secretary), asserting that in the event that Mr Williams was made liable to New Cap under section 588G(2) and 588M(2) of the Corporations Act:   * he was entitled to be indemnified by New Cap by the operation of a directors indemnity provision contained in New Cap's constitution; * his participation in the decision to approve the US$30 million loan was based on the misleading and deceptive conduct of Mr Daya, Mr Peck, Mr Ghose and Mr Aroney during the board meeting on 31 December 1998; and * his participation in New Cap incurring the inwards reinsurance debts was based on the misleading and deceptive representations of Mr Daya to the Due Diligence Committee of New Cap that New Cap was "solvent and maintained its claims paying ability".   Mr Aroney, supported by New Cap and Mr Peck, applied for summary dismissal of the cross claim.  **(c) Decision**   Justice Barrett refused the indemnity claim and the misleading and deceptive conduct claims insofar as they related to "internal communications".    **(i) Indemnity claim**   Article 146 of New Cap's constitution indemnified each director against all losses which the director "may properly incur or become liable to pay by reason of any contract properly entered into or other act or thing properly done by him as such officer or in any way to the discharge of his duties".    Mr Williams contended that a liability under sections 588G(2) and 588M(2) of the Corporations Act was a liability in respect of which he was entitled to be indemnified under article 146.   Justice Barrett dismissed Mr Williams' claim to be indemnified by New Cap. His Honour said that a director's liability under sections 588G(2) and 588M(2) arose as a result of his failure to prevent his company incurring the relevant debts. Any loss or damage resulting from a contravention of section 588G(2) was not a debt "properly incurred"; nor would "the discharge of his duties" include allowing the company to incur the debts.    Justice Barrett went on to say that even if New Cap's constitution did operate to indemnify Mr Williams against an order under section 588M(2), the company would be prevented from doing so by section 199A(2) of the Corporations Act.     His Honour said that the result of an order under section 588M(2) would be a liability owed by Mr Williams to New Cap, and would fall within the prohibition in section 199A(2) preventing a company from indemnifying its officers against liabilities owed to the company.     **(ii) Misleading and deceptive conduct claims**   Mr Williams advanced several claims involving allegations of misleading and deceptive conduct against Mr Ghose, Mr Peck, Mr Daya and Mr Aroney under section 52 of the Trade Practices Act 1974 (Cth), section 42 of the Fair Trading Act 1987 (NSW), section 12DA of the Australian Securities and Investments Commission Act 2001 (Cth) (ASICA) and section 955(2) of the Corporations Law (as it then was).    Justice Barrett noted that, in order for conduct to fall within the scope of the Trade Practices Act, Fair Trading Act or ASICA, it must be conduct "in trade or commerce". The representations made in relation to the US$30 million loan were made at a board meeting and were therefore internal communications within the company. His Honour said that in order to determine whether these "internal communications" were "in trade or commerce" they should be considered by having regard to the reason for the communication and its intended purpose.     Justice Barrett found that the discussions between the directors of New Cap, in consideration of whether to commit to the US$30 million loan, were antecedent to New Cap entering into the loan agreement.  As such, the discussions were not "in" trade or commerce, but rather "were anterior to and preparatory for an act "in" trade or commerce".     Justice Barrett applied the same reasoning to the inwards reinsurance debts. In this case the alleged representations were made by Mr Daya to the Due Diligence Committee.  His Honour noted that it was likely that the Due Diligence Committee had members (for example, legal and accounting advisers) external to New Cap.     Mr Daya's alleged representations could therefore not be described as purely "internal communications".  Justice Barrett found that "to the extent that the conduct was conduct towards persons who included members of the Due Diligence Committee the claims cannot be said to be doomed to fail on the `in trade or commerce' ground".    Justice Barrett also noted that as Mr Daya, Mr Peck and Mr Aroney were not bodies corporate they did not fall within the scope of section 52 of the Trade Practices Act.    There is no "in trade or commerce" requirement for conduct to fall within section 955(2) of the Corporations Law. Instead section 955(2) requires that the misleading or deceptive conduct is made "in or in connection with... any dealing in securities". Justice Barrett noted that the effect of regulation 7.12.03 of the Corporations Law Regulations was that a "document issued by the body corporate acknowledging or evidencing indebtedness of the body to a related body corporate" will not be a "security" for the purposes of section 955(2).     It was not clear on the evidence whether the US$30 million loan was a loan between related bodies corporate. His Honour stated that if sufficient evidence was produced to prove a "related body corporate" relationship between the company providing the loan and New Cap, Mr Williams' claim under section 955(2) of the Corporations Law would fail.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.8 Section 411(1) of the Corporations Act: Requirements of the first application to a court in the scheme of arrangement procedure**   (By Adam Charles, Freehills)   Hostworks Group Limited ACN 008 010 820, in the matter of Hostworks Group Limited ACN 008 010 820 [2008] FCA 64, Federal Court of Australia, Mansfield J, 12 February 2008   The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2008/february/2008fca64.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2008/february/2008fca64.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   This decision sets out the reasons for the making of orders pursuant to section 411(1) of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) ('the Act') for the convening of a meeting of the members of Hostworks Group Limited ('Hostworks') for the purpose of considering a proposed scheme of arrangement ('Proposed Scheme'), pursuant to which Hostworks would become a wholly owned subsidiary of Broadcast Australia Pty Ltd ('Broadcast').   In making these orders Mansfield J considered the requirements of section 411(1) of the Act. Due to the particular features of the proposed scheme, Mansfield J also considered the concept of performance risk, "no-shop" and "no-talk" restrictions, break fees, deemed warranties by members of a target and the "classes" of members affected.   **(b) Facts**   On 7 December 2007 Hostworks and Broadcast entered into an Implementation Agreement to give effect to the Proposed Scheme, which, if it became effective, would result in Broadcast paying to the members of Hostworks $0.41 for each share in the capital of Hostworks. Under the Proposed Scheme all holders of options issued over the unissued share capital in Hostworks ('Option Holders') would have the opportunity to either:   * have their options cancelled; * receive $0.41 less the option exercise price; or * exercise their options and then receive the scheme consideration for the shares.   The Implementation Agreement also provided that a break fee of $675,000 was payable by Hostworks to Broadcast (Mansfield J does not canvas what events would cause the fee to become payable, however, the failure by shareholders to approve the Proposed Scheme was not such an event).    On 7 December 2007 Broadcast also entered into a Deed Poll by which it covenanted in favour of each of the members of Hostworks to perform its obligations under the Proposed Scheme ('Deed Poll').    On 14 December 2007 Broadcast entered into Option Deeds with 3 members of Hostworks ('Option Grantors'), pursuant to which Broadcast was granted call options to acquire the Options Grantors' shares in Hostworks, representing 19% of the issued share capital in Hostworks ('Option Deeds').    **(c) Decision**   Mansfield J held that it is not the court's role on an application under section 411(1) of the Act to pass a final view on whether a scheme should be approved. His Honour held that the settled position is that the role of the court at the first court proceeding in the scheme procedure is to review the proposed scheme and the proposed explanatory statement to be sent to members and invite the company to attend to matters which seem to the court to require attention before the distribution of the documents.    His Honour's judgment goes on to consider whether the requirements of section 411(1) of the Act had been satisfied in this instance. That is:   * that there had been proper disclosure in the proposed explanatory statement to be sent to the members of Hostworks in respect of the Proposed Scheme; * that Hostworks was a "Pt 5.1 body"; * that the Proposed Scheme was properly described as a "compromise or arrangement"; and * that ASIC had had a reasonable opportunity to review the Proposed Scheme.   Mansfield J held that the proposed explanatory statement must, in addition to prescribed information, explain the effect of the proposed scheme and set out any information that is material to the making of a decision by members to approve or not approve the proposed scheme. His Honour held that in this instance, these requirements had been satisfied.   As Hostworks was a public company limited by shares, Mansfield J concluded that it satisfied the definition of a "Pt 5.1 body" under section 9 of the Act.   His Honour held that "arrangement" is a term of wide import, not limited by the expression "compromise". An arrangement can extend to any subject matter that a company is able to agree with its members. Mansfield J noted that the acquisition of a company's issued share capital for cash, so that the company becomes a wholly owned subsidiary of the acquirer, is a common use of the Pt 5.1 procedure.     Finally, Mansfield J turned to the requirement that ASIC must have 14 days notice of the hearing of the application, or such lesser period of notice as the court or ASIC permits, and a reasonable opportunity to examine the terms of the proposed scheme and make submissions to the court. Whilst, in this instance, ASIC was only provided with the relevant documents 7 days before the hearing, ASIC had consented to a lesser period than the requisite 14 days notice and indicated that it did not intend to make submissions or oppose the application.   His Honour also considered the requirement under section 411(17) that a scheme must not be proposed for the purpose of avoiding Chapter 6 of the Act, or that ASIC provide a statement that it has no objection to the scheme. Whilst not concluding as to whether this requirement must be met at this stage of the procedure, Mansfield J determined, on the basis of a provisional view provided by ASIC and the information available, that it was likely these requirements were satisfied at this stage in the present matter.    As a general proposition, Mansfield J considered that, if the proposed scheme was supported by the members at the proposed scheme meeting, there appeared to be no reason why the scheme would not then be approved by the Court at the second court proceeding. Whilst His Honour expressed an opinion that this test is at a slightly higher level than necessary, Mansfield J held that, as a general proposition, there was nothing to suggest that the Proposed Scheme worked unfairly as between members of Hostworks, or that in any other respect the directors of Hostworks or others associated with it, or with Broadcast, would profit to the detriment of the members of Hostworks, or that they would profit differently from the other members of Hostworks. Accordingly, his Honour concluded that if approved by the members, there did not appear to be any reason why the scheme would not be approved at the second court proceeding.    Mansfield J also made specific comments on particular features of the Proposed Scheme:   * There was a "performance risk": members of Hostworks faced a risk of their shares being transferred to Broadcast, but there being a delay in the provision of the scheme consideration and the only remedy available to members being to sue on the deed poll. However, his Honour considered that this risk was ameliorated in this instance by the scheme consideration being paid to Hostworks before the divestment of the shares to be held on trust for the members. * Mansfield J considered that, with reference to the approach adopted in other decisions, the "no-shop" and "no-talk" provisions (which were subject to a fiduciary duty carve-out) in the Implementation Agreement did not present a reason not to order a convening of the scheme meeting. * His Honour considered the break fee provision of the Implementation Agreement. His Honour noted that in this instance the fee was not payable if the members of Hostworks failed to support or approve the Proposed Scheme. His Honour concluded that the fee would thus not have a coercive affect on members such that they would vote in favour of the scheme irrespective of its merits. Further, Mansfield J noted that the particular fee in this instance was a figure agreed by the parties as a genuine and reasonable pre-estimate of the costs that Broadcast would suffer if the proposed scheme did not proceed and that it was less than 1% of the equity value of Hostworks and thus accorded with the Takeovers Panel's guideline in respect of the quantum of break fees. Whilst his Honour expressed doubt as to whether it was apposite to determine the appropriateness of a break fee by reference to a percentage of equity value, rather than a genuine pre-estimate of costs, Mansfield J concluded that the fee in this instance did not present an impediment to the making of the order. * His Honour commented upon the warranty given by each member of Hostworks under the Implementation Agreement that its shares would be free from all mortgages and encumbrances. His Honour held that the object and consequence of such a clause is simply to ensure that shareholders whose shares are subject to encumbrances do not receive the same consideration as that received for shares which are free from encumbrances, without any obligation, in effect, to refund the acquirer the amount required to discharge the encumbrances. * In considering whether there should be meetings of separate classes of shareholders and Option Holders to consider the Proposed Scheme and whether the Option Grantors should be treated at a separate class, his Honour held that the relevant question is whether the Option Holders or the Option Grantors have rights which are so dissimilar as to make it impossible to consult together with a view to their common interest. Whilst his Honour held that he could subsequently be convinced otherwise by a dissenting shareholder, it was concluded that the relevant parties did not have different interests.   [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.9 Application to set aside a statutory demand dismissed as the plaintiff's time for compliance with the statutory demand had expired**  (By Kathryn Finlayson, Minter Ellison)   Ox Operations Pty Ltd v Land Mark Property Developments (Vic) Pty Ltd (in liquidation) [2008] FCA 61, Federal Court of Australia, Gordon J, 11 February 2008   The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2008/february/2008fca61.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2008/february/2008fca61.htm" \t "_new)   or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   An application to set aside a statutory demand will be dismissed if the plaintiff's time for compliance with the statutory demand has expired.   In an application to set aside a statutory demand, the plaintiff bears the onus of displacing the prima facie position of indebtedness and establishing that a genuine dispute exists under section 459H(1)(a).    **(b) Facts**   The plaintiff and the defendant are members of the Land Mark Group of companies.    On or about 30 May 2007, the liquidator of the defendant served a statutory demand for payment of a debt of $544,574.60 on the plaintiff.  The debt was said to comprise loans made by the defendant to the plaintiff from 17 March 2006 to 18 September 2006 which loans were evidenced by a general ledger, an extract from a document entitled 'Account Transactions [Accrual]' and bank statements for a cheque account with corresponding cheque butts which corresponded to the entries in the general ledger.   The plaintiff applied to have the statutory demand set aside pursuant to section 459H of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default). On 22 November 2007, the Registrar dismissed the plaintiff's application.   The plaintiff applied to review the Registrar's decision.  It argued that a genuine dispute existed under section 459H(1)(a) of the Corporations Act on the basis that:   * the plaintiff was not indebted to the defendant as any monies the defendant provided to the plaintiff were funds held by it on trust or as agent for other members of the Landmark Group ('First Ground of Challenge'); and * the plaintiff was not indebted to the defendant as the general ledger did not and could not reflect the true position ('Second Ground of Challenge').   The defendant submitted that the application should be dismissed on the basis that:   * the review was of no utility as the plaintiff was deemed to be insolvent; and * in the alternative, the plaintiff had failed to satisfy the court that there was a genuine dispute in relation to the debt the subject of the statutory demand.   **(c) Decision**   Justice Gordon held that the application for review should be dismissed as it had no utility as the plaintiff's time for compliance with the statutory demand had expired. Although as a matter of statutory construction an application to extend time for compliance with a statutory demand may be made under section 459F(2)(a)(i) after the time for compliance had expired, her Honour was of the view, consistent with the majority of the Victorian Court of Appeal in Aussie Vic Plant Hire Pty Ltd v Esanda Finance Corporation Ltd (2007) 63 ACSR 300, that the court should not extend the time for compliance on the basis that the view that the court had no power to extend time had existed for more than ten years and one could not say that it was positively wrong. However, as an appeal from the decision of the Victorian Court of Appeal had been heard and judgment reserved by the High Court, her Honour also considered the merits of the plaintiff's application.    In relation to the First Ground of Challenge, Justice Gordon held that it did not raise a genuine dispute as the evidence filed on behalf of the plaintiff to establish that the defendant was acting as trustee or agent was not sufficient to displace the prima facie position established by the general ledger of the defendant pursuant to section 1305(1) of the Corporations Act. Further, neither the plaintiff's nor the defendant's accounts supported the contention that the defendant was acting as trustee or agent.     In relation to the Second Ground of Challenge, her Honour held that it was not available to the plaintiff as it was not raised expressly, by necessary inference or by a reasonably available inference in the affidavit filed in support of the plaintiff's application. Neither the affidavit nor the supporting documents attached to it raised the suggestion that the payments were not made to the defendant but to another entity.   Her Honour also held that, even if the Second Ground of Challenge was available to the defendant, it did not raise a genuine dispute because the plaintiff bore the onus of displacing the prima facie position of indebtedness and failed to do so.     Justice Gordon also granted the defendant's application to set aside a Notice to Produce served on it by the plaintiff on the eve of the hearing on the basis that the documents requested related to the Second Ground of Challenge which was not available to the plaintiff.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.10 Financial assistance and material prejudice to shareholders**  (By Simon Chapple, Freehills)  Kinarra Pty Ltd and Peter John McDougall v On Q Group Limited [2008] VSC 12, Victorian Supreme Court, Robson J, 7 February 2008  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/vic/2008/february/2008vsc12.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2008/february/2008vsc12.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   This case explores how the interlinking elements of a transaction need to be considered in order to determine whether financial assistance has been provided, and exposes the possible evidentiary difficulties for a plaintiff in bringing such an action.   On Q Group Limited ('On Q') proposed to enter into a joint venture with Ipay Express Pte Ltd ('IPay') to use and to market an electronic business management system ('EBMS') in the Middle East.  The joint venture company was to be called IPay Me & A.  IPay agreed to purchase 10 per cent of issued shares in On Q and contribute $20 million of equity to IPay Me & A.  On Q would hold 22 per cent and IPay would hold 78 per cent of the capital in IPay Me & A.   Kinarra Pty Ltd and Peter McDougall ('the Plaintiffs') were shareholders of On Q. The Plaintiffs argued that by entering into the transaction, On Q was financially assisting IPay to acquire shares in On Q to the material prejudice of On Q and its shareholders and therefore that On Q was in contravention of section 260A of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) ('the Act').   Robson J noted that the ultimate question in relation to the question of financial assistance was whether the transaction (looking at all its interlinking elements) effected a net transfer of value to the person acquiring shares (who is, in this case, IPay). Robson J held that the Plaintiffs had not adduced sufficient evidence to establish their characterisation of the transaction. Robson J therefore found that the defendant had not breached section 260A of the Act. Further, after considering the defendant's reasons for entering into the transaction, Robson J held that even if On Q did financially assist IPay to acquire shares in On Q, the transaction would not materially prejudice the company, its shareholders, or the company's ability to pay its shareholders.   **(b) Facts**   The principal business of On Q is licensing the EBMS technology and related intellectual property to others to operate and market. On Q has been interested in licensing EBMS for overseas use since 2005. These efforts led to a proposal for On Q to licence EBMS to a proposed joint venture between Ipay and On Q, which would use and market EBMS in the Middle East.   The parties accepted that the proposed transaction had three interrelated parts:   * Under a share subscription agreement, IPay would subscribe for 10 per cent of On Q's capital at 30 cents per share. At the date of trial, the shares traded on the Australian Stock Exchange at 23 cents per share. * Under a shareholder agreement, On Q and IPay agreed to form an incorporated joint venture company to be known as IPay Me & A.  On Q would hold 22 per cent and IPay would hold 78 per cent of the capital in IPay Me & A. Under the shareholder agreement, IPay would fund the first US$20 million of expenditure by the joint venture. * On Q agreed to grant a licence to the joint venture company to use EBMS. The licence would be exclusive for the Middle East and Africa and non-exclusive for Pakistan, India and the Philippines. No separate licence fee or royalty would be payable. Instead, On Q would have its interest of 22 per cent of IPay Me & A and ongoing services contracts with the joint venture.   The Plaintiffs claimed that through this transaction, On Q was financially assisting IPay to acquire shares in On Q to the material prejudice of On Q or its shareholders. The Plaintiffs sought the following orders:   * a declaration that the transaction contravened section 260A of the Act;  and * an injunction under section 1324 of the Act restraining On Q from proceeding with the transaction.   **(c) Decision**   **(i) The nature of financial assistance and the meaning of material prejudice**   Section 260A(1) of the Act provides that a company may financially assist a person to acquire shares in the company, or a holding company of the company, if the giving of assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors.  There was no dispute between the parties as to the meaning of financial assistance. The parties referred to Charterhouse Investment Trust v Tempest Diesels in which Hoffman J referred to the fact that the words have no technical meaning and their "frame of reference is in my judgment the language of ordinary commerce". The parties also relied on Re HIH Insurance Ltd (in liquidation); ASIC v Adler, in which Santow J adopted the impoverishment approach and noted that the ultimate question was whether the transaction (looking at all its interlinking elements) effects a net transfer of value to the person acquiring shares.   **(ii) The onus of proof**   Robson J considered the different onus of proof in relation to each of the orders sought by the Plaintiffs.     In relation to section 260A of the Act, Robson J followed the approach of Santow J and the Court of Appeal in Re HIH Insurance Ltd (in liquidation); ASIC v Adler. Santow J held that to make out a contravention of section 260A of the Act, it was only necessary for the plaintiff to show that the relevant company financially assisted a person to acquire shares in the company. The onus was on the person seeking to defend the transaction to show that the assistance did not materially prejudice shareholders or creditors.   Section 1324 of the Act requires the court to adopt a slightly different approach when considering an application for an injunction to restrain a company from proceeding with a transaction. Section 1324 provides that the court must assume that the conduct constitutes, or would constitute, a contravention of section 260A, unless the company proves otherwise. Applying this to the circumstances of the case, Robson J held that the Plaintiffs were only required to prove that the transaction is of a kind that leaves open the allegation that On Q is assisting IPay to acquire shares in On Q. Once proved, the onus shifted to On Q to show that there was no financial assistance, or if there was, that there was no material prejudice to shareholders.   **(iii) Plaintiffs' characterisation of the transaction**   The Plaintiffs argued that the transaction had the following characteristics:   * IPay would purchase 10 per cent of the shares in On Q at slightly above market value. * On Q would licence its only real asset, EBMS, to IPay Me & A. The Plaintiffs argued that On Q would receive no royalties or direct financial benefit for doing so. The Plaintiffs argued that this licence and associated intellectual property is worth between $80 million and $100 million. * Although IPay would contribute $20 million to IPay Me & A, if On Q had been required to make a pro rata contribution, it would have been required to invest $5.64 million.  Thus, the benefit On Q received in this respect was only $5.64 million.   The plaintiffs argued that the financial benefit to On Q is:   * the difference between the sale price of the shares and current market value of the shares, which is approximately $600,000; * the retention of a deposit of $550,000; and * a 22 per cent share in the value of IPay M & A (estimated to be worth between $22 million and $27 million).   On this analysis, the plaintiffs argued that On Q's net gain out of the transaction was around $27 million, for which it has exchanged an asset worth $80 million - $100 million. Although the purchase of the shares in On Q at 30 cents per share may be seen as initially advantageous to the company as the current share price stood at 21 cents, the net effect of the transaction would be materially prejudicial to the company and to its shareholders.   **(iv) Defendant's characterisation of the transaction**   On Q argued that the transaction would benefit the company and its shareholders in the following ways:   * the opportunity to provide services at a considerable profit margin to IPay M & A; * On Q's 22 per cent interest in IPay Me & A; and * exposure to the Middle East market at a reduced risk.   On Q also argued that it had previously struggled to establish an operating business in the Middle East. IPay brought substantial access to funds and their expertise in the region for the benefit of the joint venture. Further, On Q argued that the directors who supported the transaction (who were also substantial shareholders) did so in the belief that the transaction was in the best interests of the company.  **(v) Conclusions**  Robson J was critical of the evidence that was relied upon by the Plaintiffs and that the Plaintiffs had provided no factual evidence that On Q is financially assisting IPay to acquire shares in On Q. The Plaintiffs were unable to substantiate their estimate of the value of the EBMS licence.     As a result, Robson J held that the Plaintiffs had not established that the transaction as a whole would involve On Q financially assisting IPay to acquire shares in On Q and accordingly that the Plaintiffs had not made out a contravention of section 260A of the Act. Further, Robson J held that for the purposes of section 1324 the Plaintiffs had not proved the threshold issue that the transaction is of the kind that left open the allegation that On Q is assisting IPay to acquire shares in On Q. Thus, the presumption raised by section 1324 of the Act was not available to the Plaintiffs. Robson J also held that, after reviewing the evidence of the directors of On Q, that even if On Q did financially assist IPay to acquire shares in On Q, the transaction would not materially prejudice the company, its shareholders, or the company's ability to pay its shareholders.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.11 Court refuses to determine liquidator's application for direction**   (By Leally Chen, Blake Dawson)    Re Anglican Insurance Ltd [2008] NSWSC 41, Supreme Court of New South Wales, Barrett J, 6 February 2008   The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/february/2008nswsc41.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2008/february/2008nswsc41.htm" \t "_new)   or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   The liquidators of Anglican Insurance Ltd (AIL), a general insurance company with a church-based clientele sought, on an ex parte basis, under section 511 of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) a direction from the court that AIL has effectively transferred all insurance liabilities to Vero Insurance Limited (Vero) by entering into a serious of contractual arrangements with Vero such that these insurance liabilities now become liabilities of Vero to the exclusion of AIL. The court held that it would not be "just and beneficial" for the court to determine this question on the liquidator's unilateral application because the direction sought by AIL directly affects the interests of Vero. The court suggested that the appropriate course of action for the liquidator would be filing an amended originating process by which appropriate declaratory relief is sought with Vero being added as a party.       **(b) Facts**   Following the Insurance Commissioner appointed for the purpose of the Insurance Act 1973 (Cth)'s decision to not approve AIL's reinsurance arrangements, AIL decided to cease writing new insurances and enter into an agreement with Phoenix Insurance Limited (Phoenix) with respect to the outstanding arrangements.      By a series of contractual arrangements, Phoenix undertook to AIL that Pheonix would meet and discharge (and indemnify) AIL against all AIL's outstanding insurance claims and liabilities. Phoenix later became liable to indemnify AIL against all relevant claims and also became entitled to receive and retain the benefit of any insurance held by AIL. The rights of AIL against Phoenix under these contractual arrangements were replaced by corresponding rights of AIL against Vero by a deed of novation subsequently. AIL also assigned to Vero all its rights under all contracts of reinsurance. Later, Vero also confirmed that it assumes all liability of AIL as an insurer under the insurance contracts and agreed to reimburse AIL for costs and expenses incurred by AIL in meeting reasonable requests of Vero in relation to claims and proceedings. However, none of the contracts of insurance were novated as there were many hundreds of contracts and it was not practical to do so.    At AIL's request, its authority to carry on insurance business was revoked by the Insurance Commissioner after the entering into these contractual arrangements and AIG became subject to members' voluntary winding up on 16 August 1999 with liquidators appointed.       **(c) Decision**   The questions which arise from this application are:   * Whether it is appropriate for the court to determine the question whether the insurance liabilities of AIL are now insurance liabilities of Vero; and * If the answer is yes to the first question, whether the insurance liabilities of AIL are now insurance liabilities of Vero? * Depending on the answer to the second question, there is a subsidiary question about what needs to be done to bring the winding up of AIL to a conclusion.   **(i) Whether it is appropriate for the court to make a determination under section 511**   Section 511 provides that a liquidator may apply to the court to determine any question arising in the winding up of a company.  The court, if satisfied that the determination of the question or exercise of power will be just and beneficial, may accede wholly or partially to any such application on such terms and conditions as it thinks fit or may make such other order on the application as it thinks just.     In this case, the court held that it was not appropriate for the court to determine this application by the liquidator under section 511 on the following basis:   * an application under section 511 is not the occasion for making orders affecting the rights of outsiders given that a determination under section 511 does not bind anyone except the liquidator and those entitled to participate under the winding up; * the function of a liquidator's application for directions is 'to give him advice as to his proper course of action in the liquidation; it is not to determine the rights and liabilities arising from the company's transactions before liquidation"; * the court must confine itself, in giving directions, to matters concerning administration of the estate and has no authority to resolve substantive matters in dispute between a trustee and a third party; * it would not be "just and beneficial" for the court to determine the question of whether AIL has effectively transferred all of its insurance liabilities to Vero based on the liquidator's unilateral application as the interests of Vero would be affected by such direction; and * there is a possibility that a properly constituted proceeding between AIL and Vero may later cause the respective rights and obligations of the parties to be determined in a binding way to some other effect.   The court suggested that the liquidator should file an amended originating process by adding Vero as a party to the proceeding.     **(ii) Whether AIL had effective transferred all of its liabilities to Vero**   The liquidator argued that AIL had effectively transferred all its insurance liabilities to Vero such that the insurance liabilities of AIL were now insurance liabilities of Vero to the exclusion of AIL on either one of the following bases:   * section 36 of the Insurance Act, as previously in force, had such an effect that AIL must have transferred all of its liabilities to Vero.  It was argued that the Insurance Commissioner relied on section 36 to revoke AIL's insurance licence and by doing so, the Commissioner indicated that he was "satisfied that the body corporate has no liabilities in respect of insurance business carried on by it in Australia" under section 36(8); and * Cohen J in CSR Ltd v The New Zealand Insurance Co Ltd (1993) held that the operation of section 36 gives rise to a trust in favour of the policyholders such that the assignee insurer could be sued in respect of insurance liabilities originally undertaken by the assignor to its policyholders.   The court, while did not directly addressing the answer to the second question in light of the conclusion it reached for the first question, commented that the conclusion to the second question would be based on the precise terms of the assignment agreements.         **(iii) What needs to be done to bring the winding up to conclusion**   The court suggested that the liquidator should bring an amended application adding Vero as an applicant if it wished to resolve the second question.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.12 Is ASIC exempt from paying court costs?**   (By Rose Lee, Clayton Utz)   ASIC v Krecichwost, [2007] NSWSC 1458, Supreme Court of New South Wales, Barrett J, 14 December 2007   The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2007/december/2007nswsc1458.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2007/december/2007nswsc1458.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   This case concerned arguments as to costs in relation to asset preservation litigation initiated by ASIC, which another company subsequently joined.   In addition to making costs orders that followed the event, Barrett J held that:   * The fact that ASIC was a public authority did not confer immunity from an adverse costs order in civil proceedings. * Costs awarded against a company in liquidation (where the liquidator initiated the litigation) do not need a court order conferring priority (even if the court had power to make such an order) because they already enjoy priority under section 556.   **(b) Facts**   On 5 July 2007, ASIC brought proceedings against thirteen defendants to secure property through orders under section 1323 of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default).   As a result, the court made an asset preservation order in respect of property owned by one of the defendants, Macarthur. This order was subsequently amended, allowing a property in Camden to be sold. A mortgage held by St George Bank Limited was to be paid out of the proceeds of sale. The property was also subject to a second (unregistered) mortgage to York but the property was sold without any proceeds passing to York. York filed an interlocutory application seeking to recover the balance of the proceeds of sale.    Fincorp Developments also claimed an interest in the Camden property and wanted to intervene in the proceedings begun by York. Fincorp Developments was in liquidation. The court ordered that Fincorp be joined "conditionally".    As a result of later hearing, York was, by 24 September, in a position where $300,000.00 of the balance of the proceeds would pass to York subject to any applications made on that date. No applications were made on 24 September 2007 contesting York's eventual receipt of the $300,000.00 and hence the interlocutory processes of York and Fincorp Developments were dismissed. The only argument before the court was in relation to the costs of the processes filed by York and Fincorp Developments.    This required his Honour to deal with three substantive issues:   1. Was it appropriate to order costs in relation to York's and Fincorp's interlocutory applications? 2. ASIC argued that no costs order should be made against it because it was a public authority performing statutory functions for public purposes. 3. York argued that, if awarded costs against Fincorp, those costs should rank in priority to the claims of other unsecured creditors.   **(c) Decision**    **(i) Costs on an interlocutory application**   A costs order was warranted, for three reasons:   * The matters that initially became the subject of the orders on 5 July 2007 and were affected by the ongoing regime were, as regards York and Macarthur, discrete matters arising in the context of ASIC's more wide-ranging moves to secure property by orders under section1323. The resolution that emerged on 24 September 2007 marked, in a real sense, completion of that discrete aspect. * York had no further part to play in ASIC's ongoing proceedings. * It was not meaningful or helpful, in the context of proceedings brought by ASIC under section 1323 to regard individual freezing orders as being of some interlocutory kind.   **(ii) Costs order against ASIC**   Barrett J held that costs could be awarded against ASIC. If there was a public authority exemption, it applied to prosecutors in criminal proceedings. ASIC's action under section 1323 was a civil one. If ASIC resorted to civil proceedings under the Corporations Act, the general rule in civil proceedings - that costs follow the event - would apply. There were no special circumstances warranting departure from the rule.    **(iii) Priority for costs**   York submitted that a number of 19th century cases were authority for the proposition that a defendant unsuccessfully sued by a company in liquidation could obtain an order giving priority to that defendant's costs ahead of other unsecured creditors.   Barrett J pointed out that costs awarded against a company in proceedings initiated by its liquidator are accorded the highest priority under section 556. Therefore it was unnecessary for him to make an order as to the priority to be accorded to York's costs. In obiter, he added that there is no power for a court to alter the order of the system of priorities in sections 555 and 556 or to accord a priority creditor a higher priority within one of the priority classes established by section 556.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5)  **5.13 Setting aside a statutory demand for being vague and ambiguous**   (By Peter Sise, Clayton Utz)   LSI Australia v LSI holdings; LSI Australia v LSI Consulting [2007] NSWSC 1406, Supreme Court of New South Wales, Austin J, 6 December 2007   The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2007/december/2007nswsc1406.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2007/december/2007nswsc1406.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)    **(a) Summary**   LSI Australia Pty Ltd ("LSIA") was served with two statutory demands (the "demands") which it sought to have set aside. LSIA claimed that the vague and ambiguous description of the debts in the demands amounted to a "defect" causing "substantial injustice" within the meaning of section 459J(1)(a) of the [Corporations Act 2001](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default) (the "Act") and for this reason the demands should be set aside. Austin J found in favour of LSIA. His Honour said that a demand must "identify, to a reasonable person in the shoes of a director of the debtor company, the general nature of the debt to a sufficient degree that the director can assess whether there is a genuine dispute as to the existence or amount of the debt or an offsetting claim". Further, his Honour held that the Graywinter  principle precludes reliance on section 459J(1)(a) as a ground to set aside a demand unless the matters relied on in this regard are evident, albeit not necessarily fully articulated, in the affidavit in support of the application filed within the 21 day time limit under section 459G(3).   **(b) Facts and issues**    Under section 459G(3) of the Act, an application to set aside a statutory demand must be made by filing and serving an application and supporting affidavit within 21 days of receiving the demand. This time limit cannot be extended (David Grant & Co Pty Ltd v Westpac Banking Corporation (1995) 184 CLR 265).     A consequence of the 21 day time limit is that the grounds relied on to set aside the demand must be raised in the supporting affidavit which is filed and served within the 21 day period. A supplementary affidavit, filed after the 21 days has elapsed, cannot be used to introduce fresh grounds if those grounds have not already been raised in the initial affidavit. This is known as the "Graywinter principle" after the case of Graywinter Properties Pty Ltd v Gas & Fuel Corporation Superannuation Fund (1996) 70 FCR 452.     In the present case, LSIA was served with two demands.  The debt in the first demand was described as the "[a]mount due owing and payable by the Debtor to the Creditor in accordance with the Accounts of the Debtor: $99,825.44." In the second demand, the debt was described as the "[a]mount due owing and payable by the Debtor to the Creditor, being moneys lent to the Debtor by the Creditor: $5,887.20".   Relevantly for present purposes, LSIA sought to set aside the demands on the following two grounds:   * there was a genuine dispute as to the existence of the debts claimed in the demands (section 459H); and * there was a "defect" with each demand which would cause "substantial injustice" to LSIA if the demands were not set aside (section  459J(1)(a)).   **(c) Decision**   Applying the Graywinter principle, Austin J did not set aside the demands on the section 459H ground (genuine dispute as to the existence of the debts), because the matter LSIA ultimately sought to rely on, namely an indemnity clause in a sale and purchase agreement, was first raised in a supplementary affidavit filed and served after the 21 day limitation period.     In relation to the section 459J(1)(a) ground, LSIA contended that each demand contained a "defect", being the vague and ambiguous description of the debts contained in the demands. These defects were said to have caused "substantial injustice" to LSIA as they prevented LSIA from realising the true nature of the debts, and hence the basis on which LSIA was able to contend that there was a genuine dispute about the existence of the debts, until after the 21 day limitation period had expired for the purposes of section 459H.     Austin J considered the meaning of "defect" making reference to the definition in section 9 of the Act and Topfelt Pty Ltd v State Bank of NSW Ltd (1993) 12 ACSR 381 at 392. His Honour concluded that a statutory demand is defective:  "[i]f the demand is so vague or ambiguous that it fails to identify, to a reasonable person in the shoes of a director of the debtor company, the general nature of the debt to a sufficient degree that the director can assess whether there is a genuine dispute as to the existence or amount of the debt or an offsetting claim" (at [54]).  Austin J concluded that the descriptions of the debts in the demands were "so vague or ambiguous" as to amount to defects. His Honour held that the defects created "substantial injustice" because they placed LSIA in a position where it could not identify the true nature of the debts and hence could not adequately make an application to set aside the demands. If the court did not set aside the demands, LSIA would suffer the substantial injustice of having the presumption of insolvency raised against it in any subsequent winding up proceedings.   The final question for Austin J was whether the Graywinter principle prevented LSIA from relying on section 459J(1)(a) as a ground for setting aside the demands when LSIA had not referred to section 459J(1)(a) in its initial affidavits.  His Honour accepted that the Graywinter principle applied to section 459J(1)(a) but held that in this case it had been satisfied. In this regard, his Honour said that an affidavit supporting an application to set aside a statutory demand does not have to fully articulate the grounds for setting aside the statutory demand so long as the grounds emerge from the affidavit and its annexures. It is even sufficient if the grounds relied on are not articulated in the affidavit at all so long as they are evident on the face of the documents annexed to the affidavit.  Austin J found that the initial affidavits showed that LSIA misunderstood the nature of the debt claimed in the first demand and was non-plussed as to what the claim in the second demand was all about.  These were the essential "ingredients" for the case under section 459J(1)(a). The later affidavits filed by LSIA were supplementary in nature as they simply expanded and consolidated what was already evident from the initial affidavits in this regard.  For this reason, the supplementary affidavits were permissible under the Graywinter principle for the purposes of the section 459J(1)(a) point.  On this basis, LSIA made out its case under section 459J(1)(a) and the two demands were set aside.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/LAWLEX-old-editions/LAWLEX%20Corporate%20Law%20Bulletin%20No.%20127-%20March%202008.htm%23h5) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **6. Contributions** |  |  | | |  | | |  | | --- | | If you would like to contribute an article or news item to the Bulletin, please email it to: "[cclsr@law.unimelb.edu.au](mailto:cclsr@law.unimelb.edu.au" \t "_new)".  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