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1. RECENT CORPORATE LAW AND CORPORATE GOVERNANCE DEVELOPMENTS

(A) REPORT OF THE HIH ROYAL COMMISSION

On 16 April 2003, the Commonwealth Treasurer, The Hon Peter Costello MP, released the Report of the HIH Royal Commission. The Royal Commission was established at the Government's instigation following the financial collapse of the HIH Insurance Group in March 2001. HIH was the second largest general insurance company in Australia and its collapse affected individuals, community groups, and the public generally. The Commission operated from September 2001 until the Report was delivered to the Governor-General on 4 April 2003. The Government appointed Mr Justice Owen as the Commissioner.

(A) Government response to the report

When releasing the report, the Treasurer made a number of responses to the recommendations of the Commissioner. They are outlined below.

The Commissioner concluded that the primary reason for the collapse of HIH was the failure to provide properly for future claims. This failure was essentially due to mismanagement and an inadequate response to pressures emerging in insurance markets internationally.

The Commissioner identified a number of possible breaches of the [Corporations Law (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=7375" \t "default) and the [Crimes Act 1900 No. 40 (NSW)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=3907" \t "default). There are 56 matters (relating to 18 individuals) that Mr Justice Owen has indicated should be referred either to the Australian Securities and Investments Commission (ASIC) or (in a small number of cases) to the NSW Director of Public Prosecutions. The Government is referring these possible breaches to those authorities immediately.

In respect of the Corporations Law referrals, a taskforce will be established immediately under the direction of ASIC to examine these issues and prepare briefs for possible proceedings. Additional funding will be provided in the budget for this task. The Government will give consideration to whether a Special Prosecutor will be appointed to prosecute criminal charges.

ASIC has already brought some proceedings arising from the failure of HIH. None of the Commissioner's findings that there might have been a breach of the law relates to or touches on those proceedings.

There were many individuals and companies who were the subject of adverse comment in counsel assisting's closing submissions. The Commissioner makes it clear in the first volume of his report that "where there is no finding in this report against [a] person or company, the reputation of that person or company emerges entirely free of any adverse implications".

The Commissioner also concludes that the Australian Prudential Regulation Authority (APRA) did not cause the collapse of HIH. He notes in the third volume of his report that "APRA's failure to act did not contribute to the collapse of HIH. However, the manner in which APRA exercised its powers and discharged its responsibilities under the Insurance Act fell short of that which the community was entitled to expect from the prudential regulator of the insurance industry".

The Commissioner has made 61 policy recommendations. The recommendations cover corporate governance and financial reporting, APRA's governance arrangements, the regulation of general insurance and APRA's internal processes. Some recommendations seek action by the States and Territories.

The demise of HIH occurred under regulatory arrangements that have since been substantially strengthened. New legislation for general insurers was enacted in September 2001 and new prudential standards were issued in February 2002. This new framework, which commenced on 1 July 2002, means that general insurance companies are now subject to much more robust arrangements. The reforms ensure that companies establish appropriate systems of governance and internal controls, in addition to more transparent valuation of liabilities and risk-based capital adequacy.

There has also been a transition in supervisory practice from one based on oversighting individual `transactions' to a `systems' based approach, consistent with international regulatory standards and the direction of modern regulatory practice.

The Government will consider very carefully the Commissioner's recommendations. The recommendations propose continuing the broad architecture for the financial system introduced by the Government following the Wallis Report. Under this structure APRA is responsible for prudential regulation of all deposit-taking institutions, general and life insurance and superannuation, and ASIC is responsible for maintaining market integrity, consumer protection and the supervision of companies. The Commissioner notes the potential for improving the clarity of roles and coordination between the regulatory agencies.

The Government accepts in-principle the Commissioner's recommendation to replace APRA's non-executive board with an executive group (or commission). The executive group would carry the responsibility and be accountable for the operation and performance of APRA - this arrangement would further strengthen Australia's existing regulatory framework. As the Commissioner has suggested, the Government wishes to consider his recommendations on these matters in light of the Uhrig Report into Statutory Authorities and Office Holders, which is due to be delivered to the Government in mid-May. Soon after, the Government expects to be able to introduce legislation into the Parliament to give effect to any changes to the governance arrangements of APRA.

The Government released its proposals to enhance corporate disclosure under the CLERP 9 paper in September last year. At that time the Government indicated that the CLERP 9 proposals would also allow any further recommendations from the Royal Commission to be added to legislative proposals.

The Commissioner's recommendations are generally consistent with the CLERP 9 proposals. The Government will be considering the corporate governance and financial reporting recommendations from the Commissioner in preparing the legislation to enact the CLERP proposals.

Draft legislation will be released for public comment in the next few months. The Governments expects to introduce the legislation into the Parliament early in the Spring Sittings.

Copies of the report are available on the Royal Commission website at [http://www.hihroyalcom.gov.au](http://www.hihroyalcom.gov.au" \t "_new)

(B) Policy recommendations made by the Commissioner

Following is a list of the 61 policy recommendations made by the Commissioner.

(i) Corporate governance

(1) The disclosure and other requirements of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), the relevant accounting standards and the Australian Stock Exchange Listing Rules that relate to directors' remuneration be reviewed as a matter of priority, to ensure that together they achieve clear and comprehensive disclosure of all remuneration or other benefits paid to directors in whatever form.

(2) The Corporations Act 2001 be amended to repeal the existing legislative provisions relating to the definition of the extended classes of personnel upon whom duties are imposed by the Act and to substitute instead a definition that is clear, simple and certain of application.

The definition would focus on the function performed by the relevant person-not the classification of their legal relationship to the corporate entity-and avoid expressions such as 'employee' in favour of a functional orientation.

The definition would then form the basis of a regime having the following features:

(a) All the general duties imposed by Chapter 2D of the Corporations Act should be imposed on directors, secretaries and the wider class of personnel encompassed within the functional definition.

(b) The duties imposed by ss 182(1), 183(1) and 184(2) of the Act should be imposed on all persons performing functions for and on behalf of corporations, whether employees or suppliers of services under contract.

(c) The liabilities created by s 1309 of the Act should be imposed on all persons and not be restricted to a limited class of management personnel.

(d) The classes of personnel prohibited from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on the company by any written law should be extended.

(ii) Financial reporting and assurance

(3) The Commonwealth Government broaden the membership of the Australian Accounting Standards Board to include people with business or professional backgrounds beyond the accounting profession.

(4) Australia participate fully in the development of international accounting standards and pursue the adoption of high-quality, consistent and readily understood accounting standards.

(5) In adopting international standards, Australia reserve the right to require more stringent standards that are not inconsistent with the relevant international standards. These would generally relate to disclosure requirements.

(6) The Australian Accounting Standards Board alter the Urgent Issues Group or create a separate group that is able promptly to issue binding rulings on important and urgent matters concerning the interpretation and application of the accounting standards.

The board should extend the constitution of the Urgent Issues Group or the separate group beyond accounting professionals and include lawyers and users of financial statements.

(7) The professional accounting bodies develop guidelines to encourage their members to consult independent third parties or the Urgent Issues Group when there is disagreement with the management of companies concerning the interpretation or application of accounting standards.

(8) The Australian Accounting Standards Board amend accounting standard AASB 1023 to include the following:

(a) a definition of insurance that includes the requirement for a material transfer of insurance risk;

(b) a requirement that insurance liabilities be valued at a level of sufficiency of at least 75 per cent, as required by APRA's prudential standards. Companies should be explicitly permitted to set prudential margins in excess of 75 per cent if the company's board considers that appropriately reflects a true and fair view of the financial position of the insurer;

(c) a requirement that entities disclose in their financial statements:

- the valuation of their insurance liabilities at a central estimate  
- a 75 per cent level of sufficiency  
- the margin ultimately adopted by the entity

(d) a requirement that premium revenue and insurance liabilities be recognised on the commencement of a contract of insurance. This will require the recognition of premium liabilities;

(e) a requirement that, in estimating the present value of liabilities, future cash flows be discounted using a risk-free rate similar to that required by the prudential standards;

(f) a requirement that companies subject to the standard disclose a 10-year claims-development table that includes past estimates of claims on an undiscounted basis as well as the actual costs of settling claims. This information should be provided both net and gross of reinsurance.

(9) All standards of independence of auditors in Australia, including those contained in legislation and professional standards such as Professional Statement F1, be consistent with the standard of independence defined as follows:

(a) An auditor is not independent with respect to an audit client if the auditor might be impaired-or a reasonable person with full knowledge of all relevant facts and circumstances might apprehend that the auditor might be impaired-in the auditor's exercise of objective and impartial judgment on all matters arising out of the auditor's engagement.

(b) A reference to an auditor includes both an individual auditor and an audit firm. In determining whether an auditor or an audit firm is independent, all relevant circumstances should be considered, including all pre-existing relationships between the auditor, the audit firm and the audit client, including its management and directors.

(10) The Corporations Act 2001 should be amended to require the board to provide a statement in the annual report that identifies all non-audit services provided by the audit firm and the fees applicable to each item of work and explains why those non-audit services do not compromise audit independence.

(11) In implementing the CLERP 9 proposal for restrictions on employment relationships between an auditor and the audit client, the amendments provide for the following:

(a) a mandatory period of four years following resignation from an audit firm before a former partner who was directly involved in the audit of a client can become a director of the client or take a senior management position with the client. This restriction should be extended to include key senior audit personnel;

(b) an extension of the restriction to a former partner who was not directly involved in the audit of a client. In the opinion of the Commissioner, the current proposed period of two years would be appropriate for such a partner;

(c) a prohibition on any more than one former partner of an audit firm, at any time, being a director of or taking a senior management position with the client.

These restrictions should be enforceable against both the audit firm and the relevant former partner or senior audit team member.

(12) In implementing the CLERP 9 proposal for rotation of audit personnel, the requirement for rotation of the lead engagement partner and review partner be extended to key senior audit personnel.

(13) The Corporations Act 2001 be amended to require the disclosure in audit reports of the following:

(a) the impact of the position taken by the reporting entity where alternative accounting treatments are reasonably open from the reading of an accounting standard and the difference between those accounting treatments is material;

(b) the significant matters arising in the audit process.

The Corporations Act should be amended to require audit reports to be presented in plain English and to require the inclusion of an operating and financial review as part of an annual report, which would be the subject of audit.

(14) The Corporations Act 2001 be amended to require public listed companies to include a brief, plain English summary of the nature and scope of the audit services provided by their auditor each year.

(15) Both the Australian Prudential Regulation Authority and the Institute of Actuaries of Australia introduce compulsory certification of the completeness and accuracy of data.

(16) The Institute of Actuaries of Australia and the Australian Prudential Regulation Authority introduce a requirement for more detailed disclosure of the exercise, incidence and impact of subjective judgment and departure from historical experience.

(17) The Australian Prudential Regulation Authority extend the qualifications of the approved actuary to require that they not be an employee or partner of the organisation to which the approved auditor belongs.

(iii) Regulation of general insurance

(18) The [Australian Prudential Regulation Authority Act 1998 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=5782" \t "default) be amended to replace APRA's non-executive board with an executive group. This group would comprise the chief executive officer and two or three executive commissioners and would carry the responsibility, and account to government, for the operation and performance of APRA.

(19) The Australian Prudential Regulation Authority Act 1998 be amended to provide the chief executive with the power to establish an advisory board.

(20) The direct involvement of representatives of the Australian Securities and Investments Commission and the Reserve Bank of Australia in the governance of the Australian Prudential Regulation Authority be discontinued. This will require amendment of the Australian Prudential Regulation Authority Act 1998.

(21) The Australian Prudential Regulation Authority chief executive instigate, as a matter of urgency, a review of APRA's organisational structure. The object of the review should be to achieve a workable and effective balance between accountability for and knowledge of particular financial services on one hand and cross-sectoral functional skills and perspective on the other. In particular, the review should consider the creation of a specialist team to take primary responsibility for the supervision of general insurers.

The review should report to APRA's board with recommendations on APRA's appropriate internal structure, given its responsibilities across the deposit-taking, insurance and superannuation sectors. The board should publicly respond to its recommendations.

(22) The Commonwealth Government consider removing the requirement for the Treasurer's agreement to operational decisions involving APRA's prudential oversight of general insurers.

(23) Given the inconsistencies between the [Insurance Act 1973 No. 76 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6398" \t "default) and the [Banking Act 1959 No. 6 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6665" \t "default), the Commonwealth Government review the current legislative provisions for merit review of APRA's decisions for the purposes of ensuring consistency.

(24) The Australian Prudential Regulation Authority implement a programme to build the skills of staff involved in the supervision of general insurers. This should involve a review of its human resource management policies to assess APRA's competitiveness in the financial services sector labour market. The review should take account of the adequacy of remuneration, training and career structures as well as other steps to increase APRA's attractiveness as an employer.

(25) The Commonwealth Government adopt a three-year rolling funding arrangement to set the Australian Prudential Regulation Authority's budget.

(26) The Australian Prudential Regulation Authority develop a more skeptical, questioning and, where necessary, aggressive approach to its prudential supervision of general insurers. Consultation, inquiry and constructive dialogue should be balanced by firmness in its requirements and a preparedness to enforce compliance with applicable standards. In particular, APRA should take a firm approach to ensuring regulated entities' timely compliance in the lodging of returns and the provision of information.

(27) The Australian Prudential Regulation Authority continue to develop and review processes, guidelines and training to assist its staff in considering the appropriate approach to take towards supervised entities in different situations.

(28) The Australian Prudential Regulation Authority develop systems to encourage its staff and management continually to question their assumptions, views and conclusions about the financial viability of supervised entities, particularly on the receipt of new information about an entity.

(29) The Australian Prudential Regulation Authority develop an internal system for tracking all relevant information concerning regulated entities.

(30) The Australian Prudential Regulation Authority develop mechanisms for investigating the reinsurance arrangements of authorised general insurers on a random but frequent basis.

(31) The effectiveness of the current memorandum of understanding between the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission be reviewed.

The processes for liaison, coordination and exchange of information between APRA and ASIC should be reviewed on a regular basis. To facilitate the exchange of information, the Commonwealth Government should make a regulation specifying ASIC for the purposes of s 56(5)(a) the Australian Prudential Regulation Authority Act 1998.

(32) Matters relating to the coordination of Commonwealth regulation affecting the insurance industry be the province of the Commonwealth Treasury.

(33) Coordination of the matters related to the regulation of the insurance industry be addressed through the proposed ministerial council.

(34) Authorised insurers be required to make greater disclosure of information about their financial position. In particular, all financial and statistical information general insurers currently provide to the Australian Prudential Regulation Authority in their regular returns should be made public.

(35) Information that enables external users to make an informed assessment of an insurer's outstanding claims provisions and reinsurance arrangements be published by the insurer or the Australian Prudential Regulation Authority. APRA should develop reporting returns for insurers that would enable this to occur if existing returns are insufficient.

In particular, general insurers should publish:

(a) material equivalent to the 'schedule P' loss-development data published in the United States;

(b) a summary of the approved actuary's valuation of the outstanding claims liabilities, including the methodologies and assumptions underlying that valuation.

(36) Insurers be required to make greater disclosure of qualitative information relating to their risk- and reinsurance-management strategies. Other qualitative information-where the prospect of disclosure may affect the quality of information provided to companies-need not be disclosed.

(37) The Australian Prudential Regulation Authority identify and make known the kinds of regulatory activities that in its view should be disclosed publicly (whether or not the insurer in question is a listed company) and should specify the process by which such disclosure should occur.

(38) As a matter of high priority, the Australian Prudential Regulation Authority develop and promulgate a standard for the effective regulation of authorised insurers that operate as part of a corporate group.

The proposed prudential standard on corporate groups should include a minimum capital requirement at the group level as well as the authorised entity level.

(39) The Australian Prudential Regulation Authority monitor the financial condition of corporate groups, including those with foreign operations. Pending the development of the proposed prudential standard on supervision of corporate groups, APRA should use existing powers to require groups to provide any information it considers necessary to perform this role.

(40) The Australian Prudential Regulation Authority take steps to ensure that it effectively exchanges with relevant foreign regulators information and intelligence on the operations of Australian insurers with international operations.

(41) The Australian Prudential Regulation Authority modify the prudential standards to require the annual production by an authorised general insurer's approved actuary of a report on the overall financial condition of the insurer.

(42) The Commonwealth Government amend the Insurance Act 1973 to extend prudential regulation to all discretionary insurance-like products-to the extent that it is possible to do so within constitutional limits.

(43) Section 462(3) of the Corporations Act 2001 be amended so that the Australian Prudential Regulation Authority may apply to wind up a company that is an authorised insurer if any of the criteria specified in section 52(1)(aa), (ab) or (a) of the Insurance Act 1973 are met.

(44) Section 461 of the Corporations Act 2001 be amended to specify that the interests of policyholders are interests to which the court should have regard in deciding whether to make a winding-up order.

(45) The Australian Stock Exchange amend Listing Rule 3.1 to require - or publish a guidance note making it clear - that price-sensitive announcements have the approval of either the board or a delegate of the board subject to ratification by the board.

(46) The Australian Stock Exchange amend the Listing Rules to prohibit 'blacklisting'-defined as exclusion of a person or organisation from briefings by a company or a pattern of such exclusion in the face of negative reports on the company by those analysts over a specific period.

(47) The Australian Stock Exchange clarify Listing Rule 11.1, so that it applies to any significant change in the business or assets of a listed company, whether it be by acquisition, disposal, amalgamation or otherwise. The ASX amend the Listing Rules to define 'significant change', so that it encompasses financial and geographic factors as well as the nature and scale of the company's business.

(48) The Australian Stock Exchange amend Listing Rule 11.2, so that it applies to any disposal of the whole or substantially the whole of the assets or operations of a listed company.

(iv) State and territory regulation

(49) That the states and territories not undertake any prudential regulation of general insurance. The Australian Prudential Regulation Authority should be the sole prudential regulator in this field.

If such regulation is to continue, state and territory governments should ensure that it is consistent with the requirements of the Insurance Act 1973. This is a matter that might properly be referred to the proposed ministerial council.

(50) To the extent that states and territories continue to involve themselves in prudential regulation, the Australian Prudential Regulation Authority should share all information relating to the prudential regulation of relevant general insurers with relevant state and territory bodies.

The states and territories should provide APRA with all relevant information that may concern the financial condition of relevant general insurers. This exchange of information should proceed through memorandums of understanding between APRA and each relevant state and territory body.

APRA and the state and territory instrumentalities should review applicable secrecy provisions and where necessary seek legislative action to ensure they do not inhibit the free flow of information between APRA and the instrumentalities relevant to the prudential regulation of general insurers.

(51) The states and territories implement a process designed to reduce inconsistencies in their statutory schemes. This is a task that would appropriately be overseen by the proposed ministerial council.

(52) State and territory governments apply relevant prudential requirements to government insurers and statutory fund schemes. This is a matter that would appropriately be overseen by the proposed ministerial council.

(53) The states and territories consider allowing greater price flexibility in their statutory schemes. This is a matter that would be appropriate for consideration by the proposed ministerial council.

(54) The Commonwealth Government move to identify or establish a ministerial council or like arrangement to provide a ready and regular forum for the discussion and resolution by the Commonwealth and the states and territories of matters relevant to general insurance-and perhaps to other financial services.

The ministerial council (or other similar body) should consider measures to:

(a) avoid duplication in the prudential regulation of general insurers;

(b) remove regulatory inconsistencies;

(c) achieve a consistent approach to the prudent management of state and territory monopolies.

It could also play a part in:

(a) moves to introduce greater price flexibility in statutory schemes;

(b) the introduction of a policyholder support scheme;

(c) the removal of anomalies in the taxation arrangements applicable to general insurers.

(v) Taxation and general insurance

(55) State and territory governments abolish stamp duty on general insurance products. It would be appropriate for this process to be coordinated through the proposed ministerial council with responsibility for general insurance.

(56) Those states that have not already done so abolish fire services levies on insurers.

(57) State and territory governments exclude the cost of the GST for the purposes of calculating stamp duties or any other state or territory levies that are imposed on insurance premiums.

(58) Governments avoid imposing on insurers levies and other taxes that cannot be passed on to policyholders.

(59) The Commonwealth Government review the current requirements of the [Income Tax Assessment Act 1936 No. 27 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6606" \t "default) with a view to changing the Act to bring it into alignment with the modified accounting standards proposed by the Commissioner.

(60) The Commonwealth Government amend the income tax regime to encourage the creation and use of catastrophe reserves. Contributions to catastrophe reserves would be tax deductible. Releases from the reserve would be assessable for tax.

(vi) A policyholder support scheme

(61) The Commonwealth Government introduce a systematic scheme to support the policyholders of insurance companies in the event of the failure of any such company.

(B) COMMONWEALTH GOVERNMENT RESPONSE TO THE REVIEW OF THE COMPETITION PROVISIONS OF THE TRADE PRACTICES ACT 1974

On 16 April 2003 the Commonwealth Government released the report of the Dawson Committee on the review of the competition provisions of the [Trade Practices Act 1974 No. 51 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6426" \t "default) and at the same time released the following response.

The report is available on the Treasury website at [http://www.treasury.gov.au](http://www.treasury.gov.au" \t "_new)

Part 1: Overview

(a) The importance of competition

The object of the Trade Practices Act 1974 (the Act) is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection. The competition laws are contained in Part IV of the Act and are comprehensive and far-reaching. Broadly speaking, Part IV prohibits collusive agreements, misuse of market power, exclusive dealing and mergers that substantially lessen competition in a market. Some provisions are subject to a competition test, while other provisions prohibit conduct on a per se basis, that is, regardless of their likely effect on competition. Part VII of the Act provides for the authorisation and/or notification of otherwise prohibited conduct when that conduct is justified in the public interest, notwithstanding a lessening of competition.

Whilst various specific provisions of the Act have been reviewed in recent years, there had not been a comprehensive review of the competition provisions since the Hilmer Committee in 1993. In light of significant structural and regulatory changes that have impacted upon the competitiveness of Australian businesses, economic development and consumer interests, it was considered timely to review the competition provisions of the Act.

The Committee reviewed the competition and authorisation provisions of the Act to establish whether they meet the needs of business, consumers and the economy in the current environment or whether improvements might be made to ensure that they are effective. The Committee also had regard to the way in which the competition provisions and related aspects of the Act have been administered.

Against this background, the Government's response to the Committee's recommendations is set out below.

Recommendation 1.1 The consideration of possible changes to Australia's regulatory framework should continue to have regard to international developments in the area of competition.

Recommendation 1.2 Australian Governments should ensure that the competition provisions of the Act are applied as broadly as possible across the economy and extend to the commercial activities of governments themselves.

Recommendation 1.3 Competition provisions should be uniformly applied and measures which are specific to a particular industry should be avoided.

Recommendation 1.4 The competition provisions should not be regarded as a means of implementing an industry policy or the preservation of particular corporations that are not able to withstand competitive forces.

Government response:

The Government notes the Committee's conclusion that the competition provisions in Part IV of the Act have served Australia well and that the ACCC has been commendably vigorous in discharging its responsibility to enforce those provisions.

The Government agrees with the values expressed in Recommendations 1.1 to 1.4. The Government supports the need to make sure that our competition provisions reflect international best practice and notes the international consultation and research undertaken by the Committee in completing this review. The Government supports a broad and uniform application of the competition provisions across the economy.

The Government accepts that the competition provisions are designed to protect the competitive process rather than a specific market structure or individual competitors and that competition laws should be distinguished from industry policy. Competition laws should not be seen as a means of achieving social outcomes unrelated to the encouragement of competition, or of preserving businesses that are not able to withstand competitive forces.

Recommendation 1.5 Businesses should seek to ensure that voluntary compliance programs are provided for their staff and the ACCC should review the assistance it is able to provide to business in this regard in consultation with interested parties through the reconstituted consultative committee recommended by the Committee.

Government response:

The Government accepts the principle expressed in this recommendation. Compliance is enhanced by businesses ensuring staff understand the competition provisions.

Part 2: Mergers

(a) Merger clearance under section 50

Section 50 of the Act prohibits mergers that would have the effect or be likely to have the effect of substantially lessening competition in a market. In the absence of a formal statutory arrangement, a system has evolved under which the ACCC provides informal clearances for proposed mergers which it considers would not be in breach of section 50.

The Committee did not consider that any amendment to the current section 50 mergers test was necessary, but did recommend changes to the ACCC's merger processes.

While the Committee found that there is generally widespread support for the informal clearance system, which is praised for its relative speed and efficiency, it also found significant weaknesses with the system. These weaknesses are evident in the absence of an effective mechanism for review and the absence of reasons for the ACCC's decisions.

Recommendation 2.1 The ACCC should provide adequate reasons for its decisions (taking care to protect any confidentiality) in the informal clearance process when requested to do so by the parties and in cases where it rejected a merger or accepted undertakings.

Government response:

The Government supports the provision of reasons by the ACCC for its informal clearance decisions when requested by the applicants and in cases where it has rejected a merger or accepted undertakings. This will improve the process by promoting a better understanding of the ACCC's decisions and reducing uncertainty.

Recommendation 2.2 A voluntary formal clearance process should be introduced, parallel to the existing informal clearance process, in relation to merger applications requiring consideration under section 50. This formal clearance process should have the following features:

2.2.1 on application by the parties, the ACCC might grant a binding clearance upon the basis that a proposed merger would not contravene section 50. The applicant would have immunity from proceedings by any party while complying with any conditions specified by the ACCC as a condition of the approval of the merger. The ACCC would be required to monitor compliance with these conditions;

2.2.2 the information required for such an application, which could be set out in revisions to the ACCC's Merger Guidelines, should not be onerous but should be sufficient for the ACCC to make a reasoned assessment;

2.2.3 the Act should require the ACCC to make a decision within 40 days which would allow the ACCC to consult with third parties. If a decision is not provided within 40 days, the clearance of the merger should be deemed to be refused. The 40 day limit should be capable of extension only at the request of the applicant; and

2.2.4 only the applicants should be granted a right of review on the merits by the Tribunal. The application for review should be made within 14 days of the ACCC's decision. The hearing before the Tribunal should be on the material before the ACCC and not a hearing de novo. Decisions of the Tribunal should be made within 30 days. The Tribunal should be able to grant or reject a clearance or grant a clearance subject to conditions.

Government response:

The Government agrees that the creation of a formal, but not compulsory, clearance process, operating in parallel with the existing informal system, will retain the advantages of the current system but will overcome some of its disadvantages.

An optional formal system will provide parties with an alternative process for progressing their merger. Parties will be able to use the informal system and request reasons and/or use the optional formal system. Under the formal system parties would be presented with reasons for the ACCC's decision and be given the opportunity to have the Tribunal review an unfavourable decision. The decisions of the Tribunal will also provide guidance to the ACCC in its approach to clearance upon questions such as the definition of the relevant market or the lessening of competition likely to result from the merger. Under this system, the ACCC will have 40 days to make a decision. This will increase the level of certainty for business.

(b) Merger authorisation process

Mergers that would otherwise contravene section 50 may be authorised where the public benefit arising from the merger is such that the proposal ought to proceed.

Currently the ACCC is responsible for assessing merger authorisations. The Committee found that this process has been less than satisfactory, largely as a result of the time taken by the ACCC to reach a decision and the risk of third party intervention by way of review by the Tribunal. These factors have rendered the authorisation process commercially unrealistic for many merger proposals. The Committee noted that only five authorisations of mergers have been sought from the ACCC since 1995.

Recommendation 2.3 Applications for the authorisation of mergers should be made directly to the Tribunal. This process should have the following features:

2.3.1. applications should be considered within a statutory time limit of three months;

2.3.2. there should be no review on the merits of the Tribunal's decision; and

2.3.3. the Tribunal should have the power to remit an application for consideration by the ACCC if it were of the view that the application required a decision solely on competition issues under section 50 rather than a decision concerning public benefit and the ACCC had yet to formally examine the matter.

Government response:

The Government agrees that direct applications to the Tribunal will greatly reduce the time required to consider merger authorisations. It will also meet the perception of some parties that the ACCC is not able to look afresh at authorisation applications based upon public benefit where it has previously considered a matter under section 50. If third party interests are considered as part of the Tribunal's assessment, rather than through an appeal process, great savings in time and certainty of outcome will be achieved.

Part 3: Market conduct

(a) Misuse of market power

Section 46 of the Act prohibits the misuse of market power, which requires the demonstration of an anti-competitive purpose. The addition of an effects test was proposed in a number of submissions because of the perceived difficulty of proving purpose.

The Committee recommended against the amendment of section 46 to introduce an effects test. The Committee was of the view that the introduction of an effects test would increase the risk of regulatory error and render purpose ineffective as a means of distinguishing between pro-competitive and anti-competitive behaviour. Overseas experience, so far as it is of assistance, did not indicate that the introduction of an effects test would be appropriate.

In March 2003, the Committee reaffirmed its recommendations in light of the High Court decision in Boral v ACCC, maintaining that no amendment should be made to section 46, although the position could be reviewed after a number of other cases are determined, such as Safeway, Rural Press and Universal Music. The Committee noted and endorsed observations by the High Court in the Boral case that the purpose of section 46 is to promote competition and that successful competition is bound to cause damage to some competitors.

Recommendation 3.1 No amendment should be made to section 46.

Recommendation 3.2 The ACCC should give consideration to issuing guidelines on its approach to Part IVA.

Recommendation 3.3 The ACCC should consult with industry and issue guidelines on the application of Part IV to intellectual property.

Government response:

The Government acknowledges the extensive consideration given to possible amendments to section 46, including the introduction of an effects test, by this and previous reviews, and supports the recommendation that no amendment should be made to section 46.

The Government supports the development of guidelines by the ACCC.

(b) Price discrimination

Price discrimination occurs when like goods or services are provided to different people at different prices and the differences in price are unrelated to the costs of providing the goods or services. Price discrimination can be pro-competitive or anti-competitive. To be anti-competitive, the corporation engaging in price discrimination must have market power. For these reasons, the Committee concluded that it was appropriate to consider the effect of price discrimination on competition on a case by case basis in accordance with section 46. The Committee also concluded that the principle of 'like terms for like customers' did not offer a suitable basis for regulation of the grocery industry.

Recommendation 4.1 No change should be made to the Act in relation to price discrimination.

Government response:

The Government accepts the Committee's reasoning and hence this recommendation.

(c) Cease and desist orders

Cease and desist orders have been described by proponents as emergency administrative cessation of conduct orders that would be issued by the ACCC if it considered that a breach, or threatened breach of the Act has occurred. The Committee found no evidence that the existing process of obtaining an interim injunction, to cease conduct that may potentially be in breach or threatened breach of certain parts of the Act, was cumbersome or overly difficult. Moreover, the Committee was of the view that it was not clear that the proposed cease and desist powers would be any speedier or more efficient than the existing process of obtaining an interim injunction.

Recommendation 5.1 The Act should not be amended to introduce a power to make cease and desist orders or to extend the powers of the ACCC under section 155 of the Act so that they apply after the commencement of judicial proceedings.

Government response:

The Government accepts the view of the Committee that the case for cease and desist orders has not been made and that the existing provision of obtaining an interim injunction has not been demonstrated to be deficient.

(d) Authorisation

Non-merger market conduct that would otherwise contravene the competition provisions may be granted immunity through authorisation. Authorisation enables efficient or welfare enhancing arrangements, such as joint ventures or collective bargaining processes, to be protected even though they may reduce competition.

Depending on the provision that would otherwise be contravened, conduct may be authorised by the ACCC either because the public benefit arising from the conduct outweighs the detriment caused by the lessening of competition or because the public benefit arising from the conduct is such that the proposal ought to proceed. An exception is misuse of market power, which cannot be authorised. Any person with sufficient interest, including third parties, may seek review of the ACCC's authorisation determinations before the Tribunal.

The Committee agreed that the considerable time and expense associated with non-merger authorisation applications were of concern. A large part of the expense was said to be associated with the costs of preparing an authorisation application, which may be addressed through a better understanding of the process.

Recommendation 6.1 The Act should be amended to include a time limit of six months for the consideration of non-merger applications for authorisation by the ACCC, and consideration should be given to imposing a time limit on any review by the Tribunal.

Recommendation 6.2 The ACCC should be given a discretion to waive, in whole or in part, the fee for filing a non-merger application for authorisation where it would impose an unduly onerous burden on an applicant.

Recommendation 6.3 The ACCC should develop an informal system of consultation with non-merger applicants for authorisation designed to provide those persons with guidance about the authorisation process and the requirements of the Act.

Government response:

The Government considers the non-merger authorisation provisions to be an important feature of the Australian system of competition regulation. These provisions allow a flexible response to evolving market situations, including industries undergoing structural change.

The Government will amend the Act to include a time limit of six months for the consideration of non-merger applications for authorisation by the ACCC. The ACCC will be provided with a discretion to waive, in whole or in part, the fee for filing a non-merger application for authorisation. The Government supports the development by the ACCC of an informal system of consultation with non-merger applicants for authorisation.

These changes will improve the accessibility and effectiveness of the authorisation process by reducing the time and cost involved in obtaining authorisation.

(e) Collective bargaining

Any contract, arrangement or understanding (agreement) that has the purpose, effect or likely effect of substantially lessening competition will breach the Act. Collective bargaining agreements are therefore constrained by the Act because they will often, for example, involve agreements between competitors on the price of goods or services. Such agreements are deemed to substantially lessen competition. However, the Committee found that collective bargaining by small businesses negotiating with big business may also benefit the community. Such arrangements may provide competing small businesses with sufficient bargaining power to balance that of the big businesses with which they have to deal.

Recommendation 7.1 A notification process should be introduced, along the lines of the process provided for by section 93 of the Act, for collective bargaining by small businesses (including co-operatives that meet the definition of small business) dealing with large business.

Recommendation 7.2 A transaction value approach should be adopted to provide a definition of small business. Initially the amount of transactions should be set at $3 million but be variable by the Minister by regulation.

Recommendation 7.3 A period of 14 days should be required to elapse before a notification takes effect.

Recommendation 7.4 Provision should be made for third parties to make a collective bargaining notification on behalf of a group of small businesses.

Government response:

The Government accepts these recommendations and will develop a notification process for collective bargaining by small businesses dealing with large business. While small business will retain access to the authorisation provisions, the proposed notification process is to be based on the Committee's recommendations and will be speedier and simpler for small business than existing processes. To ensure that costs are kept to a minimum for small businesses, the notification fee is to be set at an appropriately low level. Immunity is to extend for three years from the date of notification, and third party representative actions will be allowed. It will aim to provide an appropriate balance of power where small businesses are competing or dealing with businesses that have substantial market power.

(f) Per se prohibitions

Certain types of agreements between competitors are prohibited per se, that is, they are deemed to be illegal regardless of their likely effect on competition. These agreements include those that contain exclusionary provisions, fix prices or involve third line forcing. Where net public benefits arise from such agreements they may be authorised.

(g) Exclusionary provisions

An exclusionary provision has the purpose of preventing, restricting or limiting the supply or acquisition of goods or services to or from particular persons or classes of persons either altogether or in particular circumstances or on particular conditions.

Recommendation 8.1 The Act should be amended so that it is a defence in proceedings based upon the prohibition of an exclusionary provision to prove that the exclusionary provision did not have the purpose, effect or likely effect of substantially lessening competition.

Recommendation 8.2 The Act should also be amended to restrict the persons or classes of persons to which a prohibited exclusionary provision relates, to a competitor or competitors, actual or potential, of one or more of the parties to the exclusionary provision.

Government response:

The Government agrees with these recommendations. Although much of the behaviour covered by the present prohibition may damage competition, there is a risk that the prohibition may also be capturing some behaviour that is not detrimental to competition. To ensure the prohibition only ever stops harmful behaviour, the Government will establish a competition defence, as outlined in Recommendation 8.1. In addition, the prohibition will be confined to those agreements that target competitors, actual or potential, of the parties to the agreement.

(h) Third line forcing

Third line forcing occurs when goods or services are sold, or sold at a discount, but only if the purchaser also buys other goods or services from a third person. The petrol discounts offered by some supermarkets are an example of third line forcing conduct.

Recommendation 8.3 The prohibition of third line forcing should cease to be a per se prohibition and be made subject to a substantial lessening of competition test.

Recommendation 8.4 Related companies should be treated as a single entity for the purposes of section 47.

Recommendation 8.5 Section 93(2) should be repealed.

Government response:

The Government accepts that the prohibition on third line forcing should no longer be prohibited per se because third line forcing can be beneficial and pro-competitive. The Government notes that very few of the hundreds of notifications received annually by the ACCC are opposed. This amendment will generate benefits for business by reducing the need for notifications, generating savings in terms of cost and time. The technical amendments outlined in Recommendations 8.4 and 8.5 will improve the operation of the third line forcing provisions.

(i) Joint ventures

Goods and services can be supplied more efficiently by businesses cooperating in joint ventures that provide scale and scope not achievable by any single business. The businesses involved will usually need to agree on the price to be charged for the venture's output. Consequently, the Act recognises the need to exempt joint ventures from the per se prohibition of agreements that fix prices.

The existing joint venture exemption was introduced primarily to benefit ventures in the mining and manufacturing sectors. However, this exemption was found by the Committee to be too narrow for many newer forms of joint venture, such as those found in e-commerce. The Committee was of the view that many joint ventures may be pro-competitive, particularly when they are employed as a means of developing new products or services, or producing existing products or services more efficiently. Although the Committee was also conscious of the potential for anti-competitive effects, it felt that on balance the existing provisions of the Act to be too narrow.

Recommendation 9.1 The Act should be amended by substituting for the current exemption to section 45A(1) provided by section 45A(2), a provision that section 45A(1) does not apply to a provision of a contract or arrangement made, or of an understanding arrived at, or of a proposed contract or arrangement to be made, or of a proposed understanding to be arrived at, if it is proved that the provision is for the purposes of a joint venture and the joint venture does not have the purpose, effect or likely effect of substantially lessening competition.

Recommendation 9.2 The ACCC should develop and issue guidelines outlining its approach to joint ventures.

Government response:

To ensure that legitimate joint ventures are not impeded by the Act, the Government proposes a competition defence similar to that set out in Recommendation 9.1. The Government supports the issuing of guidelines by the ACCC.

(j) Dual listed companies

A dual-listed company (DLC) operates in a similar manner to an entity established via a merger and involves two corporations, one listed on a domestic stock exchange and the other listed on a foreign stock exchange, contracting to operate their businesses as a unified enterprise. Unlike the corporate groups established by merger, DLCs are not considered a single economic entity for the purpose of the competition provisions.

Recommendation 9.3 The Act should be amended to allow intra-party transactions in a DLC to be treated on the same basis as related party transactions within a group of companies. Consistently with this, the aggregate size of the DLC should be recognised for the purposes of assessing the entity's market power.

Government response:

The Government will amend the Act as proposed to ensure consistency between DLCs and corporate groups.

Part 4: Penalties

(a) Criminal penalties

'Hard core' or serious cartel behaviour, such as price fixing, can cripple competition and harm the economy. The competition provisions already prohibit such behaviour. The Act enables the Federal Court to impose significant civil penalties for any breach, including pecuniary penalties of up to $10 million for corporations and $500,000 for individuals.

Such penalties aside, many submissions supported the introduction of criminal penalties, including imprisonment, for serious cartel behaviour, primarily because criminal sanctions were said to be better able to deter corporations and individuals from engaging in such behaviour.

Other submissions to the Committee questioned the need for criminal sanctions and highlighted the problems that would have to be addressed if criminal sanctions were to be introduced. These problems include developing an appropriately defined criminal offence and combining any such offence with a workable leniency or amnesty policy (to encourage cartel participants to reveal the existence of cartel behaviour). Problems also relate to the concurrent operation of civil and criminal sanctions, and the development of a workable method of combining a clear and certain leniency policy with a criminal regime.

Recommendation 10.1 The Committee is of the view that solutions must be found to the problems identified by it before criminal sanctions are introduced for serious cartel behaviour. The problems are, importantly, the development (preferably by a joint body representing the Director of Public Prosecutions (DPP), the Attorney-General's Department, the ACCC and the Treasury) of a satisfactory definition of serious cartel behaviour and a workable method of combining a clear and certain leniency policy with a criminal regime. Subject to this proviso, the Committee recommends the introduction of criminal sanctions for serious, or hard-core, cartel behaviour, with penalties to include fines against any convicted corporation and imprisonment and fines, as appropriate, for implicated individuals.

Government response:

The Government accepts, in principle, that criminal penalties may be more effective than civil penalties in deterring people from engaging in serious cartel behaviour.

The Government will further consider the introduction of criminal penalties for serious cartel behaviour. Appropriate solutions must be found to the problems identified by the Committee. In addition, to enhance the welfare of Australians, any new criminal penalty must be applied broadly and must not impose significant additional uncertainty and complexity for business. Any new offence must also work well in the context of the Australian legal system, because it will only deter if the risk of conviction and substantial penalty are real.

(b) Civil penalties

The Act enables the Federal Court to impose significant civil penalties for any breach of the competition provisions, including pecuniary penalties of up to $10 million for corporations and $500,000 for individuals. In addition, the Federal Court may make other orders including the cessation of unlawful conduct and the payment of compensation or damages. Civil community service orders, probation orders and publicity orders may also be made.

The Committee concluded that comparable jurisdictions enable Courts to deter illegal behaviour by imposing maximum penalties upon corporations that are either a multiple of the gain or a proportion of the corporation's turnover. The Committee also supported recent New Zealand amendments providing an option for Courts to exclude individuals from being involved in the management of a corporation and prohibiting corporations from indemnifying their officers, employees or agents from the payment of a pecuniary penalty.

Recommendation 10.2 The Act should be amended so that:

10.2.1 the maximum pecuniary penalty for corporations be raised to be the greater of $10 million or three times the gain from the contravention or, where gain cannot be readily ascertained, 10 per cent of the turnover of the body corporate and all of its interconnected bodies corporate (if any);

10.2.2 the Court be given the option to exclude an individual implicated in a contravention from being a director of a corporation or being involved in its management; and

10.2.3 corporations be prohibited from indemnifying, directly or indirectly, officers, employees or agents against the imposition of a pecuniary penalty upon an officer, employee or agent.

Government response:

No corporation should benefit from anti-competitive behaviour. The Government will raise the maximum pecuniary penalty applicable to corporations. Also as proposed, the Government will introduce an option for Courts to exclude implicated individuals from being a director of a corporation or being involved in its management, and will address avoidance issues by prohibiting corporations from indemnifying officers, employees or agents.

Part 5: Administration

(a) Accountability of the ACCC

The Committee's terms of reference required it to examine the administration as well as the policy of the competition provisions. More submissions dealt with the ACCC's administration of the Act than with the Act itself.

Recommendation 11.1 Consideration should be given to the establishment of a single Joint Parliamentary Committee to oversee the ACCC's administration of the Act.

Government response:

The Government accepts this recommendation. The Government notes the Committee's view that the ACCC has been commendably vigorous in discharging its responsibilities under the Act.

The Government encourages the Parliament to establish a Joint Parliamentary Committee to provide further oversight of the administration of the Act by the ACCC. The Joint Committee would be well placed to develop a special understanding of the responsibilities of the ACCC and of the concerns of the parties with whom it deals.

Recommendation 11.2 The Act should be amended to establish a consultative committee to advise the ACCC on the administration of the Act. The consultative committee should be constituted so that it is convened by an independent chairperson appointed by the Treasurer. The chairperson should appoint the members of the committee in consultation with the ACCC. The committee should report to Parliament by way of a dedicated section of the ACCC's annual report.

Recommendation 11.3 An associate commissioner should be appointed to the ACCC to receive and respond to individual complaints about the administration of the Act and to report each year in the ACCC's annual report.

Government response:

The Government accepts the principle of putting in place effective consultative and complaints handling arrangements. The Government has commissioned a report by Mr John Uhrig, AC on the corporate governance of Commonwealth statutory authorities and office holders, which is expected to report shortly. After considering that report, the Government will announce a more specific response on these recommendations.

Recommendation 11.4 Consideration should be given to the manner in which the remuneration of commissioners is determined to ensure that the Government is able to attract as commissioners candidates of sufficient calibre.

Recommendation 11.5 The ACCC should consider the temporary placement of ACCC staff with other parties to develop staff resources.

Government response:

The Government believes that remuneration should be set by the Remuneration Tribunal. The Government notes the Remuneration Tribunal's review of the entitlements of office holders in 2002 (determination 23/2002). This determination has greatly increased the flexibility of remuneration packages which may be offered to full-time office holders (including ACCC Commissioners). Full-time office holders may now convert non-salary benefits into an additional salary payment and may also receive remuneration in lieu of performance pay. Accordingly, the need for the review of ACCC remuneration has been addressed.

The Government accepts Recommendation 11.5 and encourages the ACCC to build upon its existing arrangements for exchanges with other regulatory authorities. The Government also encourages the ACCC to develop staff exchanges with key groups with which it interacts.

Recommendation 11.6 The ACCC should review its service charter, in conjunction with the proposed consultative committee, in the light of the outcome of this review and the relevant recommendations of the Wilkinson Review.

Government response:

The Government agrees that the ACCC should review its service charter. Subject to the Government's specific response to recommendation 11.2, there is no objection to the proposed consultative committee contributing to such a review in order that the concerns of interested parties may be taken into account.

(b) Use of media

The Committee noted that the ACCC has been successful in raising the community's awareness of the importance of competitive markets and in encouraging compliance with the Act. It also noted that many of the submissions it received expressed concern regarding the manner in which the ACCC releases information and makes comments to the media.

Recommendation 12.1 A media code of conduct should be developed through the proposed restructured consultative committee.

Recommendation 12.2 The media code should be based on the following principles:

12.2.1 the public interest is served by the ACCC disseminating information about the aims of the Act and the ACCC's activities in encouraging and enforcing compliance with it. This extends to information about proceedings instituted by it, but an objective and balanced approach is necessary to ensure fairness to individual parties;

12.2.2 the code should cover all formal and informal comment by ACCC representatives;

12.2.3 whilst it may be necessary for the ACCC to confirm or deny the existence of an investigation in exceptional circumstances, the ACCC should decline to comment on investigations;

12.2.4 with the object of preserving procedural fairness, commentary on the commencement of court proceedings by the ACCC should only be by way of a formal media release confined to stating the facts; and

12.2.5 reporting the outcome of court proceedings should be accurate, balanced and consistent with the sole objective of ensuring public understanding of the court's decision.

Government response:

The Government accepts this recommendation. The Report notes the Committee's observation that the ACCC should exercise care in publicising particular matters to ensure that there is no unfairness to the parties involved. The development of a code of conduct governing the ACCC's use of the media will assist the ACCC's relationship with business and consumers. Subject to the Government's specific response to recommendation 11.2, the proposed consultative committee could appropriately contribute to the development of this code of conduct. The principles outlined in Recommendation 12.2 provide a useful foundation for developing this code of conduct.

(c) ACCC investigation powers

Section 155 of the Act provides the ACCC with the power to obtain information, documents and evidence in the course of investigating possible contraventions of the Act and for use in proceedings under the Act. The Committee identified concerns that the ACCC's investigative powers lack adequate safeguards, particularly in relation to section 155(2), which provides the ACCC with the power to enter premises and inspect documents without the need for a warrant.

Recommendation 13.1 The ACCC should continue to give careful consideration to the financial implications of requests for information that are made to businesses consistent with the ACCC's guidelines on this matter.

Government response:

The Government accepts this recommendation. While the ACCC needs broad investigative powers for the purpose of detecting and prosecuting contraventions, it should, nevertheless, be concerned about the effect of information requests upon recipients.

Recommendation 13.2 The function of conducting an examination of a person who is in receipt of a section 155(1)(c) notice should be delegable to senior staff of the ACCC.

Government response:

The Government supports the flexibility provided by this recommendation because ACCC Commissioners need not be directly involved in the detail of particular investigations.

Recommendation 13.3 Section 155(2) of the Act, which provides for the ACCC to enter premises and inspect documents, should be amended to:

13.3.1 require the ACCC to seek a warrant from a Federal Court Judge or Magistrate for the exercise of these powers; and

13.3.2 provide the ACCC with the power to search for and seize information.

Government response:

The ACCC has extensive powers under section 155(2) to enter premises and inspect documents but these do not require that a warrant be sought. Regulatory power must be matched with appropriate accountability.

The Act will be amended to require the ACCC to seek a warrant, although these should be capable of issue by a State or Territory judicial officer. Providing the ACCC with the power to search and seize information will provide greater clarification and certainty, as the elements of these powers are generally well known.

Recommendation 13.4 Section 155 should also be amended to:

13.4.1. extend the availability of the ACCC's investigative powers to circumstances where the ACCC is considering the revocation of an authorisation under sections 91B and 91C; and

13.4.2 repeal the redundant section 155(4).

Government response:

The Government agrees with this recommendation. These technical amendments will improve the general application of the ACCC's investigative powers.

Recommendation 13.5 It should be made explicit in the Act that section 155 does not require the production of documents to which legal professional privilege attaches.

Government response:

The Government agrees with this recommendation. Preserving legal privilege is in the public interest because it facilitates the obtaining of legal advice and promotes the observance of the law. This recommendation is consistent with the finding of the High Court in ACCC v Daniels Corporation International.

(C) NEW EUROPEAN CORPORATE GOVERNANCE TRANSPARENCY AND DISCLOSURE REPORT PUBLISHED

On 15 April 2003 Standard & Poor's Governance Services announced that it had published the European component of its global transparency and disclosure study, which examines disclosure of corporate governance-related information by companies in the world's major and emerging markets.

The new report 'Transparency and Disclosure Study: Europe' examines aggregate transparency and disclosure standards among companies in the Standard & Poor's Europe 350 index, based on their annual reports and, where applicable, their 20-F regulatory filings in the US. Previous studies have examined corporate transparency and disclosure standards in the US, Canada, Japan, Asia, and Latin America.

The authors of the study have focused on aggregated data instead of individual company rankings as in previous studies, thereby enabling better country-by-country comparison and analysis. Standard & Poor's emphasises that the study is not a measure of countries' corporate governance standards and should not be interpreted as a proxy for measuring companies' corporate governance standards. The study, however, does examine the level of disclosure of governance-related issues, which, in turn, facilitates analysis of the governance practices of individual companies.

The study's findings include:

- Disclosure of corporate governance-related information in Europe compares favourably with Asia, but less favourably with North America, although the level of disclosure in annual reports alone (excluding other regulatory filings) is higher in Europe than in the US;  
- Disclosure of governance-related information in the UK, France, and the Netherlands is among the highest globally. Within Europe, disclosure standards are lowest in Italy and Spain;  
- The varying practices in individual countries suggest that governance-related disclosure is not constrained by local regulatory filing requirements;  
- In all countries analyzed, companies with American Depositary Receipt (ADR) listings have higher governance-related disclosure levels than companies without an ADR listing; and  
- European companies provide consistently high levels of financial information, but are weaker in disclosing ownership information and investor rights in annual reports.

Questions that are less likely to be answered in European annual reports include: The percentage of cross-ownership; the ownership structure of affiliates; details of the chief executive officer's contract; specifics on performance-related pay for directors and senior executives; the form in which directors' salaries are paid; and the number of shares held in other affiliated companies by managers.

The full report 'Transparency and Disclosure Study: Europe' is available at [http://www.governance.standardandpoors.com](http://www.governance.standardandpoors.com" \t "_new) under the Transparency & Disclosure Study icon in the right-hand column.

(D) SEC TO REVIEW CURRENT PROXY RULES AND REGULATIONS TO IMPROVE CORPORATE DEMOCRACY

On 14 April 2003 the United States Securities and Exchange Commission announced that it had directed the Division of Corporation Finance to examine current proxy regulations and develop possible changes to those regulations to improve corporate democracy.

"The current rules concerning shareholder proposals and director elections are clear and we are enforcing them as such, but the time has come for a thorough review of the proxy rules and regulations to ensure that they are serving the best interests of today's investors, while at the same time, fostering sound corporate governance and transparent business practices," said Chairman William Donaldson.

The Commission has directed the Division of Corporation Finance to formulate possible changes in the proxy rules and regulations and their interpretations regarding procedures for the election of corporate directors. This review will address shareholder proposals, the nomination process, elections of directors, the solicitation of proxies for director elections, contests for corporate control, and the disclosure and other requirements imposed on large shareholders and groups of shareholders. As part of this process, the Commission has asked the Division to consult with all interested parties, including representatives of pension funds, shareholder advocacy groups, and representatives from the business and legal communities. The Commission has requested that the Division provide its recommendations to the Commission by 15 July of this year.

(E) GOVERNMENT ACTS TO REGULATE UNSOLICITED OFFERS TO BUY SHARES AT BELOW MARKET PRICE

On 8 April 2003 the Parliamentary Secretary to the Treasurer, Senator Ian Campbell announced new Regulations to deal with unsolicited offers to buy shares at below market price.

Section 1364 of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed by regulations or necessary or convenient to be prescribed by such regulations for carrying out or giving effect to the Act.

A market practice had developed whereby persons approach shareholders off-market and make offers to purchase shares well below market value, essentially trading on the potential ignorance of those shareholders. In the past, the [Financial Services Reform Act 2001 No. 122 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=58127" \t "default) (FSRA) has not imposed conditions or restrictions upon the practice of such businesses.

The purpose of the Regulations is to expand the definition of a financial service under the Act to include the making of unsolicited off-market offers to purchase financial products from investors, by persons in the business of acquiring financial products. Defining these offers as financial services ensures that persons involved in this practice would need to become licensed under the Financial Services Reform Act 2001 (FSRA) licensing regime. A licensing exemption would, however, be available if the person discloses the current market value of the financial product they wish to purchase when making the offer.

The Regulations would support the reforms to the regulation of the financial services industry, which were included in the FSRA and associated legislation, by promoting disclosure and protecting inexperienced financial product holders from businesses that offer to purchase financial products off-market at grossly undervalued prices.

(F) REGULATORS ISSUE INTERAGENCY PAPER ON SOUND PRACTICES TO STRENGTHEN THE RESILIENCE OF THE US FINANCIAL SYSTEM

On 8 April 2003 the United States Securities and Exchange Commission announced that three federal regulatory agencies issued an "Interagency Paper on Sound Practices to Strengthen the Resilience of the US Financial System." Among other things, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission identified sound practices to strengthen the resilience of critical US financial markets and minimize the immediate systemic effects of a wide-scale disruption.

On 5 September 2002, the agencies published for comment a draft of the paper in the Federal Register. The agencies have incorporated many of the suggestions that were made. The final paper, which applies most directly to the clearing and settlement activities of a limited number of financial institutions, provides more flexibility to firms in managing geographic dispersion of backup facilities and staffing arrangements, and takes into account other considerations relevant to cost-effective implementation of sound practices.

The paper is available on the SEC's website at [http://www.sec.gov](http://www.sec.gov" \t "_new)

(G) FSA PROPOSALS TO MAKE FUND MANAGERS MORE ACCOUNTABLE TO INVESTORS

On 7 April 2003 the United Kingdom Financial Services Authority (FSA) proposed a new policy where managers would be more accountable to investors. Under this policy fund managers would no longer be able to incur costs for services additional to dealing without the customer's express agreement. This means that managers would have to negotiate with their customers on how much to pay for such services. The FSA is also proposing that managers would no longer be able to use soft commissions to purchase services such as dealings screens.

Gay Huey-Evans, Director of the FSA's Markets and Exchanges Division said:

"Up to 40% of total commission spend is used to acquire services additional to dealing so it is important that investors are clear on how their money is spent. These proposals are designed to do away with distortions in the market and make fund managers more answerable to their clients. Our analysis suggests changes to the regulatory approach should foster competition and ensure a better overall outcome for investors."

At the moment brokers typically provide a range of additional services to fund managers. The main ones are market information technology and investment research. Services are provided under two types of arrangements - 'bundling' and 'softing'. 'Bundling' refers to the provision by brokers of other in-house services, such as research, together with dealing in securities in a single commission charge. 'Softing' is the practice by which a broker agrees to pay for the supply of services from a third party to a fund manager in return for an agreed volume of business at an agreed commission rate. In both cases, the value of the services provided is dependent on how much business the fund manager places with the broker. The costs for these services are included in the commissions which are passed through by fund managers directly as charges to their clients.

In 2000 over £2.3 billion were paid as commission by UK institutional fund managers to UK brokers. It is estimated that fund managers spent between £660 and £880 million of the commission on services additional to dealing. Of this between £500 million and £720 million was spent on investment research. In 2001 at least £90 million was spent on market pricing and information services.

Paul Myners' review of institutional investment published in March 2001 suggested that commission costs incurred by fund managers on their clients' behalf should be reflected in the fund manager's fee to investors. The Government subsequently agreed with the FSA that it would examine these issues in the context of its review of best execution. The FSA's proposals deal with the fund managers' conflicts of interest by requiring them to be directly accountable to their clients for the costs of additional services.

The consultation ends on 29 August 2003. Consultation paper 'CP176: Bundled Brokerage and Soft Commission Arrangements' can be accessed at [http://www.fsa.gov.uk/pubs/cp/](http://www.fsa.gov.uk/pubs/cp/" \t "_new)

(H) GROUP OF 100 RELEASES GUIDE TO REVIEW OF OPERATIONS AND FINANCIAL CONDITION

On 2 April 2003 the Group of 100 (which represents Australia's senior finance executives) published its Guide of Review of Operations and Financial Condition. The Guide provides general guidance on the form and content of a review of operations and financial condition that is aimed at complementing and supplementing the financial statements. It provides a framework for the directors of a company to discuss and analyse its performance and the opportunities and risks underlying its results and financial condition to ensure communication by the company on a consistent basis.

The review is aimed at meeting the information needs of users of financial reports and providing them with a basis for forming a view as to the likely future performance of the company in the context of the strategies of the company for achieving long term value creation and known trends in performance. This requires that the review contains a discussion of the operations of the period, including an explanation of unusual or infrequent events and transactions, and an analysis of the opportunities and risks facing the company, together with a planned approach to managing those opportunities and risks.

The Guide states that the review should:

- Explain the objectives of the company and how they are to be achieved.  
- Include discussion and analysis of key financial and non-financial performance indicators used by management in their assessment of the company and its performance.  
- Discuss the main factors and influences that may have a major effect on future results whether or not they were significant in the period under review.  
- Discuss the main activities of the company, including significant features of operating performance within the period covered by the financial report.  
- Discuss the overall return attributable to shareholders in terms of dividends and increases in shareholders' funds.  
- Include a commentary on the results for the financial year and dividends, both in total and in per share terms indicating the directors' overall distribution policy.  
- Discuss the current level of capital expenditure and other expenditure enhancing future performance, together with planned future expenditure (both committed, and authorised but not committed) and how it is expected to contribute future performance.  
- Contain a discussion of the capital structure of the company, including the maturity profile of its debt, types of financial instruments used, and currency and interest rate exposures.  
- Discuss the cash generated from operations and other cash flows during the period under review, including commentary on any special factors that influenced cash flows.  
- Discuss the company's liquidity and funding at the end of the period under review.  
- Comment on the strengths and resources of the company whose value may not be fully reflected in the statement of financial position.  
- Discuss and explain the significance of critical accounting policies, estimates and judgments made and their impact on the company's financial condition, changes in operation and results of operations.  
- Discuss and explain the significance and impact of changes in legislation, regulations and other external requirements which has had a material effect in the reporting period or is expected to have a material effect in future periods on the company's financial condition, changes in financial condition and results of operations.  
- Discuss the company's risk profile and risk management practices if these are not dealt with elsewhere in the annual report.  
- Discuss the nature of the company's corporate governance policies and practices if these are not dealt with elsewhere in the annual report.

The Guide is available on the Group of 100 website at [http://www.group100.com.au](http://www.group100.com.au" \t "_new)

(I) CLERP 7 BECOMES LAW  
(By Tom Bostock, Partner, Mallesons)

The [Corporations Legislation Amendment Act 2003 No. 24 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=69307" \t "default) ("the CLERP 7 Act") was passed on 27 March 2003 and received Royal Assent on 11 April 2003. The principal objective of the CLERP 7 Act, and the associated [Corporations (Review Fees) Act 2003 No. 23 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=69306" \t "default) and [Corporations (Fees) Amendment Act 2003 No. 22 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=69304" \t "default) ("the Fees Acts") is to implement "CLERP 7 Simplified Lodgements and Compliance Streamlining Paperwork under the Corporations Law", the Proposals Paper for which was issued in early 2000. Except for the other amendments noted in section 3 below, the CLERP Act and the Fees Acts will commence on 1 July 2003. The principal amendments to the Corporations Legislation (as defined in CA s9) are as follows:

(1) CLERP 7 amendments

The main CLERP 7 amendments are:

(a) Abolition of company annual returns (Schedule 1 to the Act)

In place of the annual return, companies will be required to confirm or correct company particulars using information provided by ASIC in the form of an Extract of Particulars and, where necessary a Return of Particulars, and pay an annual "review" fee. There will be new requirements for lodging information about company members and any ultimate holding company.

(b) Streamlining document lodgment requirements (Schedule 3 to the Act)

A number of existing company forms will be replaced by multi-purpose form. In addition, electronic lodgement of, and payment for, documents will be facilitated and encouraged; and telephone notice may be given to ASIC of changes relating to misspelling or other minor typographical error.

(c) Modification of the Corporations Act fees regime (Part 9.10 in Schedule 1 and the Fees Acts)

The Fees Schedule will be simplified and fees relief provided for small business. Annual fees will be introduced for occupational licence holders, while there will be progressive implementation of user pays principles for fees for occupational licensing, fund raising and takeovers.

Because of section 55 of the [Constitution](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=3877" \t "default), the fee proposals are covered by separate legislation in the form of the Fees Acts.

(2) Harmonisation with the new tax system (use of ABN and extension of lodgment periods)

Schedule 2 to the CLERP 7 Act contains a number of fairly minor and technical amendments that are intended to harmonize some requirements of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) with similar requirements in the [A New Tax System (Australian Business Number) Act 1999 No. 84 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=14477" \t "default).

In particular, if the last nine digits of a company's ABN are the same as its ACN, the company will from 1 July 2003 have the choice of using either its ABN or its ACN or its common seal on its public documents and in any other case when the company's ACN is required to permitted to be used under a Commonwealth law administrated by ASIC.

(3) Other amendments

Schedule 5 to the CLERP 7 Act contains a number of miscellaneous amendments to the Corporations Legislation as follows:

- increase from $250,000 to $1,000,000 the amount for which ASIC may render itself liable under contracts entered into by it without Ministerial approval;  
- amend Part 9 of the ASIC Act to permit the Chairman of ASIC (an ex officio member of CAMAC) to appoint an alternate (being a member or a senior officer of ASIC) to attend any meeting of CAMAC;  
- repeal CA s201C to remove the prohibition on the election or re-election of a director of a public company or a subsidiary of a public company who has reached 72 years of age; and  
- amend the CA to exclude charges over electronically-controlled securities created after 11 April 2003 from the charges provisions in CA Chapter 2K.

The first two of those items commence retrospectively on 15 July 2001, immediately after the commencement of the Corporations Act 2001. The last two items commence on the date of Royal Assent ie 11 April 2003.

(4) Extension of lodging periods

(a) Schedule 4 to the CLERP 7 Act extends from 14 to 28 days the time within which the following may be lodged without penalty with ASIC:

- CA s142(2) - notice of change of registered office;  
- CA s146(1) - change of principal place of business;  
- CA s205B(1) - notice of appointment of director;  
- CA s205B(2) - notice of appointment of alternate director;  
- CA s205B(4) - notice of change of personal details of director;  
- CA s205B(5) - notice of cessation of office of director;  
- CA s254X(1) - notice to ASIC of share issue.

(b) The Schedule 4 changes become operative on 1 July 2003. If at that time a company is required to lodge a notice under any of the above provisions and the time for lodgment has not expired, the extended period under Schedule 4 applies by new CA s1448 to that notice.

(5) Fees

With effect form 1 July 2003 the Corporations (Fees) Act 2003:

- increases from $5000 to $10,000 the maximum fee which may be prescribed by regulation for lodgement with ASIC of a document or any other chargeable matter;  
- increases from $25,000 to $50,000 the maximum fee, or sum of fees, for any chargeable matter which may be prescribed by regulation; and  
- permits the regulations to prescribe different fees for the same chargeable matter, depending on whether or not the matter is complied with by electronic means.

The Corporations (Review Fees) Act 2003, enables the regulations to prescribe review fees up to a maximum of $10,000 for companies, registered schemes, registered Australian bodies, registered auditors and liquidators and persons holding an Australian financial services licence. A review fee need not bear any relationship to the cost of providing any service.

(J) SEC REQUIRES EXCHANGE LISTING STANDARDS FOR AUDIT COMMITTEES

On 1 April 2003 the United States Securities and Exchange Commission voted to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the audit committee requirements established by the Sarbanes-Oxley Act of 2002. The new rules and amendments implement the requirements of Section 10A(m)(1) of the Securities Exchange Act of 1934, as added by section 301 of the Sarbanes-Oxley Act of 2002.

Under the new rules, national securities exchanges and national securities associations will be prohibited from listing any security of an issuer that is not in compliance with the following requirements.

- Each member of the audit committee of the issuer must be independent according to the specified criteria in section 10A(m).  
- The audit committee must be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the issuer, and the registered public accounting firm must report directly to the audit committee.  
- The audit committee must establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.  
- The audit committee must have the authority to engage independent counsel and other advisors, as it determines necessary to carry out its duties.  
- The issuer must provide appropriate funding for the audit committee.

The new rules will establish section 10A(m)'s two criteria for audit committee member independence.

- Audit committee members must be barred from accepting any consulting, advisory or compensatory fee from the issuer or any subsidiary, other than in the member's capacity as a member of the board or any board committee.  
- An audit committee member must not be an affiliated person of the issuer or any subsidiary apart from capacity as a member of the board or any board committee.

The new rules will apply to both domestic and foreign listed issuers. It is important to note that, based on significant input from and dialogue with foreign regulators and foreign issuers and their advisers, several provisions, applicable only to foreign private issuers, have been included that seek to address the special circumstances of particular foreign jurisdictions. These provisions include:

- allowing non-management employees to serve as audit committee members, consistent with "co-determination" and similar requirements in some countries;  
- allowing shareholders to select or ratify the selection of auditors, also consistent with requirements in many foreign countries;  
- allowing alternative structures such as boards of auditors to perform auditor oversight functions where such structures are provided for under local law; and  
- addressing the issue of foreign government shareholder representation on audit committees.

The new rules also will make several updates to the Commission's disclosure requirements regarding audit committees, including updates to the audit committee financial expert disclosure requirements for foreign private issuers.

The Commission voted to establish two sets of implementation dates for listed issuers. Generally, listed issuers will be required to comply with the new listing rules by the date of their first annual shareholders meetings after 15 January 2004, but in any event no later than 31 October 2004. Foreign private issuers and small business issuers will be required to comply by 31 July 2005.

(K) CORPORATES SPLIT OVER RESPONSE TO EXECUTIVE REMUNERATION CONCERNS

On 30 March 2003 Chartered Secretaries Australia (CSA) released the results of a survey concerning executive remuneration.

Fifty-three per cent of respondents in the CSA survey of members in the ASX Top 200 companies believe disclosure of executive remuneration should be legislated while 47 per cent opt for "if not, why not, please explain". Nor is there a consensus that information gained from full disclosure of remuneration will assist shareholders make more informed investment decisions with 59 per cent saying it would not, and 41 per cent saying it would.

The survey also found diverse views about the extent to which disclosure of executive remuneration genuinely benefits investors. 53 per cent of respondents felt disclosure drives payments upwards, and 47 per cent think it does not. Moreover, only 41 per cent believe disclosing the information genuinely affects shareholders' ability to make an informed investment decision.

The survey also shows directors and executives are under increasing pressure to deliver real value, with 88 per cent of respondents agreeing that remuneration needs to be more closely linked to performance. And although 71 per cent of companies pay retirement benefits to directors, 56 per cent are considering abolishing them.

(L) SENATE PASSES REPAYMENT OF DIRECTORS' BONUSES BILL

On 28 March 2003 the Senate of the Australian Commonwealth Parliament passed without amendment the [Corporations' Amendment (Repayment of Directors' Bonuses) Bill 2002](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=65715" \t "default).

The Bill amends the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) to permit liquidators to reclaim unreasonable payments made to the directors of insolvent companies. The Bill applies to transactions that involve a director of the company or close associate, meaning a relative of the director or the spouse of a director. In both cases, de facto spouses are included. To be caught, the transaction must have been unreasonable and entered into during the four years leading up to a company's liquidation, regardless of its solvency at the time of the transaction.

The Bill was described in more detail in the March issue of the Corporate Law Bulletin.

(M) CalPERS RELEASES 2003 CORPORATE GOVERNANCE FOCUS LIST

On 27 March 2003 the California Public Employees' Retirement System (CalPERS) announced Xerox Corporation and five others have been put on its corporate governance Focus List and will be the primary focus of its corporate governance activism in the upcoming proxy season.

In a letter sent to the Xerox Chairman and CEO Anne Mulcahy, CalPERS asked the Stamford, Connecticut-based company to take immediate steps to expand the board by three independent directors and split the position of Chairman and Chief Executive Officer.

In addition to Xerox, the 2003 Focus List includes: Gemstar-TV Guide International, Inc. of Pasadena, California; JDS Uniphase Corp. of San Jose, California; Manugistics Group, Inc. of Rockville, Maryland; Midway Games, Inc. of Chicago, Illinois; and Parametric Technology of Needham, Massachusetts.

CalPERS Focus List of companies was selected from the pension fund's investments in more than 1,800 US corporations, and was based on the companies' long-term stock performance, corporate governance practices, and an economic value-added (EVA (r)) evaluation.

EVA (r) measures a company's net operating profit after tax, minus its cost of capital. By using EVA (r) and stock performance, CalPERS has pinpointed companies where poor market performance is due to underlying financial performance problems as opposed to industry or extraneous factors alone.

Xerox tops CalPERS list as one of the most ineffective boards. The company was fined by the SEC and forced to restate earnings from 1997 though 2000. Its Board has also been publicly accused of financial manipulation by its own former employees.

"We were shocked to learn that Xerox has a policy that its board members are 'strongly recommended' not to communicate directly with institutional investors," said Rob Feckner, Chair of CalPERS Investment Committee. "This is reason enough to ensure that a fresh perspective is added to this board."

In August 2001, Xerox's auditor KPMG reportedly issued a management letter that told the company "that its 'tone at the top' was a material weakness," according to a Bloomberg news story.

Other problem companies under CalPERS microscope include Gemstar, whose out-going CEO Henry Yuen and CFO Elsie Leung were granted severance packages totaling $22 million and $7 million, respectively. The two executives retained their Board seats and together will swap a total of about 20 million stock options for some 8 million restricted shares and 9 million new options.

CalPERS wants Gemstar to commit to a majority of independent directors on its board, audit, compensation and nominating committees.

Gemstar's stock performance declined 88.2 percent for the one-year period ended December 31, 2002 versus its peer group in the Russell 1000 Consumer Index that fell 24.2 percent. From 1998 to 2001, its EVA declined by approximately $984 million. CalPERS also wants Gemstar to develop and seek shareowner approval for an executive compensation policy that considers performance-based stock options.

JDS Uniphase scored the worst out of the companies CalPERS screened in terms of EVA, a direct result of what is believed to be a lack of financial discipline in the Company's acquisition strategy during the late 1990's internet boom. Its EVA fell by $11.5 billion between 1999 and 2002. CalPERS wants JDS to eliminate its co-Chairman structure in favour of a separate Chairman and CEO, declassify the Board and seek shareholder approval for the company's poison pill. JDS Uniphase's stock performance was down approximately 71 percent in the year ended December 31, 2002, compared to its peers in the S&P 500 Telecom Equipment Index that fell approximately 54 percent.

Parametric Technology has ignored CalPERS repeated requests to meet and discuss performance and governance concerns. CalPERS is concerned that each Board member was paid 100,000 options or more "in recognition of extensive work during Fiscal year 2001", at a time when Parametric's stock declined 41 percent. Parametric has a six member classified board.

Midway's stock is down more than 77 percent for the five year period ended December 31, 2002 versus its peer index the S&P Smallcap Leisure Products Index that lost 16 percent. CalPERS believes that Midway has not been able to capitalize on the rapid growth of the entertainment software industry because of inadequate execution of its business plan. The Board also lacks a lead independent director and only 27 percent of its 11 directors are independent according to CalPERS definition of independence. CalPERS wants Midway to add two new independent directors in the next year and separate the positions of its Chair and CEO.

Manugistics Group's similar lack of separation between the CEO and Chair and no lead director has left its nine-member board with clear issues of independence. The nominating committee is less than 100 percent independent and three of the nine board members have affiliated relationships with the Company.

Manugistics performance was down 88 percent for the one-year period ended December 31, 2002 versus a 46 percent decline for its peers in the Russell 2000 Technology Index.

Seven additional companies have been put on CalPERS monitoring list for poor corporate governance, and possible actions regarding the companies will be disclosed throughout the proxy season and year.

For more information on CalPERS Focus List, visit [http://www.calpers-governance.org](http://www.calpers-governance.org" \t "_new)

(N) SECURITIES MARKETS: EUROPEAN COMMISSION PROPOSES DIRECTIVE TO INCREASE INVESTOR PROTECTION AND TRANSPARENCY

On 26 March 2003 the European Commission presented a proposal for a Directive introducing minimum transparency requirements for information which must be provided by companies whose securities are traded on a regulated market, such as a stock exchange. The proposal, a key part of the Financial Services Action Plan, aims to enhance investor protection, attract investors to the European market place and improve the efficiency, openness and integrity of European capital markets. It would also remove certain national barriers linked to transparency requirements, which may discourage issuers from having their securities admitted to trading on more than one regulated market in the EU. In order to achieve these aims, the proposed Directive would upgrade the current level and frequency of the mandatory financial information that issuers have to provide to the markets throughout the financial year. It would also simplify requirements issuers must meet on the use of languages and on the way information is disseminated. The proposal will be submitted to the European Parliament and the EU's Council of Ministers for adoption under the so-called "co-decision" procedure.

The Commission's proposal, which follows extensive two-year consultations with the markets, regulators and other interested parties, is part of a comprehensive strategy aiming to improve the clarity, reliability and comparability of the information provided to investors. Other related Commission initiatives cover accounting standards, prospectuses and company law.

The proposed Directive will upgrade existing EU law to bring it into line with the requirements of a more global economy.

(1) Scope

The proposed Directive will apply to all companies whose securities are admitted to trading on a regulated market in the EU. It takes into account the particularities of wholesale bond markets, such as the Eurobond markets, along the same lines as in the Prospectus Directive (currently before the Council and Parliament). There will thus be no periodic reporting requirements for those who issue solely bonds the denomination of which is €50,000 or more.

(2) Information to be disclosed

The Directive updates and upgrades periodic information requirements for securities issuers. Current EU law dates back some twenty years and must be modernised to take into account the introduction of International Accounting Standards (IAS) for all companies listed in the EU from 2005 (see IP/02/827 and IP/01/200 and MEMO/01/40). Several Member States have already increased their requirements for the mandatory disclosure of information by issuers, largely exceeding the requirements currently imposed by EU law.

The proposed Directive balances greater market transparency for all investors with avoiding unnecessary burdens and costs on issuers. It would introduce a pragmatic policy mix of more detailed half-yearly financial reports and less extensive quarterly financial information for the first and third quarter of each financial year.

The proposed Directive would require all securities issuers to disclose to the public periodically:

- an audited annual financial report (financial statements based on international accounting standards) and a management report, within three months of the end of each financial year; and  
- a half-yearly condensed financial report based on international accounting standards on interim financial reporting (IAS-34) as well as an update of the last annual management report.

In addition, share issuers would also need to publish a less extensive quarterly financial information report for the first and third quarter of a financial year. This would include the share issuers' net turnover, profit and loss before or after deduction of tax, plus, if the issuer so chooses, short trend information on the company's future development for the remaining part of the financial year. Member States would not be able to require share issuers to publish this short trend information in their quarterly reports.

Companies who issue only debt securities, who are currently not subject to any interim reporting requirement at all, would under the proposal be required to issue half-yearly financial reports for the first six months of a financial year.

All this interim information would need to be within 60 days after the end of the period concerned.

The proposed Directive also upgrades the current requirements on information that is not periodic:

- to give the public swifter and better information about the material interests of important shareholders, more changes in issuers' shareholding structures would need to be disclosed within shorter time limits. The shareholders involved and the company itself would have to ensure that such information became public; and  
- securities issuers would have to provide information to holders of shares and debt securities so as to facilitate participation in general meetings. This would include information about proxy voting under the law of the issuer's home Member State.

The proposal would allow companies to convey this information by electronic means, under certain conditions (see below). However, it does not deal with the conditions for electronic voting or harmonise proxy voting in the EU. These issues are linked to company law and corporate governance, on which the Commission will issue a separate Communication this Spring taking into account the report by the Commission's High level Group of Company Law Experts of November 2002 (see IP/02/1600).

(3) Languages

The proposed Directive covers requirements on the use of languages. At present, each Member State where a company is listed may require that information disclosed to the public is in its official language(s). Responses to consultation demonstrated that issuers whose securities are traded in several Member States find having to produce information in many different languages costly and burdensome. Under the proposed Directive, when disclosing information to a host Member State market, such issuers would be able to use, in addition to the language of their own home Member State, a language customary in the international sphere of finance.

(4) Dissemination of information to the public

The proposed Directive would make sure that issuers disseminate information on time throughout their home Member State as well as abroad. In order to do so, issuers would be able, if they chose, to use means of dissemination located outside their home Member State or to channel all financial information through a single source. The host Member States where an issuer's securities are traded would not be able to impose their own policy, but would have to allow the issuer to use its internet site, backed up by an efficient electronic alert system the details of which would be laid down by future implementing rules. The proposal also provides, if necessary, for the Commission to establish a list of the media which the home Member State may impose.

(5) Background

The Commission prepared its proposal on the basis of extensive consultations with national authorities, security issuers, investors, auditors, stock exchanges and market participants over two years (see IP/02/684).

The proposal has been drafted in conformity with the institutional arrangements laid down in the Stockholm European Council Resolution which resulted from the recommendations of the Committee of Wise Men chaired by Baron Alexander Lamfalussy on the efficiency and transparency of the EU legislative process relating to securities markets (see IP/02/195). It is therefore a "framework Directive" in line with the February 2002 agreement with the European Parliament on improving the regulation of EU securities markets.

The proposal sets out the general high-level obligations which Member States authorities would have to enforce. It also provides for the use of technical implementing measures so as to ensure its uniform implementation and to adapt to changing market and supervisory realities. The scope of the implementing measures will be decided by the European Parliament and the Council by co-decision. The Commission's implementing measures will be developed on the basis of technical advice provided by the Committee of European Securities Regulators (CESR) following open consultation of market practitioners.

The full text of the proposal is available on the Commission's website at [http://www.europa.eu.int/](http://www.europa.eu.int/" \t "_new)

(O) CHANGE REQUIRED FOR COMPANIES TO COMPLY WITH UK HIGGS REPORT

On 26 March 2003 Monks Partnership, part of PricewaterhouseCoopers, released a survey which highlights some of the areas where UK companies do not currently comply with the recommendations of the Higgs' Review of the role and effectiveness of non-executive directors regarding board committees. Compliance with Higgs' recommendations is not mandatory. Where there is non-compliance, the onus is on the company to provide a clear explanation in its annual report.

According to the findings, 38% of industrial and service sector companies do not have a formal nomination committee. Where there is a nomination committee, 61% are chaired by the company chairman rather than an independent director, as recommended by Higgs.

The Higgs Review recommends that the remuneration and audit committees should each have a minimum of three independent directors. Based on companies' opinions on independence, the survey findings indicate that 13% of remuneration committees and 12% of audit committees do not meet this recommendation. Higgs also provides a definition of the independent director and if his definition were to be applied the level of non-compliance would rise.

The findings show that 41% of smaller industrial and service sector companies - with a turnover of less than £500m - have fewer than three non-executive directors (excluding the chairman and deputy chairman). In these companies, the recommendation for a minimum of three independent directors to sit on both the audit and remuneration committees will currently not be met.

As suggested by Higgs, just over half the larger companies pay a base fee to their non-executive directors, with an additional fee paid for membership and/or chairmanship of the remuneration and audit committees. Typically, fees of £5,000 are paid for membership or chairmanship of these committees.

Overall, Monks Partnership found that the typical fee paid to a FTSE 100 non-executive director was £37,000, an increase of £2,000 over 2002 while non-executive chairmen's fees typically remained static at £200,000. Comparable figures for FTSE 250 companies were £30,000 and £115,000.

(P) SARBANES-OXLEY ACT REQUIRES CHANGES IN CORPORATE CONTROL, COMPLIANCE, ACCORDING TO PRICEWATERHOUSECOOPERS SURVEY OF SENIOR EXECUTIVES

Implementation of the Sarbanes-Oxley Act of 2002, enacted largely in response to US corporate and accounting scandals, has resulted in changes in controls and compliance practices at nearly 85 percent of large US multinational companies, according to a PricewaterhouseCoopers survey of senior executives released on 24 March 2003. However, only about a third of executives at those companies believe the new law of itself will restore investor confidence in the capital markets or aid their companies' ability to create shareholder value.

The Sarbanes-Oxley Act, enacted last year, requires company executives, boards of directors and independent auditors to take specific actions to achieve greater corporate accountability and transparency. The intent of the law was to help restore public trust in US business and corporate reporting.

Asked for their overall assessment, senior executives characterized Sarbanes-Oxley as:

- A good and adequate response to problems in accounting and reporting - 9%  
- A good first step in company accounting and reporting, but more needs to be done - 33%  
- A well-meaning attempt, but will impose unnecessary costs on companies - 42%  
- Ill-considered and hastily-passed legislation that won't make any difference - 15%  
- Will actually harm rather than improve the capital markets - 1%

Of the executives interviewed, 84 percent acknowledge that Sarbanes-Oxley has changed control and compliance practices in their company, but just four percent cited significant changes, and 27 percent, modest change, while 53 percent said the new law simply formalizes what their company has been already doing. Eighty-two percent expressed confidence their company is in full compliance with the law, while 13 percent said they had more to do.

Thirty-one percent of executives said Sarbanes-Oxley will restore public confidence in the capital markets, while 50 percent said the law will have no impact in itself, and 19 percent were uncertain. Among those expecting Sarbanes-Oxley to bolster confidence, three percent anticipate it will have a major influence, 19 percent a moderate impact, and nine percent a small one.

Thirty-two percent said Sarbanes-Oxley will have a positive impact on their company's ability to increase shareholder value, while 56 percent expect its impact on shareholder value to be neutral, and six percent negative.

The initial costs of complying with Sarbanes-Oxley were perceived as modest: only three percent say it has been very costly to implement, and 29 percent somewhat costly. In contrast, 46 percent say implementation has not been particularly costly, and 15 percent not at all costly. But 71 percent of surveyed executives believe that costs will increase over the long term - including 12 percent expecting much higher future costs, and 59 percent somewhat higher.

Sixty-five percent of executives said the Sarbanes-Oxley Act presents increased risk for their CEO, CFO, and other key executives who are required to certify the company's financial reports. Seventeen percent said those executives face much higher risk, and 48 percent generally higher risk. Only two percent expect lower risk, while 32 percent perceive no real change.

Those interviewed expect an average of 18.6 executives, other than the CEO or CFO, will be required to provide sub-certifications at their company. Only 20 percent expect no additional sub-certifications will be needed, and 13 percent were not certain.

There was a direct correlation between executives' outlook on the cost of implementing the law and their evaluation of its impact. Only 31 percent of those worried about higher future costs gave the law a positive overall evaluation, compared 70 percent positives from the minority who see no additional future cost impact.

(Q) EUROPEAN UNION NOT TO CAP AUDITOR LIABILITY

On 24 March 2003, Frits Bolkestein, Member of the European Commission in charge of the Internal Market and Taxation, presented a speech in which he stated that the European Union would not be moving to cap the liability of auditors.

Following is an extract from his speech:

"I should like to give you my views on limiting auditor liability. You may consider them to be somewhat provocative but I hope they will further the debate. I should like to say at the outset that, in the current political climate, I think there would be little support for a regulatory intervention which would generally limit auditor liability. After so many major financial reporting scandals and potential audit failures, regulators need to act to restore investor confidence. An intervention limiting liability, to my mind, would not serve to revive the trust of investors.

"At present, I see four clear reasons for not limiting auditor liability:

(1) Unlimited auditor liability is a quality driver.

If the auditor delivers permanently high quality he has no liability exposure. There is no more effective liability risk management than delivering high quality audits.

(2) Liability systems exist for the protection of the persons who suffered damage not for the convenience of those who may be at fault.

Therefore, the "deep pocket" approach is principally sound because someone who has suffered damage should not have to shoulder the burden of suing separately all parties which have a partial responsibility for proper financial statements. In any case, all Member States have the concept of joint and several liability as a fundamental element in their civil liability systems.

(3) Increased auditor liability is partly a self-created problem.

Here, there are two considerations:

(i) The growth of audit firms and the branding of one name one firm world-wide has significantly increased the potential damage to the whole network in case of a potential audit failure committed by one of the local firms. This drives the willingness of networks of audit firms to settle for higher amounts. Trends in liability claims should not be considered in absolute terms but relative to the increased turnover and profit of audit firms, figures that are not easily available worldwide.

(ii) Claims from potential audit failures have been settled too easily out of Court. As a consequence there is very little case law clarifying the boundaries of auditor liability. An unanswered question for me is whether out of Court settlements are initiated by the audit firms' desire to limit the damage to the brand name or by the risk judgment of insurance companies.

(4) Audit is by its very nature a function which is carried out in the public interest

This implies that 3rd parties should be able to rely on the correctness of companies' financial statements and be in a position to claim damages in case of fraudulent financial reporting. EU company law specifically recognises the protection of third parties such as creditors as one of its major objectives. In this context the Commission is somewhat concerned about the recent modification to some UK audit reports which seem, in response to the ruling in the Bannerman case, to try to limit auditor liability to third parties via wording in the audit report."

In relation to EU initiatives dealing with auditing, Mr Bolkestein stated:

"In my view the EU capital market cannot function properly without high quality audits and there is nothing that can replace them. If the recent series of financial reporting scandals have shown one thing, it is the importance of proper financial reporting. Improper financial reporting due to management manipulation, audit failures or shortcomings in corporate governance have undermined seriously trust in capital markets.

"As I said at the outset I am firmly committed to maintaining public confidence of the audit function. In this context the Commission is considering undertaking a study on the broader economic impact of increased exposure of auditors to liability. Indeed, the Commission is preparing a Communication on audit priorities which should be adopted in parallel with the Action Plan on Company Law and Corporate Governance around mid May. This Communication will consider updating existing EU law, in particular the 8th Directive, including improving the internal market for audit services. It will also address how the regulatory framework and structures for the statutory audit function can be improved and auditor independence can be re-enforced.

"In addition, the Commission's forthcoming Action Plan on Company Law and Corporate Governance will set out a series of actions for the short and medium term. Many of the actions are aimed at clarifying the role and responsibility of those involved in managing and governing a company. There can be no doubt that the clarification of the role and the position of the statutory auditor would have a positive effect on the assessment of his liability in the case of an audit failure. The responsibilities of auditors, directors, independent directors and audit committees will also be clarified, including the confirmation of the collective responsibility of board members for financial and key non-financial statements."

The full speech is available on the European Union website at [http://europa.eu.int/rapid/start/cgi/guesten.ksh?p\_actiongettxt=gt&doc=SPEECH/03/151|0|RAPID&lg=EN&display=](http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=SPEECH/03/151%7C0%7CRAPID&lg=EN&display=" \t "_new)

(R) AUSTRALIA'S FUNDS MANAGEMENT MARKET FIFTH LARGEST IN THE WORLD

In February 2003 the Investment Company Institute, which is an association of US and international mutual and other investment funds, reported that Australia's funds management pool was now the fifth largest in the world and the biggest in Asia.

Mutual fund assets in Australia now total US$339 billion, with the size of the Australia pool surpassing other major financial centres such as the UK and Japan. Australia was previously ranked seventh largest in the world and second in Asia, with total mutual fund assets of US$304 billion as at September 2001. The data for the latest survey is for the third quarter of 2002 and relates to 36 countries.

Total assets of worldwide mutual funds declined 7.9 percent in the third quarter of 2002 to $10.65 trillion. The third quarter decline in worldwide mutual fund assets primarily reflected global weakness in equity prices. Stock price indexes in virtually every one of the reporting countries moved lower in the quarter, with most decreasing more than 10 percent and some between 20 and 40 percent.

In this environment, equity fund assets fell 17.5 percent, with 29 reporting countries posting declines. At the end of the third quarter, assets of equity funds were $3.972 trillion, down from $4.816 trillion at the end of the second quarter.

Also contributing to the decline in equity fund assets in the third quarter was a net outflow of $64 billion from these funds. The outflow was largest among US equity funds, but European equity funds also experienced a net outflow. In contrast, equity funds in Asia-Pacific countries recorded a net inflow, largely reflecting net sales by exchange-traded funds in Japan. Despite the outsized drop in stock prices, the net outflow for all countries was relatively small, amounting for the quarter to only 1.6 percent of average assets for the 25 countries reporting net sales.

Balanced/mixed funds, which invest in stocks and bonds, also felt the effects of the retreat in stock prices. Assets of these funds fell 10.1 percent in the third quarter to $855 billion. The decline was broad-based, with all but one of the reporting countries posting decreases. Balanced/mixed funds recorded a net outflow of $14 billion in the quarter.

Assets of bond funds increased 2.6 percent in the third quarter to $2.395 trillion. Net sales of these funds were $48 billion in the quarter, reflecting strength in the US and Europe. Bond funds in the Asia-Pacific region recorded an outflow, extending a development that began in the last half of 2001.

Assets of money market funds declined 0.3 percent in the third quarter to $3.016 trillion, reflecting an outflow of $27 billion from these funds. European money market funds continued to experience strong inflows during the third quarter. In the US, however, institutional investors reacted to the low level of yields on money funds by shifting to higher-yielding open-market instruments.

At the end of the third quarter, assets of equity funds represented 37 percent of all worldwide mutual fund assets, down from 42 percent at the end of the second quarter. The asset shares of money market and bond funds were up slightly in the third quarter.

The number of funds increased 1.1 percent in the third quarter to 52,988. The composition of the number by type of fund, however, was largely unchanged.

Further information is available on the Investment Company Institute website at [http://www.ici.org](http://www.ici.org" \t "_new)

2. RECENT ASIC DEVELOPMENTS

(A) MANAGED DISCRETIONARY ACCOUNT SERVICES PPP

On 16 April 2003 ASIC released a policy proposal paper on managed discretionary account (MDA) services. The paper sets out ASIC's new proposals for regulating MDA services offered to retail clients under the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default).

An MDA service is defined as a service involving certain features including:

- a client giving their money or other assets to the MDA service operator, or access to their money or assets (the client's contributions);  
- the operator having discretions to buy and sell financial products using the client's contributions; and  
- the operator agreeing to manage the financial products acquired or derived from using the client's contributions as a discrete portfolio belonging to the client.

Some services currently marketed as separately managed accounts (SMAs), individually managed accounts (IMAs), investment advisory programs (IAPs), managed discretionary portfolio services (MDPSs) and discretionary portfolio accounts (DPAs), may fall within ASIC's definition of MDA services. If they do, then they will be regulated under the new policy.

Comments on the policy proposal paper are sought by 22 May 2003. Copies can be obtained by phoning the ASIC Infoline on 1300 300 630, or downloaded from ASIC's website at [http://www.asic.gov.au](http://www.asic.gov.au" \t "_new)

A summary of the paper follows.

(1) How does ASIC propose to regulate MDA services?

ASIC proposes to exempt MDA operators from the managed investment and financial product disclosure provisions in the Corporations Act, on condition that they (among other things):

- have an Australian Financial Services licence (AFS licence) with the appropriate authorisations - ie dealing and probably custodial and depository services and financial product advice (unless outsourcing the custody and financial product advice functions relating to the MDA service to another AFS licensee with the appropriate authorisations);  
- give clients a Financial Services Guide containing certain detailed information relating to the MDA service;  
- enter into an MDA contract with the client, which meets certain requirements;  
- have an investment program included in the MDA contract that is suitable for the client in light of their investment objectives, particular needs and financial situation and also review the suitability of the program for the client at least annually;  
- give a client quarterly reports or on-going electronic access to information about the cost and performance of their portfolio; and  
- carry out certain audits relating to the client's portfolio, covering compliance with the licence and class order conditions under which the MDA service is operated, and report to ASIC and the client on those matters.

(2) When will the new policy come into effect?

ASIC expects to have its new policy ready in the last quarter of 2003.

(3) People other than market participants

People already lawfully operating MDA services may continue to do so until 11 March 2004 (the conclusion of the [Financial Services Reform Act 2001 No. 122 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=58127" \t "default) transition period), after which they will be required to comply with the new policy. They can also opt-in to the new policy at any time before 11 March 2004.

People who start operating an MDA service between commencement of the new policy and 11 March 2004, or who are operating a MDA service which is not presently covered by an existing ASIC relief or no action position, will need to comply immediately. These operators will need to apply for the relevant AFS licence.

(4) Market participants

Currently, Sydney Futures Exchange (SFE) participants operate MDA services under ASIC class order relief [CO 01/1598] and [CO 02/186], and ex-associate participants of SFE operate MDA services under ASIC class order relief [CO 02/1022]. These class orders exempt them from the managed investment provisions and the hawking and advertising prohibitions in the Corporations Act.

Australian Stock Exchange (ASX) participants operate DPAs (which have MDA features) under a no-action position adopted by ASIC from the managed investment provisions.

ASIC has extended the class order relief and the no-action position until 11 March 2004, to enable market participants to make a smooth transition to the new policy.

However, market participants can also opt-in to the new policy at any time before 11 March 2004. (See Class Order [03/233] which extends Class Order [02/1022], Class Order [03/234] which extends Class Order [01/1598], and Class Order [03/235] which extends Class Order [02/186].)

ASIC will consult with ASX and SFE to assess whether their participants should be given any additional relief. Generally, such relief might be considered if market operators produce outcomes similar to those outlined in the policy proposal paper, through the relevant market rules and supervision.

(5) Further information

A copy of the policy proposal paper and Class Orders [01/1598], [02/186], [02/1022],  
[03/233], [03/234] and [03/235] can be obtained from ASIC's Infoline on 1300 300 630, or from the ASIC website at [http://www.asic.gov.au](http://www.asic.gov.au" \t "_new)

(B) LONG-RANGE FINANCIAL FORECASTS

Prospectuses and Product Disclosure Statements (PDSs) containing long-range financial forecasts are the focus of an ongoing targeted campaign revealed on 16 April 2003 by the Australian Securities and Investments Commission (ASIC).

Issuers are being warned to take care that any financial forecasts included in offer documents are not misleading. This is a key requirement of the law and of ASIC Policy Statement 170 (PS 170).

ASIC is aware of a number of prospectuses and PDSs that contain forecasts for ten, fifteen or twenty years and beyond. Typically these relate to agricultural schemes involving crops with long life-cycles, such as trees or vines.

Such forecasts generally depend on variables such as inflation, exchange rates, pricing and market conditions well into the future. Often disclosure documents claim they are based on independent expert opinions about the variables. However, long-range forecasts are misleading if they are not consistent with the expert opinions on which they are based.

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(C) ASIC RELEASES STAGE TWO RESULTS OF ACCOUNTING SURVEILLANCE

On 10 April 2003 ASIC released the second stage results of the accounting surveillance project begun in July 2002.

The project reviewed the audited full-year financial reports of more than 1000 listed companies with balance dates between 30 June and 31 July, with particular attention to capitalised and deferred expenses, recognition of revenue, and recognition of controlled entities and assets.

The second stage of the project follows a release of initial results on 18 December 2002. The December results identified 31 companies for further follow-up, some with multiple issues, and ASIC has since been in discussion with those companies in relation to the issues of concern.

'Following discussions with the companies and in some cases their auditors, we have received information that has adequately resolved 19 queries. However, we are continuing our enquiries in relation to 16 companies where we continue to have concerns with the application of an accounting standard or standards', ASIC Chief Accountant, Mr Greg Pound said.

'These companies should be aware that we may take further action if the matters cannot be resolved', Mr Pound said.

(1) Disclosure

Following further enquiries, ASIC has accepted the accounting policies and reporting of transactions in relation to 13 companies. In 10 of these cases ASIC is requesting an improvement in disclosure for future financial reports lodged by the companies.

'High-quality, comprehensive financial reporting necessitates adequate disclosure and explanation of accounting policies such as revenue recognition, and other factors such as valuation methodologies and the accounting treatment of significant transactions', Mr Pound said.

'Had there been better disclosure by these companies in the first instance, ASIC may not have expressed a concern', Mr Pound said.

'ASIC encourages companies to ensure that their financial report disclosures are clear and comprehensive, as they are vital components of a high-quality financial report and help to ensure people reading the report fully understand the treatments used', he said.

Shortcomings were noted in other areas of disclosure by listed companies more generally and included:

- expenses reported as 'other expenses' despite exceeding 10% of total expenses. In these circumstances they should be classified and disclosed separately; and   
- the need for separate disclosure of assets carried at recoverable amount within a class of non-current assets.

(2) Accounting policy

The following companies have changed their accounting policy in the area of concern identified by ASIC. The companies have implemented the change in their 31 December 2002 half-yearly financial reports.

(a) Harvey World Travel and Futuris Corporation Limited (now reporting net revenues only from agency transactions rather than the gross value of customer transactions);

(b) Astro Mining (asset write-down);

(c) King Minerals NL (asset reclassification);

(d) Tele2000 Limited, now Entertainment Media and Telecoms Corporation Ltd (use of fair value of shares, rather than a notional value, for acquisition and the restatement of goodwill); and

(e) Wilson Investments Taurine Fund Limited (asset revaluations now recorded against a reserve rather than in profit).

(3) Revenue

It appears there may be a trend towards inappropriate revenue reporting by companies who act in an agency relationship, for example travel agencies. Some companies in this position are reporting revenues on a gross basis, rather than reporting the net amounts of commission to which they are entitled.

'This is an area that will receive particular attention during the third phase of this surveillance project, and it will be a focus of an ongoing review in industry sectors that operate in an agency relationship', Mr Pound said.

While there is no profit impact, due to an equivalent overstatement of expenses, ASIC considers that reporting gross values of the transactions with customers is contrary to the requirements of Accounting Standard AASB 1004 'Revenue', and misleading, as it creates a false impression of the size of the company's operations and controlled resource flows.

In a recently issued Supplementary Prospectus, Flight Centre Limited has noted that it is currently addressing a matter in relation to revenue from the sale of airline tickets, etc with ASIC. The accounting policy adopted by Flight Centre was identified as an issue during the surveillance programme.

(4) Continuing concerns

ASIC is continuing to seek further information and explanations from the companies where concerns remain unresolved.

In situations where ASIC believes a company's interpretation of an accounting standard is incorrect or difficult to justify, ASIC will request the company to make a disclosure to the market and change their policy of reporting at 30 June 2003, or face the prospect of litigation.

The nature of the issues in this category include:

- off-balance sheet reporting of loan securitisations through special purpose entities. Where appropriate, the matter is also being discussed with the relevant industry regulator;   
- overstatement of the carrying value of assets;   
- accounting for the transfer of assets to shareholders;   
- inappropriate deferring of expenses as assets;   
- premature recognition of revenue for example through attaching all revenue to one component of contract involving multiple deliverables   
- recognising revenue in relation to uncertain compensation claims;   
- recognising principal repayments as revenue from purchased receivables;   
- write-off of expenses to retained earnings;   
- non-consolidation of a controlled entity; and   
- failure to apply fair value to an acquisition.

'These are not systemic issues, but are specific to the 16 companies with which we are continuing our deliberations', Mr Pound said.

In a relatively small number of cases, the interpretation of accounting standards may warrant referral to the Urgent Issues Group of the Australian Accounting Standards Board for consideration.

(5) Third stage

In the third stage of the account surveillance project, ASIC has commenced a review of the full-year financial reports of approximately 180 listed public companies with balance dates between 31 August and 31 December.

This review will focus on the three risk areas covered by the 30 June to 31 July balance date reviews.

For further information contact:

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(D) ASIC PROVIDES RELIEF ON REQUIREMENT TO PROVIDE UP TO DATE INFORMATION IN PDSS

On 10 April 2003 ASIC issued a new Class Order exemption, [CO 03/0237], relating to the requirement under s1012J of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the Act) that the information in a Product Disclosure Statement (PDS) must be up to date.

CO 03/0237 has been issued in response to industry concerns about the possible need to regularly prepare Supplementary Product Disclosure Statements (SPDS) to update a PDS where there have not been material adverse developments.

The Class Order relief exempts issuers of PDSs from the requirement to ensure a PDS is up to date at the time when it is given, provided that the issuer makes the up to date information available through a web site, a toll-free telephone service, or other facility that provides convenient access for investors.

The relief will be available where the update does not include materially adverse information of a kind that must be disclosed in a SPDS.

ASIC intends that the CO 03/0237 will:

- alleviate concerns about possible compliance failure where a PDS does not contain the most current information available at the time it is given to investors, even though it was up to date when it was prepared;  
- remove a perceived barrier to the appropriate disclosure of relevant performance information in a PDS; and  
- respond to industry concerns about the additional costs of preparing, printing, and distributing SPDSs to their advisory networks to update information that changes quickly.

The Class Order is available on the ASIC website at [http://www.asic.gov.au](http://www.asic.gov.au" \t "_new)

(E) ASIC MOVES TO PROTECT INTEGRITY OF ITS PUBLIC DATABASE

On 8 April 2003 Mr David Knott, Chairman of ASIC, announced an upgrading of surveillance and security measures to further enhance the integrity of ASIC's public database.

'ASIC's action results from increased concerns that bogus companies are being used in connection with serious crime, including credit card fraud and money laundering. Heightened surveillance has included monitoring the activities of a small number of persons believed to be involved in bogus company registrations and filings', Mr Knott said.

Resulting from this surveillance, a suspect was arrested in Queensland and he will appear in court later in April. As ASIC's investigations are continuing, it is not intended to make any further public comment on this aspect at this time.

Initiatives to increase security of ASIC'S public database include:

- From 1 July 2003 a new system for verifying changes lodged on behalf of companies will be introduced.  
- Company PINs, to be introduced later this year, will be required to be quoted before changes can be made to existing company records.  
- Arrangements are being implemented with the Australian Taxation Office that will link incorporation of new companies with the concurrent issue of an ABN by the ATO. This will increase the level of scrutiny that is applied to company registrations.

Under the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), ASTC maintains the public database on companies in Australia. The database contains details on:

- 1.25 million companies  
- 2.5 million directors  
- 3000 managed investment schemes  
- Professional registers of 60,000 professionals (eg liquidators, auditors).

Last year, there were:

- 90,175 new companies registered  
- 9.11 million searches or the public database  
- 1.1 million forms lodged to change company information.

For further information contact:

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(F) ASIC ACTS TO PREVENT INSOLVENT TRADING

On 7 April 2003 ASIC announced the initial results of a pilot program targeted at insolvent trading, known as ASIC's Directors Insolvent Trading pilot.

Since early January ASIC, through its newly formed National Insolvency Co-ordination Unit (NICU), ASIC has been working with senior insolvency specialists from PricewaterhouseCoopers and Ernst & Young in both Sydney and Melbourne, to target directors involved with companies suspected of insolvent trading.

ASIC is testing a focused approach to dealing with possible insolvent trading before it occurs, in addition to prosecuting directors after a company has failed.

'The program aims to make company directors aware of their company's financial position, to encourage them to seek advice from insolvency professionals and where necessary, to take action to appoint voluntary administrators or liquidators to companies that are insolvent', ASIC Executive Director Public and Commercial Services, Mr Mark Drysdale said.

The companies targeted in the program range in size from small proprietary companies to listed entities. They have been identified through a range of sources, including complaints received from the public, as well as referrals from other programs within ASIC.

ASIC has identified some key operational and financial practices which, in combination with other practices, indicate a company is at significant risk of insolvency. These include\*:

- poor cash flow, or no cash flow forecasts;  
- disorganised internal accounting procedures;  
- incomplete financial records;  
- absence of budgets and corporate plans;  
- continuing loss-making activity;  
- accumulating debt and excess liabilities over assets;  
- default on loan or interest payments;  
- increased monitoring and/or involvement of financier;  
- outstanding creditors of more than 90 days;  
- instalment arrangements entered into to repay trade creditors;  
- judgment debts received;  
- significant unpaid tax and superannuation liabilities;  
- difficulties in obtaining finance;  
- difficulties in realising current assets (eg stock, debtors); and  
- loss of key management personnel.

To date, ASIC has conducted solvency reviews of 130 companies associated with 35 directors, including a number of large corporate groups. This has resulted in directors taking action to consider appointing voluntary administrators or liquidators to ten companies.

During the process of visiting companies to assess solvency, a number of directors have been assisting ASIC to assess the true financial position of corporate groups. They are currently preparing detailed management accounts to demonstrate the true financial position of the companies of interest to ASIC.

ASIC is reminding directors that Section 180 of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) requires them to exercise a degree of care and diligence in the discharge of their duties. This includes taking steps to ensure they are properly informed about the financial position of the company and, ensuring the company does not trade while insolvent.

Section 588G of the Corporations Act states that where a director fails to prevent a company incurring a debt when the company is insolvent, that officer will be guilty of an offence known as insolvent trading.

A breach of this provision can attract both criminal and civil penalties, including pecuniary penalties of up to $220,000 and imprisonment for up to five years, or both. In addition, compensation proceedings may be initiated by ASIC, a liquidator or creditors against a director personally, in reparation of the debt.

\* The above are examples only and are not to be taken as a comprehensive list of indicators of insolvency problems.

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(G) ASIC LAUNCHES MANAGED FUNDS FEES CALCULATOR

On 2 April 2003 ASIC launched its fees calculator for managed investments.

If a person wants to invest a single lump sum in a managed fund, the calculator will estimate:

- what you will pay in fees,  
- how fees may affect your investment returns over time, and  
- how different fee structures may affect your investment.

The calculator was developed following a report to ASIC from Professor Ian Ramsay. His report highlighted challenges that consumers face when trying to understand the impact of fees charged on managed funds.

Professor Ramsay examined a number of online fee calculators and commended the one offered by the Ontario Securities Commission.

The fees calculator is available on the ASIC website at [http://www.fido.asic.gov.au](http://www.fido.asic.gov.au" \t "_new)

(H) CORPORATE LAW ECONOMIC REFORM PROGRAM 7

On 2 April 2003 ASIC released the following information on CLERP 7. The [Corporations Legislation Amendment Bill 2003 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=67175" \t "default) was passed on the 27 March 2003.

(1) What are the key features of the reforms?

(a) Companies and schemes will no longer be required to lodge an annual return, but ASIC must be advised of any changes to company details when they occur.

(b) Annual returns will be replaced by an Annual Statement.

(c) Companies and schemes will receive an Annual Statement based on the date of registration ('the review date'). It will include a 'statement of details' to review, and an invoice statement to pay.

- An annual review fee, listed on the invoice statement, will be payable within 2 months of a review date or late fees will occur.  
- The 'statement of details' must be reviewed. If the information is correct, no documents are required to be lodged with ASIC, however the review fee must still be paid. Changes must be notified to ASIC within 28 days of the review date.  
- ASIC may require information to be lodged, for example, where data is missing.

(d) Changes to scheme details must be notified within 28 days of the review date. The form for scheme change notification is Form 491 Change to scheme details.

(e) Changes to company details must be notified to ASIC throughout the year as they happen. Late lodgment fees will apply. The form for company change notification is Form 484 Change to company details.

(f) The notification period for many changes will increase from 14 to 28 days.

(g) One form (Form 484) must be used to notify ASIC of a wide range of changes to company details including:

- registered office and principal place of business address;  
- officeholder details;  
- members (top 20 in each class);  
- share structure; and  
- ultimate holding company (for proprietary companies only).

(h) The directors of each company will be required to hold a solvency resolution within 2 months of their review date.

- If the directors are of the opinion that there are not reasonable grounds to think the company will be able to pay its debts, or the directors have not passed a solvency resolution they will be required to lodge notification with ASIC (Form 485 Statement in relation to company solvency).  
- If the directors are of the opinion that the company is solvent, they are not required to lodge a form with ASIC.

(i) New compliance tools will include:

- late payment fees where an annual review fee is not paid within 2 months of the annual review date, and  
- late review fees for not bringing company or scheme details up to date within 28 days of the review date.

(j) ASIC will improve our online lodgment services, both via the internet and via agent software (EDGE).

- EDGE and ECR users should contact their software supplier for details of relevant changes.  
- Internet lodgment of documents will be made easier for both companies and agents.

(2) What are the key features of the reforms for public companies?

Apart from the reforms for all companies listed above:

(a) Public companies need only advise changes to member's details and share structure at time of review.

(b) The laws that govern directors over the age of 72 years have been repealed (old section 201C).

- There is no longer a requirement for directors of public companies and their subsidiaries to cease at the age of 72 years unless appointed by a special resolution.

(3) What are the key reforms for proprietary companies?

(a) Proprietary companies must advise changes to issued shares within 28 days of the change.

(b) Proprietary companies must advise changes to the top 20 members within 28 days of the change, these changes include:

- name and address;  
- increase or decrease in shares held;  
- new members; and  
- cessation of members.

(c) Proprietary companies must advise changes to their ultimate holding company within 28 days of the change.

(d) Registration of new companies (Form 201 Application for registration as an Australian company) will include the requirement to notify details of issue of shares and members.

(4) When will the changes take effect?

The new legislative requirements take effect on Tuesday 1 July 2003.

(5) Can the review date be changed?

Companies and schemes can apply to change their review date for the following reasons:

(a) To vary (align or spread) the review dates of companies with a common holding company.

(b) To vary the review dates of companies with common officeholders.

(c) To vary the review dates of managed investment schemes with a common responsible entity.

(d) Under exceptional circumstances to be determined by ASIC.

Companies can apply from 1 June 2003 by lodging a Form 488 Application to vary review date of a company or registered scheme together with the $30 non-refundable application fee. The Form 488 and a Review Fee information sheet will be available in late May from Company forms.

(6) When will the new forms be available?

The new forms will be available from ASIC's enquiry line on 03 5177 3988 and ASIC's Service Centres from late May.

(I) ASIC RELEASES RESULTS OF CODE MONITORING REPORT

On 31 March 2003 ASIC released its annual monitoring report on compliance with the Banking, Credit Union and Building Society Codes of Practice and the Electronic Funds Transfer (EFT) Code.

The codes are voluntary but almost all Australian financial institutions have signed up to the codes that are relevant to them, and are bound by their provisions. The report covers the period from April 2001 to March 2002.

'While there's been a steep increase in the number of transactions covered by the codes, the overall incidence of complaints remained low', ASIC's Deputy Executive Director of Consumer Protection, Ms Delia Rickard said.

'Complaints under the Banking Code of Conduct decreased from 3.28 per million transactions in the 2000/2001 reporting period to 2.17 in this one - at the same time, the number of banking transactions rose by roughly 500 million to 4,334 million. The majority of disputes dealt with internally were resolved in favour of the customer (48%) or by mutual agreement (13%)'.

'Of concern was the increase in complaints under the Credit Union Code. While still small in number (2524) when compared to the total number of transactions (438,848,061), they rose from 3.8 per million in the last period to 5.8 per million in the current period. Of these however, 64% were resolved within the credit union in the customer's favour, and 7.5% by mutual agreement.

There was a smaller increase under the Building Society Code from 1.2 to 1.7 per million transactions, with 55.2% resolved internally in favour of the customer, and 13% by mutual consent', Ms Rickard said

'The largest number of disputes under the banking and credit union codes related to EFT (PIN)-based transactions. Other common complaint categories were fees and charges, account debiting and crediting, and service delivery.'

The EFT Code of Conduct, as it applied at the time the monitoring period relates to, sets out the rules for allocating liability for disputed ATM and EFTPOS transactions.

In the period under review, the overall number of complaints under the EFT code increased from 121,434 in 2000/2001 to 132,517 in 2001/02. This corresponded with an increase of 140 million in the number of ATM and EFTPOS transactions performed by Australians, to over 1,640 million transactions.

The rate of complaints per million transactions remained constant at 81 complaints per million transactions. However, there was a marked change in the breakdown of these complaints:

- complaints about system malfunction rose by 18.6% to 97,047 (76% of these complaints were resolved in favour of the card holder);   
- complaints about unauthorised transactions fell by 6.2% to 23,978 or 14 per million transactions. Of these, the customer was found liable in 57 per cent of cases, or in 8 transactions per million; and   
- there was a 32% decrease in complaints relating to areas such as confusion over the merchant name or processing date or double debit complaints. These fell to 11,493, of which 78% were resolved in favour of the card issuer.

The unauthorised transaction cases under the Code are categorised under a number of different causes. An area of concern was the increase in the number of unauthorised transaction cases where cards were forged, faulty, expired or cancelled. The number of such cases where the card issuers was liable, accounted for less than one percent (33) of the total complaints in the 2000/2001 monitoring period, but jumped to 334 instances in the current review (4.2%).

It should be noted that consumers now have greater protection for the electronic banking transactions than they did at the time the monitoring report relates to.

A revised EFT Code of Conduct came into force on 1 April 2002, and extended the coverage of the code from the ATM and EFTPOS transactions mentioned in the monitoring report, to include all forms of electronic funds transfers, including internet, mobile phone and telephone banking and stored value products such as prepaid telephone cards.

A copy of the executive summary and report is available at FIDO, ASIC's consumer website at [http://www.fido.asic.gov.au](http://www.fido.asic.gov.au" \t "_new)

(J) ASIC EXPANDS RELIEF FOR DIFFERENTIAL FEES

On 31 March 2003 ASIC issued a new Class Order [CO 03/217] on differential fee arrangements.

CO 03/217, which took effect on 27 March 2003, expands upon the relief already provided through Class Order 02/214: Differential Fees [CO 02/214] by broadening the circumstances in which ASIC will exempt the Responsible Entity (RE) of a managed investment scheme from the equal treatment requirement in paragraph 601FC(1)(d) of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the Act).

The expanded relief for differential fees reflects ASIC's monitoring of its policy, and ongoing consideration given to changes in the market place.

The amendments effected by CO 03/217 allow a RE to discriminate between members of a registered scheme in relation to fees, based on:

- aggregation of a member's interests across the range of financial products issued by the RE (or its related body corporate), that are regulated under the Act;   
- use of electronic services, or effecting electronic transactions for investments in a managed fund or other financial product issued by RE, that are regulated under the Act;   
- aggregation of holdings of a member and certain family members across a range of financial products offered/issued by the RE (or related body corporate) according to the value or period of time during which the aggregated interests have been held; and  
- members who are employees of the RE (or related body corporate), provided the value of the employees' interests relative to the other members does not exceed 5 per cent.

Each of the preceding range of differential fee structures will only apply if the arrangements benefit the scheme as a whole, are economically justifiable and do not compromise investor rights. This is in accordance with the core principles expressed in ASIC Policy Statement 136 Managed Investments: Discretionary powers and closely related schemes.

The differential fee structures will only apply if they are disclosed in accordance with the good disclosure principles of ASIC Policy Statement 168 Disclosure: Product Disclosure Statements (and other disclosure obligations). An important policy objective of the recent financial services reforms is to ensure that consumers can understand and compare the fees that apply to their investment in managed investment schemes.

ASIC considers that these exemptions from the formal and strict application of the statutory equivalence requirement do not undermine equality of treatment. Rather, they represent the extent of relief which ASIC is prepared to provide within the framework of the current legislative requirements.

Treasury is currently considering changes to the Act, following the report of the Managed Investments Act Review.

These recent exemptions are in addition to the specific excepted differential fee arrangements that were granted under a variation to the CO 02/214 in December 2002.

In order to minimise any disruption to the existing arrangements, the existing CO 02/214 and new CO 03/217 will co-exist until 11 March 2004. Until then, REs can choose to rely on either of the Class Orders. CO 02/214 will be revoked on 11 March 2004.

A copy of CO 03/217 will be published in the ASIC Gazette, and is available from the ASIC website at [http://www.asic.gov.au](http://www.asic.gov.au" \t "_new)

3. RECENT ASX DEVELOPMENTS

(A) ASX LISTING RULES - PACKAGE OF GUIDANCE NOTE AMENDMENTS

On 31 March 2003, ASX issued a package of revised Guidance Notes and new Guidance Note 9A - Corporate Governance - ASX Corporate Governance Council - Principles of Good Corporate Governance and Best Practice Recommendations. The Guidance Notes which have been revised and the substantive changes made are briefly summarised below.

(1) Guidance Note 9A - Corporate Governance - ASX Corporate Governance Council - Principles of Good Corporate Governance and Best Practice Recommendations

(2) Guidance Note 9A was issued to coincide with the release of the ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations on 31 March 2003. Guidance Note 9A incorporates a condensed version of that document. Listing rule amendments to require reporting by reference to the principles and recommendations and to mandate audit committees for the top 500 entities included in the All Ordinaries Index were implemented on 1 January 2003.

The transitional arrangements that apply in relation to the relevant listing rules and implementation of the principles and recommendations are outlined on ASX's website at [http://www.asx.com.au](http://www.asx.com.au" \t "_new)

(3) Guidance Note 9 - Disclosure of Corporate Governance Practices: Listing Rule 4.10 remains in force in relation to former listing rule 4.10.3, as that applies to listed entities preparing reports in accordance with that rule. ASX will withdraw Guidance Note 9 when all listed entities have made the full transition to the new corporate governance framework.

(4) Guidance Note 10 - Review of Operations and Activities

This Guidance Note was updated to incorporate amendments to the Guide to the Review of Operations and Financial Condition issued by the Group of 100.

(5) Guidance Note 12 - Changes to Activities: Listing Rules 11.1, 11.2 and 11.3

The Guidance Note was revised to further clarify ASX policy and application of the listing rules in relation to changes to activities, including discussion in relation to what ASX may consider constitutes a main undertaking.

(6) Guidance Note 16 - Trading Halts

The Guidance Note was amended to include more substantive discussion of trading halts as a tool of good disclosure policy, including the circumstances where ASX may consider a request for a "back to back" trading halt and the use of voluntary suspension as an alternative mechanism.

(7) Guidance Note 20 - ASX Online

This Guidance Note was revised to clarify that financial reports lodged electronically with ASX under Australian Securities and Investments Commission Practice Note 61 should be backed up with signed hard copies retained by the entity for seven years. Contact details for ASX Online have also been corrected.

(B) ASX CORPORATE GOVERNANCE COUNCIL PUBLISHES PRINCIPLES OF GOOD CORPORATE GOVERNANCE

On 31 March 2003, the Australian Stock Exchange Corporate Governance Council released its Principles of Good Corporate Governance. The Principles, and commentary on the Principles, are available on the ASX website at [http://www.asx.com.au/corporategovernance](http://www.asx.com.au/corporategovernance" \t "_new)

(1) Background

The ASX Corporate Governance Council (the Council) was convened in August 2002 as a collaborative, industry-based body set up to develop corporate governance recommendations for listed entities which reflect international best practice.

On 1 January 2003 ASX introduced listing rule amendments to enhance compliance with corporate governance best practice and to mandate audit committees for the top 500 companies included in the All Ordinaries Index.

The rules reflect ASX policy that it is appropriate to focus on disclosure of corporate governance practices rather than prescribe adoption of a particular practice or practices. This allows listed entities a degree of flexibility to consider a range of means to address specific governance issues and take account of corporate governance principles as they evolve over time.

The disclosure based approach, requiring that an entity highlight any areas of departure from the best practice recommendations of the Council and explain that departure, is referred to as "if not, why not?".

The ASX Corporate Governance Council includes representatives of the following   
bodies:

Association of Superannuation Funds of Australia Ltd   
Australasian Investor Relations Association   
Australian Council of Superannuation Investors   
Australian Institute of Company Directors   
Australian Institute of Superannuation Trustees   
Australian Shareholders. Association   
Australian Stock Exchange Limited   
Business Council of Australia   
Chartered Secretaries Australia   
CPA Australia   
Group of 100   
Institute of Actuaries of Australia   
Institute of Chartered Accountants in Australia   
Institute of Internal Auditors Australia   
International Banks and Securities Association of Australia   
Investment and Financial Services Association   
Law Council of Australia   
National Institute of Accountants   
Property Council of Australia   
Securities and Derivatives Industry Association   
Securities Institute of Australia

(2) Disclosure of corporate governance practices (applying the "if not, why not?" approach)

According to ASX, the best practice recommendations are not prescriptions. They are guidelines, designed to produce an efficiency, quality or integrity outcome. The recommendations do not require a "one size fits all" approach to corporate governance. Instead, it states aspirations of best practice for optimising corporate performance and accountability in the interests of shareholders and the broader economy. If a company considers that a recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it, a flexibility tempered by the requirement to explain why.

Companies are encouraged to use the guidance as a focus for re-examining their corporate governance practices and to determine whether and to what extent the company may benefit from a change in approach, having regard to the company's particular circumstances. There is little value in a checklist approach to corporate governance that does not focus on the particular needs, strengths and weaknesses of the company.

The Council recognises that the range in size and diversity of companies is significant and that smaller companies may face particular issues in attaining all recommendations from the outset. Performance and effectiveness can be compromised by material change that is not managed sensibly. Where a company is considering widespread structural changes in order to meet best practice, the company is encouraged to prioritise its needs and to set and disclose best practice goals against an indicative timeframe for meeting them.

Under ASX Listing Rule 4.10, companies are required to provide a statement in their annual report disclosing the extent to which they have followed these best practice recommendations in the reporting period. Where companies have not followed all the recommendations, they must identify the recommendations that have not been followed and give reasons for not following them.

(3) What is the disclosure period?

The change in reporting requirement applies to the company's first financial year commencing after 1 January 2003. Accordingly, where a company's financial year begins on 1 July, disclosure will be required in relation to the financial year 1 July 2003 - 30 June 2004 and will be made in the annual report published in 2004.

Companies are encouraged to make an early transition to the best practice recommendations and are requested to consider reporting by reference to the recommendations in their corporate reporting this year.

(4) Audit committees

Specific requirements apply in relation to audit committees for companies within the S&P/ASX All Ordinaries Index.

Those companies are subject to ASX Listing Rule 12.7, which requires that an entity that was included in the S&P/ASX All Ordinaries Index at the beginning of its financial year have an audit committee during that year. The composition, operation and responsibility of the audit committee must comply with the best practice recommendations of the ASX Corporate Governance Council. These are set out in Principle 4.

This rule applies for the first financial year of an entity commencing after 1 January 2003.

(5) What entities are affected?

The best practice recommendations have been articulated to apply to companies and other types of listed entities. Where appropriate, the term "company" is used in the best practice recommendations to encompass any listed entity, including listed managed investment schemes (trusts), listed stapled entities, and listed foreign entities. Also where appropriate, references to shareholders and investors will include references to unitholders of unit trusts.

Specific application of the recommendations for trusts has been highlighted.

(6) The essential corporate governance principles

A company should:

(a) Lay solid foundations for management and oversight

Recognise and publish the respective roles and responsibilities of board and management.

(b) Structure the board to add value

Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

(c) Promote ethical and responsible decision-making

Actively promote ethical and responsible decision-making.

(d) Safeguard integrity in financial reporting

Have a structure to independently verify and safeguard the integrity of the company's financial reporting.

(e) Make timely and balanced disclosure

Promote timely and balanced disclosure of all material matters concerning the company.

(f) Respect the rights of shareholders

Respect the rights of shareholders and facilitate the effective exercise of those rights.

(g) Recognise and manage risk

Establish a sound system of risk oversight and management and internal control.

(h) Encourage enhanced performance

Fairly review and actively encourage enhanced board and management effectiveness.

(i) Remunerate fairly and responsibly

Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined.

(j) Recognise the legitimate interests of stakeholders

Recognise legal and other obligations to all legitimate stakeholders.

(7) Best practice recommendations

Principle 1: Lay solid foundations for management and oversight

Recognise and publish the respective roles and responsibilities of board and management.

The company's framework should be designed to:

- enable the board to provide strategic guidance for the company and effective oversight of management;  
- clarify the respective roles and responsibilities of board members and senior executives in order to facilitate board and management accountability to both the company and its shareholders; and  
- ensure a balance of authority so that no single individual has unfettered powers.

How to achieve best practice

Recommendation 1.1: Formalise and disclose the functions reserved to the board and those delegated to management.

Principle 2: Structure the board to add value

Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

An effective board is one that facilitates the efficient discharge of the duties imposed by law on the directors and adds value in the context of the particular company's circumstances. This requires that the board be structured in such a way that it:

- has a proper understanding of, and competence to deal with, the current and emerging issues of the business; and  
- can effectively review and challenge the performance of management and   
exercise independent judgment.

Ultimately the directors are elected by the shareholders. However the board and its delegates play an important role in the selection of candidates for shareholder vote.

How to achieve best practice

Recommendation 2.1: A majority of the board should be independent directors.

Recommendation 2.2: The chairperson should be an independent director.

Recommendation 2.3: The roles of chairperson and chief executive officer should not be exercised by the same individual.

Recommendation 2.4: The board should establish a nomination committee.

Recommendation 2.5: Provide the information indicated in "Guide to reporting on Principle 2".

Principle 3: Promote ethical and responsible decision-making

Actively promote ethical and responsible decision-making.

The company should:

- clarify the standards of ethical behaviour required of company directors and key executives (that is, officers and employees who have the opportunity to materially influence the integrity, strategy and operation of the business and its financial performance) and encourage the observance of those standards; and  
- publish its position concerning the issue of board and employee trading in company securities and in associated products which operate to limit the economic risk of those securities.

How to achieve best practice

Recommendation 3.1: Establish a code of conduct to guide the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any other key executives as to:

3.1.1 the practices necessary to maintain confidence in the company's integrity

3.1.2 the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

Recommendation 3.2: Disclose the policy concerning trading in company securities by directors, officers and employees.

Recommendation 3.3: Provide the information indicated in "Guide to reporting on Principle 3".

Principle 4: Safeguard integrity in financial reporting

Have a structure to independently verify and safeguard the integrity of the company's financial reporting.

This requires the company to put in place a structure of review and authorisation designed to ensure the truthful and factual presentation of the company's financial position. The structure would include, for example:

- review and consideration of the accounts by the audit committee; and  
- a process to ensure the independence and competence of the company's external auditors.

Such a structure does not diminish the ultimate responsibility of the board to ensure the integrity of the company's financial reporting.

How to achieve best practice

Recommendation 4.1: Require the chief executive officer (or equivalent) and the chief financial officer (or equivalent) to state in writing to the board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards.

Recommendation 4.2: The board should establish an audit committee.

Recommendation 4.3: Structure the audit committee so that it consists of:

- only non-executive directors;  
- a majority of independent directors;   
- an independent chairperson, who is not chairperson of the board; and  
- at least three members.

Recommendation 4.4: The audit committee should have a formal charter.

Recommendation 4.5: Provide the information indicated in "Guide to reporting on Principle 4".

Principle 5: Make timely and balanced disclosure

Promote timely and balanced disclosure of all material matters concerning the company.

This means that the company must put in place mechanisms designed to ensure compliance with the ASX Listing Rule requirements such that:

- all investors have equal and timely access to material information concerning the company, including its financial situation, performance, ownership and governance; and  
- company announcements are factual and presented in a clear and balanced way.

"Balance" requires disclosure of both positive and negative information.

How to achieve best practice

Recommendation 5.1: Establish written policies and procedures designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior management level for that compliance.

Recommendation 5.2: Provide the information indicated in "Guide to reporting on Principle 5".

Principle 6: Respect the rights of shareholders

Respect the rights of shareholders and facilitate the effective exercise of those rights.

This means that a company should empower its shareholders by:

- communicating effectively with them;  
- giving them ready access to balanced and understandable information about the company and corporate proposals; and  
- making it easy for them to participate in general meetings.

How to achieve best practice

Recommendation 6.1: Design and disclose a communications strategy to promote effective communication with shareholders and encourage effective participation at general meetings.

Recommendation 6.2: Request the external auditor to attend the annual general meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report.

Principle 7: Recognise and manage risk

Establish a sound system of risk oversight and management and internal control.

This system should be designed to:

- identify, assess, monitor and manage risk; and  
- inform investors of material changes to the company's risk profile.

This structure can enhance the environment for identifying and capitalising on opportunities to create value.

How to achieve best practice

Recommendation 7.1: The board or appropriate board committee should establish policies on risk oversight and management.

Recommendation 7.2: The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the board in writing that:

7.2.1 the statement given in accordance with best practice recommendation 4.1 (the integrity of financial statements) is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the board;

7.2.2 the company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.

Recommendation 7.3: Provide the information indicated in "Guide to reporting on Principle 7".

Principle 8: Encourage enhanced performance

Fairly review and actively encourage enhanced board and management effectiveness.

This means that directors and key executives should be equipped with the knowledge and information they need to discharge their responsibilities effectively, and that individual and collective performance is regularly and fairly reviewed.

How to achieve best practice

Recommendation 8.1: Disclose the process for performance evaluation of the board, its committees and individual directors, and key executives.

Principle 9: Remunerate fairly and responsibly

Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined.

This means that companies need to adopt remuneration policies that attract and maintain talented and motivated directors and employees so as to encourage enhanced performance of the company. It is important that there be a clear relationship between performance and remuneration, and that the policy underlying executive remuneration be understood by investors.

How to achieve best practice

Recommendation 9.1: Provide disclosure in relation to the company's remuneration policies to enable investors to understand (i) the costs and benefits of those policies and (ii) the link between remuneration paid to directors and key executives and corporate performance.

Recommendation 9.2: The board should establish a remuneration committee.

Recommendation 9.3: Clearly distinguish the structure of non-executive directors' remuneration from that of executives.

Recommendation 9.4: Ensure that payment of equity-based executive remuneration is made in accordance with thresholds set in plans approved by shareholders.

Recommendation 9.5: Provide the information indicated in "Guide to reporting on Principle 9".

Principle 10: Recognise the legitimate interests of stakeholders

Recognise legal and other obligations to all legitimate stakeholders.

Companies have a number of legal and other obligations to non-shareholder stakeholders such as employees, clients/customers and the community as a whole. There is growing acceptance of the view that organisations can create value by better managing natural, human, social and other forms of capital. Increasingly, the performance of companies is being scrutinised from a perspective that recognises these other forms of capital. That being the case, it is important for companies to demonstrate their commitment to appropriate corporate practices.

How to achieve best practice

Recommendation 10.1: Establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders.

4. RECENT TAKEOVERS PANEL MATTERS

(A) ANACONDA 18 REVIEW PANEL AFFIRMS DECISION ON DISPERSAL OF EXCESS SHARES

On 10 April 2003 the Takeovers Panel announced that on Tuesday 11 March 2003, MatlinPatterson Global Opportunities Partners LP (MP Global) applied for a review of the decision and the proposed orders in the Anaconda 16-17 proceedings concerning the affairs of Anaconda Nickel Ltd. (Anaconda).

The Review Panel in Anaconda 18 affirmed the decision of the Anaconda 16-17 Panel that the acquisition by MP Global of a parcel of 5 or 6% of the shares in Anaconda (Excess Shares) and the subsequent sale from MP Global to Australian Investments United Pty Ltd (AIU) (Share Sale Agreement) constituted unacceptable circumstances and should be reversed.

(1) Background

The Excess Shares are part of the shares in Anaconda that were issued to MP Global under a 14:1 rights issue (the Rights Issue) by Anaconda which closed on 14 February 2003. The Excess Shares are those shares issued to MP Global under the Rights Issue which would have caused MP Global's voting power in Anaconda after the completion of the Rights Issue to be greater than its voting power immediately before the Rights Issue (which, being greater than 20% was prohibited under section 606 of the [Corporations Act 2001 No. 50 (Cth) (Act)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default)). The 5 or 6% of voting power carried by the Excess Shares would take MP Global's voting power in Anaconda from 36 or 37% to 42%. Glencore International AG (Glencore) currently holds 46.5% of the voting power in Anaconda after the completion of the Rights Issue, which Glencore fully underwrote.

MP Global was obliged to sell the Excess Shares because it had acquired a greater percentage of the Anaconda Rights (Rights) under its offer for the Rights (Rights Offer) than the percentage of shares in Anaconda that it acquired under the takeover offer for existing shares in Anaconda that it had made (Share Offer). Exercising all of the Rights it acquired and acquiring all of the shares (including the Excess Shares) would have breached section 606 (as described above).

MP Global sought to prevent a breach of the Act by selling its interests in the Excess Shares to AIU, under the Share Sale Agreement, to take effect immediately the Excess Shares were issued. In doing so, MP Global sought to rely on section 609(2) of the Act which provides that if MP Global held, or was issued, the Excess Shares as a bare trustee for AIU under the Share Sale Agreement then any relevant interest that MP Global had in the Excess Shares as the registered holder would be disregarded for the purposes of ascertaining any breach of section 606 of the Act.

The Panel considered the terms of the Share Sale Agreement and the events leading up to and surrounding the issue of the Excess Shares. It considered that there appeared, prima facie, to have been a breach of section 606, in that the shares had been issued to MP Global. The Panel considered that in the circumstances, the onus of proof lay on MP Global and AIU to show that they could rely on the exception in section 609(2) of the Act which, in these circumstances, involves showing that they were not associated other than as bare trustee and beneficiary. The Panel considered the evidence brought before it by the various parties, and decided that MP Global and AIU had not satisfied the burden of proof required to assure the Panel that they were entitled to the defence in section 609(2). This evidence will be outlined in the Panel's reasons.

The Anaconda 18 Review Panel did not come to this view lightly. It recognises that the Share Sale Agreement is worth some $20 million, and the possible profit or loss on sale of the Excess Shares is considerable. However, for similar reasons to those set out by the Anaconda 16-17 Panel, the Anaconda 18 Review Panel does not consider that the Share Sale Agreement should stand.

In such circumstances the Panel considered that the onus would be on MP Global to demonstrate that the subsequent purchaser of the Excess Shares (here AIU) is not an associate. MP Global has failed to do so. However, in saying that, the Panel notes that none of Glencore, Anaconda or any other party to the proceedings has produced evidence which is convincing that MP Global and AIU are associated persons.

The Anaconda 18 Panel agreed with the Anaconda 16-17 Panel that it would constitute unacceptable circumstances for MP Global to exercise all the Rights it had acquired under its Rights Offer, and then seek to determine the identity of the purchaser of the Excess Shares. If it had not come to the view that MP Global was required to demonstrate that the prima facie breach of section 606 did not occur because MP Global could rely on being a bare trustee (under section 609(2) of the Act), the Panel would have come to the conclusion, in the alternative, that the public interest requires dispersal of the Excess Shares in an open, competitive process. The Anaconda 18 Review Panel considers that in the special circumstances applicable to this matter, a sale through such a process is required to ensure that shares in Anaconda are acquired in an efficient, competitive and informed market.

In coming to the findings that it has, the Anaconda 18 Panel is not making any finding of impropriety by MP Global or AIU.

However, the Panel considers that the Share Sale Agreement, and the process by which it was brought into being, constituted unacceptable circumstances. The Panel's orders are designed to take the situation back to before the Share Sale Agreement was entered into and ensure that a proper process for disposing of the Excess Shares is carried out, in the interests of an efficient, competitive and informed market for control of voting shares in Anaconda.

The Panel considered that neither MP Global nor AIU are unfairly harmed by its declaration and orders because the Share Sale Agreement was entered into by a flawed process and therefore AIU and MP Global should not have arrived at the position which the Panel is now required to unwind. Any potential windfall profit which AIU will not now gain is one for which it had should not have been placed in a position which entitled it to that profit.

(2) A substantial interest

The Anaconda Panel considered that the Excess Shares do, and did, constitute a substantial interest in Anaconda. In part this follows the legislature's view of a substantial shareholding at 5% of the voting shares in a company. In part, the Anaconda Panel considers that the Excess Shares constitute a substantial interest because of the current closeness of the voting power of MP Global and Glencore. The Excess Shares in the hands of a person who supported Glencore's involvement in the management of Anaconda would guarantee Glencore control of Anaconda. However, in the hands of a supporter of MP Global's involvement, the Excess Shares could put MP Global within striking range of Glencore's voting power. On that basis, the Excess Shares are a strategic parcel, and well within the size with which the Panel should be concerned. Indeed, the vigour with which the various parties have prosecuted these proceedings, and the Anaconda 16-17 proceedings, is evidence of the importance of the parcel.

Consideration of the state of play of the Rights Offer and Share Offer at the time the Share Sale Agreement was entered into shows the balance of power in Anaconda even more fluid, and the Excess Shares as being even more strategically important at that time, and circumstances surrounding their disposal even more potentially significant and even more open to review by the Panel. The Panel's view is that the unacceptability or otherwise of the Share Sale Agreement should be considered more in the light of the circumstances of the time it was entered into, than on the basis of today's circumstances.

(3) Proposed orders in Anaconda 18

The Review Panel proposed to make similar orders to those proposed in the Anaconda 16-17 decision i.e. that the Excess Shares be dispersed by way of a book build by a broker appointed by ASIC.

However, the Review Panel proposes that its orders will not be implemented until the result of any review of the Anaconda 15 decision has been resolved. The Review Panel considers that a further short delay in the dispersal of the Excess Shares will not materially adversely affect Anaconda or its shareholders, but finally disposing of the Excess Shares before the result of Anaconda 15 is settled could adversely affect the range of orders available to any Review Panel in the Anaconda 15 matter.

The orders that the Anaconda 18 Review Panel proposes are as follows:

(a) the Share Sale Agreement between MP Global and AIU will be cancelled, from its outset;

(b) the legal and beneficial title to the Excess Shares will vest in ASIC, for sale by a stockbroker appointed by ASIC, by way of a bookbuild. A number of brokers have recently been involved in transactions in, or advice in relation to, Anaconda shares on behalf of parties to these or other Anaconda proceedings. The Panel will specify a number of those brokers whose involvement in conducting the sale process might risk some public perception of conflict, and who therefore should not conduct the bookbuild;

(c) the proceeds of the sale (net of selling costs, which will be commission only) will be returned to MP Global. MP Global therefore carries the risk of any profit or loss on the sale of the Excess Shares1. The Panel makes no orders restraining MP Global and AIU from making any arrangements they wish as a consequence of the Panel cancelling the Share Sale Agreement;

(d) none of AIU, MP Global, Anaconda or Glencore, or their associates may participate in the sale. The Panel understands that both MP Global and Glencore, and their associates, would currently be precluded, by section 606, from purchasing any of the Excess Shares;

(e) consistent with the Truth in Takeovers principle, the number of Excess Shares to be vested and sold shall be calculated by reference to the percentage voting power which MP Global held at the close of its Rights Offer. This is consistent with MP Global's announcement on 6 February 2003 that that was how and when it would calculate the number of Rights it could exercise;

(f) the broker will be instructed to seek to maximise the sale price of the Excess Shares while not selling more than 1% of the total shares in Anaconda to any person (alone or in combination with their associates);

(g) to assist the broker monitor the 1% cap, any prospective purchaser will be required to give to the Panel (under the Panel's Rules for proceedings), via the broker and with any bid or order, a warranty that they are not associated with any of MP Global, AIU, Anaconda or Glencore. They will also be required to give a similar warranty setting out, to the best of their knowledge, the identity of any associate of theirs who is bidding for any of the Excess Shares in the bookbuild;

(h) ASIC will be instructed to seek further instructions if the broker is unable to dispose of the whole parcel within the 1% cap within a reasonable time given the size of the parcel of Excess Shares and given the current free float of Anaconda shares, at a price of $0.06 per share or more, and without unduly depressing the market price of Anaconda shares;

(i) ASIC will be instructed to seek further instructions if the broker receives bids which are so high that they suggest that the bidder is indifferent, commercially, as to the price it pays;

(j) ASIC will be instructed to seek further instructions from the Panel if it appears, in the course of the bookbuild, that the 1% cap would unfairly harm MP Global's interests.

The Review Panel has requested ASIC to commence inquiries for a suitable broker in order to ensure that the process may proceed as expeditiously as possible once it is feasible to make final orders.

The interim order that the Anaconda 16-17 Panel made preventing further sale, transfer or voting of the Excess Shares until the Anaconda 16-17 and 18 matters have been decided remains in place. If the sale process requires further time, the Anaconda 18 Review Panel will consider extending the Anaconda 16-17 Panel's interim order.

(4) Precedent disposal orders

The Panel has settled the orders for the dispersal of the Excess Shares in light of the specific circumstances of the Anaconda 18 proceedings. It specifically advises that each set of circumstances in which it orders vesting or disposal of securities will be considered on their own merits and that orders in other matters may take materially different forms to the orders in Anaconda 18.

(5) Process

The President of the Panel appointed Simon McKeon (President), David Gonski and Professor Ian Ramsay to consider the Anaconda 18 application.

The Review Panel will publish its reasons for this decision on the Panel's website when they are finalised.

(6) Anaconda 16-17 decision

On Friday 07 March 2003, the Sitting Panel in the Anaconda 16-17 proceedings advised parties that it had decided to make a declaration of unacceptable circumstances in relation to the affairs of Anaconda. It also provided draft orders requiring dispersal of the Excess Shares in Anaconda subscribed for by MP Global (under the Corporations Act the Panel must provide draft orders to affected persons for comment prior to making the order).

The Anaconda 16 and 17 applications were from Anaconda and Glencore, and were made on 21 February 2003.

The Anaconda 16-17 Panel proposed making final orders similar to those currently proposed by the Anaconda 18 Panel. However, it decided not to make any orders, in order to allow the Anaconda 18 Panel an opportunity to consider the review application without circumstances having changed materially due to Anaconda 16-17 orders being executed.

The Anaconda 16-17 Panel will publish the reasons for its decision on the Panel's website when they are finalised.

(B) PANEL PUBLISHES GUIDANCE NOTE ON BROKER HANDLING FEES FOR COMMENT

On 28 March 2003 the Takeovers Panel released for public comment a draft Guidance Note on broker handling fees. The Guidance Note aims to assist bidders and the market to determine what is likely to be unacceptable in terms of the handling fees paid to brokers who obtain acceptances under a takeover bid.

The Panel noted that the practice of offering broker handling fees has become increasingly widespread recently.

In its discussion of broker handling fees, the Panel pointed out that broker handling fees may promote the principle set out in section 602(a) of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) of having efficient, competitive and informed markets if they encourage brokers to alert and inform their clients about a bid.

There are, however, concerns that arise if broker handling fees are excessively high, or are only available for a limited period of time. In these circumstances, broker handling fees have the potential to cause brokers to place unacceptable pressure on shareholders to accept an offer under the bid before they have had a reasonable time and adequate information to assess the merits of a bid.

The Guidance Note proposes limits on a broker handling fee of 0.75% of the consideration payable to an accepting target shareholder and $750 for each acceptance. A minimum payment should generally not exceed $50 for each acceptance.

The Panel also said that:

(a) once a broker handling has been made, it should generally be available for the balance of the bid period; and

(b) broker handling fees should always be disclosed fully to the market and to the offeree shareholder.

The Panel wishes to thank the sub-committee members, Mr Simon Mordant, Mr Braddon Jolley and Ms Carol Buys. The Panel is especially grateful for the input and assistance received from external sub-committee members, Mr Bruce Skelton and Mr Paul Masi.

Comments are sought on the policy until Friday 9 May 2003. The policy is available on the Panel's website at [http://www.takeovers.gov.au/Content/guidance/broker.asp](http://www.takeovers.gov.au/Content/guidance/broker.asp" \t "_new)

5. RECENT CORPORATE LAW DECISIONS

(A) FORECASTERS BEWARE: INDEPENDENT EXPERT LIABILITY FOR NEGATIVE ASSURANCES  
(By Damien Bruce, Freehills)

Reiffel v ACN 075 839 226 Ltd [2003] FCA 194, Federal Court of Australia, Gyles J, 14 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/march/2003fca194.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/march/2003fca194.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Overview

In the recent decision of the Federal Court of Australia in Reiffel v ACN 075 839 226 Ltd [2003] FCA 194, the court held that independent experts can be liable for misleading and deceptive conduct in relation to negative assurances given on financial forecasts in a prospectus.

(2) The facts

The named applicant in the representative proceeding was the part-owner of an apartment in a real estate development. In late 1996, a prospectus was issued which, in broad terms, enabled an owner of an apartment to lease their apartment to an apartment hotel business in return for an interest in the pooled revenue and expenses of the business. The structure was intended to operate as a unit trust, with the apartment owners retaining ownership of their leased apartments and receiving their "profits" from the business in the form of rental receipts under the lease.

An independent expert had been engaged to prepare a report in respect of the trading forecasts in the prospectus and a sensitivity analysis on the trading forecasts. The forecasts had been prepared by Genitron 2000 Pty Limited ("Genitron"), the principal of which was also a director of the manager of the scheme.

In its report, the independent expert provided several negative assurances, namely, statements to the effect that nothing had come to the attention of the independent expert which caused it to believe that a state of affairs existed that was not the case. Specifically, these negative assurances were that nothing had come to the attention of the independent expert which caused it to believe that the:

(a) directors' assumptions did not provide a reasonable basis for the trading forecasts;

(b) trading forecasts had not been calculated properly on the basis of the directors' assumptions;

(c) trading forecasts were not consistent with the Australian accounting standards; or

(d) trading forecasts were not reasonable.

The independent expert also concluded that the underlying assumptions accompanying the sensitivity analysis were reasonable (a positive opinion).

The applicant applied for, and was issued, units under the prospectus.

The forecasts turned out to be inaccurate and the applicant sustained significant losses. The applicant brought an action alleging misleading or deceptive conduct on the part of the independent expert.

Evidence led indicated that the independent expert had disagreed with the methodology that had been used by Genitron to calculate figures for occupancy and room rates which were used in preparation of the trading forecasts. In forming their conclusions, the independent expert had used their own method to determine figures for occupancy and room rates, but did not make this clear in the opinion. The figures which the independent expert arrived at led the expert to conclude that Genitron's figures fell within a range which was not unreasonable, which the independent expert understood to be the scope of their role.

The independent expert argued in response that:

(a) their negative assurance should be interpreted literally and was therefore not misleading and deceptive; and

(b) the positive opinion as to the reasonableness of the sensitivity analysis was not misleading as they had merely verified the arithmetic involved in the sensitivity analysis.

(3) The decision

The court disagreed with the independent expert, holding instead that:

(a) assurances are to be interpreted objectively as they would ordinarily be understood. Specifically, the court held that the independent expert "did not hold the opinions it expressed in the manner those opinions would be understood by the reader"; and

(b) the independent expert's reasonableness opinion related to the reasonableness of the assumed variations in the variables that affect the forecast, as the role of the sensitivity analysis was to show a range which would properly account for the subjective judgements and business risks involved.

The court also stated that, although an independent expert need not guarantee that the opinion given is correct, they must form and express the opinion with "care, skill and due diligence" appropriate to their expertise. The court did not find any breach of such duty in this case.

However, the court held that the independent expert, in providing only negative assurances and failing to note the differences between their methodology and that used by Genitron, had engaged in misleading and deceptive conduct. The court noted that the independent expert should have been skeptical given Genitron's association with the manager of the scheme.

The court stated that the independent expert should have at least:

(a) disclosed the disagreement that they had with the methodology adopted by Genitron;

(b) noted the effect of the disagreement upon the forecast tables;

(c) explained what they had independently done by way of investigation and methodology; and

(d) in that light, expressed their opinion as to whether the forecasts were within a reasonable range.

Such an approach would have been consistent with ASIC Information Release dated 7 February 2001, IR 01/05 "ASIC provides guidance for preparers and reviewers of prospective financial information included in disclosure documents".

The court also considered whether section 1318 of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) should apply. This section provides the court with a broad discretion to excuse a defendant where the defendant had acted honestly and ought fairly to be excused for their conduct. In this instance, the court did not exercise its discretion on the basis that the independent expert had accepted a conventional professional assignment, which was undertaken for reward and under circumstances where the expert expressly consented to the use of its report in its context.

(4) Implications

This decision illustrates the need to ensure forecasts are formed with a reasonable basis and do not mislead investors. Indeed, in its reasons, the court stated that "acceptance of responsibility by an expert for the opinion expressed is an important aspect of the protection for investors".

The two key points to arise from the case may be summarised as follows:

(a) where an independent expert disagrees with the information in a prospectus that relates to its engagement, it should make this clear; and

(b) statements made by independent experts in prospectuses will be assessed objectively by how an ordinary reader would understand them, in the context of the entire document.

(B) WHEN AVAILABLE INDEMNITY UNDER INSURANCE POLICY IS CONSIDERED TO BE EXAMINABLE AFFAIRS OF COMPANY  
(By Marianthe McLiesh, Mallesons Stephen Jaques)

In the matter of Re Clutha Limited (in liquidation) [2003] NSWSC 235, New South Wales Supreme Court, Gzell J, 31 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc235.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc235.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Background

The liquidator obtained a summons for the examination of an insurance officer and an order for production directed to the Insurer to produce records. These records concerned all costs charged against a directors' and officers' liability corporate reimbursement insurance policy issued by it in favour of the former officers of Clutha Ltd (in liquidation). The policy was issued by Pacific Indemnity as agent for CGU Insurance Ltd. The liquidator and Clutha brought proceedings against its former officers. The liquidator sought the summons for examination and order for production in order to assess the extent of the available indemnity of the defendants.

(2) The arguments

(a) The applicants argued that the summons for examination relating to ascertaining the level of indemnity available, for the purpose of enabling the liquidator to decide whether or not to pursue the claim, should not be allowed because in Kelly v Murphy (1993) 12 ACSR 365 the Court of Appeal in NSW had previously decided to the contrary.

(b) Secondly, it was argued that the investigation was not for the benefit of the liquidator but for the benefit of a creditor funding the liquidator and constituted an abuse of process.

(3) The decision

(a) Examinable affairs - available indemnity under Insurance Policy

Justice Gzell stated that prima facie the liquidator was entitled to conduct an examination and to require the production of documents with respect to the level of indemnity available to the former officers of Clutha. In support of this, Justice Gzell referred to section 596B(1)(b)(ii) of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), which provided for the examination of persons who may be able to give information about examinable affairs of the corporation. In addition, his Honour referred to section 53(a) which included in the examinable affairs, the property of the corporation. Finally, he referred to the definition of property in section 9, which included a thing in action.

Consequently, his Honour held that the indemnity available was a chose in action against the former officers of Clutha and formed part of the property of the corporation. Its relative value was therefore an important aspect. The available level of indemnity under the policy was a matter going to the value of the property of the corporation. Accordingly, his Honour held that documents relating to policies of professional indemnity insurance formed part of the examinable affairs of the corporation. In his Honour's opinion, the decision of the Court of Appeal, relied on by the applicants, did not stand for the proposition that an inquiry as to the existence of insurance cover and its quantum were never an examinable affair, or that such an inquiry was always oppressive.

(4) Abuse of process

There was evidence before Justice Gzell that a creditor was funding the liquidator's examination and acquiring debts from other creditors, which was argued to be an abuse of process. His Honour rejected the applicant's submission. He held that it did not follow that because the funder of the liquidator was advancing its own interests, that the liquidator sought to conduct the examination solely in the interests of that party.

In addition, it was submitted that the liquidator had indicated that, if the solicitors of the former officers of Clutha revealed the available level of indemnity under the insurance policy, the examination and order for production would be abandoned. It was submitted that this too was an abuse of process. The solicitors refused to reveal that amount. In rejecting the applicant's submission, his Honour held that where details of the available level of indemnity were not obtainable, then the liquidator was entitled to ascertain the value of the chose in action and the remaining available level of indemnity under the insurance policy. His Honour concluded that the liquidator was entitled to have the insurance officer examined and the Insurer produce the documents that were relevant to the ascertainment of that amount.

(5) Conclusion

His Honour held that documents relating to policies of professional indemnity insurance formed part of the examinable affairs of the corporation. However, his Honour found that the summons issued to the insurance officer was unlimited, and ordered that the examination be limited to the balance remaining under the insurance policy.

With respect to the purpose of the examination, his Honour followed earlier decisions. His Honour agreed that it was within the contemplation of section 596B of the Corporations Act to conduct an examination for the purpose of ascertaining what amount was likely to be recovered from an insurer.

It was not an abuse of process for a creditor to fund a liquidator's examination. His Honour held that it did not follow that, because the funder of the liquidator was advancing its own interests, the liquidator should be presumed to be conducting the examination solely in the interests of that party.

(C) WHEN ACTION FOR RECOVERY OF A LOAN ARISES AND WHETHER AN ANNUAL RETURN CONSTITUTES ACKNOWLEDGMENT OF DEBT OWED TO A COMPANY  
(By Timothy Cleary, Mallesons Stephen Jaques)

VL Finance Pty Ltd v Legudi [2003] VSC 57, Supreme Court of Victoria, Nettle J, 13 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/march/2003vsc57.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/march/2003vsc57.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Introduction

This case involves the question of when the right of action for recovery of a loan arises. This is relevant in the context of the [Limitations of Actions Act 1958 No. 6295 (Vic)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=455" \t "default), section 5 of which will prevent recovery where the limitation period has expired. The case also concerns whether a company's annual return constitutes an acknowledgment of debts owed to the company for the purpose of causing the limitation period to begin again. A further, minor, issue is whether a loan can be created solely by oral agreement and journal entries in a company's books.

(2) The facts

The Legudi Group of Companies was comprised of a holding company, Legudi Holdings Pty Ltd ("Holdings"), an operating company, Legudi & Sons Pty Ltd ("Sons"), and a land holding company, Legudi Freehold Properties Pty Ltd ("Properties"). The defendants were directors of both Sons and Properties. Sons owed debts of approximately $2 million to the plaintiffs, VL Finance Pty Ltd ("VL"), secured by a charge over the assets of Properties. During 1990, it became apparent that Sons was approaching insolvency. To prevent this, a plan was enacted to shore up the balance sheet of Sons.

Sons assigned the debt it owed to VL to Properties by a contract of novation. Sons then owed $2 million to Properties. Properties loaned $2 million to various members of the Legudi family, including the defendants, who used these funds to subscribe for new preference shares in Sons. Sons then used the proceeds from the share issue to repay Properties. The result of these transactions was that Sons' debt had been repaid, meaning that it was no longer in danger of insolvency, and Properties' new debt to VL was offset by the loans it had made to the family members.

These transactions were completed solely by journal entries in the accounts of Sons and Properties. No written contracts were entered into, and no money changed hands between either company, or between the companies and members of the family. No date was set for repayment of the loans and no interest payments were made to Properties by the family members. Instead, interest was allowed to accrue as an increase in the obligations of the family members to Properties, reflected by further journal entries in the company's accounts.

In 1994, a receiver was appointed to Sons, which triggered the security that VL held over Properties' assets. Properties' assets were insufficient to cover its debt to VL, and a liquidator was appointed to Properties. The liquidator purported to assign the debts owed to Properties by the defendants over to VL. VL then demanded payment of the debts.

(3) The issues

There were three grounds on which the defendants sought to avoid payment of the debts:

(a) that the debts did not, in fact, exist;

(b) that Properties had taken unconscientious advantage of the defendants; and

(c) that any action for recovery was statute-barred by the Limitations of Actions Act 1958 (Vic). In response to this argument, the plaintiffs argued that the annual return of Properties constituted an acknowledgment of the debts causing the limitation period to begin again.

(4) The existence of the debts

The defendants contended that no loans had been created from Properties to the family members because none of the family members received any cash in their hands. Nettle J dismissed this argument and noted that "there is no reason why loans agreed to by [sic] made by a family company to members of the family cannot be created orally or by conduct and sufficiently evidenced by book entry" (at para 30) (see also Valoutin Pty Ltd v Furst (1998) 154 ALR 119; Hancock Family Memorial Foundation Ltd v Porteous (1999) 32 ACSR 124). He referred to Spargo's case (1873) LR8 ChApp 407 at 414 as establishing that obligations may be set off against each other without the need for money to change hands (at para 30).

(5) Unconscientious advantage

The defendants also contended that they did not understand the nature of the plan, in particular that it would make them debtors of Properties. They argued that they suffered from a lack of education, had only a limited ability to read and write English and a limited involvement in the management of the companies (at para 34). Nettle J did not accept that these disadvantages were made out in the case of either defendant (at paras 35-38).

However, even if Nettle J had accepted that the defendants had been under a disadvantage, it is unlikely that they would have succeeded on this ground. Nettle J framed this argument as one of non est factum (at para 32). As such, he considered that the argument was misconceived. A plea of non est facum arises where a document signed by a party is radically different from what that party believes it to be, and therefore operates to make the document void or voidable. It does not invalidate a transaction that is not in writing. Therefore, it may be that the documents by which the new shares were issued could have been avoided, but not the undocumented loans that accompanied them (at para 32).

(6) Limitation of actions

The defendants argued that recovery of the debts was statute-barred by section 5 of the Limitations of Actions Act 1958 (Vic). This argument depended upon determining when the action for recovery of the debts arose. Nettle J referred to the judgment of Fullagar J in Ogilvie v Adams [1981] VR 1041 in which it was established that, unless a contract provides to the contrary, the obligation to repay a debt (and therefore the cause of action) arises instantly upon the creation of the debt (at para 40).

Nettle J did accept, following Fullagar J in Ogilvie, that it is not necessary for the contract to contain specific words preventing the obligation to repay a debt from arising immediately. It may be that it is an implied term of the contractual relationship between the parties that the obligation to repay does not arise until some period of notice is given. However, any such implication must arise from the contractual relationship (that is, the loan) itself. As Fullagar J put it in Ogilvie, the implication "must (in order to effect the alteration) be found in the contractual relationship between the parties, not in some purpose or motive, real or supposed, by reason of which the loan was made and with respect to which the contract is silent" (Ogilvie at 1050, quoted at para 41). Nettle J held that there was nothing in the contractual relationship between the defendants and Properties to imply that the action for recovery would not arise immediately upon making the loans (at para 42).

The plaintiffs argued that the rule in Ogilvie v Adams no longer represented all the law on this subject, as a result of the decisions in Gleeson v Gleeson [2002] NSWSC 418 and Brooker v Pridham (1986) 10 ACLR 428. Nettle J rejected this argument, and considered that both these cases actually supported the principle in Ogilvie. In Gleeson, the express terms of the contract yielded a clear implication that notice must be given (at para 49), while in Brooker the contract had to be interpreted in that way or else it would "fly in the face of all that the parties had done" (at para 53).

In the context of this case, Nettle J held that the loan had to become immediately repayable if the restructuring plan was to provide any real increase equity as a result of the issue of shares in Sons (at para 57). The result of this finding was that the cause of action for recovery of the loans arose immediately after they were created. They were therefore statute-barred by section 5 of the Limitations of Actions Act 1958 (Vic) by the time this action was brought.

The final issue for consideration was whether there had been any acknowledgment of the debts owed by the defendants, thereby causing the limitation period to begin again. Nettle J discussed the authorities on the requirements of acknowledgment and held that "a document does not constitute an acknowledgment unless it is in substance expressive of the debtor's intention to admit the debt and to have the document produced and used for that purpose" (at para 63).

The plaintiffs argued that the reference to the debts owed by the defendants in Properties' annual return should be treated as an acknowledgment for the purpose of causing time to begin again. The annual return did not identify the individual loans made to each of the defendants, merely the total amount of money owed to Properties. Nor was it signed by the defendants as individuals, but rather by one of the defendants in his capacity as a director of Properties. Nettle J rejected this submission for two main reasons. First, even if an annual return could constitute an acknowledgment (and Nettle J considered that that might be possible), in this case it could only be a statement of the debts owed to the company, made by the company itself, not by those owing the debts, and therefore could not be taken as expressing an intention by them to acknowledge those debts (at para 67). Secondly even if the annual return could be regarded as an acknowledgment of the debts of the director who had signed it, it could not also constitute an acknowledgment of the debts owed by the other defendant (at para 69). Therefore, there had been no acknowledgment of the debts for the purposes of section 24(3) of the Limitations of Actions Act 1958 (Vic).

(7) Conclusions

The findings of Nettle J may be summarised as follows:

(a) A valid loan may be created by oral agreement between the parties, reflected in journal entries in the company's books, even though no money changes hands.

(b) The defendants were not the victims of unconscientious advantage.

(c) In the absence of any explicit provision for when a loan is to be repayable, the right of action for recovery arises immediately upon its creation. In this case, recovery was therefore statute-barred by the time this action was brought. Reference to the existence of the debts owed to a company in its annual return does not constitute an acknowledgment for the purpose of causing time to start running again.

(D) ALLEGED BREACH OF TRADE PRACTICES ACT

Australian Competition and Consumer Commission v IMB Group Pty Ltd [2003] FCAFC 17 Federal Court of Australian, Full Court, Cooper, Kiefel and Emmett JJ, 20 February 2003  
(By Rebecca Preston, Blake Dawson Waldron)

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/february/2003fcafc17.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/february/2003fcafc17.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Summary

The Australian Competition and Consumer Commission ("ACCC") instituted proceedings against IMB Group Pty Ltd ("IMB"), Logan Lions Limited ("LLL") and a number of individuals associated with IMB and LLL, seeking remedies for breaches of sections 52 and 47 of the [Trade Practices Act 1974 No. 51 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6426" \t "default) (the "Act").

The ACCC claimed that the breach of section 47 occurred by the establishment of a scheme that made the future purchase of shares in a company and life membership of a rugby club (neither of which existed at the time the scheme was communicated) conditional on the prior purchase of an insurance policy from IMB. IMB acted as an agent of Legal & General Life of Australia Limited ("Legal & General") and National Mutual Life Association of Australasia ("National Mutual") in the sale of certain insurance policies. The ACCC further claimed that a number of misleading representations had been made in promoting the scheme in breach of section 52 of the Act.

In relation to the contravention of the prohibitions against exclusive dealing, the issues on appeal were essentially legal ones, whereas those relating to misleading and deceptive conduct were factual. There was no evidence to support a claim that any of the representations made were in breach of section 52. As regards section 47 the Full Court of the Federal Court held that there was no breach of section 47(6) or (7) of the Act. If a benefit or privilege was conditional on anything, it was conditional on the purchase of an insurance policy

(2) Facts

The proceeding arose out of a scheme for the development of a sports and entertainment complex to be established in Logan City, near Brisbane. The scheme involved entering a local rugby league team into the national competition under the name "the Logan Lions" and constructing a sporting complex around the team.

The construction was to be funded by subscriptions for shares in LLL, the construction company. The plan was that participants in the scheme were to purchase insurance policies through IMB and then borrow against the value of the policies and apply the proceeds to payment of LLL shares. IMB was also to provide, free of charge, all information including a feasibility study, in relation to the development concept. In late 1990 Messrs Ivers, who conceived the scheme, acquired shares in IMB. In early 1991 they entered an agency agreement with National Mutual and subsequently Legal & General to solicit investment in insurance policies to be issued by the two insurers. LLL was incorporated in June 1994. Though initially it was thought that the policies would be able to generate sufficient finance to fund the construction, it later became clear that this was not the case and the capital value of the policies then came to be seen as a means of raising finance from external lenders. The capital value of the policies, together with the proposed centre, would be security for such external borrowing. About 3,200 insurance policies were sold by IMB in the period March 1991 - September 1993, mostly as a result of people attending seminars conducted by IMB.

The scheme was launched on 15 September 1993 at a function where certain representations were made as to the intention of IMB Group to fund the initial stage of the project through a private placement of $20m. On 20 September 1993, as a result of communications with the ACCC, Legal & General instructed IMB to cease selling insurance policies for promotion of the Logan Lions Football Club, bringing the scheme promoted by IMB to an end.

(3) Findings

The ACCC alleged that in selling the insurance policies the respondents offered to supply services, namely the benefit or privilege of an opportunity to acquire shares in a company and an opportunity to become a foundation life member of a club, on the condition that those persons acquired services, namely, rights and benefits under either the National Mutual or Legal & General policies, in breach of section 47(6) and (7) of the Act. The Full Court of the Federal Court noted that neither IMB nor any of the individual respondents were in a position to offer either options or club memberships given that neither the company in which options were said to be offered, nor the club, were in existence at the time. The most that could be said was that the respondents offered to use their best endeavours to bring about a framework which facilitated these opportunities.

In any event, there could be no breach of section 47 because the relevant subsections therein require the benefit or privilege offered to be conditional on the purchase of services from a third party. The scheme required the insurance policies to be taken out with IMB not just because IMB would then get the commissions involved, but to ensure that IMB would be in a position, in the future, to offer the opportunities in question. If there was a condition, it was that that services be acquired from IMB, not Legal & General or National Mutual. It was of no interest to any of the respondents for participants to take out insurance otherwise than through the established agency arrangements.

On the facts, it was held that none of the representations made by the respondents fulfilled the requirements of section 52. It was alleged that the offer of benefits conditional on the purchase of an insurance policy was misleading and deceptive. No particulars were given as to why this was so, however, on appeal the ACCC argued that the offer was misleading and deceptive because the benefits offered could not be supplied. The Court was not prepared to entertain this allegation because it was raised for the first time in the appeal proceedings.

Other representations that came under scrutiny by the Court were representations as to the future value of the insurance policies. The Court held that participants understood through the representations of the respondents that an estimate as to the future value of the insurance policies was not guaranteed, but rather was subject to market influences. Accordingly, value estimates derived in a model prepared by National Mutual and communicated to potential participants were not considered to be misleading. It was also noted that although the National Mutual model estimated the ten year value of the policies to be $24,369, the rounding up of this figure by the respondents to $25,000 and subsequent communication of this figure was not misleading or deceptive. On the contrary, the rounding up made it less likely that the figure conveyed certainty, thereby decreasing the potential for people to be misled.

It was also alleged statements regarding the commencement and completion of the complex, the attributes and value of the complex and future value of shares were misleading as there were no reasonable grounds for thinking the necessary funding could be obtained. The Court held that the respondents had feasibility studies undertaken and no reason suggested that the proposal would be unattractive to a lender and it was not unreasonable to accept that without approval in principle a lender would not be likely to view the proposal seriously.

In terms of accessorial liability the Court held that in assessing such liability, unless wilful blindness can be shown, it is necessary to establish actual knowledge on the part of the person alleged to have been liable as an accessory of each of the essential elements of contravention. In this case, no evidence was led as to actual knowledge held by any of the individual respondents and therefore declarations were not made stating that the respondents were knowingly concerned in or party to any contraventions of the Act.

(E) RESIDUAL POWERS OF DIRECTOR TO DEFEND A WINDING-UP OF THE COMPANY AFTER AN INTERIM RECEIVER HAS BEEN APPOINTED  
(Sarah Lang, Blake Dawson Waldron)

Australian Securities and Investments Commission v Australian Investors Forum P/L [2003] NSWSC 130, Supreme Court of New South Wales, Austin J, 7 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc130.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc130.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Summary

Casabanca Pty Ltd was placed in interim receivership by the court to protect its assets. Mr Luvara, the sole director of Casabanca, retained Tzovaras Legal to act for himself personally, and for Casabanca, in defending an application for winding-up on just and equitable grounds.

Tzovaras Legal then sought to recover costs and disbursements incurred in defending the winding-up application, out of the funds held by the receiver, Mr Macintosh. Mr Macintosh refused to pay Tzovaras Legal, on the grounds that Mr Luvara had no authority to instruct lawyers on Casabanca's behalf, without the consent of the receiver.

Austin J found that the board of directors does have a residual power to defend a winding-up application, where the company has been placed in interim receivership by the court. Mr Luvara was therefore entitled to instruct lawyers to defend Casabanca's winding-up. This is primarily because it is inappropriate for the receiver appointed by the court on the application of ASIC to defend a winding-up, as the receiver should remain disinterested between the parties.

His Honour therefore made an order for Mr Macintosh to release funds to pay Tzovaras Legal's costs and disbursements relating to Casabanca.

(2) Facts

Mr Luvara was the sole director of Casabanca Pty Ltd. ASIC brought proceedings that Mr Luvara be disqualified from managing a corporation, and that Casabanca be wound up under section 461(1)(k) of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the "just and equitable grounds").

During the proceedings, the court had made interim asset preservation orders against Mr Luvara, on the application of ASIC. These orders allowed Mr Luvara to pay ordinary expenses up to a certain amount, and to pay costs reasonably incurred in the legal proceedings, up to $25,000 (this was later increased to $75,000). On 2 November 2001, the court made orders under section 1323 Corporations Act 2001 (Cth) appointing Mr Macintosh to be interim receiver and manager of the property of Casabanca.

In April 2002, Mr Luvara and Casabanca engaged Tzovaras Legal to act for them.

Tzovaras Legal subsequently submitted two tax invoices totalling $43,111.13 for professional costs and disbursements directed to Casabanca, which were accepted by the court as being accounts for work done on behalf of the company. Other tax invoices were directed to Mr Luvara personally.

Mr Macintosh had paid approximately $500,000 into court in the course of his receivership. Tzovaras Legal sought payment of its costs and disbursements out of these funds. Mr Macintosh declined to make the payment on the basis that:

(a) he had not instructed the lawyers to act on behalf of the company;

(b) Mr Luvara had no authority to instruct solicitors, once a receiver had been appointed; and

(c) there was no good reason for the company to be represented as it was impecunious.

(3) Findings

The question for the court was "whether the appointment of an interim receiver under section 1323 deprived the sole director of the company of all of his management powers, so that thereafter he had no power to instruct lawyers to act on the company's behalf - even for the purpose of defending the proceeding to wind the company up, and even though the appointment of the interim receiver was made by interlocutory application in that very proceeding".

Austin J held that the Mr Macintosh had only those particular receiver's powers which the court had previously conferred on him, and not all the powers of a receiver under section 420. Specifically, the listed powers did not confer the power to "make or defend an application for the winding up of the corporation" under section 420(2)(u).

His Honour then cited Moss Steamship Company Ltd v Whinney [1912]AC 254 which held that the appointment of a receiver does not "dissolve or annihilate a company". Austin J interpreted this to indicate that although a company may be in receivership, not every power of the board of directors has been superseded.

Austin J then compared interim receivership with a situation of provisional liquidation. He found that, until it was abolished by section 471A of the Corporations Act 2001 (Cth), directors had a residual power to appeal against the winding up of a company, after a provisional liquidator had been appointed.

His Honour stated that the rationale behind this residual power was that it would be inappropriate to give the liquidator, "the carriage, on behalf of the company, of the defence to the winding-up proceeding in the course of which he was appointed". His Honour held that the same reasoning could be used to show that where an interim receiver has been appointed, on the application of ASIC, in a proceeding brought by ASIC, it is not appropriate for the receiver to defend the winding-up. Since the company is entitled to a defence, it follows that the board of directors have a residual power to defend the winding-up, even without the consent of the interim receiver. Mr Luvara was therefore entitled to authorise Tzovaras Legal to act for Casabanca in defending the winding-up.

In accordance with this finding, Austin J made an order directing Mr Macintosh to release out of the receivership sufficient funds to pay costs and disbursements incurred by Tzovaras Legal in defending the winding-up of Casabanca.

(F) SECTION 588F OF THE CORPORATIONS ACT OPERATES TO DENY A CHARGEE THEIR INTEREST IN NON-SPECIFIC PROPERTY  
(By Michael Jackson, Phillips Fox)

Tolcher v National Australia Bank [2003] NSWSC 207, Supreme Court of New South Wales, Palmer J, 14 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc207.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc207.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Background

On 6 November 1998, Lloyd Scott Enterprises Pty Ltd ('LSE') entered into a first ranking debenture with the National Australia Bank ('the Defendant'). The debenture was subject to a charge in favour of the Defendant ('the Charge'). The Charge was fixed as to 'all the present and future estate, right, title and interest' of LSE in all its real and personal property, and was floating as to whatever property, if any, was not the subject of the fixed charge.

On 20 July 2001, Raymond George Tolcher was appointed liquidator of LSE ('the Plaintiff'). As a result of his investigations the liquidator made claims against Key Equipment Finance Australia Pty Ltd ('Key') in respect of an unfair preference under section 588FA of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) ('the Act') and insolvent trading as a shadow director of LSE against under section 588M of the Act.

The liquidator's claims against Key were the subject of mediation. On 5 December 2001 a settlement was reached and a deed was executed ('the Settlement Deed'). The Settlement Deed provided that upon the payment of $2,500,000 by Key to the liquidator, the liquidator covenanted not to sue Key in respect of his claims. Key then covenanted not to sue the liquidator in respect of any claim it might have or might have had 'by reason or related to or connected with' the liquidator's claims.

The question that therefore came before the Court was whether the $2,500,000 recovered from Key under the Settlement Deed was property of LSE which was subject to the Charge, or was property which was available to LSE's unsecured creditors in the administration of the winding up.

(2) Judgment

Justice Palmer began by noting the principle that where there has been a charge over specific property and that property is recovered by the liquidator that property will not be available for distribution to the company's unsecured creditors. However, his Honour further stated that the position is otherwise where non-specific property which would have been subject of a floating charge (such as money of the company) has come into possession of a liquidator as a result of proceedings taken or claims made by the liquidator.

To clarify this position, Palmer J had regard to the decision in N A Kratzmann Pty Ltd (in liq) v Tucker (No 2) (1968) 123 CLR 295. In that case, the High Court ruled that where security has been given over the assets of a bankrupt and a payment made by that person is subsequently declared void for being a preference payment, the moneys recovered are not subject to the charge. This is because that money is no longer the same as the money of the bankrupt, but rather is the money of the liquidator, whose title to it does not depend upon any succession to any title that the bankrupt had.

Counsel for the Defendant argued that the decision in Kratzmann was no longer good law. Relying on section 558FF(1)(a) of the Act, Counsel submitted that the section allowed the court to make an order directing a person to pay the company rather than the liquidator (as the section's predecessor allowed and in relation to which Kratzmann was decided).

However, Palmer J dismissed that submission, referring to SJP Formwork (Aust) Pty Ltd (in liq) v Deputy Commissioner of Taxation (2000) 35 ACSR 604 which affirmed that section 588FF(1)(a) has not altered the law as was laid down by the High Court in Kratzmann. In Formwork, the Supreme Court of New South Wales could find no legislative intent in support of the argument raised by the Defendant.

In this case, Palmer J held that despite the fact that section 588FF(1)(a) includes the phrase 'pay the company' the company was in liquidation and as such was being controlled by the liquidator, who was bound to apply the money in accordance with the law as stated in Kratzmann.

Even though the above decisions relate to recovery of preferences, Palmer J held their reasoning to be equally applicable to recoveries for claims for insolvent trading under section 588M of the Act. His Honour's decision was based on section 588Y(1) which provides 'an amount paid to a company under section...588M...is not available to pay a secured debt of the company unless all the company's unsecured debts have been paid in full'.

Palmer J observed that this construction of section 558Y(1) further illustrates there is no legislative intention that the property recovered by a liquidator in exercise of the statutory right conferred by section 588M should be regarded as property of the company so as to be available to a secured creditor and contrary to the principle established in Kratzmann. Evidence for this was the use of the words 'an amount paid to a company' in section 558Y, whereas under section 588M(2) only the liquidator is empowered to commence proceedings under the section to recover a debt due 'to the company'.

His Honour held that the Plaintiff was entitled to the following declarations: first, that the money paid to him as liquidator of LSE pursuant to the Settlement Deed was not the subject of the Charge; and second, that the Plaintiff was to apply the money paid under the Settlement Deed in accordance with Subdivision D of Division 6 Part 5.6 of the Corporations Act 2001 as to the priorities therein in the payment of unsecured debts or claims provable in the winding-up of LSE. The Defendant was ordered to pay the Plaintiff's costs.

(G) AUTHORITY OF DIRECTORS TO INSTITUTE PROCEEDINGS IN THE NAME OF THE COMPANY AFTER APPOINTMENT OF RECEIVERS  
(By Michael Jackson, Phillips Fox)

Gartner v Ernst & Young [2003] FCA 152, Federal Court of Australia, Mansfield J, 14 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/march/2003fca152.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/march/2003fca152.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Background

In early 2001, relying upon the advice of Ernst & Young ('the accountants'), the Gartners and the Gartner Companies ('the applicants') decided they would construct their own winery rather than purchase a pre-existing one. The finance necessary for the construction of the winery and working capital was sought through the National Australia Bank ('the bank'). This also was done on the advice of the accountants. On 11 October 2001, the bank offered finance to the applicants and that offer was accepted.

The security for the financing arrangements was to be the assets of the Gartner Family Group. Being guided by the accountants, financial guarantees were given by the Gartners and the Gartner companies granted debentures to the bank on 23 November 2001.

Each of the applicants was aware in November 2001 that there was still a shortfall in funding of $3 million. The subsequent application to the bank for additional funding was refused. As a consequence, the proposed development did not go ahead as planned and on 9 August 2001 the bank appointed receivers to each of the Gartner companies. However, on 8 August 2001, the applicants had purportedly rescinded their respective financing agreements and the various securities and guarantees.

The applicants alleged that the representations made by the accountants and the bank amounted to breaches of sections 52 and 51AA of the [Trade Practices Act 1974 No. 51 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6426" \t "default). They further alleged that the advice given by the accountants was negligent and in breach of their retainer, and hence that the applicants' loss was recoverable from them. In addition, the applicants sought to set aside the various loan security instruments.

(2) The accountants' application

The accountants applied under Order 9 rule 7(1)(a) of the [Federal Court Rules 1979 No. 140 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=8830" \t "default) ('the Rules') to set aside the application and statement of claim insofar as they related to the accountants or alternatively for an order under Order 20 Rule 2. They argued that the directors of the Gartner companies could only bring the action if they had received the express prior consent of the receiver to do so. Furthermore, the accountants argued that such consent could only be given if the receivers had secured a satisfactory indemnity for any costs liability and that the assets subject to the debentures were not exposed to risk of reduction in the event of an adverse costs order.

(3) The bank's action

On 16 August 2002, the bank through its solicitors informed the solicitors for the applicants that the Gartner companies had not sought the authority of the receivers to commence proceedings. They asserted that 'under no circumstance do any of the directors of those companies have any authority to pledge any asset of a company or incur any liability in respect of those proceedings'. However, Mansfield J held that there was no evidence to suggest that the bank (or the receivers or managers) had formally objected to the institution and maintenance of proceedings.

(4) The judgment

Mansfield J considered the debentures granted by the Gartner companies to be relevantly identical with the 'mortgaged property' being the whole of the undertaking and assets and property of each Gartner company. A fixed charge existed on all the present and future estates and interests in the assets of each Gartner company and a floating charge was created over the remaining property. His Honour found that, subject to whether or not the debentures had been validly rescinded (in which case the receivers would not have been validly appointed), the floating charges crystallised prior to the institution of proceedings with the bank's written notice dated 6 August 2002.

Mansfield J noted that the choses in action that the Gartner companies were pursuing were part of the 'mortgaged property' in the debentures which were now, if not validly rescinded, all subject to a fixed charge. His Honour further observed that under the terms of each debenture and the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), the receivers would be entitled to bring the present proceedings in the name of each of the Gartner companies, again subject to the several debentures not having been validly rescinded.

In relation to the accountant's two-stage submission regarding the directors' ability to bring an action when receivers have control of the company, his Honour dealt with the second stage first. Mansfield J held that whether or not an indemnity was sought was a matter of commercial judgment for the receivers, not for the court. Referring to Deangrove Pty Ltd (Receivers and Managers Appointed) v Commonwealth Bank of Australia (2001) 108 FCR 77 and Newhart Developments Ltd v Co-operative Commercial Bank Ltd [1978] 1 QB 814 at 819, Mansfield J held that it is for the receivers to judge the terms upon which they might consent to the directors bringing such proceedings, as there may be good reason why the receivers may consent to the institution of proceedings without a full indemnity for costs. It was therefore irrelevant in the circumstances that no indemnity had been given.

In relation to the first stage of the accountant's submission, Mansfield J held that the receivers had not been aware of the proceedings prior to them being instituted and upon learning of them had not taken any steps to bring them to an end. His Honour therefore concluded from this evidence that the receivers consented to the continuation of proceedings. In light of the authorities, Mansfield J held that there was no legal impediment to the directors having instituted the proceedings against the accountants, or to the maintaining of the proceedings.

Turning his attention to the debentures, Mansfield J noted that it was obviously more convenient that the claim against the accountants should be able to proceed at this point rather than await the determination of the status of the debentures, as that determination may take some time to resolve. The parties had earlier consented to the issue of the bank's liability being heard separate from other issues.

Mansfield J then dismissed an application by the accountants for an order for security of costs. His Honour considered that such an order would be inappropriate where there is no apparent clash between what the directors regard as being in the best interest of the company and what the receivers regard as being in the best interest of the bank. Additionally, where this position is maintained there is no reason why the directors should be held to have no power to institute and maintain the proceedings against the accountants.

In conclusion, his Honour referred to the judgment of Thomas J in Brooklands Motor Co Ltd (In Receivership) v Bridge Wholesale Acceptance Corporation (Australia) Ltd [1993] MCLR 448 where it was held that the directors of a company had the residual power to commence proceedings in the name of a company to enforce a financing agreement accepted by the managing director after the appointment of receivers by an earlier financier. In this case, as the receivers had not objected to the directors commencing proceedings it was assumed that the receivers did not consider those proceedings to be prejudicial to the obligation under the debentures. Mansfield J therefore dismissed the application to dismiss the Gartner companies' proceedings against the accountants.

(H) SETTLEMENT OF ASIC PROCEEDINGS INVOLVING MULTIPLE DEFENDANTS - ONE DEFENDANT OBJECTING TO SETTLEMENT BETWEEN ASIC AND ANOTHER DEFENDANT  
(By Felicity Slater, Clayton Utz)

ASIC v Rich [2003] NSWSC 186, Supreme Court of New South Wales, Bryson J, 21 March 2003.

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc186.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc186.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

Can one of several defendants to proceedings instituted by ASIC intervene to prevent a settlement between ASIC and another defendant who makes admissions about a course of conduct involving both of the defendants?

(1) Facts and arguments

It was argued for Mr Rich, one of the executive directors of the failed company One.Tel Ltd, that he was entitled to have restrictions imposed on the terms of a statement of agreed facts which formed the basis of a settlement between ASIC and another executive director, Mr Keeling, in which Mr Keeling made various admissions as to the cause of the losses suffered by the company.

These admissions were to be made by agreement as part of a compromise in which Mr Keeling admitted to a liability for damages and consented to being disqualified from acting as a director of a company for a decade. They were not the result of any finding by the court on the basis of evidence before it. They were, however, to be the subject of section 1317 declarations made by the Court, by consent of ASIC and Mr Keeling, which are given the status of "conclusive evidence" by section 1317F of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default).

Mr Rich contended that, although the declarations were made pursuant to a settlement between Mr Keeling and ASIC, to which they alone were party, the declarations sought could have legal or practical effect on other parties who did not consent to them, and for that reason they ought not to be made without a hearing on the merits. He argued that the Court should not give its imprimatur to agreed declarations of fact where the facts which, on their face, the declarations establish, were actually hotly in dispute (for example, as to the financial circumstances of the One.Tel Group).

Added force was given to this concern by the inclusion in the terms of settlement of a clause (clause 20) which recorded that the admissions and consent orders "will not constitute full satisfaction of ASIC's claims made in these proceedings and that ASIC is at liberty to pursue its claims against the other defendants and any other persons." In Baxter v Obacelo Pty Ltd (2001) 205 CLR 635 the High Court had held that such a term, taken with the conduct of the parties, "plainly indicate that the [plaintiffs] and [the settling co-defendant] contemplated that the [plaintiffs] would pursue their claims against the [other co-defendant]. There was no acceptance of the sum paid under that settlement as full satisfaction of the loss or damage...suffered."

In recognition of this concern, ASIC and Mr Keeling added a clause to the agreed declarations "that they are intended to be operative only between the plaintiff and the second defendant and are not intended to be binding on or in any way affect any other defendant in the proceedings."

Despite this exclusion from the agreed terms of the declarations, counsel for Mr Rich resisted the making of the declarations. He argued that whether or not section 1317F makes such a declaration conclusive evidence as against Mr Rich of any facts, those facts would be seen to be obtaining the Court's imprimatur or token of approval of their correctness when the Court made the declarations. He referred to possible litigants other than ASIC (for example, a liquidator, creditors, or insurers of the defendants seeking to avoid liability) who, it might be anticipated, might rely or seek to rely on section 1317F to contend that the declarations against Mr Keeling were conclusive evidence of some of the facts set out in the declarations.

(2) Decision

Bryson J rejected the challenge.

As to the common law position, he held that principles of res judicata and issue estoppel had no application other than between ASIC and Mr Keeling, or persons whose interests were so closely related to theirs as to be in privity with them.

As to the effect of section 1317F (which provides that "A declaration of contravention is conclusive evidence of the matters referred to in subsection 1317E(2)"), his Honour held that section 1317F makes evidence conclusive only where it is evidence of matters referred to in section 1317E(2); it would not be correct, nor would it be reasonably arguable, that circumstances so referred to would be conclusively established for the purposes of establishing the circumstances of anyone else's conduct.

His Honour concluded:

"While I cannot guard effectively against insubstantial arguments being put in some future case, I am of the view that the availability of conclusive evidence about the conduct of Mr Keeling imposes no risk on any other person such as Mr Rich...that the circumstances of his conduct might be held to have been conclusively established. No reasonable person would regard facts as objectively established against Mr Rich...by the position achieved in Mr Keeling's litigation. There is no rational basis for a fear that a Court addressing claims against them would misunderstand the position, or would treat the declarations to which Mr Keeling had consented as establishing anything. Mr Keeling is exposed to reliance on declarations adverse to him in other litigation which his conduct is relevant. It cannot...be supposed that the declarations could ever be available against them."

His Honour proceeded to accept the settlement, and concluded that in the circumstances the proposed penalty of $92 million and ten years' disqualification from participation in the management of a company was appropriate.

(I) REJECTING PROOFS OF DEBT AT A CREDITORS' MEETING  
(By Elizabeth O'Donovan, Deacons)

Mario Michael Spiteri v John Ross Lindholm [2003] VSC 42, Supreme Court of Victoria, Hansen J, 13 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/march/2003vsc42.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/march/2003vsc42.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Summary

Mario Spiteri ("Spiteri") and Econ Industries Pty Ltd ("Econ") ("Plaintiffs") brought proceedings to appeal against the decision of an administrator ("Lindholm") of Waleri Nominees Pty Ltd ("Company") who acted as Chairman of the second meeting of creditors of the Company and rejected the proofs of debt lodged by the Plaintiffs for voting purposes at the second meeting of creditors.

Spiteri was the sole director, secretary and shareholder of the Company and Econ as well as the sole director, secretary and shareholder of Valecave Pty Ltd ("Valecave").

The Plaintiffs had both claimed to be creditors of the Company and lodged proofs of debt at the second creditors' meeting and objected to Lindholm's decision to reject the proofs of debt on the basis that Lindholm should have followed the procedure in reg 5.6.26(2) and marked the Plaintiffs' informal proof of debt thereby allowing the Plaintiffs' to vote in respect of the amount claimed.

Lindholm rejected the Plaintiffs' proofs on the basis that he had not received the books and records of the Company despite repeatedly requesting Spiteri to deliver them and was therefore unable to verify the figures contained within the Plaintiffs' proofs.

Hansen J held that Lindholm was entitled to reject the Plaintiffs' proofs and he could not be expected to have followed the procedure set out in reg 5.6.26(2) as he had been unable to refer to the books and records of the Company and was not in a position to make a just estimate of the proofs.

(2) Background

The Company, Spiteri and some of Spiteri's other companies, including Valecave, had banking facilities with the National Australia Bank Limited ("NAB").

The Company fell into financial difficulties and NAB demanded that the Company pay its outstanding debts and demanded payment from Spiteri and Valecave under their guarantee as well as payment of the sum owed by Valecove under its mortgage. Valecave paid that amount but the Company still owed a considerable amount to NAB.

Shortly thereafter, NAB appointed Lindholm and Georges jointly as administrators of the Company. The first meeting of creditors was convened and Lindholm was provided with proofs of debt by, amongst others, NAB for a secured debt and an unsecured debt from Spiteri for loans to the Company.

At the meeting, Lindholm reported to the creditors and noted that he had not received a report of the affairs from Spiteri as required by the Corporations Act 2001 and that Spiteri had not delivered up the books and records of the Company.

Spiteri's solicitor submitted that the proof of debt claimed by NAB was subject to a pre-existing dispute and NAB's proof should not be admitted nor should NAB be admitted to vote. Lindholm disagreed and allowed NAB to vote in respect of the amount claimed. Lindholm admitted Spiteri's proof of debt for $1 only because of the lack of supporting documentation.

The Plaintiffs then sought an order to object to Lindholm's decision to admit NAB's proof of debt for voting purposes and to remove Lindholm as administrator. The proceeding was dismissed and the second meeting of creditors took place.

Before the second meeting of the creditors, Lindholm received some draft financial accounts for the company but still had not received the books and records of the Company.

At the second meeting Lindholm accepted all the proofs of debt except the Plaintiffs' proofs were rejected on the basis that Lindholm was unable to verify the figures contained in the proofs without having access to the books and records of the Company.

The Company was then wound up by resolution of the creditors.

(3) Submissions by Spiteri

Spiteri and Econ appealed against Lindholm's decision to reject the proofs of debt of the plaintiffs and relied on the approach in Vincent, White & Associates Pty Ltd v Vouris (1998) 28 ACSR 93 by Hodgson CJ in Eq by submitting that the court was justified in exercising its supervisory power as the administrator's action had such importance so as to warrant intervention by the Court.

The Plaintiffs submitted that the materials put before Lindholm at the second creditors meeting sufficiently verified the proofs of debts claimed. Further, the Plaintiffs submitted that Lindholm should not have rejected the proofs outright as Lindholm could only have had some doubt as to whether they should be admitted or rejected and therefore ought to have followed the procedure set out in reg 5.6.26(2). That procedure requires that Lindholm mark the proofs as objected to and allow the plaintiffs to vote.

(4) Submissions by Lindholm

Lindholm submitted that since he did not have the books and records of the Company to enable him to verify the proofs he was not in "in doubt" as required by reg 5.6.26(2) as to whether to admit or reject the proofs and was therefore not required to follow the procedure set out in reg 5.6.26(2).

It was further submitted by Counsel for Lindholm that since the Plaintiffs had deliberately withheld information contrary to the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), it was unreasonable to expect that Lindholm should have exercised his judgment to accept the proofs of the Plaintiffs as reasonable and sufficient evidence of the claimed debts.

(5) Voting procedures at creditors' meetings

The regulations relating to voting at a creditors' meeting are as follows:

Reg 5.6.23(1) provides that a person is not entitled to vote as a creditor unless his or her debt or claim has been admitted in whole or in part by the administrator, or he or she has lodged with the chairperson of the meeting particulars of the debt or claim or a formal proof of that debt or claim.

Reg 5.6.23(2) provides that:

"A creditor must not vote in respect of:

(a) an unliquidated debt; or  
(b) a contingent; or  
(c) an unliquidated or a contingent claim; or  
(d) a debt the value of which is not established;

unless a just estimate of its value has been made."

Reg 5.6.26 provides:

"5.6.26(1) [Chairperson may admit or reject] The chairperson of a meeting has the power to admit or reject a proof of debt or claim for the purposes of voting.

5.6.26(2) [Cases of doubt] If the person is in doubt whether a proof of debt or claim should be admitted or rejected, he or she must mark that proof as objected to and allow the creditor to vote, subject to the vote being declared invalid if the objection is sustained.

5.6.26(3) [Appeal] A decision by the chairperson to admit or reject a proof of debt or claim for the purposes of voting may be appealed against to the Court within 14 days after the decision."

Counsel for the Plaintiffs relied on Re Oriel Homes Pty Ltd (1997) 15 ACLC 564 in which Thomas J considered the interpretation of reg 5.6.23(1) and (2) and reg 5.6.26 and held that if the chairperson is in genuine doubt then the claim must be allowed at the amount claimed and should be marked as "objected to" and the creditor be allowed to vote at that value.

However, Hansen J preferred the interpretation given to reg 5.6.26(1) by Hodgson CJ in Vincent, White & Associates Pty Ltd v Vouris (1998) 28 ACSR 93 at 100, who considered the views of Thomas J in Re Oriel Homes Pty Ltd (1997) 15 ACLC 564 and held:

"I do not interpret Thomas J as saying that wherever there is genuine doubt as to the correct amount of the debt, the chairperson must allow the creditor to vote in the amount claimed. Such a view would in my opinion be contrary to the intention of Part 5.3A and the regulations, and in particular to reg 5.6.23(2)."

Hansen J took the view that since Lindholm was not able to make any just estimate of the proof of debt, he was not "in doubt" as to whether to admit the proofs and therefore was not obliged to comply with reg 5.6.26(2).

(6) Conclusion

Hansen J emphasised that Spiteri had demonstrated a deliberate, tactical and wrongful refusal to comply with the lawful request to produce the books and records of the Company.

Hansen J dismissed the Plaintiffs' claim and held that due to the refusal of Spiteri to deliver up the books and records of the Company, and other deficiencies in the proofs, Lindholm was entitled to reject the proofs of Spiteri and Econ. Hansen J also commented that the decision was warranted since the books and records may not have verified the debts and may have confirmed the existence of voidable transactions. The administrator was not obliged to comply with reg 5.6.26(2).

(J) UNJUST MORTGAGES: FAMILY ACQUIRED DEBT  
(By John Corbett, Corrs Chambers Westgarth)

St George Bank Limited v Trimarchi [2003] NSWSC 151, Supreme Court of New South Wales, Dunford J, 14 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc151.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc151.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Introduction

The plaintiff, St George Bank, sued the defendants (an elderly Italian couple) to recover moneys owing after they had defaulted on their mortgage and the bank had mortgaged the properties. The bank made a further claim; that if the mortgage was void or unenforceable, the plaintiff be subrogated to the rights of a previous mortgagee, National Mutual. The defendants argued that the loan agreement and mortgage with both St George Bank and National Mutual were 'unjust' within the meaning of the [Contracts Review Act 1980 No. 16 (NSW)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=10771" \t "default) and therefore should be set aside. Additionally, the second defendant (Mrs Trimarchi) relied on the principle of 'unconscionable conduct to enforce guarantees', which was expounded in Garcia v National Australia Bank Limited (1998) 194 CLR 395.

(2) Facts

The defendants were elderly Italian immigrants, Domenico and Lucia Trimarchi, who had limited English. Domenico had worked for many years as a self-employed builder and Lucia had been a housewife. Their son Anthony was a solicitor, involved in property investment.

In 1994, the defendants mortgaged their home and two investment properties to National Mutual as security to finance Anthony's property investments. On the evidence, the defendants trusted their son implicitly; they knew very little about the arrangement other than it was to help his business and that everything would 'be all right'. On 4 March 1995 Global Funds Management, manager of the National Mutual mortgage, notified Anthony that the loan facility would not be extended beyond its maturity date of 29 June 1995. The loan was not repaid. The defendants were served with notices under section 57(2)(b) of the [Real Property Act 1900 No. 25 (NSW)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=4197" \t "default). Anthony told his parents not to worry as he would 'fix it up'.

Anthony failed to disclose his financial state to his parents; in evidence tendered to the Court, he described how he started drinking heavily and defalcating from his firm's trust account. In August 1995 St George Bank, through its lending official Chris Brigg, provided a temporary overdraft facility of $25,000 for Anthony Trimarchi. By 5 October it was overdrawn and Anthony began seeking alternative refinancing options. He contacted Chris Briggs, who was apparently aware of Mr Trimarchi's difficult financial position. Briggs approved the refinancing loan, based partly on security of the mortgage from Mr Trimarchi's parents, with a condition precedent being a 'recommendation' (as distinct to a condition) that Domencio and Lucia receive independent advice. Communication between St George Bank and the defendants was always through Anthony; the defendants never personally received addressed correspondence or met any bank officials.

Mr and Mrs Trimarchi received legal advice from their son's legal partner, Adrian Matiussi. That advice, Druman J held, was totally meaningless to the defendants, who were, his honour suggested, in the habit of slavishly following what their son told them when it came to money and legal matters. The Court was satisfied the solicitor did not tell them in clear and specific terms that they could lose all their property, that the mortgage was for only a one year term and that at the end of that term it would be necessary to either sell the properties or re-finance the loan. Mr and Mrs Trimarchi also received financial advice from Aldo Demasi, who did not explain the total financial effect of the mortgage, the wisdom of entering into the transaction or how they were going to obtain the money to meet the huge repayments.

In the loan application, Anthony misrepresented the true financial state of his parents; he claimed they had no liabilities (when in fact they were liable for the full amount of the National Mutual mortgage), failed to provide details of his parents income and expenditure and forged his parents' signatures.

On 20 December 1995, the defendants accepted an offer of a finance facility from St George Bank. On 19 January 1996, a twelve-month mortgage was executed over the couples' three properties. Other properties owned by Anthony and his wife were used as security for the loan. On 22 January 1996 St George Bank paid out the National Mutual mortgage of $2,675,000.

The money owing to St George Bank was not repaid by the due date. St George Bank obtained possession of the properties owned by Anthony and his wife; the proceeds of sale reducing the debt. A sum of $1,148,075, however, remained outstanding.

The defendants argued that the Contracts Review Act 1980 (NSW) provided a comprehensive doctrinal framework to deal with 'unjust' contracts and should be interpreted liberally. The defendants argued that a party's understanding of the nature and effect of the documents being signed is relevant to whether the contract is 'unjust'. 'Unjust', within the meaning of the Act, includes unconscionable, harsh or oppressive. 'Injustice' is to be construed in a corresponding manner: West v AGC (Advances) Limited (1986) 5 NSLWR 610 at 620. The defendants further argued that a contract may also be unjust because of the way in which it was made (procedural injustice) or because of the way in which it operates (substantial injustice). Unfairness by the other party to the contract is not essential to a finding that the contract was unjust or to the granting of relief, nor is knowledge on the part of the other party.

Section 6(2) of the Act excludes relief for contracts 'entered into in the course of or for the purpose of a trade, business or profession'. The Bank argued that the defendants were carrying out a business and were therefore unable to rely on the Act. Dunford J held that even if it could be argued that the defendants had a beneficial interest in the properties, the loans they entered into were not 'in the course of' a business carried on by Mr. and Mrs. Trimarchi.

(3) Decision

The court set aside the loan agreement and mortgage of St George Bank and made judgment for the defendants. Anthony Trimarchi's conveyancing transactions were described by counsel as being more complex than the theory of relativity! Dunford J held that the proposition, by St George Bank, that two semi-literate Italian migrants could have had a full or sufficient understanding of what was involved in the transaction defied credibility. Although the Trimarchis knew what a mortgage was, the Court held that they had no meaningful appreciation of a mortgage of such complexity. There was a huge difference between a simple housing loan for a fixed amount, secured by a mortgage over the relevant housing property and a mortgage to secure a business loan raised to fund an investment or series of speculative investments, undertaken with others and secured by mortgages over properties not the subject of the investment. The Court held that neither of the defendants knew or had any meaningful appreciation of what they had entered into.

The Bank submitted that the defendants were borrowers or principal debtors. The Court held that they were, in substance and in fact, merely guarantors for the debts incurred by their son in his property speculation business. The defendants had no real understanding of what they were letting themselves into, were not consulted by St George Bank, received inadequate advice and the contract they signed with St George Bank was unjust, within the meaning of the Contracts Review Act 1980 (NSW).

In relation to the National Mutual mortgage, the Court held that the defendants had little if any knowledge of what they were entering into, or of their sudden increase in liabilities. National Mutual had only dealt with Anthony Trimarchi. Under such circumstances, the National Mutual mortgage was also held to be unjust, within the meaning of the Contracts Review Act 1980 (NSW).

Having found both the St George Bank and National Mutual mortgage agreements unjust, the Court held that the only way injustice to the defendants could be rectified was by discharging the loan agreement and mortgage. Based on the circumstances of the case, the Court held that it need not rely on Garcia v National Australia Bank. Judgment was entered for the defendants and the plaintiff ordered to pay the defendants' costs.

(4) Conclusion

This case highlights the difficulties which can arise when parties engage in complex financial arrangements without receiving adequate legal or financial advice. The case is an excellent example of the pitfalls that can occur when parties enter into financial arrangements out of a sense of duty or family obligation. It also indicates how Courts are reluctant to sanction financial arrangements entered into between parties with disproportionate bargaining power and which are manifestly 'unjust'.

(K) CAN LEAVE TO COMMENCE LEGAL ACTION AGAINST A COMPANY BEING WOUND UP BE GIVEN BY A COURT THAT DID NOT GRANT THE WINDING UP ORDER?  
(By Klay Brown, Corrs Chambers Westgarth)

Sihota v Pacific Sands Motel [2003] NSWSC 119, New South Wales Supreme Court, Austin J, 3 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc119.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc119.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Summary

In this case, it was held that leave to begin proceedings against a company in liquidation under section 471B of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (Act) could be granted by a "Court" (as defined in section 58AA of the Act) other than the actual court that made the winding up order.

Accordingly, it was held that a broad construction of the words "Court" in section 58AA(1) of the Act, in comparison to the definition of "court" in section 9 of the Act, should be adopted to reflect the legislature's intention in establishing a national corporations law scheme in Australia.

(2) Facts

The proceedings began on 20 December 2002, when limited extensions of a caveat over a development property in Kingscliff in New South Wales were granted in favour of Mr Sihota. At that time the Mr Sihota made an interlocutory application to the Supreme Court of New South Wales under section 471B of the Act for leave to commence proceedings against Pacific Sands Motel Pty Limited (Pacific Sands) seeking to extend the caveat. However, the Supreme Court of Queensland had earlier in March 2002 made an order that Pacific Sands be wound up.

(3) Relevant law

In this case, Austin J was required to consider whether leave under section 471B of the Act could be granted by a "Court" (as defined in section 58AA of the Act) other than the court that made the winding up order.

Under section 471B of the Act no person can begin or proceed with:

(a) a proceeding in a court against the company or in relation to property of the company; or

(b) enforcement process in relation to such property;

except with the leave of the Court and in accordance with such terms (if any) as the Court imposes while a company is being wound up or while a provisional liquidator is acting.

Section 471B of the Act makes a distinction between a "court" and a "Court".

The term "Court" is defined in section 58AA of the Act as meaning the Federal Court, the Supreme Court of a State or Territory, the Family Court of Australia or a court to which section 41 of the [Family Law Act 1975 No. 53 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6863" \t "default) applies because of a proclamation made under subsection 41(2) of that Act.

(4) Decision

Austin J was referred to Barrett J's observation as to the distinction between "Courts" and "courts" in Re FAI General Insurance Co Limited [2002] NSWSC 262, where his Honour Barrett J stated:

"...it is plain that the proceedings in relation to which the prohibition upon proceeding without leave applies are proceedings in any court whatsoever; but that the Court from which the necessary leave is to be obtained is the Court by which the order for winding up was made."

Barrett J's view was consistent with the observations of McLelland CJ in Re Sydney Formworks Pty Ltd [1965] NSWR 646 that "the Court administering the liquidation may give leave" and the observations of von Doussa J in State Bank of South Australia v Clockwork Motors Pty Ltd (1991) 101 ALR 402.

Austin J, however, did not follow that line of reasoning for several reasons.

First, his Honour noted that Barrett J's observations in Re FAI General Insurance were obiter. Secondly, Re Sydney Formworks could be distinguished from the present case due to the different legislative arrangements that were in operation at the time that case was heard. Namely, prior to 1979, as company law was administered by each State and Territory, there were no co-operative or cross vesting arrangements to cause amendments to the companies law in force in the Australian Capital Territory to be automatically applied in other States and Territories. In particular, before cross-vesting legislation was enacted the general position was that only the Supreme Court of the State of Territory whose legislation was in question had jurisdiction to make orders to give effect to statutory rights and liabilities or with respect to a statutory procedure.

Austin J considered that the Full Federal Court decision in Acton Engineering Pty Limited v Campbell (1991) 103 ALR 437 was authority for the notion that any Court having jurisdiction under the [Corporations Law](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=7375" \t "default) (as it was then referred to), including the Federal Court, had jurisdiction to grant leave to commence or continue proceedings against a company in liquidation under what was then section 471(2) of the Corporations Law (Cth) so that no Court had primacy over any other. Further, Part 9.6A of the Act establishes jurisdictional arrangements for the Federal Court and the Supreme Courts under which, generally speaking, their jurisdiction is concurrent and no Court is given primacy over another. Accordingly, Austin J considered that the structure of the current statutory scheme suggests a legislative intention that any "Court" should have jurisdiction to make orders consequent upon orders made by any other "Court".

Based on these findings Austin J stated that the definition of "Court" in section 58AA(1) of the Act should be substituted with the words "the Court" whenever the latter words appear in section 471B of the Act and granted leave for the plaintiff to commence the relevant proceedings.

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1. RECENT CORPORATE LAW AND CORPORATE GOVERNANCE DEVELOPMENTS

(A) REPORT OF THE HIH ROYAL COMMISSION

On 16 April 2003, the Commonwealth Treasurer, The Hon Peter Costello MP, released the Report of the HIH Royal Commission. The Royal Commission was established at the Government's instigation following the financial collapse of the HIH Insurance Group in March 2001. HIH was the second largest general insurance company in Australia and its collapse affected individuals, community groups, and the public generally. The Commission operated from September 2001 until the Report was delivered to the Governor-General on 4 April 2003. The Government appointed Mr Justice Owen as the Commissioner.

(A) Government response to the report

When releasing the report, the Treasurer made a number of responses to the recommendations of the Commissioner. They are outlined below.

The Commissioner concluded that the primary reason for the collapse of HIH was the failure to provide properly for future claims. This failure was essentially due to mismanagement and an inadequate response to pressures emerging in insurance markets internationally.

The Commissioner identified a number of possible breaches of the [Corporations Law (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=7375" \t "default) and the [Crimes Act 1900 No. 40 (NSW)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=3907" \t "default). There are 56 matters (relating to 18 individuals) that Mr Justice Owen has indicated should be referred either to the Australian Securities and Investments Commission (ASIC) or (in a small number of cases) to the NSW Director of Public Prosecutions. The Government is referring these possible breaches to those authorities immediately.

In respect of the Corporations Law referrals, a taskforce will be established immediately under the direction of ASIC to examine these issues and prepare briefs for possible proceedings. Additional funding will be provided in the budget for this task. The Government will give consideration to whether a Special Prosecutor will be appointed to prosecute criminal charges.

ASIC has already brought some proceedings arising from the failure of HIH. None of the Commissioner's findings that there might have been a breach of the law relates to or touches on those proceedings.

There were many individuals and companies who were the subject of adverse comment in counsel assisting's closing submissions. The Commissioner makes it clear in the first volume of his report that "where there is no finding in this report against [a] person or company, the reputation of that person or company emerges entirely free of any adverse implications".

The Commissioner also concludes that the Australian Prudential Regulation Authority (APRA) did not cause the collapse of HIH. He notes in the third volume of his report that "APRA's failure to act did not contribute to the collapse of HIH. However, the manner in which APRA exercised its powers and discharged its responsibilities under the Insurance Act fell short of that which the community was entitled to expect from the prudential regulator of the insurance industry".

The Commissioner has made 61 policy recommendations. The recommendations cover corporate governance and financial reporting, APRA's governance arrangements, the regulation of general insurance and APRA's internal processes. Some recommendations seek action by the States and Territories.

The demise of HIH occurred under regulatory arrangements that have since been substantially strengthened. New legislation for general insurers was enacted in September 2001 and new prudential standards were issued in February 2002. This new framework, which commenced on 1 July 2002, means that general insurance companies are now subject to much more robust arrangements. The reforms ensure that companies establish appropriate systems of governance and internal controls, in addition to more transparent valuation of liabilities and risk-based capital adequacy.

There has also been a transition in supervisory practice from one based on oversighting individual `transactions' to a `systems' based approach, consistent with international regulatory standards and the direction of modern regulatory practice.

The Government will consider very carefully the Commissioner's recommendations. The recommendations propose continuing the broad architecture for the financial system introduced by the Government following the Wallis Report. Under this structure APRA is responsible for prudential regulation of all deposit-taking institutions, general and life insurance and superannuation, and ASIC is responsible for maintaining market integrity, consumer protection and the supervision of companies. The Commissioner notes the potential for improving the clarity of roles and coordination between the regulatory agencies.

The Government accepts in-principle the Commissioner's recommendation to replace APRA's non-executive board with an executive group (or commission). The executive group would carry the responsibility and be accountable for the operation and performance of APRA - this arrangement would further strengthen Australia's existing regulatory framework. As the Commissioner has suggested, the Government wishes to consider his recommendations on these matters in light of the Uhrig Report into Statutory Authorities and Office Holders, which is due to be delivered to the Government in mid-May. Soon after, the Government expects to be able to introduce legislation into the Parliament to give effect to any changes to the governance arrangements of APRA.

The Government released its proposals to enhance corporate disclosure under the CLERP 9 paper in September last year. At that time the Government indicated that the CLERP 9 proposals would also allow any further recommendations from the Royal Commission to be added to legislative proposals.

The Commissioner's recommendations are generally consistent with the CLERP 9 proposals. The Government will be considering the corporate governance and financial reporting recommendations from the Commissioner in preparing the legislation to enact the CLERP proposals.

Draft legislation will be released for public comment in the next few months. The Governments expects to introduce the legislation into the Parliament early in the Spring Sittings.

Copies of the report are available on the Royal Commission website at [http://www.hihroyalcom.gov.au](http://www.hihroyalcom.gov.au" \t "_new)

(B) Policy recommendations made by the Commissioner

Following is a list of the 61 policy recommendations made by the Commissioner.

(i) Corporate governance

(1) The disclosure and other requirements of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), the relevant accounting standards and the Australian Stock Exchange Listing Rules that relate to directors' remuneration be reviewed as a matter of priority, to ensure that together they achieve clear and comprehensive disclosure of all remuneration or other benefits paid to directors in whatever form.

(2) The Corporations Act 2001 be amended to repeal the existing legislative provisions relating to the definition of the extended classes of personnel upon whom duties are imposed by the Act and to substitute instead a definition that is clear, simple and certain of application.

The definition would focus on the function performed by the relevant person-not the classification of their legal relationship to the corporate entity-and avoid expressions such as 'employee' in favour of a functional orientation.

The definition would then form the basis of a regime having the following features:

(a) All the general duties imposed by Chapter 2D of the Corporations Act should be imposed on directors, secretaries and the wider class of personnel encompassed within the functional definition.

(b) The duties imposed by ss 182(1), 183(1) and 184(2) of the Act should be imposed on all persons performing functions for and on behalf of corporations, whether employees or suppliers of services under contract.

(c) The liabilities created by s 1309 of the Act should be imposed on all persons and not be restricted to a limited class of management personnel.

(d) The classes of personnel prohibited from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on the company by any written law should be extended.

(ii) Financial reporting and assurance

(3) The Commonwealth Government broaden the membership of the Australian Accounting Standards Board to include people with business or professional backgrounds beyond the accounting profession.

(4) Australia participate fully in the development of international accounting standards and pursue the adoption of high-quality, consistent and readily understood accounting standards.

(5) In adopting international standards, Australia reserve the right to require more stringent standards that are not inconsistent with the relevant international standards. These would generally relate to disclosure requirements.

(6) The Australian Accounting Standards Board alter the Urgent Issues Group or create a separate group that is able promptly to issue binding rulings on important and urgent matters concerning the interpretation and application of the accounting standards.

The board should extend the constitution of the Urgent Issues Group or the separate group beyond accounting professionals and include lawyers and users of financial statements.

(7) The professional accounting bodies develop guidelines to encourage their members to consult independent third parties or the Urgent Issues Group when there is disagreement with the management of companies concerning the interpretation or application of accounting standards.

(8) The Australian Accounting Standards Board amend accounting standard AASB 1023 to include the following:

(a) a definition of insurance that includes the requirement for a material transfer of insurance risk;

(b) a requirement that insurance liabilities be valued at a level of sufficiency of at least 75 per cent, as required by APRA's prudential standards. Companies should be explicitly permitted to set prudential margins in excess of 75 per cent if the company's board considers that appropriately reflects a true and fair view of the financial position of the insurer;

(c) a requirement that entities disclose in their financial statements:

- the valuation of their insurance liabilities at a central estimate  
- a 75 per cent level of sufficiency  
- the margin ultimately adopted by the entity

(d) a requirement that premium revenue and insurance liabilities be recognised on the commencement of a contract of insurance. This will require the recognition of premium liabilities;

(e) a requirement that, in estimating the present value of liabilities, future cash flows be discounted using a risk-free rate similar to that required by the prudential standards;

(f) a requirement that companies subject to the standard disclose a 10-year claims-development table that includes past estimates of claims on an undiscounted basis as well as the actual costs of settling claims. This information should be provided both net and gross of reinsurance.

(9) All standards of independence of auditors in Australia, including those contained in legislation and professional standards such as Professional Statement F1, be consistent with the standard of independence defined as follows:

(a) An auditor is not independent with respect to an audit client if the auditor might be impaired-or a reasonable person with full knowledge of all relevant facts and circumstances might apprehend that the auditor might be impaired-in the auditor's exercise of objective and impartial judgment on all matters arising out of the auditor's engagement.

(b) A reference to an auditor includes both an individual auditor and an audit firm. In determining whether an auditor or an audit firm is independent, all relevant circumstances should be considered, including all pre-existing relationships between the auditor, the audit firm and the audit client, including its management and directors.

(10) The Corporations Act 2001 should be amended to require the board to provide a statement in the annual report that identifies all non-audit services provided by the audit firm and the fees applicable to each item of work and explains why those non-audit services do not compromise audit independence.

(11) In implementing the CLERP 9 proposal for restrictions on employment relationships between an auditor and the audit client, the amendments provide for the following:

(a) a mandatory period of four years following resignation from an audit firm before a former partner who was directly involved in the audit of a client can become a director of the client or take a senior management position with the client. This restriction should be extended to include key senior audit personnel;

(b) an extension of the restriction to a former partner who was not directly involved in the audit of a client. In the opinion of the Commissioner, the current proposed period of two years would be appropriate for such a partner;

(c) a prohibition on any more than one former partner of an audit firm, at any time, being a director of or taking a senior management position with the client.

These restrictions should be enforceable against both the audit firm and the relevant former partner or senior audit team member.

(12) In implementing the CLERP 9 proposal for rotation of audit personnel, the requirement for rotation of the lead engagement partner and review partner be extended to key senior audit personnel.

(13) The Corporations Act 2001 be amended to require the disclosure in audit reports of the following:

(a) the impact of the position taken by the reporting entity where alternative accounting treatments are reasonably open from the reading of an accounting standard and the difference between those accounting treatments is material;

(b) the significant matters arising in the audit process.

The Corporations Act should be amended to require audit reports to be presented in plain English and to require the inclusion of an operating and financial review as part of an annual report, which would be the subject of audit.

(14) The Corporations Act 2001 be amended to require public listed companies to include a brief, plain English summary of the nature and scope of the audit services provided by their auditor each year.

(15) Both the Australian Prudential Regulation Authority and the Institute of Actuaries of Australia introduce compulsory certification of the completeness and accuracy of data.

(16) The Institute of Actuaries of Australia and the Australian Prudential Regulation Authority introduce a requirement for more detailed disclosure of the exercise, incidence and impact of subjective judgment and departure from historical experience.

(17) The Australian Prudential Regulation Authority extend the qualifications of the approved actuary to require that they not be an employee or partner of the organisation to which the approved auditor belongs.

(iii) Regulation of general insurance

(18) The [Australian Prudential Regulation Authority Act 1998 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=5782" \t "default) be amended to replace APRA's non-executive board with an executive group. This group would comprise the chief executive officer and two or three executive commissioners and would carry the responsibility, and account to government, for the operation and performance of APRA.

(19) The Australian Prudential Regulation Authority Act 1998 be amended to provide the chief executive with the power to establish an advisory board.

(20) The direct involvement of representatives of the Australian Securities and Investments Commission and the Reserve Bank of Australia in the governance of the Australian Prudential Regulation Authority be discontinued. This will require amendment of the Australian Prudential Regulation Authority Act 1998.

(21) The Australian Prudential Regulation Authority chief executive instigate, as a matter of urgency, a review of APRA's organisational structure. The object of the review should be to achieve a workable and effective balance between accountability for and knowledge of particular financial services on one hand and cross-sectoral functional skills and perspective on the other. In particular, the review should consider the creation of a specialist team to take primary responsibility for the supervision of general insurers.

The review should report to APRA's board with recommendations on APRA's appropriate internal structure, given its responsibilities across the deposit-taking, insurance and superannuation sectors. The board should publicly respond to its recommendations.

(22) The Commonwealth Government consider removing the requirement for the Treasurer's agreement to operational decisions involving APRA's prudential oversight of general insurers.

(23) Given the inconsistencies between the [Insurance Act 1973 No. 76 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6398" \t "default) and the [Banking Act 1959 No. 6 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6665" \t "default), the Commonwealth Government review the current legislative provisions for merit review of APRA's decisions for the purposes of ensuring consistency.

(24) The Australian Prudential Regulation Authority implement a programme to build the skills of staff involved in the supervision of general insurers. This should involve a review of its human resource management policies to assess APRA's competitiveness in the financial services sector labour market. The review should take account of the adequacy of remuneration, training and career structures as well as other steps to increase APRA's attractiveness as an employer.

(25) The Commonwealth Government adopt a three-year rolling funding arrangement to set the Australian Prudential Regulation Authority's budget.

(26) The Australian Prudential Regulation Authority develop a more skeptical, questioning and, where necessary, aggressive approach to its prudential supervision of general insurers. Consultation, inquiry and constructive dialogue should be balanced by firmness in its requirements and a preparedness to enforce compliance with applicable standards. In particular, APRA should take a firm approach to ensuring regulated entities' timely compliance in the lodging of returns and the provision of information.

(27) The Australian Prudential Regulation Authority continue to develop and review processes, guidelines and training to assist its staff in considering the appropriate approach to take towards supervised entities in different situations.

(28) The Australian Prudential Regulation Authority develop systems to encourage its staff and management continually to question their assumptions, views and conclusions about the financial viability of supervised entities, particularly on the receipt of new information about an entity.

(29) The Australian Prudential Regulation Authority develop an internal system for tracking all relevant information concerning regulated entities.

(30) The Australian Prudential Regulation Authority develop mechanisms for investigating the reinsurance arrangements of authorised general insurers on a random but frequent basis.

(31) The effectiveness of the current memorandum of understanding between the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission be reviewed.

The processes for liaison, coordination and exchange of information between APRA and ASIC should be reviewed on a regular basis. To facilitate the exchange of information, the Commonwealth Government should make a regulation specifying ASIC for the purposes of s 56(5)(a) the Australian Prudential Regulation Authority Act 1998.

(32) Matters relating to the coordination of Commonwealth regulation affecting the insurance industry be the province of the Commonwealth Treasury.

(33) Coordination of the matters related to the regulation of the insurance industry be addressed through the proposed ministerial council.

(34) Authorised insurers be required to make greater disclosure of information about their financial position. In particular, all financial and statistical information general insurers currently provide to the Australian Prudential Regulation Authority in their regular returns should be made public.

(35) Information that enables external users to make an informed assessment of an insurer's outstanding claims provisions and reinsurance arrangements be published by the insurer or the Australian Prudential Regulation Authority. APRA should develop reporting returns for insurers that would enable this to occur if existing returns are insufficient.

In particular, general insurers should publish:

(a) material equivalent to the 'schedule P' loss-development data published in the United States;

(b) a summary of the approved actuary's valuation of the outstanding claims liabilities, including the methodologies and assumptions underlying that valuation.

(36) Insurers be required to make greater disclosure of qualitative information relating to their risk- and reinsurance-management strategies. Other qualitative information-where the prospect of disclosure may affect the quality of information provided to companies-need not be disclosed.

(37) The Australian Prudential Regulation Authority identify and make known the kinds of regulatory activities that in its view should be disclosed publicly (whether or not the insurer in question is a listed company) and should specify the process by which such disclosure should occur.

(38) As a matter of high priority, the Australian Prudential Regulation Authority develop and promulgate a standard for the effective regulation of authorised insurers that operate as part of a corporate group.

The proposed prudential standard on corporate groups should include a minimum capital requirement at the group level as well as the authorised entity level.

(39) The Australian Prudential Regulation Authority monitor the financial condition of corporate groups, including those with foreign operations. Pending the development of the proposed prudential standard on supervision of corporate groups, APRA should use existing powers to require groups to provide any information it considers necessary to perform this role.

(40) The Australian Prudential Regulation Authority take steps to ensure that it effectively exchanges with relevant foreign regulators information and intelligence on the operations of Australian insurers with international operations.

(41) The Australian Prudential Regulation Authority modify the prudential standards to require the annual production by an authorised general insurer's approved actuary of a report on the overall financial condition of the insurer.

(42) The Commonwealth Government amend the Insurance Act 1973 to extend prudential regulation to all discretionary insurance-like products-to the extent that it is possible to do so within constitutional limits.

(43) Section 462(3) of the Corporations Act 2001 be amended so that the Australian Prudential Regulation Authority may apply to wind up a company that is an authorised insurer if any of the criteria specified in section 52(1)(aa), (ab) or (a) of the Insurance Act 1973 are met.

(44) Section 461 of the Corporations Act 2001 be amended to specify that the interests of policyholders are interests to which the court should have regard in deciding whether to make a winding-up order.

(45) The Australian Stock Exchange amend Listing Rule 3.1 to require - or publish a guidance note making it clear - that price-sensitive announcements have the approval of either the board or a delegate of the board subject to ratification by the board.

(46) The Australian Stock Exchange amend the Listing Rules to prohibit 'blacklisting'-defined as exclusion of a person or organisation from briefings by a company or a pattern of such exclusion in the face of negative reports on the company by those analysts over a specific period.

(47) The Australian Stock Exchange clarify Listing Rule 11.1, so that it applies to any significant change in the business or assets of a listed company, whether it be by acquisition, disposal, amalgamation or otherwise. The ASX amend the Listing Rules to define 'significant change', so that it encompasses financial and geographic factors as well as the nature and scale of the company's business.

(48) The Australian Stock Exchange amend Listing Rule 11.2, so that it applies to any disposal of the whole or substantially the whole of the assets or operations of a listed company.

(iv) State and territory regulation

(49) That the states and territories not undertake any prudential regulation of general insurance. The Australian Prudential Regulation Authority should be the sole prudential regulator in this field.

If such regulation is to continue, state and territory governments should ensure that it is consistent with the requirements of the Insurance Act 1973. This is a matter that might properly be referred to the proposed ministerial council.

(50) To the extent that states and territories continue to involve themselves in prudential regulation, the Australian Prudential Regulation Authority should share all information relating to the prudential regulation of relevant general insurers with relevant state and territory bodies.

The states and territories should provide APRA with all relevant information that may concern the financial condition of relevant general insurers. This exchange of information should proceed through memorandums of understanding between APRA and each relevant state and territory body.

APRA and the state and territory instrumentalities should review applicable secrecy provisions and where necessary seek legislative action to ensure they do not inhibit the free flow of information between APRA and the instrumentalities relevant to the prudential regulation of general insurers.

(51) The states and territories implement a process designed to reduce inconsistencies in their statutory schemes. This is a task that would appropriately be overseen by the proposed ministerial council.

(52) State and territory governments apply relevant prudential requirements to government insurers and statutory fund schemes. This is a matter that would appropriately be overseen by the proposed ministerial council.

(53) The states and territories consider allowing greater price flexibility in their statutory schemes. This is a matter that would be appropriate for consideration by the proposed ministerial council.

(54) The Commonwealth Government move to identify or establish a ministerial council or like arrangement to provide a ready and regular forum for the discussion and resolution by the Commonwealth and the states and territories of matters relevant to general insurance-and perhaps to other financial services.

The ministerial council (or other similar body) should consider measures to:

(a) avoid duplication in the prudential regulation of general insurers;

(b) remove regulatory inconsistencies;

(c) achieve a consistent approach to the prudent management of state and territory monopolies.

It could also play a part in:

(a) moves to introduce greater price flexibility in statutory schemes;

(b) the introduction of a policyholder support scheme;

(c) the removal of anomalies in the taxation arrangements applicable to general insurers.

(v) Taxation and general insurance

(55) State and territory governments abolish stamp duty on general insurance products. It would be appropriate for this process to be coordinated through the proposed ministerial council with responsibility for general insurance.

(56) Those states that have not already done so abolish fire services levies on insurers.

(57) State and territory governments exclude the cost of the GST for the purposes of calculating stamp duties or any other state or territory levies that are imposed on insurance premiums.

(58) Governments avoid imposing on insurers levies and other taxes that cannot be passed on to policyholders.

(59) The Commonwealth Government review the current requirements of the [Income Tax Assessment Act 1936 No. 27 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6606" \t "default) with a view to changing the Act to bring it into alignment with the modified accounting standards proposed by the Commissioner.

(60) The Commonwealth Government amend the income tax regime to encourage the creation and use of catastrophe reserves. Contributions to catastrophe reserves would be tax deductible. Releases from the reserve would be assessable for tax.

(vi) A policyholder support scheme

(61) The Commonwealth Government introduce a systematic scheme to support the policyholders of insurance companies in the event of the failure of any such company.

(B) COMMONWEALTH GOVERNMENT RESPONSE TO THE REVIEW OF THE COMPETITION PROVISIONS OF THE TRADE PRACTICES ACT 1974

On 16 April 2003 the Commonwealth Government released the report of the Dawson Committee on the review of the competition provisions of the [Trade Practices Act 1974 No. 51 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6426" \t "default) and at the same time released the following response.

The report is available on the Treasury website at [http://www.treasury.gov.au](http://www.treasury.gov.au" \t "_new)

Part 1: Overview

(a) The importance of competition

The object of the Trade Practices Act 1974 (the Act) is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection. The competition laws are contained in Part IV of the Act and are comprehensive and far-reaching. Broadly speaking, Part IV prohibits collusive agreements, misuse of market power, exclusive dealing and mergers that substantially lessen competition in a market. Some provisions are subject to a competition test, while other provisions prohibit conduct on a per se basis, that is, regardless of their likely effect on competition. Part VII of the Act provides for the authorisation and/or notification of otherwise prohibited conduct when that conduct is justified in the public interest, notwithstanding a lessening of competition.

Whilst various specific provisions of the Act have been reviewed in recent years, there had not been a comprehensive review of the competition provisions since the Hilmer Committee in 1993. In light of significant structural and regulatory changes that have impacted upon the competitiveness of Australian businesses, economic development and consumer interests, it was considered timely to review the competition provisions of the Act.

The Committee reviewed the competition and authorisation provisions of the Act to establish whether they meet the needs of business, consumers and the economy in the current environment or whether improvements might be made to ensure that they are effective. The Committee also had regard to the way in which the competition provisions and related aspects of the Act have been administered.

Against this background, the Government's response to the Committee's recommendations is set out below.

Recommendation 1.1 The consideration of possible changes to Australia's regulatory framework should continue to have regard to international developments in the area of competition.

Recommendation 1.2 Australian Governments should ensure that the competition provisions of the Act are applied as broadly as possible across the economy and extend to the commercial activities of governments themselves.

Recommendation 1.3 Competition provisions should be uniformly applied and measures which are specific to a particular industry should be avoided.

Recommendation 1.4 The competition provisions should not be regarded as a means of implementing an industry policy or the preservation of particular corporations that are not able to withstand competitive forces.

Government response:

The Government notes the Committee's conclusion that the competition provisions in Part IV of the Act have served Australia well and that the ACCC has been commendably vigorous in discharging its responsibility to enforce those provisions.

The Government agrees with the values expressed in Recommendations 1.1 to 1.4. The Government supports the need to make sure that our competition provisions reflect international best practice and notes the international consultation and research undertaken by the Committee in completing this review. The Government supports a broad and uniform application of the competition provisions across the economy.

The Government accepts that the competition provisions are designed to protect the competitive process rather than a specific market structure or individual competitors and that competition laws should be distinguished from industry policy. Competition laws should not be seen as a means of achieving social outcomes unrelated to the encouragement of competition, or of preserving businesses that are not able to withstand competitive forces.

Recommendation 1.5 Businesses should seek to ensure that voluntary compliance programs are provided for their staff and the ACCC should review the assistance it is able to provide to business in this regard in consultation with interested parties through the reconstituted consultative committee recommended by the Committee.

Government response:

The Government accepts the principle expressed in this recommendation. Compliance is enhanced by businesses ensuring staff understand the competition provisions.

Part 2: Mergers

(a) Merger clearance under section 50

Section 50 of the Act prohibits mergers that would have the effect or be likely to have the effect of substantially lessening competition in a market. In the absence of a formal statutory arrangement, a system has evolved under which the ACCC provides informal clearances for proposed mergers which it considers would not be in breach of section 50.

The Committee did not consider that any amendment to the current section 50 mergers test was necessary, but did recommend changes to the ACCC's merger processes.

While the Committee found that there is generally widespread support for the informal clearance system, which is praised for its relative speed and efficiency, it also found significant weaknesses with the system. These weaknesses are evident in the absence of an effective mechanism for review and the absence of reasons for the ACCC's decisions.

Recommendation 2.1 The ACCC should provide adequate reasons for its decisions (taking care to protect any confidentiality) in the informal clearance process when requested to do so by the parties and in cases where it rejected a merger or accepted undertakings.

Government response:

The Government supports the provision of reasons by the ACCC for its informal clearance decisions when requested by the applicants and in cases where it has rejected a merger or accepted undertakings. This will improve the process by promoting a better understanding of the ACCC's decisions and reducing uncertainty.

Recommendation 2.2 A voluntary formal clearance process should be introduced, parallel to the existing informal clearance process, in relation to merger applications requiring consideration under section 50. This formal clearance process should have the following features:

2.2.1 on application by the parties, the ACCC might grant a binding clearance upon the basis that a proposed merger would not contravene section 50. The applicant would have immunity from proceedings by any party while complying with any conditions specified by the ACCC as a condition of the approval of the merger. The ACCC would be required to monitor compliance with these conditions;

2.2.2 the information required for such an application, which could be set out in revisions to the ACCC's Merger Guidelines, should not be onerous but should be sufficient for the ACCC to make a reasoned assessment;

2.2.3 the Act should require the ACCC to make a decision within 40 days which would allow the ACCC to consult with third parties. If a decision is not provided within 40 days, the clearance of the merger should be deemed to be refused. The 40 day limit should be capable of extension only at the request of the applicant; and

2.2.4 only the applicants should be granted a right of review on the merits by the Tribunal. The application for review should be made within 14 days of the ACCC's decision. The hearing before the Tribunal should be on the material before the ACCC and not a hearing de novo. Decisions of the Tribunal should be made within 30 days. The Tribunal should be able to grant or reject a clearance or grant a clearance subject to conditions.

Government response:

The Government agrees that the creation of a formal, but not compulsory, clearance process, operating in parallel with the existing informal system, will retain the advantages of the current system but will overcome some of its disadvantages.

An optional formal system will provide parties with an alternative process for progressing their merger. Parties will be able to use the informal system and request reasons and/or use the optional formal system. Under the formal system parties would be presented with reasons for the ACCC's decision and be given the opportunity to have the Tribunal review an unfavourable decision. The decisions of the Tribunal will also provide guidance to the ACCC in its approach to clearance upon questions such as the definition of the relevant market or the lessening of competition likely to result from the merger. Under this system, the ACCC will have 40 days to make a decision. This will increase the level of certainty for business.

(b) Merger authorisation process

Mergers that would otherwise contravene section 50 may be authorised where the public benefit arising from the merger is such that the proposal ought to proceed.

Currently the ACCC is responsible for assessing merger authorisations. The Committee found that this process has been less than satisfactory, largely as a result of the time taken by the ACCC to reach a decision and the risk of third party intervention by way of review by the Tribunal. These factors have rendered the authorisation process commercially unrealistic for many merger proposals. The Committee noted that only five authorisations of mergers have been sought from the ACCC since 1995.

Recommendation 2.3 Applications for the authorisation of mergers should be made directly to the Tribunal. This process should have the following features:

2.3.1. applications should be considered within a statutory time limit of three months;

2.3.2. there should be no review on the merits of the Tribunal's decision; and

2.3.3. the Tribunal should have the power to remit an application for consideration by the ACCC if it were of the view that the application required a decision solely on competition issues under section 50 rather than a decision concerning public benefit and the ACCC had yet to formally examine the matter.

Government response:

The Government agrees that direct applications to the Tribunal will greatly reduce the time required to consider merger authorisations. It will also meet the perception of some parties that the ACCC is not able to look afresh at authorisation applications based upon public benefit where it has previously considered a matter under section 50. If third party interests are considered as part of the Tribunal's assessment, rather than through an appeal process, great savings in time and certainty of outcome will be achieved.

Part 3: Market conduct

(a) Misuse of market power

Section 46 of the Act prohibits the misuse of market power, which requires the demonstration of an anti-competitive purpose. The addition of an effects test was proposed in a number of submissions because of the perceived difficulty of proving purpose.

The Committee recommended against the amendment of section 46 to introduce an effects test. The Committee was of the view that the introduction of an effects test would increase the risk of regulatory error and render purpose ineffective as a means of distinguishing between pro-competitive and anti-competitive behaviour. Overseas experience, so far as it is of assistance, did not indicate that the introduction of an effects test would be appropriate.

In March 2003, the Committee reaffirmed its recommendations in light of the High Court decision in Boral v ACCC, maintaining that no amendment should be made to section 46, although the position could be reviewed after a number of other cases are determined, such as Safeway, Rural Press and Universal Music. The Committee noted and endorsed observations by the High Court in the Boral case that the purpose of section 46 is to promote competition and that successful competition is bound to cause damage to some competitors.

Recommendation 3.1 No amendment should be made to section 46.

Recommendation 3.2 The ACCC should give consideration to issuing guidelines on its approach to Part IVA.

Recommendation 3.3 The ACCC should consult with industry and issue guidelines on the application of Part IV to intellectual property.

Government response:

The Government acknowledges the extensive consideration given to possible amendments to section 46, including the introduction of an effects test, by this and previous reviews, and supports the recommendation that no amendment should be made to section 46.

The Government supports the development of guidelines by the ACCC.

(b) Price discrimination

Price discrimination occurs when like goods or services are provided to different people at different prices and the differences in price are unrelated to the costs of providing the goods or services. Price discrimination can be pro-competitive or anti-competitive. To be anti-competitive, the corporation engaging in price discrimination must have market power. For these reasons, the Committee concluded that it was appropriate to consider the effect of price discrimination on competition on a case by case basis in accordance with section 46. The Committee also concluded that the principle of 'like terms for like customers' did not offer a suitable basis for regulation of the grocery industry.

Recommendation 4.1 No change should be made to the Act in relation to price discrimination.

Government response:

The Government accepts the Committee's reasoning and hence this recommendation.

(c) Cease and desist orders

Cease and desist orders have been described by proponents as emergency administrative cessation of conduct orders that would be issued by the ACCC if it considered that a breach, or threatened breach of the Act has occurred. The Committee found no evidence that the existing process of obtaining an interim injunction, to cease conduct that may potentially be in breach or threatened breach of certain parts of the Act, was cumbersome or overly difficult. Moreover, the Committee was of the view that it was not clear that the proposed cease and desist powers would be any speedier or more efficient than the existing process of obtaining an interim injunction.

Recommendation 5.1 The Act should not be amended to introduce a power to make cease and desist orders or to extend the powers of the ACCC under section 155 of the Act so that they apply after the commencement of judicial proceedings.

Government response:

The Government accepts the view of the Committee that the case for cease and desist orders has not been made and that the existing provision of obtaining an interim injunction has not been demonstrated to be deficient.

(d) Authorisation

Non-merger market conduct that would otherwise contravene the competition provisions may be granted immunity through authorisation. Authorisation enables efficient or welfare enhancing arrangements, such as joint ventures or collective bargaining processes, to be protected even though they may reduce competition.

Depending on the provision that would otherwise be contravened, conduct may be authorised by the ACCC either because the public benefit arising from the conduct outweighs the detriment caused by the lessening of competition or because the public benefit arising from the conduct is such that the proposal ought to proceed. An exception is misuse of market power, which cannot be authorised. Any person with sufficient interest, including third parties, may seek review of the ACCC's authorisation determinations before the Tribunal.

The Committee agreed that the considerable time and expense associated with non-merger authorisation applications were of concern. A large part of the expense was said to be associated with the costs of preparing an authorisation application, which may be addressed through a better understanding of the process.

Recommendation 6.1 The Act should be amended to include a time limit of six months for the consideration of non-merger applications for authorisation by the ACCC, and consideration should be given to imposing a time limit on any review by the Tribunal.

Recommendation 6.2 The ACCC should be given a discretion to waive, in whole or in part, the fee for filing a non-merger application for authorisation where it would impose an unduly onerous burden on an applicant.

Recommendation 6.3 The ACCC should develop an informal system of consultation with non-merger applicants for authorisation designed to provide those persons with guidance about the authorisation process and the requirements of the Act.

Government response:

The Government considers the non-merger authorisation provisions to be an important feature of the Australian system of competition regulation. These provisions allow a flexible response to evolving market situations, including industries undergoing structural change.

The Government will amend the Act to include a time limit of six months for the consideration of non-merger applications for authorisation by the ACCC. The ACCC will be provided with a discretion to waive, in whole or in part, the fee for filing a non-merger application for authorisation. The Government supports the development by the ACCC of an informal system of consultation with non-merger applicants for authorisation.

These changes will improve the accessibility and effectiveness of the authorisation process by reducing the time and cost involved in obtaining authorisation.

(e) Collective bargaining

Any contract, arrangement or understanding (agreement) that has the purpose, effect or likely effect of substantially lessening competition will breach the Act. Collective bargaining agreements are therefore constrained by the Act because they will often, for example, involve agreements between competitors on the price of goods or services. Such agreements are deemed to substantially lessen competition. However, the Committee found that collective bargaining by small businesses negotiating with big business may also benefit the community. Such arrangements may provide competing small businesses with sufficient bargaining power to balance that of the big businesses with which they have to deal.

Recommendation 7.1 A notification process should be introduced, along the lines of the process provided for by section 93 of the Act, for collective bargaining by small businesses (including co-operatives that meet the definition of small business) dealing with large business.

Recommendation 7.2 A transaction value approach should be adopted to provide a definition of small business. Initially the amount of transactions should be set at $3 million but be variable by the Minister by regulation.

Recommendation 7.3 A period of 14 days should be required to elapse before a notification takes effect.

Recommendation 7.4 Provision should be made for third parties to make a collective bargaining notification on behalf of a group of small businesses.

Government response:

The Government accepts these recommendations and will develop a notification process for collective bargaining by small businesses dealing with large business. While small business will retain access to the authorisation provisions, the proposed notification process is to be based on the Committee's recommendations and will be speedier and simpler for small business than existing processes. To ensure that costs are kept to a minimum for small businesses, the notification fee is to be set at an appropriately low level. Immunity is to extend for three years from the date of notification, and third party representative actions will be allowed. It will aim to provide an appropriate balance of power where small businesses are competing or dealing with businesses that have substantial market power.

(f) Per se prohibitions

Certain types of agreements between competitors are prohibited per se, that is, they are deemed to be illegal regardless of their likely effect on competition. These agreements include those that contain exclusionary provisions, fix prices or involve third line forcing. Where net public benefits arise from such agreements they may be authorised.

(g) Exclusionary provisions

An exclusionary provision has the purpose of preventing, restricting or limiting the supply or acquisition of goods or services to or from particular persons or classes of persons either altogether or in particular circumstances or on particular conditions.

Recommendation 8.1 The Act should be amended so that it is a defence in proceedings based upon the prohibition of an exclusionary provision to prove that the exclusionary provision did not have the purpose, effect or likely effect of substantially lessening competition.

Recommendation 8.2 The Act should also be amended to restrict the persons or classes of persons to which a prohibited exclusionary provision relates, to a competitor or competitors, actual or potential, of one or more of the parties to the exclusionary provision.

Government response:

The Government agrees with these recommendations. Although much of the behaviour covered by the present prohibition may damage competition, there is a risk that the prohibition may also be capturing some behaviour that is not detrimental to competition. To ensure the prohibition only ever stops harmful behaviour, the Government will establish a competition defence, as outlined in Recommendation 8.1. In addition, the prohibition will be confined to those agreements that target competitors, actual or potential, of the parties to the agreement.

(h) Third line forcing

Third line forcing occurs when goods or services are sold, or sold at a discount, but only if the purchaser also buys other goods or services from a third person. The petrol discounts offered by some supermarkets are an example of third line forcing conduct.

Recommendation 8.3 The prohibition of third line forcing should cease to be a per se prohibition and be made subject to a substantial lessening of competition test.

Recommendation 8.4 Related companies should be treated as a single entity for the purposes of section 47.

Recommendation 8.5 Section 93(2) should be repealed.

Government response:

The Government accepts that the prohibition on third line forcing should no longer be prohibited per se because third line forcing can be beneficial and pro-competitive. The Government notes that very few of the hundreds of notifications received annually by the ACCC are opposed. This amendment will generate benefits for business by reducing the need for notifications, generating savings in terms of cost and time. The technical amendments outlined in Recommendations 8.4 and 8.5 will improve the operation of the third line forcing provisions.

(i) Joint ventures

Goods and services can be supplied more efficiently by businesses cooperating in joint ventures that provide scale and scope not achievable by any single business. The businesses involved will usually need to agree on the price to be charged for the venture's output. Consequently, the Act recognises the need to exempt joint ventures from the per se prohibition of agreements that fix prices.

The existing joint venture exemption was introduced primarily to benefit ventures in the mining and manufacturing sectors. However, this exemption was found by the Committee to be too narrow for many newer forms of joint venture, such as those found in e-commerce. The Committee was of the view that many joint ventures may be pro-competitive, particularly when they are employed as a means of developing new products or services, or producing existing products or services more efficiently. Although the Committee was also conscious of the potential for anti-competitive effects, it felt that on balance the existing provisions of the Act to be too narrow.

Recommendation 9.1 The Act should be amended by substituting for the current exemption to section 45A(1) provided by section 45A(2), a provision that section 45A(1) does not apply to a provision of a contract or arrangement made, or of an understanding arrived at, or of a proposed contract or arrangement to be made, or of a proposed understanding to be arrived at, if it is proved that the provision is for the purposes of a joint venture and the joint venture does not have the purpose, effect or likely effect of substantially lessening competition.

Recommendation 9.2 The ACCC should develop and issue guidelines outlining its approach to joint ventures.

Government response:

To ensure that legitimate joint ventures are not impeded by the Act, the Government proposes a competition defence similar to that set out in Recommendation 9.1. The Government supports the issuing of guidelines by the ACCC.

(j) Dual listed companies

A dual-listed company (DLC) operates in a similar manner to an entity established via a merger and involves two corporations, one listed on a domestic stock exchange and the other listed on a foreign stock exchange, contracting to operate their businesses as a unified enterprise. Unlike the corporate groups established by merger, DLCs are not considered a single economic entity for the purpose of the competition provisions.

Recommendation 9.3 The Act should be amended to allow intra-party transactions in a DLC to be treated on the same basis as related party transactions within a group of companies. Consistently with this, the aggregate size of the DLC should be recognised for the purposes of assessing the entity's market power.

Government response:

The Government will amend the Act as proposed to ensure consistency between DLCs and corporate groups.

Part 4: Penalties

(a) Criminal penalties

'Hard core' or serious cartel behaviour, such as price fixing, can cripple competition and harm the economy. The competition provisions already prohibit such behaviour. The Act enables the Federal Court to impose significant civil penalties for any breach, including pecuniary penalties of up to $10 million for corporations and $500,000 for individuals.

Such penalties aside, many submissions supported the introduction of criminal penalties, including imprisonment, for serious cartel behaviour, primarily because criminal sanctions were said to be better able to deter corporations and individuals from engaging in such behaviour.

Other submissions to the Committee questioned the need for criminal sanctions and highlighted the problems that would have to be addressed if criminal sanctions were to be introduced. These problems include developing an appropriately defined criminal offence and combining any such offence with a workable leniency or amnesty policy (to encourage cartel participants to reveal the existence of cartel behaviour). Problems also relate to the concurrent operation of civil and criminal sanctions, and the development of a workable method of combining a clear and certain leniency policy with a criminal regime.

Recommendation 10.1 The Committee is of the view that solutions must be found to the problems identified by it before criminal sanctions are introduced for serious cartel behaviour. The problems are, importantly, the development (preferably by a joint body representing the Director of Public Prosecutions (DPP), the Attorney-General's Department, the ACCC and the Treasury) of a satisfactory definition of serious cartel behaviour and a workable method of combining a clear and certain leniency policy with a criminal regime. Subject to this proviso, the Committee recommends the introduction of criminal sanctions for serious, or hard-core, cartel behaviour, with penalties to include fines against any convicted corporation and imprisonment and fines, as appropriate, for implicated individuals.

Government response:

The Government accepts, in principle, that criminal penalties may be more effective than civil penalties in deterring people from engaging in serious cartel behaviour.

The Government will further consider the introduction of criminal penalties for serious cartel behaviour. Appropriate solutions must be found to the problems identified by the Committee. In addition, to enhance the welfare of Australians, any new criminal penalty must be applied broadly and must not impose significant additional uncertainty and complexity for business. Any new offence must also work well in the context of the Australian legal system, because it will only deter if the risk of conviction and substantial penalty are real.

(b) Civil penalties

The Act enables the Federal Court to impose significant civil penalties for any breach of the competition provisions, including pecuniary penalties of up to $10 million for corporations and $500,000 for individuals. In addition, the Federal Court may make other orders including the cessation of unlawful conduct and the payment of compensation or damages. Civil community service orders, probation orders and publicity orders may also be made.

The Committee concluded that comparable jurisdictions enable Courts to deter illegal behaviour by imposing maximum penalties upon corporations that are either a multiple of the gain or a proportion of the corporation's turnover. The Committee also supported recent New Zealand amendments providing an option for Courts to exclude individuals from being involved in the management of a corporation and prohibiting corporations from indemnifying their officers, employees or agents from the payment of a pecuniary penalty.

Recommendation 10.2 The Act should be amended so that:

10.2.1 the maximum pecuniary penalty for corporations be raised to be the greater of $10 million or three times the gain from the contravention or, where gain cannot be readily ascertained, 10 per cent of the turnover of the body corporate and all of its interconnected bodies corporate (if any);

10.2.2 the Court be given the option to exclude an individual implicated in a contravention from being a director of a corporation or being involved in its management; and

10.2.3 corporations be prohibited from indemnifying, directly or indirectly, officers, employees or agents against the imposition of a pecuniary penalty upon an officer, employee or agent.

Government response:

No corporation should benefit from anti-competitive behaviour. The Government will raise the maximum pecuniary penalty applicable to corporations. Also as proposed, the Government will introduce an option for Courts to exclude implicated individuals from being a director of a corporation or being involved in its management, and will address avoidance issues by prohibiting corporations from indemnifying officers, employees or agents.

Part 5: Administration

(a) Accountability of the ACCC

The Committee's terms of reference required it to examine the administration as well as the policy of the competition provisions. More submissions dealt with the ACCC's administration of the Act than with the Act itself.

Recommendation 11.1 Consideration should be given to the establishment of a single Joint Parliamentary Committee to oversee the ACCC's administration of the Act.

Government response:

The Government accepts this recommendation. The Government notes the Committee's view that the ACCC has been commendably vigorous in discharging its responsibilities under the Act.

The Government encourages the Parliament to establish a Joint Parliamentary Committee to provide further oversight of the administration of the Act by the ACCC. The Joint Committee would be well placed to develop a special understanding of the responsibilities of the ACCC and of the concerns of the parties with whom it deals.

Recommendation 11.2 The Act should be amended to establish a consultative committee to advise the ACCC on the administration of the Act. The consultative committee should be constituted so that it is convened by an independent chairperson appointed by the Treasurer. The chairperson should appoint the members of the committee in consultation with the ACCC. The committee should report to Parliament by way of a dedicated section of the ACCC's annual report.

Recommendation 11.3 An associate commissioner should be appointed to the ACCC to receive and respond to individual complaints about the administration of the Act and to report each year in the ACCC's annual report.

Government response:

The Government accepts the principle of putting in place effective consultative and complaints handling arrangements. The Government has commissioned a report by Mr John Uhrig, AC on the corporate governance of Commonwealth statutory authorities and office holders, which is expected to report shortly. After considering that report, the Government will announce a more specific response on these recommendations.

Recommendation 11.4 Consideration should be given to the manner in which the remuneration of commissioners is determined to ensure that the Government is able to attract as commissioners candidates of sufficient calibre.

Recommendation 11.5 The ACCC should consider the temporary placement of ACCC staff with other parties to develop staff resources.

Government response:

The Government believes that remuneration should be set by the Remuneration Tribunal. The Government notes the Remuneration Tribunal's review of the entitlements of office holders in 2002 (determination 23/2002). This determination has greatly increased the flexibility of remuneration packages which may be offered to full-time office holders (including ACCC Commissioners). Full-time office holders may now convert non-salary benefits into an additional salary payment and may also receive remuneration in lieu of performance pay. Accordingly, the need for the review of ACCC remuneration has been addressed.

The Government accepts Recommendation 11.5 and encourages the ACCC to build upon its existing arrangements for exchanges with other regulatory authorities. The Government also encourages the ACCC to develop staff exchanges with key groups with which it interacts.

Recommendation 11.6 The ACCC should review its service charter, in conjunction with the proposed consultative committee, in the light of the outcome of this review and the relevant recommendations of the Wilkinson Review.

Government response:

The Government agrees that the ACCC should review its service charter. Subject to the Government's specific response to recommendation 11.2, there is no objection to the proposed consultative committee contributing to such a review in order that the concerns of interested parties may be taken into account.

(b) Use of media

The Committee noted that the ACCC has been successful in raising the community's awareness of the importance of competitive markets and in encouraging compliance with the Act. It also noted that many of the submissions it received expressed concern regarding the manner in which the ACCC releases information and makes comments to the media.

Recommendation 12.1 A media code of conduct should be developed through the proposed restructured consultative committee.

Recommendation 12.2 The media code should be based on the following principles:

12.2.1 the public interest is served by the ACCC disseminating information about the aims of the Act and the ACCC's activities in encouraging and enforcing compliance with it. This extends to information about proceedings instituted by it, but an objective and balanced approach is necessary to ensure fairness to individual parties;

12.2.2 the code should cover all formal and informal comment by ACCC representatives;

12.2.3 whilst it may be necessary for the ACCC to confirm or deny the existence of an investigation in exceptional circumstances, the ACCC should decline to comment on investigations;

12.2.4 with the object of preserving procedural fairness, commentary on the commencement of court proceedings by the ACCC should only be by way of a formal media release confined to stating the facts; and

12.2.5 reporting the outcome of court proceedings should be accurate, balanced and consistent with the sole objective of ensuring public understanding of the court's decision.

Government response:

The Government accepts this recommendation. The Report notes the Committee's observation that the ACCC should exercise care in publicising particular matters to ensure that there is no unfairness to the parties involved. The development of a code of conduct governing the ACCC's use of the media will assist the ACCC's relationship with business and consumers. Subject to the Government's specific response to recommendation 11.2, the proposed consultative committee could appropriately contribute to the development of this code of conduct. The principles outlined in Recommendation 12.2 provide a useful foundation for developing this code of conduct.

(c) ACCC investigation powers

Section 155 of the Act provides the ACCC with the power to obtain information, documents and evidence in the course of investigating possible contraventions of the Act and for use in proceedings under the Act. The Committee identified concerns that the ACCC's investigative powers lack adequate safeguards, particularly in relation to section 155(2), which provides the ACCC with the power to enter premises and inspect documents without the need for a warrant.

Recommendation 13.1 The ACCC should continue to give careful consideration to the financial implications of requests for information that are made to businesses consistent with the ACCC's guidelines on this matter.

Government response:

The Government accepts this recommendation. While the ACCC needs broad investigative powers for the purpose of detecting and prosecuting contraventions, it should, nevertheless, be concerned about the effect of information requests upon recipients.

Recommendation 13.2 The function of conducting an examination of a person who is in receipt of a section 155(1)(c) notice should be delegable to senior staff of the ACCC.

Government response:

The Government supports the flexibility provided by this recommendation because ACCC Commissioners need not be directly involved in the detail of particular investigations.

Recommendation 13.3 Section 155(2) of the Act, which provides for the ACCC to enter premises and inspect documents, should be amended to:

13.3.1 require the ACCC to seek a warrant from a Federal Court Judge or Magistrate for the exercise of these powers; and

13.3.2 provide the ACCC with the power to search for and seize information.

Government response:

The ACCC has extensive powers under section 155(2) to enter premises and inspect documents but these do not require that a warrant be sought. Regulatory power must be matched with appropriate accountability.

The Act will be amended to require the ACCC to seek a warrant, although these should be capable of issue by a State or Territory judicial officer. Providing the ACCC with the power to search and seize information will provide greater clarification and certainty, as the elements of these powers are generally well known.

Recommendation 13.4 Section 155 should also be amended to:

13.4.1. extend the availability of the ACCC's investigative powers to circumstances where the ACCC is considering the revocation of an authorisation under sections 91B and 91C; and

13.4.2 repeal the redundant section 155(4).

Government response:

The Government agrees with this recommendation. These technical amendments will improve the general application of the ACCC's investigative powers.

Recommendation 13.5 It should be made explicit in the Act that section 155 does not require the production of documents to which legal professional privilege attaches.

Government response:

The Government agrees with this recommendation. Preserving legal privilege is in the public interest because it facilitates the obtaining of legal advice and promotes the observance of the law. This recommendation is consistent with the finding of the High Court in ACCC v Daniels Corporation International.

(C) NEW EUROPEAN CORPORATE GOVERNANCE TRANSPARENCY AND DISCLOSURE REPORT PUBLISHED

On 15 April 2003 Standard & Poor's Governance Services announced that it had published the European component of its global transparency and disclosure study, which examines disclosure of corporate governance-related information by companies in the world's major and emerging markets.

The new report 'Transparency and Disclosure Study: Europe' examines aggregate transparency and disclosure standards among companies in the Standard & Poor's Europe 350 index, based on their annual reports and, where applicable, their 20-F regulatory filings in the US. Previous studies have examined corporate transparency and disclosure standards in the US, Canada, Japan, Asia, and Latin America.

The authors of the study have focused on aggregated data instead of individual company rankings as in previous studies, thereby enabling better country-by-country comparison and analysis. Standard & Poor's emphasises that the study is not a measure of countries' corporate governance standards and should not be interpreted as a proxy for measuring companies' corporate governance standards. The study, however, does examine the level of disclosure of governance-related issues, which, in turn, facilitates analysis of the governance practices of individual companies.

The study's findings include:

- Disclosure of corporate governance-related information in Europe compares favourably with Asia, but less favourably with North America, although the level of disclosure in annual reports alone (excluding other regulatory filings) is higher in Europe than in the US;  
- Disclosure of governance-related information in the UK, France, and the Netherlands is among the highest globally. Within Europe, disclosure standards are lowest in Italy and Spain;  
- The varying practices in individual countries suggest that governance-related disclosure is not constrained by local regulatory filing requirements;  
- In all countries analyzed, companies with American Depositary Receipt (ADR) listings have higher governance-related disclosure levels than companies without an ADR listing; and  
- European companies provide consistently high levels of financial information, but are weaker in disclosing ownership information and investor rights in annual reports.

Questions that are less likely to be answered in European annual reports include: The percentage of cross-ownership; the ownership structure of affiliates; details of the chief executive officer's contract; specifics on performance-related pay for directors and senior executives; the form in which directors' salaries are paid; and the number of shares held in other affiliated companies by managers.

The full report 'Transparency and Disclosure Study: Europe' is available at [http://www.governance.standardandpoors.com](http://www.governance.standardandpoors.com" \t "_new) under the Transparency & Disclosure Study icon in the right-hand column.

(D) SEC TO REVIEW CURRENT PROXY RULES AND REGULATIONS TO IMPROVE CORPORATE DEMOCRACY

On 14 April 2003 the United States Securities and Exchange Commission announced that it had directed the Division of Corporation Finance to examine current proxy regulations and develop possible changes to those regulations to improve corporate democracy.

"The current rules concerning shareholder proposals and director elections are clear and we are enforcing them as such, but the time has come for a thorough review of the proxy rules and regulations to ensure that they are serving the best interests of today's investors, while at the same time, fostering sound corporate governance and transparent business practices," said Chairman William Donaldson.

The Commission has directed the Division of Corporation Finance to formulate possible changes in the proxy rules and regulations and their interpretations regarding procedures for the election of corporate directors. This review will address shareholder proposals, the nomination process, elections of directors, the solicitation of proxies for director elections, contests for corporate control, and the disclosure and other requirements imposed on large shareholders and groups of shareholders. As part of this process, the Commission has asked the Division to consult with all interested parties, including representatives of pension funds, shareholder advocacy groups, and representatives from the business and legal communities. The Commission has requested that the Division provide its recommendations to the Commission by 15 July of this year.

(E) GOVERNMENT ACTS TO REGULATE UNSOLICITED OFFERS TO BUY SHARES AT BELOW MARKET PRICE

On 8 April 2003 the Parliamentary Secretary to the Treasurer, Senator Ian Campbell announced new Regulations to deal with unsolicited offers to buy shares at below market price.

Section 1364 of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed by regulations or necessary or convenient to be prescribed by such regulations for carrying out or giving effect to the Act.

A market practice had developed whereby persons approach shareholders off-market and make offers to purchase shares well below market value, essentially trading on the potential ignorance of those shareholders. In the past, the [Financial Services Reform Act 2001 No. 122 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=58127" \t "default) (FSRA) has not imposed conditions or restrictions upon the practice of such businesses.

The purpose of the Regulations is to expand the definition of a financial service under the Act to include the making of unsolicited off-market offers to purchase financial products from investors, by persons in the business of acquiring financial products. Defining these offers as financial services ensures that persons involved in this practice would need to become licensed under the Financial Services Reform Act 2001 (FSRA) licensing regime. A licensing exemption would, however, be available if the person discloses the current market value of the financial product they wish to purchase when making the offer.

The Regulations would support the reforms to the regulation of the financial services industry, which were included in the FSRA and associated legislation, by promoting disclosure and protecting inexperienced financial product holders from businesses that offer to purchase financial products off-market at grossly undervalued prices.

(F) REGULATORS ISSUE INTERAGENCY PAPER ON SOUND PRACTICES TO STRENGTHEN THE RESILIENCE OF THE US FINANCIAL SYSTEM

On 8 April 2003 the United States Securities and Exchange Commission announced that three federal regulatory agencies issued an "Interagency Paper on Sound Practices to Strengthen the Resilience of the US Financial System." Among other things, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission identified sound practices to strengthen the resilience of critical US financial markets and minimize the immediate systemic effects of a wide-scale disruption.

On 5 September 2002, the agencies published for comment a draft of the paper in the Federal Register. The agencies have incorporated many of the suggestions that were made. The final paper, which applies most directly to the clearing and settlement activities of a limited number of financial institutions, provides more flexibility to firms in managing geographic dispersion of backup facilities and staffing arrangements, and takes into account other considerations relevant to cost-effective implementation of sound practices.

The paper is available on the SEC's website at [http://www.sec.gov](http://www.sec.gov" \t "_new)

(G) FSA PROPOSALS TO MAKE FUND MANAGERS MORE ACCOUNTABLE TO INVESTORS

On 7 April 2003 the United Kingdom Financial Services Authority (FSA) proposed a new policy where managers would be more accountable to investors. Under this policy fund managers would no longer be able to incur costs for services additional to dealing without the customer's express agreement. This means that managers would have to negotiate with their customers on how much to pay for such services. The FSA is also proposing that managers would no longer be able to use soft commissions to purchase services such as dealings screens.

Gay Huey-Evans, Director of the FSA's Markets and Exchanges Division said:

"Up to 40% of total commission spend is used to acquire services additional to dealing so it is important that investors are clear on how their money is spent. These proposals are designed to do away with distortions in the market and make fund managers more answerable to their clients. Our analysis suggests changes to the regulatory approach should foster competition and ensure a better overall outcome for investors."

At the moment brokers typically provide a range of additional services to fund managers. The main ones are market information technology and investment research. Services are provided under two types of arrangements - 'bundling' and 'softing'. 'Bundling' refers to the provision by brokers of other in-house services, such as research, together with dealing in securities in a single commission charge. 'Softing' is the practice by which a broker agrees to pay for the supply of services from a third party to a fund manager in return for an agreed volume of business at an agreed commission rate. In both cases, the value of the services provided is dependent on how much business the fund manager places with the broker. The costs for these services are included in the commissions which are passed through by fund managers directly as charges to their clients.

In 2000 over £2.3 billion were paid as commission by UK institutional fund managers to UK brokers. It is estimated that fund managers spent between £660 and £880 million of the commission on services additional to dealing. Of this between £500 million and £720 million was spent on investment research. In 2001 at least £90 million was spent on market pricing and information services.

Paul Myners' review of institutional investment published in March 2001 suggested that commission costs incurred by fund managers on their clients' behalf should be reflected in the fund manager's fee to investors. The Government subsequently agreed with the FSA that it would examine these issues in the context of its review of best execution. The FSA's proposals deal with the fund managers' conflicts of interest by requiring them to be directly accountable to their clients for the costs of additional services.

The consultation ends on 29 August 2003. Consultation paper 'CP176: Bundled Brokerage and Soft Commission Arrangements' can be accessed at [http://www.fsa.gov.uk/pubs/cp/](http://www.fsa.gov.uk/pubs/cp/" \t "_new)

(H) GROUP OF 100 RELEASES GUIDE TO REVIEW OF OPERATIONS AND FINANCIAL CONDITION

On 2 April 2003 the Group of 100 (which represents Australia's senior finance executives) published its Guide of Review of Operations and Financial Condition. The Guide provides general guidance on the form and content of a review of operations and financial condition that is aimed at complementing and supplementing the financial statements. It provides a framework for the directors of a company to discuss and analyse its performance and the opportunities and risks underlying its results and financial condition to ensure communication by the company on a consistent basis.

The review is aimed at meeting the information needs of users of financial reports and providing them with a basis for forming a view as to the likely future performance of the company in the context of the strategies of the company for achieving long term value creation and known trends in performance. This requires that the review contains a discussion of the operations of the period, including an explanation of unusual or infrequent events and transactions, and an analysis of the opportunities and risks facing the company, together with a planned approach to managing those opportunities and risks.

The Guide states that the review should:

- Explain the objectives of the company and how they are to be achieved.  
- Include discussion and analysis of key financial and non-financial performance indicators used by management in their assessment of the company and its performance.  
- Discuss the main factors and influences that may have a major effect on future results whether or not they were significant in the period under review.  
- Discuss the main activities of the company, including significant features of operating performance within the period covered by the financial report.  
- Discuss the overall return attributable to shareholders in terms of dividends and increases in shareholders' funds.  
- Include a commentary on the results for the financial year and dividends, both in total and in per share terms indicating the directors' overall distribution policy.  
- Discuss the current level of capital expenditure and other expenditure enhancing future performance, together with planned future expenditure (both committed, and authorised but not committed) and how it is expected to contribute future performance.  
- Contain a discussion of the capital structure of the company, including the maturity profile of its debt, types of financial instruments used, and currency and interest rate exposures.  
- Discuss the cash generated from operations and other cash flows during the period under review, including commentary on any special factors that influenced cash flows.  
- Discuss the company's liquidity and funding at the end of the period under review.  
- Comment on the strengths and resources of the company whose value may not be fully reflected in the statement of financial position.  
- Discuss and explain the significance of critical accounting policies, estimates and judgments made and their impact on the company's financial condition, changes in operation and results of operations.  
- Discuss and explain the significance and impact of changes in legislation, regulations and other external requirements which has had a material effect in the reporting period or is expected to have a material effect in future periods on the company's financial condition, changes in financial condition and results of operations.  
- Discuss the company's risk profile and risk management practices if these are not dealt with elsewhere in the annual report.  
- Discuss the nature of the company's corporate governance policies and practices if these are not dealt with elsewhere in the annual report.

The Guide is available on the Group of 100 website at [http://www.group100.com.au](http://www.group100.com.au" \t "_new)

(I) CLERP 7 BECOMES LAW  
(By Tom Bostock, Partner, Mallesons)

The [Corporations Legislation Amendment Act 2003 No. 24 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=69307" \t "default) ("the CLERP 7 Act") was passed on 27 March 2003 and received Royal Assent on 11 April 2003. The principal objective of the CLERP 7 Act, and the associated [Corporations (Review Fees) Act 2003 No. 23 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=69306" \t "default) and [Corporations (Fees) Amendment Act 2003 No. 22 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=69304" \t "default) ("the Fees Acts") is to implement "CLERP 7 Simplified Lodgements and Compliance Streamlining Paperwork under the Corporations Law", the Proposals Paper for which was issued in early 2000. Except for the other amendments noted in section 3 below, the CLERP Act and the Fees Acts will commence on 1 July 2003. The principal amendments to the Corporations Legislation (as defined in CA s9) are as follows:

(1) CLERP 7 amendments

The main CLERP 7 amendments are:

(a) Abolition of company annual returns (Schedule 1 to the Act)

In place of the annual return, companies will be required to confirm or correct company particulars using information provided by ASIC in the form of an Extract of Particulars and, where necessary a Return of Particulars, and pay an annual "review" fee. There will be new requirements for lodging information about company members and any ultimate holding company.

(b) Streamlining document lodgment requirements (Schedule 3 to the Act)

A number of existing company forms will be replaced by multi-purpose form. In addition, electronic lodgement of, and payment for, documents will be facilitated and encouraged; and telephone notice may be given to ASIC of changes relating to misspelling or other minor typographical error.

(c) Modification of the Corporations Act fees regime (Part 9.10 in Schedule 1 and the Fees Acts)

The Fees Schedule will be simplified and fees relief provided for small business. Annual fees will be introduced for occupational licence holders, while there will be progressive implementation of user pays principles for fees for occupational licensing, fund raising and takeovers.

Because of section 55 of the [Constitution](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=3877" \t "default), the fee proposals are covered by separate legislation in the form of the Fees Acts.

(2) Harmonisation with the new tax system (use of ABN and extension of lodgment periods)

Schedule 2 to the CLERP 7 Act contains a number of fairly minor and technical amendments that are intended to harmonize some requirements of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) with similar requirements in the [A New Tax System (Australian Business Number) Act 1999 No. 84 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=14477" \t "default).

In particular, if the last nine digits of a company's ABN are the same as its ACN, the company will from 1 July 2003 have the choice of using either its ABN or its ACN or its common seal on its public documents and in any other case when the company's ACN is required to permitted to be used under a Commonwealth law administrated by ASIC.

(3) Other amendments

Schedule 5 to the CLERP 7 Act contains a number of miscellaneous amendments to the Corporations Legislation as follows:

- increase from $250,000 to $1,000,000 the amount for which ASIC may render itself liable under contracts entered into by it without Ministerial approval;  
- amend Part 9 of the ASIC Act to permit the Chairman of ASIC (an ex officio member of CAMAC) to appoint an alternate (being a member or a senior officer of ASIC) to attend any meeting of CAMAC;  
- repeal CA s201C to remove the prohibition on the election or re-election of a director of a public company or a subsidiary of a public company who has reached 72 years of age; and  
- amend the CA to exclude charges over electronically-controlled securities created after 11 April 2003 from the charges provisions in CA Chapter 2K.

The first two of those items commence retrospectively on 15 July 2001, immediately after the commencement of the Corporations Act 2001. The last two items commence on the date of Royal Assent ie 11 April 2003.

(4) Extension of lodging periods

(a) Schedule 4 to the CLERP 7 Act extends from 14 to 28 days the time within which the following may be lodged without penalty with ASIC:

- CA s142(2) - notice of change of registered office;  
- CA s146(1) - change of principal place of business;  
- CA s205B(1) - notice of appointment of director;  
- CA s205B(2) - notice of appointment of alternate director;  
- CA s205B(4) - notice of change of personal details of director;  
- CA s205B(5) - notice of cessation of office of director;  
- CA s254X(1) - notice to ASIC of share issue.

(b) The Schedule 4 changes become operative on 1 July 2003. If at that time a company is required to lodge a notice under any of the above provisions and the time for lodgment has not expired, the extended period under Schedule 4 applies by new CA s1448 to that notice.

(5) Fees

With effect form 1 July 2003 the Corporations (Fees) Act 2003:

- increases from $5000 to $10,000 the maximum fee which may be prescribed by regulation for lodgement with ASIC of a document or any other chargeable matter;  
- increases from $25,000 to $50,000 the maximum fee, or sum of fees, for any chargeable matter which may be prescribed by regulation; and  
- permits the regulations to prescribe different fees for the same chargeable matter, depending on whether or not the matter is complied with by electronic means.

The Corporations (Review Fees) Act 2003, enables the regulations to prescribe review fees up to a maximum of $10,000 for companies, registered schemes, registered Australian bodies, registered auditors and liquidators and persons holding an Australian financial services licence. A review fee need not bear any relationship to the cost of providing any service.

(J) SEC REQUIRES EXCHANGE LISTING STANDARDS FOR AUDIT COMMITTEES

On 1 April 2003 the United States Securities and Exchange Commission voted to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the audit committee requirements established by the Sarbanes-Oxley Act of 2002. The new rules and amendments implement the requirements of Section 10A(m)(1) of the Securities Exchange Act of 1934, as added by section 301 of the Sarbanes-Oxley Act of 2002.

Under the new rules, national securities exchanges and national securities associations will be prohibited from listing any security of an issuer that is not in compliance with the following requirements.

- Each member of the audit committee of the issuer must be independent according to the specified criteria in section 10A(m).  
- The audit committee must be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the issuer, and the registered public accounting firm must report directly to the audit committee.  
- The audit committee must establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.  
- The audit committee must have the authority to engage independent counsel and other advisors, as it determines necessary to carry out its duties.  
- The issuer must provide appropriate funding for the audit committee.

The new rules will establish section 10A(m)'s two criteria for audit committee member independence.

- Audit committee members must be barred from accepting any consulting, advisory or compensatory fee from the issuer or any subsidiary, other than in the member's capacity as a member of the board or any board committee.  
- An audit committee member must not be an affiliated person of the issuer or any subsidiary apart from capacity as a member of the board or any board committee.

The new rules will apply to both domestic and foreign listed issuers. It is important to note that, based on significant input from and dialogue with foreign regulators and foreign issuers and their advisers, several provisions, applicable only to foreign private issuers, have been included that seek to address the special circumstances of particular foreign jurisdictions. These provisions include:

- allowing non-management employees to serve as audit committee members, consistent with "co-determination" and similar requirements in some countries;  
- allowing shareholders to select or ratify the selection of auditors, also consistent with requirements in many foreign countries;  
- allowing alternative structures such as boards of auditors to perform auditor oversight functions where such structures are provided for under local law; and  
- addressing the issue of foreign government shareholder representation on audit committees.

The new rules also will make several updates to the Commission's disclosure requirements regarding audit committees, including updates to the audit committee financial expert disclosure requirements for foreign private issuers.

The Commission voted to establish two sets of implementation dates for listed issuers. Generally, listed issuers will be required to comply with the new listing rules by the date of their first annual shareholders meetings after 15 January 2004, but in any event no later than 31 October 2004. Foreign private issuers and small business issuers will be required to comply by 31 July 2005.

(K) CORPORATES SPLIT OVER RESPONSE TO EXECUTIVE REMUNERATION CONCERNS

On 30 March 2003 Chartered Secretaries Australia (CSA) released the results of a survey concerning executive remuneration.

Fifty-three per cent of respondents in the CSA survey of members in the ASX Top 200 companies believe disclosure of executive remuneration should be legislated while 47 per cent opt for "if not, why not, please explain". Nor is there a consensus that information gained from full disclosure of remuneration will assist shareholders make more informed investment decisions with 59 per cent saying it would not, and 41 per cent saying it would.

The survey also found diverse views about the extent to which disclosure of executive remuneration genuinely benefits investors. 53 per cent of respondents felt disclosure drives payments upwards, and 47 per cent think it does not. Moreover, only 41 per cent believe disclosing the information genuinely affects shareholders' ability to make an informed investment decision.

The survey also shows directors and executives are under increasing pressure to deliver real value, with 88 per cent of respondents agreeing that remuneration needs to be more closely linked to performance. And although 71 per cent of companies pay retirement benefits to directors, 56 per cent are considering abolishing them.

(L) SENATE PASSES REPAYMENT OF DIRECTORS' BONUSES BILL

On 28 March 2003 the Senate of the Australian Commonwealth Parliament passed without amendment the [Corporations' Amendment (Repayment of Directors' Bonuses) Bill 2002](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=65715" \t "default).

The Bill amends the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) to permit liquidators to reclaim unreasonable payments made to the directors of insolvent companies. The Bill applies to transactions that involve a director of the company or close associate, meaning a relative of the director or the spouse of a director. In both cases, de facto spouses are included. To be caught, the transaction must have been unreasonable and entered into during the four years leading up to a company's liquidation, regardless of its solvency at the time of the transaction.

The Bill was described in more detail in the March issue of the Corporate Law Bulletin.

(M) CalPERS RELEASES 2003 CORPORATE GOVERNANCE FOCUS LIST

On 27 March 2003 the California Public Employees' Retirement System (CalPERS) announced Xerox Corporation and five others have been put on its corporate governance Focus List and will be the primary focus of its corporate governance activism in the upcoming proxy season.

In a letter sent to the Xerox Chairman and CEO Anne Mulcahy, CalPERS asked the Stamford, Connecticut-based company to take immediate steps to expand the board by three independent directors and split the position of Chairman and Chief Executive Officer.

In addition to Xerox, the 2003 Focus List includes: Gemstar-TV Guide International, Inc. of Pasadena, California; JDS Uniphase Corp. of San Jose, California; Manugistics Group, Inc. of Rockville, Maryland; Midway Games, Inc. of Chicago, Illinois; and Parametric Technology of Needham, Massachusetts.

CalPERS Focus List of companies was selected from the pension fund's investments in more than 1,800 US corporations, and was based on the companies' long-term stock performance, corporate governance practices, and an economic value-added (EVA (r)) evaluation.

EVA (r) measures a company's net operating profit after tax, minus its cost of capital. By using EVA (r) and stock performance, CalPERS has pinpointed companies where poor market performance is due to underlying financial performance problems as opposed to industry or extraneous factors alone.

Xerox tops CalPERS list as one of the most ineffective boards. The company was fined by the SEC and forced to restate earnings from 1997 though 2000. Its Board has also been publicly accused of financial manipulation by its own former employees.

"We were shocked to learn that Xerox has a policy that its board members are 'strongly recommended' not to communicate directly with institutional investors," said Rob Feckner, Chair of CalPERS Investment Committee. "This is reason enough to ensure that a fresh perspective is added to this board."

In August 2001, Xerox's auditor KPMG reportedly issued a management letter that told the company "that its 'tone at the top' was a material weakness," according to a Bloomberg news story.

Other problem companies under CalPERS microscope include Gemstar, whose out-going CEO Henry Yuen and CFO Elsie Leung were granted severance packages totaling $22 million and $7 million, respectively. The two executives retained their Board seats and together will swap a total of about 20 million stock options for some 8 million restricted shares and 9 million new options.

CalPERS wants Gemstar to commit to a majority of independent directors on its board, audit, compensation and nominating committees.

Gemstar's stock performance declined 88.2 percent for the one-year period ended December 31, 2002 versus its peer group in the Russell 1000 Consumer Index that fell 24.2 percent. From 1998 to 2001, its EVA declined by approximately $984 million. CalPERS also wants Gemstar to develop and seek shareowner approval for an executive compensation policy that considers performance-based stock options.

JDS Uniphase scored the worst out of the companies CalPERS screened in terms of EVA, a direct result of what is believed to be a lack of financial discipline in the Company's acquisition strategy during the late 1990's internet boom. Its EVA fell by $11.5 billion between 1999 and 2002. CalPERS wants JDS to eliminate its co-Chairman structure in favour of a separate Chairman and CEO, declassify the Board and seek shareholder approval for the company's poison pill. JDS Uniphase's stock performance was down approximately 71 percent in the year ended December 31, 2002, compared to its peers in the S&P 500 Telecom Equipment Index that fell approximately 54 percent.

Parametric Technology has ignored CalPERS repeated requests to meet and discuss performance and governance concerns. CalPERS is concerned that each Board member was paid 100,000 options or more "in recognition of extensive work during Fiscal year 2001", at a time when Parametric's stock declined 41 percent. Parametric has a six member classified board.

Midway's stock is down more than 77 percent for the five year period ended December 31, 2002 versus its peer index the S&P Smallcap Leisure Products Index that lost 16 percent. CalPERS believes that Midway has not been able to capitalize on the rapid growth of the entertainment software industry because of inadequate execution of its business plan. The Board also lacks a lead independent director and only 27 percent of its 11 directors are independent according to CalPERS definition of independence. CalPERS wants Midway to add two new independent directors in the next year and separate the positions of its Chair and CEO.

Manugistics Group's similar lack of separation between the CEO and Chair and no lead director has left its nine-member board with clear issues of independence. The nominating committee is less than 100 percent independent and three of the nine board members have affiliated relationships with the Company.

Manugistics performance was down 88 percent for the one-year period ended December 31, 2002 versus a 46 percent decline for its peers in the Russell 2000 Technology Index.

Seven additional companies have been put on CalPERS monitoring list for poor corporate governance, and possible actions regarding the companies will be disclosed throughout the proxy season and year.

For more information on CalPERS Focus List, visit [http://www.calpers-governance.org](http://www.calpers-governance.org" \t "_new)

(N) SECURITIES MARKETS: EUROPEAN COMMISSION PROPOSES DIRECTIVE TO INCREASE INVESTOR PROTECTION AND TRANSPARENCY

On 26 March 2003 the European Commission presented a proposal for a Directive introducing minimum transparency requirements for information which must be provided by companies whose securities are traded on a regulated market, such as a stock exchange. The proposal, a key part of the Financial Services Action Plan, aims to enhance investor protection, attract investors to the European market place and improve the efficiency, openness and integrity of European capital markets. It would also remove certain national barriers linked to transparency requirements, which may discourage issuers from having their securities admitted to trading on more than one regulated market in the EU. In order to achieve these aims, the proposed Directive would upgrade the current level and frequency of the mandatory financial information that issuers have to provide to the markets throughout the financial year. It would also simplify requirements issuers must meet on the use of languages and on the way information is disseminated. The proposal will be submitted to the European Parliament and the EU's Council of Ministers for adoption under the so-called "co-decision" procedure.

The Commission's proposal, which follows extensive two-year consultations with the markets, regulators and other interested parties, is part of a comprehensive strategy aiming to improve the clarity, reliability and comparability of the information provided to investors. Other related Commission initiatives cover accounting standards, prospectuses and company law.

The proposed Directive will upgrade existing EU law to bring it into line with the requirements of a more global economy.

(1) Scope

The proposed Directive will apply to all companies whose securities are admitted to trading on a regulated market in the EU. It takes into account the particularities of wholesale bond markets, such as the Eurobond markets, along the same lines as in the Prospectus Directive (currently before the Council and Parliament). There will thus be no periodic reporting requirements for those who issue solely bonds the denomination of which is €50,000 or more.

(2) Information to be disclosed

The Directive updates and upgrades periodic information requirements for securities issuers. Current EU law dates back some twenty years and must be modernised to take into account the introduction of International Accounting Standards (IAS) for all companies listed in the EU from 2005 (see IP/02/827 and IP/01/200 and MEMO/01/40). Several Member States have already increased their requirements for the mandatory disclosure of information by issuers, largely exceeding the requirements currently imposed by EU law.

The proposed Directive balances greater market transparency for all investors with avoiding unnecessary burdens and costs on issuers. It would introduce a pragmatic policy mix of more detailed half-yearly financial reports and less extensive quarterly financial information for the first and third quarter of each financial year.

The proposed Directive would require all securities issuers to disclose to the public periodically:

- an audited annual financial report (financial statements based on international accounting standards) and a management report, within three months of the end of each financial year; and  
- a half-yearly condensed financial report based on international accounting standards on interim financial reporting (IAS-34) as well as an update of the last annual management report.

In addition, share issuers would also need to publish a less extensive quarterly financial information report for the first and third quarter of a financial year. This would include the share issuers' net turnover, profit and loss before or after deduction of tax, plus, if the issuer so chooses, short trend information on the company's future development for the remaining part of the financial year. Member States would not be able to require share issuers to publish this short trend information in their quarterly reports.

Companies who issue only debt securities, who are currently not subject to any interim reporting requirement at all, would under the proposal be required to issue half-yearly financial reports for the first six months of a financial year.

All this interim information would need to be within 60 days after the end of the period concerned.

The proposed Directive also upgrades the current requirements on information that is not periodic:

- to give the public swifter and better information about the material interests of important shareholders, more changes in issuers' shareholding structures would need to be disclosed within shorter time limits. The shareholders involved and the company itself would have to ensure that such information became public; and  
- securities issuers would have to provide information to holders of shares and debt securities so as to facilitate participation in general meetings. This would include information about proxy voting under the law of the issuer's home Member State.

The proposal would allow companies to convey this information by electronic means, under certain conditions (see below). However, it does not deal with the conditions for electronic voting or harmonise proxy voting in the EU. These issues are linked to company law and corporate governance, on which the Commission will issue a separate Communication this Spring taking into account the report by the Commission's High level Group of Company Law Experts of November 2002 (see IP/02/1600).

(3) Languages

The proposed Directive covers requirements on the use of languages. At present, each Member State where a company is listed may require that information disclosed to the public is in its official language(s). Responses to consultation demonstrated that issuers whose securities are traded in several Member States find having to produce information in many different languages costly and burdensome. Under the proposed Directive, when disclosing information to a host Member State market, such issuers would be able to use, in addition to the language of their own home Member State, a language customary in the international sphere of finance.

(4) Dissemination of information to the public

The proposed Directive would make sure that issuers disseminate information on time throughout their home Member State as well as abroad. In order to do so, issuers would be able, if they chose, to use means of dissemination located outside their home Member State or to channel all financial information through a single source. The host Member States where an issuer's securities are traded would not be able to impose their own policy, but would have to allow the issuer to use its internet site, backed up by an efficient electronic alert system the details of which would be laid down by future implementing rules. The proposal also provides, if necessary, for the Commission to establish a list of the media which the home Member State may impose.

(5) Background

The Commission prepared its proposal on the basis of extensive consultations with national authorities, security issuers, investors, auditors, stock exchanges and market participants over two years (see IP/02/684).

The proposal has been drafted in conformity with the institutional arrangements laid down in the Stockholm European Council Resolution which resulted from the recommendations of the Committee of Wise Men chaired by Baron Alexander Lamfalussy on the efficiency and transparency of the EU legislative process relating to securities markets (see IP/02/195). It is therefore a "framework Directive" in line with the February 2002 agreement with the European Parliament on improving the regulation of EU securities markets.

The proposal sets out the general high-level obligations which Member States authorities would have to enforce. It also provides for the use of technical implementing measures so as to ensure its uniform implementation and to adapt to changing market and supervisory realities. The scope of the implementing measures will be decided by the European Parliament and the Council by co-decision. The Commission's implementing measures will be developed on the basis of technical advice provided by the Committee of European Securities Regulators (CESR) following open consultation of market practitioners.

The full text of the proposal is available on the Commission's website at [http://www.europa.eu.int/](http://www.europa.eu.int/" \t "_new)

(O) CHANGE REQUIRED FOR COMPANIES TO COMPLY WITH UK HIGGS REPORT

On 26 March 2003 Monks Partnership, part of PricewaterhouseCoopers, released a survey which highlights some of the areas where UK companies do not currently comply with the recommendations of the Higgs' Review of the role and effectiveness of non-executive directors regarding board committees. Compliance with Higgs' recommendations is not mandatory. Where there is non-compliance, the onus is on the company to provide a clear explanation in its annual report.

According to the findings, 38% of industrial and service sector companies do not have a formal nomination committee. Where there is a nomination committee, 61% are chaired by the company chairman rather than an independent director, as recommended by Higgs.

The Higgs Review recommends that the remuneration and audit committees should each have a minimum of three independent directors. Based on companies' opinions on independence, the survey findings indicate that 13% of remuneration committees and 12% of audit committees do not meet this recommendation. Higgs also provides a definition of the independent director and if his definition were to be applied the level of non-compliance would rise.

The findings show that 41% of smaller industrial and service sector companies - with a turnover of less than £500m - have fewer than three non-executive directors (excluding the chairman and deputy chairman). In these companies, the recommendation for a minimum of three independent directors to sit on both the audit and remuneration committees will currently not be met.

As suggested by Higgs, just over half the larger companies pay a base fee to their non-executive directors, with an additional fee paid for membership and/or chairmanship of the remuneration and audit committees. Typically, fees of £5,000 are paid for membership or chairmanship of these committees.

Overall, Monks Partnership found that the typical fee paid to a FTSE 100 non-executive director was £37,000, an increase of £2,000 over 2002 while non-executive chairmen's fees typically remained static at £200,000. Comparable figures for FTSE 250 companies were £30,000 and £115,000.

(P) SARBANES-OXLEY ACT REQUIRES CHANGES IN CORPORATE CONTROL, COMPLIANCE, ACCORDING TO PRICEWATERHOUSECOOPERS SURVEY OF SENIOR EXECUTIVES

Implementation of the Sarbanes-Oxley Act of 2002, enacted largely in response to US corporate and accounting scandals, has resulted in changes in controls and compliance practices at nearly 85 percent of large US multinational companies, according to a PricewaterhouseCoopers survey of senior executives released on 24 March 2003. However, only about a third of executives at those companies believe the new law of itself will restore investor confidence in the capital markets or aid their companies' ability to create shareholder value.

The Sarbanes-Oxley Act, enacted last year, requires company executives, boards of directors and independent auditors to take specific actions to achieve greater corporate accountability and transparency. The intent of the law was to help restore public trust in US business and corporate reporting.

Asked for their overall assessment, senior executives characterized Sarbanes-Oxley as:

- A good and adequate response to problems in accounting and reporting - 9%  
- A good first step in company accounting and reporting, but more needs to be done - 33%  
- A well-meaning attempt, but will impose unnecessary costs on companies - 42%  
- Ill-considered and hastily-passed legislation that won't make any difference - 15%  
- Will actually harm rather than improve the capital markets - 1%

Of the executives interviewed, 84 percent acknowledge that Sarbanes-Oxley has changed control and compliance practices in their company, but just four percent cited significant changes, and 27 percent, modest change, while 53 percent said the new law simply formalizes what their company has been already doing. Eighty-two percent expressed confidence their company is in full compliance with the law, while 13 percent said they had more to do.

Thirty-one percent of executives said Sarbanes-Oxley will restore public confidence in the capital markets, while 50 percent said the law will have no impact in itself, and 19 percent were uncertain. Among those expecting Sarbanes-Oxley to bolster confidence, three percent anticipate it will have a major influence, 19 percent a moderate impact, and nine percent a small one.

Thirty-two percent said Sarbanes-Oxley will have a positive impact on their company's ability to increase shareholder value, while 56 percent expect its impact on shareholder value to be neutral, and six percent negative.

The initial costs of complying with Sarbanes-Oxley were perceived as modest: only three percent say it has been very costly to implement, and 29 percent somewhat costly. In contrast, 46 percent say implementation has not been particularly costly, and 15 percent not at all costly. But 71 percent of surveyed executives believe that costs will increase over the long term - including 12 percent expecting much higher future costs, and 59 percent somewhat higher.

Sixty-five percent of executives said the Sarbanes-Oxley Act presents increased risk for their CEO, CFO, and other key executives who are required to certify the company's financial reports. Seventeen percent said those executives face much higher risk, and 48 percent generally higher risk. Only two percent expect lower risk, while 32 percent perceive no real change.

Those interviewed expect an average of 18.6 executives, other than the CEO or CFO, will be required to provide sub-certifications at their company. Only 20 percent expect no additional sub-certifications will be needed, and 13 percent were not certain.

There was a direct correlation between executives' outlook on the cost of implementing the law and their evaluation of its impact. Only 31 percent of those worried about higher future costs gave the law a positive overall evaluation, compared 70 percent positives from the minority who see no additional future cost impact.

(Q) EUROPEAN UNION NOT TO CAP AUDITOR LIABILITY

On 24 March 2003, Frits Bolkestein, Member of the European Commission in charge of the Internal Market and Taxation, presented a speech in which he stated that the European Union would not be moving to cap the liability of auditors.

Following is an extract from his speech:

"I should like to give you my views on limiting auditor liability. You may consider them to be somewhat provocative but I hope they will further the debate. I should like to say at the outset that, in the current political climate, I think there would be little support for a regulatory intervention which would generally limit auditor liability. After so many major financial reporting scandals and potential audit failures, regulators need to act to restore investor confidence. An intervention limiting liability, to my mind, would not serve to revive the trust of investors.

"At present, I see four clear reasons for not limiting auditor liability:

(1) Unlimited auditor liability is a quality driver.

If the auditor delivers permanently high quality he has no liability exposure. There is no more effective liability risk management than delivering high quality audits.

(2) Liability systems exist for the protection of the persons who suffered damage not for the convenience of those who may be at fault.

Therefore, the "deep pocket" approach is principally sound because someone who has suffered damage should not have to shoulder the burden of suing separately all parties which have a partial responsibility for proper financial statements. In any case, all Member States have the concept of joint and several liability as a fundamental element in their civil liability systems.

(3) Increased auditor liability is partly a self-created problem.

Here, there are two considerations:

(i) The growth of audit firms and the branding of one name one firm world-wide has significantly increased the potential damage to the whole network in case of a potential audit failure committed by one of the local firms. This drives the willingness of networks of audit firms to settle for higher amounts. Trends in liability claims should not be considered in absolute terms but relative to the increased turnover and profit of audit firms, figures that are not easily available worldwide.

(ii) Claims from potential audit failures have been settled too easily out of Court. As a consequence there is very little case law clarifying the boundaries of auditor liability. An unanswered question for me is whether out of Court settlements are initiated by the audit firms' desire to limit the damage to the brand name or by the risk judgment of insurance companies.

(4) Audit is by its very nature a function which is carried out in the public interest

This implies that 3rd parties should be able to rely on the correctness of companies' financial statements and be in a position to claim damages in case of fraudulent financial reporting. EU company law specifically recognises the protection of third parties such as creditors as one of its major objectives. In this context the Commission is somewhat concerned about the recent modification to some UK audit reports which seem, in response to the ruling in the Bannerman case, to try to limit auditor liability to third parties via wording in the audit report."

In relation to EU initiatives dealing with auditing, Mr Bolkestein stated:

"In my view the EU capital market cannot function properly without high quality audits and there is nothing that can replace them. If the recent series of financial reporting scandals have shown one thing, it is the importance of proper financial reporting. Improper financial reporting due to management manipulation, audit failures or shortcomings in corporate governance have undermined seriously trust in capital markets.

"As I said at the outset I am firmly committed to maintaining public confidence of the audit function. In this context the Commission is considering undertaking a study on the broader economic impact of increased exposure of auditors to liability. Indeed, the Commission is preparing a Communication on audit priorities which should be adopted in parallel with the Action Plan on Company Law and Corporate Governance around mid May. This Communication will consider updating existing EU law, in particular the 8th Directive, including improving the internal market for audit services. It will also address how the regulatory framework and structures for the statutory audit function can be improved and auditor independence can be re-enforced.

"In addition, the Commission's forthcoming Action Plan on Company Law and Corporate Governance will set out a series of actions for the short and medium term. Many of the actions are aimed at clarifying the role and responsibility of those involved in managing and governing a company. There can be no doubt that the clarification of the role and the position of the statutory auditor would have a positive effect on the assessment of his liability in the case of an audit failure. The responsibilities of auditors, directors, independent directors and audit committees will also be clarified, including the confirmation of the collective responsibility of board members for financial and key non-financial statements."

The full speech is available on the European Union website at [http://europa.eu.int/rapid/start/cgi/guesten.ksh?p\_actiongettxt=gt&doc=SPEECH/03/151|0|RAPID&lg=EN&display=](http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=SPEECH/03/151%7C0%7CRAPID&lg=EN&display=" \t "_new)

(R) AUSTRALIA'S FUNDS MANAGEMENT MARKET FIFTH LARGEST IN THE WORLD

In February 2003 the Investment Company Institute, which is an association of US and international mutual and other investment funds, reported that Australia's funds management pool was now the fifth largest in the world and the biggest in Asia.

Mutual fund assets in Australia now total US$339 billion, with the size of the Australia pool surpassing other major financial centres such as the UK and Japan. Australia was previously ranked seventh largest in the world and second in Asia, with total mutual fund assets of US$304 billion as at September 2001. The data for the latest survey is for the third quarter of 2002 and relates to 36 countries.

Total assets of worldwide mutual funds declined 7.9 percent in the third quarter of 2002 to $10.65 trillion. The third quarter decline in worldwide mutual fund assets primarily reflected global weakness in equity prices. Stock price indexes in virtually every one of the reporting countries moved lower in the quarter, with most decreasing more than 10 percent and some between 20 and 40 percent.

In this environment, equity fund assets fell 17.5 percent, with 29 reporting countries posting declines. At the end of the third quarter, assets of equity funds were $3.972 trillion, down from $4.816 trillion at the end of the second quarter.

Also contributing to the decline in equity fund assets in the third quarter was a net outflow of $64 billion from these funds. The outflow was largest among US equity funds, but European equity funds also experienced a net outflow. In contrast, equity funds in Asia-Pacific countries recorded a net inflow, largely reflecting net sales by exchange-traded funds in Japan. Despite the outsized drop in stock prices, the net outflow for all countries was relatively small, amounting for the quarter to only 1.6 percent of average assets for the 25 countries reporting net sales.

Balanced/mixed funds, which invest in stocks and bonds, also felt the effects of the retreat in stock prices. Assets of these funds fell 10.1 percent in the third quarter to $855 billion. The decline was broad-based, with all but one of the reporting countries posting decreases. Balanced/mixed funds recorded a net outflow of $14 billion in the quarter.

Assets of bond funds increased 2.6 percent in the third quarter to $2.395 trillion. Net sales of these funds were $48 billion in the quarter, reflecting strength in the US and Europe. Bond funds in the Asia-Pacific region recorded an outflow, extending a development that began in the last half of 2001.

Assets of money market funds declined 0.3 percent in the third quarter to $3.016 trillion, reflecting an outflow of $27 billion from these funds. European money market funds continued to experience strong inflows during the third quarter. In the US, however, institutional investors reacted to the low level of yields on money funds by shifting to higher-yielding open-market instruments.

At the end of the third quarter, assets of equity funds represented 37 percent of all worldwide mutual fund assets, down from 42 percent at the end of the second quarter. The asset shares of money market and bond funds were up slightly in the third quarter.

The number of funds increased 1.1 percent in the third quarter to 52,988. The composition of the number by type of fund, however, was largely unchanged.

Further information is available on the Investment Company Institute website at [http://www.ici.org](http://www.ici.org" \t "_new)

2. RECENT ASIC DEVELOPMENTS

(A) MANAGED DISCRETIONARY ACCOUNT SERVICES PPP

On 16 April 2003 ASIC released a policy proposal paper on managed discretionary account (MDA) services. The paper sets out ASIC's new proposals for regulating MDA services offered to retail clients under the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default).

An MDA service is defined as a service involving certain features including:

- a client giving their money or other assets to the MDA service operator, or access to their money or assets (the client's contributions);  
- the operator having discretions to buy and sell financial products using the client's contributions; and  
- the operator agreeing to manage the financial products acquired or derived from using the client's contributions as a discrete portfolio belonging to the client.

Some services currently marketed as separately managed accounts (SMAs), individually managed accounts (IMAs), investment advisory programs (IAPs), managed discretionary portfolio services (MDPSs) and discretionary portfolio accounts (DPAs), may fall within ASIC's definition of MDA services. If they do, then they will be regulated under the new policy.

Comments on the policy proposal paper are sought by 22 May 2003. Copies can be obtained by phoning the ASIC Infoline on 1300 300 630, or downloaded from ASIC's website at [http://www.asic.gov.au](http://www.asic.gov.au" \t "_new)

A summary of the paper follows.

(1) How does ASIC propose to regulate MDA services?

ASIC proposes to exempt MDA operators from the managed investment and financial product disclosure provisions in the Corporations Act, on condition that they (among other things):

- have an Australian Financial Services licence (AFS licence) with the appropriate authorisations - ie dealing and probably custodial and depository services and financial product advice (unless outsourcing the custody and financial product advice functions relating to the MDA service to another AFS licensee with the appropriate authorisations);  
- give clients a Financial Services Guide containing certain detailed information relating to the MDA service;  
- enter into an MDA contract with the client, which meets certain requirements;  
- have an investment program included in the MDA contract that is suitable for the client in light of their investment objectives, particular needs and financial situation and also review the suitability of the program for the client at least annually;  
- give a client quarterly reports or on-going electronic access to information about the cost and performance of their portfolio; and  
- carry out certain audits relating to the client's portfolio, covering compliance with the licence and class order conditions under which the MDA service is operated, and report to ASIC and the client on those matters.

(2) When will the new policy come into effect?

ASIC expects to have its new policy ready in the last quarter of 2003.

(3) People other than market participants

People already lawfully operating MDA services may continue to do so until 11 March 2004 (the conclusion of the [Financial Services Reform Act 2001 No. 122 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=58127" \t "default) transition period), after which they will be required to comply with the new policy. They can also opt-in to the new policy at any time before 11 March 2004.

People who start operating an MDA service between commencement of the new policy and 11 March 2004, or who are operating a MDA service which is not presently covered by an existing ASIC relief or no action position, will need to comply immediately. These operators will need to apply for the relevant AFS licence.

(4) Market participants

Currently, Sydney Futures Exchange (SFE) participants operate MDA services under ASIC class order relief [CO 01/1598] and [CO 02/186], and ex-associate participants of SFE operate MDA services under ASIC class order relief [CO 02/1022]. These class orders exempt them from the managed investment provisions and the hawking and advertising prohibitions in the Corporations Act.

Australian Stock Exchange (ASX) participants operate DPAs (which have MDA features) under a no-action position adopted by ASIC from the managed investment provisions.

ASIC has extended the class order relief and the no-action position until 11 March 2004, to enable market participants to make a smooth transition to the new policy.

However, market participants can also opt-in to the new policy at any time before 11 March 2004. (See Class Order [03/233] which extends Class Order [02/1022], Class Order [03/234] which extends Class Order [01/1598], and Class Order [03/235] which extends Class Order [02/186].)

ASIC will consult with ASX and SFE to assess whether their participants should be given any additional relief. Generally, such relief might be considered if market operators produce outcomes similar to those outlined in the policy proposal paper, through the relevant market rules and supervision.

(5) Further information

A copy of the policy proposal paper and Class Orders [01/1598], [02/186], [02/1022],  
[03/233], [03/234] and [03/235] can be obtained from ASIC's Infoline on 1300 300 630, or from the ASIC website at [http://www.asic.gov.au](http://www.asic.gov.au" \t "_new)

(B) LONG-RANGE FINANCIAL FORECASTS

Prospectuses and Product Disclosure Statements (PDSs) containing long-range financial forecasts are the focus of an ongoing targeted campaign revealed on 16 April 2003 by the Australian Securities and Investments Commission (ASIC).

Issuers are being warned to take care that any financial forecasts included in offer documents are not misleading. This is a key requirement of the law and of ASIC Policy Statement 170 (PS 170).

ASIC is aware of a number of prospectuses and PDSs that contain forecasts for ten, fifteen or twenty years and beyond. Typically these relate to agricultural schemes involving crops with long life-cycles, such as trees or vines.

Such forecasts generally depend on variables such as inflation, exchange rates, pricing and market conditions well into the future. Often disclosure documents claim they are based on independent expert opinions about the variables. However, long-range forecasts are misleading if they are not consistent with the expert opinions on which they are based.

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(C) ASIC RELEASES STAGE TWO RESULTS OF ACCOUNTING SURVEILLANCE

On 10 April 2003 ASIC released the second stage results of the accounting surveillance project begun in July 2002.

The project reviewed the audited full-year financial reports of more than 1000 listed companies with balance dates between 30 June and 31 July, with particular attention to capitalised and deferred expenses, recognition of revenue, and recognition of controlled entities and assets.

The second stage of the project follows a release of initial results on 18 December 2002. The December results identified 31 companies for further follow-up, some with multiple issues, and ASIC has since been in discussion with those companies in relation to the issues of concern.

'Following discussions with the companies and in some cases their auditors, we have received information that has adequately resolved 19 queries. However, we are continuing our enquiries in relation to 16 companies where we continue to have concerns with the application of an accounting standard or standards', ASIC Chief Accountant, Mr Greg Pound said.

'These companies should be aware that we may take further action if the matters cannot be resolved', Mr Pound said.

(1) Disclosure

Following further enquiries, ASIC has accepted the accounting policies and reporting of transactions in relation to 13 companies. In 10 of these cases ASIC is requesting an improvement in disclosure for future financial reports lodged by the companies.

'High-quality, comprehensive financial reporting necessitates adequate disclosure and explanation of accounting policies such as revenue recognition, and other factors such as valuation methodologies and the accounting treatment of significant transactions', Mr Pound said.

'Had there been better disclosure by these companies in the first instance, ASIC may not have expressed a concern', Mr Pound said.

'ASIC encourages companies to ensure that their financial report disclosures are clear and comprehensive, as they are vital components of a high-quality financial report and help to ensure people reading the report fully understand the treatments used', he said.

Shortcomings were noted in other areas of disclosure by listed companies more generally and included:

- expenses reported as 'other expenses' despite exceeding 10% of total expenses. In these circumstances they should be classified and disclosed separately; and   
- the need for separate disclosure of assets carried at recoverable amount within a class of non-current assets.

(2) Accounting policy

The following companies have changed their accounting policy in the area of concern identified by ASIC. The companies have implemented the change in their 31 December 2002 half-yearly financial reports.

(a) Harvey World Travel and Futuris Corporation Limited (now reporting net revenues only from agency transactions rather than the gross value of customer transactions);

(b) Astro Mining (asset write-down);

(c) King Minerals NL (asset reclassification);

(d) Tele2000 Limited, now Entertainment Media and Telecoms Corporation Ltd (use of fair value of shares, rather than a notional value, for acquisition and the restatement of goodwill); and

(e) Wilson Investments Taurine Fund Limited (asset revaluations now recorded against a reserve rather than in profit).

(3) Revenue

It appears there may be a trend towards inappropriate revenue reporting by companies who act in an agency relationship, for example travel agencies. Some companies in this position are reporting revenues on a gross basis, rather than reporting the net amounts of commission to which they are entitled.

'This is an area that will receive particular attention during the third phase of this surveillance project, and it will be a focus of an ongoing review in industry sectors that operate in an agency relationship', Mr Pound said.

While there is no profit impact, due to an equivalent overstatement of expenses, ASIC considers that reporting gross values of the transactions with customers is contrary to the requirements of Accounting Standard AASB 1004 'Revenue', and misleading, as it creates a false impression of the size of the company's operations and controlled resource flows.

In a recently issued Supplementary Prospectus, Flight Centre Limited has noted that it is currently addressing a matter in relation to revenue from the sale of airline tickets, etc with ASIC. The accounting policy adopted by Flight Centre was identified as an issue during the surveillance programme.

(4) Continuing concerns

ASIC is continuing to seek further information and explanations from the companies where concerns remain unresolved.

In situations where ASIC believes a company's interpretation of an accounting standard is incorrect or difficult to justify, ASIC will request the company to make a disclosure to the market and change their policy of reporting at 30 June 2003, or face the prospect of litigation.

The nature of the issues in this category include:

- off-balance sheet reporting of loan securitisations through special purpose entities. Where appropriate, the matter is also being discussed with the relevant industry regulator;   
- overstatement of the carrying value of assets;   
- accounting for the transfer of assets to shareholders;   
- inappropriate deferring of expenses as assets;   
- premature recognition of revenue for example through attaching all revenue to one component of contract involving multiple deliverables   
- recognising revenue in relation to uncertain compensation claims;   
- recognising principal repayments as revenue from purchased receivables;   
- write-off of expenses to retained earnings;   
- non-consolidation of a controlled entity; and   
- failure to apply fair value to an acquisition.

'These are not systemic issues, but are specific to the 16 companies with which we are continuing our deliberations', Mr Pound said.

In a relatively small number of cases, the interpretation of accounting standards may warrant referral to the Urgent Issues Group of the Australian Accounting Standards Board for consideration.

(5) Third stage

In the third stage of the account surveillance project, ASIC has commenced a review of the full-year financial reports of approximately 180 listed public companies with balance dates between 31 August and 31 December.

This review will focus on the three risk areas covered by the 30 June to 31 July balance date reviews.

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(D) ASIC PROVIDES RELIEF ON REQUIREMENT TO PROVIDE UP TO DATE INFORMATION IN PDSS

On 10 April 2003 ASIC issued a new Class Order exemption, [CO 03/0237], relating to the requirement under s1012J of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the Act) that the information in a Product Disclosure Statement (PDS) must be up to date.

CO 03/0237 has been issued in response to industry concerns about the possible need to regularly prepare Supplementary Product Disclosure Statements (SPDS) to update a PDS where there have not been material adverse developments.

The Class Order relief exempts issuers of PDSs from the requirement to ensure a PDS is up to date at the time when it is given, provided that the issuer makes the up to date information available through a web site, a toll-free telephone service, or other facility that provides convenient access for investors.

The relief will be available where the update does not include materially adverse information of a kind that must be disclosed in a SPDS.

ASIC intends that the CO 03/0237 will:

- alleviate concerns about possible compliance failure where a PDS does not contain the most current information available at the time it is given to investors, even though it was up to date when it was prepared;  
- remove a perceived barrier to the appropriate disclosure of relevant performance information in a PDS; and  
- respond to industry concerns about the additional costs of preparing, printing, and distributing SPDSs to their advisory networks to update information that changes quickly.

The Class Order is available on the ASIC website at [http://www.asic.gov.au](http://www.asic.gov.au" \t "_new)

(E) ASIC MOVES TO PROTECT INTEGRITY OF ITS PUBLIC DATABASE

On 8 April 2003 Mr David Knott, Chairman of ASIC, announced an upgrading of surveillance and security measures to further enhance the integrity of ASIC's public database.

'ASIC's action results from increased concerns that bogus companies are being used in connection with serious crime, including credit card fraud and money laundering. Heightened surveillance has included monitoring the activities of a small number of persons believed to be involved in bogus company registrations and filings', Mr Knott said.

Resulting from this surveillance, a suspect was arrested in Queensland and he will appear in court later in April. As ASIC's investigations are continuing, it is not intended to make any further public comment on this aspect at this time.

Initiatives to increase security of ASIC'S public database include:

- From 1 July 2003 a new system for verifying changes lodged on behalf of companies will be introduced.  
- Company PINs, to be introduced later this year, will be required to be quoted before changes can be made to existing company records.  
- Arrangements are being implemented with the Australian Taxation Office that will link incorporation of new companies with the concurrent issue of an ABN by the ATO. This will increase the level of scrutiny that is applied to company registrations.

Under the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), ASTC maintains the public database on companies in Australia. The database contains details on:

- 1.25 million companies  
- 2.5 million directors  
- 3000 managed investment schemes  
- Professional registers of 60,000 professionals (eg liquidators, auditors).

Last year, there were:

- 90,175 new companies registered  
- 9.11 million searches or the public database  
- 1.1 million forms lodged to change company information.

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(F) ASIC ACTS TO PREVENT INSOLVENT TRADING

On 7 April 2003 ASIC announced the initial results of a pilot program targeted at insolvent trading, known as ASIC's Directors Insolvent Trading pilot.

Since early January ASIC, through its newly formed National Insolvency Co-ordination Unit (NICU), ASIC has been working with senior insolvency specialists from PricewaterhouseCoopers and Ernst & Young in both Sydney and Melbourne, to target directors involved with companies suspected of insolvent trading.

ASIC is testing a focused approach to dealing with possible insolvent trading before it occurs, in addition to prosecuting directors after a company has failed.

'The program aims to make company directors aware of their company's financial position, to encourage them to seek advice from insolvency professionals and where necessary, to take action to appoint voluntary administrators or liquidators to companies that are insolvent', ASIC Executive Director Public and Commercial Services, Mr Mark Drysdale said.

The companies targeted in the program range in size from small proprietary companies to listed entities. They have been identified through a range of sources, including complaints received from the public, as well as referrals from other programs within ASIC.

ASIC has identified some key operational and financial practices which, in combination with other practices, indicate a company is at significant risk of insolvency. These include\*:

- poor cash flow, or no cash flow forecasts;  
- disorganised internal accounting procedures;  
- incomplete financial records;  
- absence of budgets and corporate plans;  
- continuing loss-making activity;  
- accumulating debt and excess liabilities over assets;  
- default on loan or interest payments;  
- increased monitoring and/or involvement of financier;  
- outstanding creditors of more than 90 days;  
- instalment arrangements entered into to repay trade creditors;  
- judgment debts received;  
- significant unpaid tax and superannuation liabilities;  
- difficulties in obtaining finance;  
- difficulties in realising current assets (eg stock, debtors); and  
- loss of key management personnel.

To date, ASIC has conducted solvency reviews of 130 companies associated with 35 directors, including a number of large corporate groups. This has resulted in directors taking action to consider appointing voluntary administrators or liquidators to ten companies.

During the process of visiting companies to assess solvency, a number of directors have been assisting ASIC to assess the true financial position of corporate groups. They are currently preparing detailed management accounts to demonstrate the true financial position of the companies of interest to ASIC.

ASIC is reminding directors that Section 180 of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) requires them to exercise a degree of care and diligence in the discharge of their duties. This includes taking steps to ensure they are properly informed about the financial position of the company and, ensuring the company does not trade while insolvent.

Section 588G of the Corporations Act states that where a director fails to prevent a company incurring a debt when the company is insolvent, that officer will be guilty of an offence known as insolvent trading.

A breach of this provision can attract both criminal and civil penalties, including pecuniary penalties of up to $220,000 and imprisonment for up to five years, or both. In addition, compensation proceedings may be initiated by ASIC, a liquidator or creditors against a director personally, in reparation of the debt.

\* The above are examples only and are not to be taken as a comprehensive list of indicators of insolvency problems.

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(G) ASIC LAUNCHES MANAGED FUNDS FEES CALCULATOR

On 2 April 2003 ASIC launched its fees calculator for managed investments.

If a person wants to invest a single lump sum in a managed fund, the calculator will estimate:

- what you will pay in fees,  
- how fees may affect your investment returns over time, and  
- how different fee structures may affect your investment.

The calculator was developed following a report to ASIC from Professor Ian Ramsay. His report highlighted challenges that consumers face when trying to understand the impact of fees charged on managed funds.

Professor Ramsay examined a number of online fee calculators and commended the one offered by the Ontario Securities Commission.

The fees calculator is available on the ASIC website at [http://www.fido.asic.gov.au](http://www.fido.asic.gov.au" \t "_new)

(H) CORPORATE LAW ECONOMIC REFORM PROGRAM 7

On 2 April 2003 ASIC released the following information on CLERP 7. The [Corporations Legislation Amendment Bill 2003 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=67175" \t "default) was passed on the 27 March 2003.

(1) What are the key features of the reforms?

(a) Companies and schemes will no longer be required to lodge an annual return, but ASIC must be advised of any changes to company details when they occur.

(b) Annual returns will be replaced by an Annual Statement.

(c) Companies and schemes will receive an Annual Statement based on the date of registration ('the review date'). It will include a 'statement of details' to review, and an invoice statement to pay.

- An annual review fee, listed on the invoice statement, will be payable within 2 months of a review date or late fees will occur.  
- The 'statement of details' must be reviewed. If the information is correct, no documents are required to be lodged with ASIC, however the review fee must still be paid. Changes must be notified to ASIC within 28 days of the review date.  
- ASIC may require information to be lodged, for example, where data is missing.

(d) Changes to scheme details must be notified within 28 days of the review date. The form for scheme change notification is Form 491 Change to scheme details.

(e) Changes to company details must be notified to ASIC throughout the year as they happen. Late lodgment fees will apply. The form for company change notification is Form 484 Change to company details.

(f) The notification period for many changes will increase from 14 to 28 days.

(g) One form (Form 484) must be used to notify ASIC of a wide range of changes to company details including:

- registered office and principal place of business address;  
- officeholder details;  
- members (top 20 in each class);  
- share structure; and  
- ultimate holding company (for proprietary companies only).

(h) The directors of each company will be required to hold a solvency resolution within 2 months of their review date.

- If the directors are of the opinion that there are not reasonable grounds to think the company will be able to pay its debts, or the directors have not passed a solvency resolution they will be required to lodge notification with ASIC (Form 485 Statement in relation to company solvency).  
- If the directors are of the opinion that the company is solvent, they are not required to lodge a form with ASIC.

(i) New compliance tools will include:

- late payment fees where an annual review fee is not paid within 2 months of the annual review date, and  
- late review fees for not bringing company or scheme details up to date within 28 days of the review date.

(j) ASIC will improve our online lodgment services, both via the internet and via agent software (EDGE).

- EDGE and ECR users should contact their software supplier for details of relevant changes.  
- Internet lodgment of documents will be made easier for both companies and agents.

(2) What are the key features of the reforms for public companies?

Apart from the reforms for all companies listed above:

(a) Public companies need only advise changes to member's details and share structure at time of review.

(b) The laws that govern directors over the age of 72 years have been repealed (old section 201C).

- There is no longer a requirement for directors of public companies and their subsidiaries to cease at the age of 72 years unless appointed by a special resolution.

(3) What are the key reforms for proprietary companies?

(a) Proprietary companies must advise changes to issued shares within 28 days of the change.

(b) Proprietary companies must advise changes to the top 20 members within 28 days of the change, these changes include:

- name and address;  
- increase or decrease in shares held;  
- new members; and  
- cessation of members.

(c) Proprietary companies must advise changes to their ultimate holding company within 28 days of the change.

(d) Registration of new companies (Form 201 Application for registration as an Australian company) will include the requirement to notify details of issue of shares and members.

(4) When will the changes take effect?

The new legislative requirements take effect on Tuesday 1 July 2003.

(5) Can the review date be changed?

Companies and schemes can apply to change their review date for the following reasons:

(a) To vary (align or spread) the review dates of companies with a common holding company.

(b) To vary the review dates of companies with common officeholders.

(c) To vary the review dates of managed investment schemes with a common responsible entity.

(d) Under exceptional circumstances to be determined by ASIC.

Companies can apply from 1 June 2003 by lodging a Form 488 Application to vary review date of a company or registered scheme together with the $30 non-refundable application fee. The Form 488 and a Review Fee information sheet will be available in late May from Company forms.

(6) When will the new forms be available?

The new forms will be available from ASIC's enquiry line on 03 5177 3988 and ASIC's Service Centres from late May.

(I) ASIC RELEASES RESULTS OF CODE MONITORING REPORT

On 31 March 2003 ASIC released its annual monitoring report on compliance with the Banking, Credit Union and Building Society Codes of Practice and the Electronic Funds Transfer (EFT) Code.

The codes are voluntary but almost all Australian financial institutions have signed up to the codes that are relevant to them, and are bound by their provisions. The report covers the period from April 2001 to March 2002.

'While there's been a steep increase in the number of transactions covered by the codes, the overall incidence of complaints remained low', ASIC's Deputy Executive Director of Consumer Protection, Ms Delia Rickard said.

'Complaints under the Banking Code of Conduct decreased from 3.28 per million transactions in the 2000/2001 reporting period to 2.17 in this one - at the same time, the number of banking transactions rose by roughly 500 million to 4,334 million. The majority of disputes dealt with internally were resolved in favour of the customer (48%) or by mutual agreement (13%)'.

'Of concern was the increase in complaints under the Credit Union Code. While still small in number (2524) when compared to the total number of transactions (438,848,061), they rose from 3.8 per million in the last period to 5.8 per million in the current period. Of these however, 64% were resolved within the credit union in the customer's favour, and 7.5% by mutual agreement.

There was a smaller increase under the Building Society Code from 1.2 to 1.7 per million transactions, with 55.2% resolved internally in favour of the customer, and 13% by mutual consent', Ms Rickard said

'The largest number of disputes under the banking and credit union codes related to EFT (PIN)-based transactions. Other common complaint categories were fees and charges, account debiting and crediting, and service delivery.'

The EFT Code of Conduct, as it applied at the time the monitoring period relates to, sets out the rules for allocating liability for disputed ATM and EFTPOS transactions.

In the period under review, the overall number of complaints under the EFT code increased from 121,434 in 2000/2001 to 132,517 in 2001/02. This corresponded with an increase of 140 million in the number of ATM and EFTPOS transactions performed by Australians, to over 1,640 million transactions.

The rate of complaints per million transactions remained constant at 81 complaints per million transactions. However, there was a marked change in the breakdown of these complaints:

- complaints about system malfunction rose by 18.6% to 97,047 (76% of these complaints were resolved in favour of the card holder);   
- complaints about unauthorised transactions fell by 6.2% to 23,978 or 14 per million transactions. Of these, the customer was found liable in 57 per cent of cases, or in 8 transactions per million; and   
- there was a 32% decrease in complaints relating to areas such as confusion over the merchant name or processing date or double debit complaints. These fell to 11,493, of which 78% were resolved in favour of the card issuer.

The unauthorised transaction cases under the Code are categorised under a number of different causes. An area of concern was the increase in the number of unauthorised transaction cases where cards were forged, faulty, expired or cancelled. The number of such cases where the card issuers was liable, accounted for less than one percent (33) of the total complaints in the 2000/2001 monitoring period, but jumped to 334 instances in the current review (4.2%).

It should be noted that consumers now have greater protection for the electronic banking transactions than they did at the time the monitoring report relates to.

A revised EFT Code of Conduct came into force on 1 April 2002, and extended the coverage of the code from the ATM and EFTPOS transactions mentioned in the monitoring report, to include all forms of electronic funds transfers, including internet, mobile phone and telephone banking and stored value products such as prepaid telephone cards.

A copy of the executive summary and report is available at FIDO, ASIC's consumer website at [http://www.fido.asic.gov.au](http://www.fido.asic.gov.au" \t "_new)

(J) ASIC EXPANDS RELIEF FOR DIFFERENTIAL FEES

On 31 March 2003 ASIC issued a new Class Order [CO 03/217] on differential fee arrangements.

CO 03/217, which took effect on 27 March 2003, expands upon the relief already provided through Class Order 02/214: Differential Fees [CO 02/214] by broadening the circumstances in which ASIC will exempt the Responsible Entity (RE) of a managed investment scheme from the equal treatment requirement in paragraph 601FC(1)(d) of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the Act).

The expanded relief for differential fees reflects ASIC's monitoring of its policy, and ongoing consideration given to changes in the market place.

The amendments effected by CO 03/217 allow a RE to discriminate between members of a registered scheme in relation to fees, based on:

- aggregation of a member's interests across the range of financial products issued by the RE (or its related body corporate), that are regulated under the Act;   
- use of electronic services, or effecting electronic transactions for investments in a managed fund or other financial product issued by RE, that are regulated under the Act;   
- aggregation of holdings of a member and certain family members across a range of financial products offered/issued by the RE (or related body corporate) according to the value or period of time during which the aggregated interests have been held; and  
- members who are employees of the RE (or related body corporate), provided the value of the employees' interests relative to the other members does not exceed 5 per cent.

Each of the preceding range of differential fee structures will only apply if the arrangements benefit the scheme as a whole, are economically justifiable and do not compromise investor rights. This is in accordance with the core principles expressed in ASIC Policy Statement 136 Managed Investments: Discretionary powers and closely related schemes.

The differential fee structures will only apply if they are disclosed in accordance with the good disclosure principles of ASIC Policy Statement 168 Disclosure: Product Disclosure Statements (and other disclosure obligations). An important policy objective of the recent financial services reforms is to ensure that consumers can understand and compare the fees that apply to their investment in managed investment schemes.

ASIC considers that these exemptions from the formal and strict application of the statutory equivalence requirement do not undermine equality of treatment. Rather, they represent the extent of relief which ASIC is prepared to provide within the framework of the current legislative requirements.

Treasury is currently considering changes to the Act, following the report of the Managed Investments Act Review.

These recent exemptions are in addition to the specific excepted differential fee arrangements that were granted under a variation to the CO 02/214 in December 2002.

In order to minimise any disruption to the existing arrangements, the existing CO 02/214 and new CO 03/217 will co-exist until 11 March 2004. Until then, REs can choose to rely on either of the Class Orders. CO 02/214 will be revoked on 11 March 2004.

A copy of CO 03/217 will be published in the ASIC Gazette, and is available from the ASIC website at [http://www.asic.gov.au](http://www.asic.gov.au" \t "_new)

3. RECENT ASX DEVELOPMENTS

(A) ASX LISTING RULES - PACKAGE OF GUIDANCE NOTE AMENDMENTS

On 31 March 2003, ASX issued a package of revised Guidance Notes and new Guidance Note 9A - Corporate Governance - ASX Corporate Governance Council - Principles of Good Corporate Governance and Best Practice Recommendations. The Guidance Notes which have been revised and the substantive changes made are briefly summarised below.

(1) Guidance Note 9A - Corporate Governance - ASX Corporate Governance Council - Principles of Good Corporate Governance and Best Practice Recommendations

(2) Guidance Note 9A was issued to coincide with the release of the ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations on 31 March 2003. Guidance Note 9A incorporates a condensed version of that document. Listing rule amendments to require reporting by reference to the principles and recommendations and to mandate audit committees for the top 500 entities included in the All Ordinaries Index were implemented on 1 January 2003.

The transitional arrangements that apply in relation to the relevant listing rules and implementation of the principles and recommendations are outlined on ASX's website at [http://www.asx.com.au](http://www.asx.com.au" \t "_new)

(3) Guidance Note 9 - Disclosure of Corporate Governance Practices: Listing Rule 4.10 remains in force in relation to former listing rule 4.10.3, as that applies to listed entities preparing reports in accordance with that rule. ASX will withdraw Guidance Note 9 when all listed entities have made the full transition to the new corporate governance framework.

(4) Guidance Note 10 - Review of Operations and Activities

This Guidance Note was updated to incorporate amendments to the Guide to the Review of Operations and Financial Condition issued by the Group of 100.

(5) Guidance Note 12 - Changes to Activities: Listing Rules 11.1, 11.2 and 11.3

The Guidance Note was revised to further clarify ASX policy and application of the listing rules in relation to changes to activities, including discussion in relation to what ASX may consider constitutes a main undertaking.

(6) Guidance Note 16 - Trading Halts

The Guidance Note was amended to include more substantive discussion of trading halts as a tool of good disclosure policy, including the circumstances where ASX may consider a request for a "back to back" trading halt and the use of voluntary suspension as an alternative mechanism.

(7) Guidance Note 20 - ASX Online

This Guidance Note was revised to clarify that financial reports lodged electronically with ASX under Australian Securities and Investments Commission Practice Note 61 should be backed up with signed hard copies retained by the entity for seven years. Contact details for ASX Online have also been corrected.

(B) ASX CORPORATE GOVERNANCE COUNCIL PUBLISHES PRINCIPLES OF GOOD CORPORATE GOVERNANCE

On 31 March 2003, the Australian Stock Exchange Corporate Governance Council released its Principles of Good Corporate Governance. The Principles, and commentary on the Principles, are available on the ASX website at [http://www.asx.com.au/corporategovernance](http://www.asx.com.au/corporategovernance" \t "_new)

(1) Background

The ASX Corporate Governance Council (the Council) was convened in August 2002 as a collaborative, industry-based body set up to develop corporate governance recommendations for listed entities which reflect international best practice.

On 1 January 2003 ASX introduced listing rule amendments to enhance compliance with corporate governance best practice and to mandate audit committees for the top 500 companies included in the All Ordinaries Index.

The rules reflect ASX policy that it is appropriate to focus on disclosure of corporate governance practices rather than prescribe adoption of a particular practice or practices. This allows listed entities a degree of flexibility to consider a range of means to address specific governance issues and take account of corporate governance principles as they evolve over time.

The disclosure based approach, requiring that an entity highlight any areas of departure from the best practice recommendations of the Council and explain that departure, is referred to as "if not, why not?".

The ASX Corporate Governance Council includes representatives of the following   
bodies:

Association of Superannuation Funds of Australia Ltd   
Australasian Investor Relations Association   
Australian Council of Superannuation Investors   
Australian Institute of Company Directors   
Australian Institute of Superannuation Trustees   
Australian Shareholders. Association   
Australian Stock Exchange Limited   
Business Council of Australia   
Chartered Secretaries Australia   
CPA Australia   
Group of 100   
Institute of Actuaries of Australia   
Institute of Chartered Accountants in Australia   
Institute of Internal Auditors Australia   
International Banks and Securities Association of Australia   
Investment and Financial Services Association   
Law Council of Australia   
National Institute of Accountants   
Property Council of Australia   
Securities and Derivatives Industry Association   
Securities Institute of Australia

(2) Disclosure of corporate governance practices (applying the "if not, why not?" approach)

According to ASX, the best practice recommendations are not prescriptions. They are guidelines, designed to produce an efficiency, quality or integrity outcome. The recommendations do not require a "one size fits all" approach to corporate governance. Instead, it states aspirations of best practice for optimising corporate performance and accountability in the interests of shareholders and the broader economy. If a company considers that a recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it, a flexibility tempered by the requirement to explain why.

Companies are encouraged to use the guidance as a focus for re-examining their corporate governance practices and to determine whether and to what extent the company may benefit from a change in approach, having regard to the company's particular circumstances. There is little value in a checklist approach to corporate governance that does not focus on the particular needs, strengths and weaknesses of the company.

The Council recognises that the range in size and diversity of companies is significant and that smaller companies may face particular issues in attaining all recommendations from the outset. Performance and effectiveness can be compromised by material change that is not managed sensibly. Where a company is considering widespread structural changes in order to meet best practice, the company is encouraged to prioritise its needs and to set and disclose best practice goals against an indicative timeframe for meeting them.

Under ASX Listing Rule 4.10, companies are required to provide a statement in their annual report disclosing the extent to which they have followed these best practice recommendations in the reporting period. Where companies have not followed all the recommendations, they must identify the recommendations that have not been followed and give reasons for not following them.

(3) What is the disclosure period?

The change in reporting requirement applies to the company's first financial year commencing after 1 January 2003. Accordingly, where a company's financial year begins on 1 July, disclosure will be required in relation to the financial year 1 July 2003 - 30 June 2004 and will be made in the annual report published in 2004.

Companies are encouraged to make an early transition to the best practice recommendations and are requested to consider reporting by reference to the recommendations in their corporate reporting this year.

(4) Audit committees

Specific requirements apply in relation to audit committees for companies within the S&P/ASX All Ordinaries Index.

Those companies are subject to ASX Listing Rule 12.7, which requires that an entity that was included in the S&P/ASX All Ordinaries Index at the beginning of its financial year have an audit committee during that year. The composition, operation and responsibility of the audit committee must comply with the best practice recommendations of the ASX Corporate Governance Council. These are set out in Principle 4.

This rule applies for the first financial year of an entity commencing after 1 January 2003.

(5) What entities are affected?

The best practice recommendations have been articulated to apply to companies and other types of listed entities. Where appropriate, the term "company" is used in the best practice recommendations to encompass any listed entity, including listed managed investment schemes (trusts), listed stapled entities, and listed foreign entities. Also where appropriate, references to shareholders and investors will include references to unitholders of unit trusts.

Specific application of the recommendations for trusts has been highlighted.

(6) The essential corporate governance principles

A company should:

(a) Lay solid foundations for management and oversight

Recognise and publish the respective roles and responsibilities of board and management.

(b) Structure the board to add value

Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

(c) Promote ethical and responsible decision-making

Actively promote ethical and responsible decision-making.

(d) Safeguard integrity in financial reporting

Have a structure to independently verify and safeguard the integrity of the company's financial reporting.

(e) Make timely and balanced disclosure

Promote timely and balanced disclosure of all material matters concerning the company.

(f) Respect the rights of shareholders

Respect the rights of shareholders and facilitate the effective exercise of those rights.

(g) Recognise and manage risk

Establish a sound system of risk oversight and management and internal control.

(h) Encourage enhanced performance

Fairly review and actively encourage enhanced board and management effectiveness.

(i) Remunerate fairly and responsibly

Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined.

(j) Recognise the legitimate interests of stakeholders

Recognise legal and other obligations to all legitimate stakeholders.

(7) Best practice recommendations

Principle 1: Lay solid foundations for management and oversight

Recognise and publish the respective roles and responsibilities of board and management.

The company's framework should be designed to:

- enable the board to provide strategic guidance for the company and effective oversight of management;  
- clarify the respective roles and responsibilities of board members and senior executives in order to facilitate board and management accountability to both the company and its shareholders; and  
- ensure a balance of authority so that no single individual has unfettered powers.

How to achieve best practice

Recommendation 1.1: Formalise and disclose the functions reserved to the board and those delegated to management.

Principle 2: Structure the board to add value

Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

An effective board is one that facilitates the efficient discharge of the duties imposed by law on the directors and adds value in the context of the particular company's circumstances. This requires that the board be structured in such a way that it:

- has a proper understanding of, and competence to deal with, the current and emerging issues of the business; and  
- can effectively review and challenge the performance of management and   
exercise independent judgment.

Ultimately the directors are elected by the shareholders. However the board and its delegates play an important role in the selection of candidates for shareholder vote.

How to achieve best practice

Recommendation 2.1: A majority of the board should be independent directors.

Recommendation 2.2: The chairperson should be an independent director.

Recommendation 2.3: The roles of chairperson and chief executive officer should not be exercised by the same individual.

Recommendation 2.4: The board should establish a nomination committee.

Recommendation 2.5: Provide the information indicated in "Guide to reporting on Principle 2".

Principle 3: Promote ethical and responsible decision-making

Actively promote ethical and responsible decision-making.

The company should:

- clarify the standards of ethical behaviour required of company directors and key executives (that is, officers and employees who have the opportunity to materially influence the integrity, strategy and operation of the business and its financial performance) and encourage the observance of those standards; and  
- publish its position concerning the issue of board and employee trading in company securities and in associated products which operate to limit the economic risk of those securities.

How to achieve best practice

Recommendation 3.1: Establish a code of conduct to guide the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any other key executives as to:

3.1.1 the practices necessary to maintain confidence in the company's integrity

3.1.2 the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

Recommendation 3.2: Disclose the policy concerning trading in company securities by directors, officers and employees.

Recommendation 3.3: Provide the information indicated in "Guide to reporting on Principle 3".

Principle 4: Safeguard integrity in financial reporting

Have a structure to independently verify and safeguard the integrity of the company's financial reporting.

This requires the company to put in place a structure of review and authorisation designed to ensure the truthful and factual presentation of the company's financial position. The structure would include, for example:

- review and consideration of the accounts by the audit committee; and  
- a process to ensure the independence and competence of the company's external auditors.

Such a structure does not diminish the ultimate responsibility of the board to ensure the integrity of the company's financial reporting.

How to achieve best practice

Recommendation 4.1: Require the chief executive officer (or equivalent) and the chief financial officer (or equivalent) to state in writing to the board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards.

Recommendation 4.2: The board should establish an audit committee.

Recommendation 4.3: Structure the audit committee so that it consists of:

- only non-executive directors;  
- a majority of independent directors;   
- an independent chairperson, who is not chairperson of the board; and  
- at least three members.

Recommendation 4.4: The audit committee should have a formal charter.

Recommendation 4.5: Provide the information indicated in "Guide to reporting on Principle 4".

Principle 5: Make timely and balanced disclosure

Promote timely and balanced disclosure of all material matters concerning the company.

This means that the company must put in place mechanisms designed to ensure compliance with the ASX Listing Rule requirements such that:

- all investors have equal and timely access to material information concerning the company, including its financial situation, performance, ownership and governance; and  
- company announcements are factual and presented in a clear and balanced way.

"Balance" requires disclosure of both positive and negative information.

How to achieve best practice

Recommendation 5.1: Establish written policies and procedures designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior management level for that compliance.

Recommendation 5.2: Provide the information indicated in "Guide to reporting on Principle 5".

Principle 6: Respect the rights of shareholders

Respect the rights of shareholders and facilitate the effective exercise of those rights.

This means that a company should empower its shareholders by:

- communicating effectively with them;  
- giving them ready access to balanced and understandable information about the company and corporate proposals; and  
- making it easy for them to participate in general meetings.

How to achieve best practice

Recommendation 6.1: Design and disclose a communications strategy to promote effective communication with shareholders and encourage effective participation at general meetings.

Recommendation 6.2: Request the external auditor to attend the annual general meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report.

Principle 7: Recognise and manage risk

Establish a sound system of risk oversight and management and internal control.

This system should be designed to:

- identify, assess, monitor and manage risk; and  
- inform investors of material changes to the company's risk profile.

This structure can enhance the environment for identifying and capitalising on opportunities to create value.

How to achieve best practice

Recommendation 7.1: The board or appropriate board committee should establish policies on risk oversight and management.

Recommendation 7.2: The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the board in writing that:

7.2.1 the statement given in accordance with best practice recommendation 4.1 (the integrity of financial statements) is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the board;

7.2.2 the company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.

Recommendation 7.3: Provide the information indicated in "Guide to reporting on Principle 7".

Principle 8: Encourage enhanced performance

Fairly review and actively encourage enhanced board and management effectiveness.

This means that directors and key executives should be equipped with the knowledge and information they need to discharge their responsibilities effectively, and that individual and collective performance is regularly and fairly reviewed.

How to achieve best practice

Recommendation 8.1: Disclose the process for performance evaluation of the board, its committees and individual directors, and key executives.

Principle 9: Remunerate fairly and responsibly

Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined.

This means that companies need to adopt remuneration policies that attract and maintain talented and motivated directors and employees so as to encourage enhanced performance of the company. It is important that there be a clear relationship between performance and remuneration, and that the policy underlying executive remuneration be understood by investors.

How to achieve best practice

Recommendation 9.1: Provide disclosure in relation to the company's remuneration policies to enable investors to understand (i) the costs and benefits of those policies and (ii) the link between remuneration paid to directors and key executives and corporate performance.

Recommendation 9.2: The board should establish a remuneration committee.

Recommendation 9.3: Clearly distinguish the structure of non-executive directors' remuneration from that of executives.

Recommendation 9.4: Ensure that payment of equity-based executive remuneration is made in accordance with thresholds set in plans approved by shareholders.

Recommendation 9.5: Provide the information indicated in "Guide to reporting on Principle 9".

Principle 10: Recognise the legitimate interests of stakeholders

Recognise legal and other obligations to all legitimate stakeholders.

Companies have a number of legal and other obligations to non-shareholder stakeholders such as employees, clients/customers and the community as a whole. There is growing acceptance of the view that organisations can create value by better managing natural, human, social and other forms of capital. Increasingly, the performance of companies is being scrutinised from a perspective that recognises these other forms of capital. That being the case, it is important for companies to demonstrate their commitment to appropriate corporate practices.

How to achieve best practice

Recommendation 10.1: Establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders.

4. RECENT TAKEOVERS PANEL MATTERS

(A) ANACONDA 18 REVIEW PANEL AFFIRMS DECISION ON DISPERSAL OF EXCESS SHARES

On 10 April 2003 the Takeovers Panel announced that on Tuesday 11 March 2003, MatlinPatterson Global Opportunities Partners LP (MP Global) applied for a review of the decision and the proposed orders in the Anaconda 16-17 proceedings concerning the affairs of Anaconda Nickel Ltd. (Anaconda).

The Review Panel in Anaconda 18 affirmed the decision of the Anaconda 16-17 Panel that the acquisition by MP Global of a parcel of 5 or 6% of the shares in Anaconda (Excess Shares) and the subsequent sale from MP Global to Australian Investments United Pty Ltd (AIU) (Share Sale Agreement) constituted unacceptable circumstances and should be reversed.

(1) Background

The Excess Shares are part of the shares in Anaconda that were issued to MP Global under a 14:1 rights issue (the Rights Issue) by Anaconda which closed on 14 February 2003. The Excess Shares are those shares issued to MP Global under the Rights Issue which would have caused MP Global's voting power in Anaconda after the completion of the Rights Issue to be greater than its voting power immediately before the Rights Issue (which, being greater than 20% was prohibited under section 606 of the [Corporations Act 2001 No. 50 (Cth) (Act)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default)). The 5 or 6% of voting power carried by the Excess Shares would take MP Global's voting power in Anaconda from 36 or 37% to 42%. Glencore International AG (Glencore) currently holds 46.5% of the voting power in Anaconda after the completion of the Rights Issue, which Glencore fully underwrote.

MP Global was obliged to sell the Excess Shares because it had acquired a greater percentage of the Anaconda Rights (Rights) under its offer for the Rights (Rights Offer) than the percentage of shares in Anaconda that it acquired under the takeover offer for existing shares in Anaconda that it had made (Share Offer). Exercising all of the Rights it acquired and acquiring all of the shares (including the Excess Shares) would have breached section 606 (as described above).

MP Global sought to prevent a breach of the Act by selling its interests in the Excess Shares to AIU, under the Share Sale Agreement, to take effect immediately the Excess Shares were issued. In doing so, MP Global sought to rely on section 609(2) of the Act which provides that if MP Global held, or was issued, the Excess Shares as a bare trustee for AIU under the Share Sale Agreement then any relevant interest that MP Global had in the Excess Shares as the registered holder would be disregarded for the purposes of ascertaining any breach of section 606 of the Act.

The Panel considered the terms of the Share Sale Agreement and the events leading up to and surrounding the issue of the Excess Shares. It considered that there appeared, prima facie, to have been a breach of section 606, in that the shares had been issued to MP Global. The Panel considered that in the circumstances, the onus of proof lay on MP Global and AIU to show that they could rely on the exception in section 609(2) of the Act which, in these circumstances, involves showing that they were not associated other than as bare trustee and beneficiary. The Panel considered the evidence brought before it by the various parties, and decided that MP Global and AIU had not satisfied the burden of proof required to assure the Panel that they were entitled to the defence in section 609(2). This evidence will be outlined in the Panel's reasons.

The Anaconda 18 Review Panel did not come to this view lightly. It recognises that the Share Sale Agreement is worth some $20 million, and the possible profit or loss on sale of the Excess Shares is considerable. However, for similar reasons to those set out by the Anaconda 16-17 Panel, the Anaconda 18 Review Panel does not consider that the Share Sale Agreement should stand.

In such circumstances the Panel considered that the onus would be on MP Global to demonstrate that the subsequent purchaser of the Excess Shares (here AIU) is not an associate. MP Global has failed to do so. However, in saying that, the Panel notes that none of Glencore, Anaconda or any other party to the proceedings has produced evidence which is convincing that MP Global and AIU are associated persons.

The Anaconda 18 Panel agreed with the Anaconda 16-17 Panel that it would constitute unacceptable circumstances for MP Global to exercise all the Rights it had acquired under its Rights Offer, and then seek to determine the identity of the purchaser of the Excess Shares. If it had not come to the view that MP Global was required to demonstrate that the prima facie breach of section 606 did not occur because MP Global could rely on being a bare trustee (under section 609(2) of the Act), the Panel would have come to the conclusion, in the alternative, that the public interest requires dispersal of the Excess Shares in an open, competitive process. The Anaconda 18 Review Panel considers that in the special circumstances applicable to this matter, a sale through such a process is required to ensure that shares in Anaconda are acquired in an efficient, competitive and informed market.

In coming to the findings that it has, the Anaconda 18 Panel is not making any finding of impropriety by MP Global or AIU.

However, the Panel considers that the Share Sale Agreement, and the process by which it was brought into being, constituted unacceptable circumstances. The Panel's orders are designed to take the situation back to before the Share Sale Agreement was entered into and ensure that a proper process for disposing of the Excess Shares is carried out, in the interests of an efficient, competitive and informed market for control of voting shares in Anaconda.

The Panel considered that neither MP Global nor AIU are unfairly harmed by its declaration and orders because the Share Sale Agreement was entered into by a flawed process and therefore AIU and MP Global should not have arrived at the position which the Panel is now required to unwind. Any potential windfall profit which AIU will not now gain is one for which it had should not have been placed in a position which entitled it to that profit.

(2) A substantial interest

The Anaconda Panel considered that the Excess Shares do, and did, constitute a substantial interest in Anaconda. In part this follows the legislature's view of a substantial shareholding at 5% of the voting shares in a company. In part, the Anaconda Panel considers that the Excess Shares constitute a substantial interest because of the current closeness of the voting power of MP Global and Glencore. The Excess Shares in the hands of a person who supported Glencore's involvement in the management of Anaconda would guarantee Glencore control of Anaconda. However, in the hands of a supporter of MP Global's involvement, the Excess Shares could put MP Global within striking range of Glencore's voting power. On that basis, the Excess Shares are a strategic parcel, and well within the size with which the Panel should be concerned. Indeed, the vigour with which the various parties have prosecuted these proceedings, and the Anaconda 16-17 proceedings, is evidence of the importance of the parcel.

Consideration of the state of play of the Rights Offer and Share Offer at the time the Share Sale Agreement was entered into shows the balance of power in Anaconda even more fluid, and the Excess Shares as being even more strategically important at that time, and circumstances surrounding their disposal even more potentially significant and even more open to review by the Panel. The Panel's view is that the unacceptability or otherwise of the Share Sale Agreement should be considered more in the light of the circumstances of the time it was entered into, than on the basis of today's circumstances.

(3) Proposed orders in Anaconda 18

The Review Panel proposed to make similar orders to those proposed in the Anaconda 16-17 decision i.e. that the Excess Shares be dispersed by way of a book build by a broker appointed by ASIC.

However, the Review Panel proposes that its orders will not be implemented until the result of any review of the Anaconda 15 decision has been resolved. The Review Panel considers that a further short delay in the dispersal of the Excess Shares will not materially adversely affect Anaconda or its shareholders, but finally disposing of the Excess Shares before the result of Anaconda 15 is settled could adversely affect the range of orders available to any Review Panel in the Anaconda 15 matter.

The orders that the Anaconda 18 Review Panel proposes are as follows:

(a) the Share Sale Agreement between MP Global and AIU will be cancelled, from its outset;

(b) the legal and beneficial title to the Excess Shares will vest in ASIC, for sale by a stockbroker appointed by ASIC, by way of a bookbuild. A number of brokers have recently been involved in transactions in, or advice in relation to, Anaconda shares on behalf of parties to these or other Anaconda proceedings. The Panel will specify a number of those brokers whose involvement in conducting the sale process might risk some public perception of conflict, and who therefore should not conduct the bookbuild;

(c) the proceeds of the sale (net of selling costs, which will be commission only) will be returned to MP Global. MP Global therefore carries the risk of any profit or loss on the sale of the Excess Shares1. The Panel makes no orders restraining MP Global and AIU from making any arrangements they wish as a consequence of the Panel cancelling the Share Sale Agreement;

(d) none of AIU, MP Global, Anaconda or Glencore, or their associates may participate in the sale. The Panel understands that both MP Global and Glencore, and their associates, would currently be precluded, by section 606, from purchasing any of the Excess Shares;

(e) consistent with the Truth in Takeovers principle, the number of Excess Shares to be vested and sold shall be calculated by reference to the percentage voting power which MP Global held at the close of its Rights Offer. This is consistent with MP Global's announcement on 6 February 2003 that that was how and when it would calculate the number of Rights it could exercise;

(f) the broker will be instructed to seek to maximise the sale price of the Excess Shares while not selling more than 1% of the total shares in Anaconda to any person (alone or in combination with their associates);

(g) to assist the broker monitor the 1% cap, any prospective purchaser will be required to give to the Panel (under the Panel's Rules for proceedings), via the broker and with any bid or order, a warranty that they are not associated with any of MP Global, AIU, Anaconda or Glencore. They will also be required to give a similar warranty setting out, to the best of their knowledge, the identity of any associate of theirs who is bidding for any of the Excess Shares in the bookbuild;

(h) ASIC will be instructed to seek further instructions if the broker is unable to dispose of the whole parcel within the 1% cap within a reasonable time given the size of the parcel of Excess Shares and given the current free float of Anaconda shares, at a price of $0.06 per share or more, and without unduly depressing the market price of Anaconda shares;

(i) ASIC will be instructed to seek further instructions if the broker receives bids which are so high that they suggest that the bidder is indifferent, commercially, as to the price it pays;

(j) ASIC will be instructed to seek further instructions from the Panel if it appears, in the course of the bookbuild, that the 1% cap would unfairly harm MP Global's interests.

The Review Panel has requested ASIC to commence inquiries for a suitable broker in order to ensure that the process may proceed as expeditiously as possible once it is feasible to make final orders.

The interim order that the Anaconda 16-17 Panel made preventing further sale, transfer or voting of the Excess Shares until the Anaconda 16-17 and 18 matters have been decided remains in place. If the sale process requires further time, the Anaconda 18 Review Panel will consider extending the Anaconda 16-17 Panel's interim order.

(4) Precedent disposal orders

The Panel has settled the orders for the dispersal of the Excess Shares in light of the specific circumstances of the Anaconda 18 proceedings. It specifically advises that each set of circumstances in which it orders vesting or disposal of securities will be considered on their own merits and that orders in other matters may take materially different forms to the orders in Anaconda 18.

(5) Process

The President of the Panel appointed Simon McKeon (President), David Gonski and Professor Ian Ramsay to consider the Anaconda 18 application.

The Review Panel will publish its reasons for this decision on the Panel's website when they are finalised.

(6) Anaconda 16-17 decision

On Friday 07 March 2003, the Sitting Panel in the Anaconda 16-17 proceedings advised parties that it had decided to make a declaration of unacceptable circumstances in relation to the affairs of Anaconda. It also provided draft orders requiring dispersal of the Excess Shares in Anaconda subscribed for by MP Global (under the Corporations Act the Panel must provide draft orders to affected persons for comment prior to making the order).

The Anaconda 16 and 17 applications were from Anaconda and Glencore, and were made on 21 February 2003.

The Anaconda 16-17 Panel proposed making final orders similar to those currently proposed by the Anaconda 18 Panel. However, it decided not to make any orders, in order to allow the Anaconda 18 Panel an opportunity to consider the review application without circumstances having changed materially due to Anaconda 16-17 orders being executed.

The Anaconda 16-17 Panel will publish the reasons for its decision on the Panel's website when they are finalised.

(B) PANEL PUBLISHES GUIDANCE NOTE ON BROKER HANDLING FEES FOR COMMENT

On 28 March 2003 the Takeovers Panel released for public comment a draft Guidance Note on broker handling fees. The Guidance Note aims to assist bidders and the market to determine what is likely to be unacceptable in terms of the handling fees paid to brokers who obtain acceptances under a takeover bid.

The Panel noted that the practice of offering broker handling fees has become increasingly widespread recently.

In its discussion of broker handling fees, the Panel pointed out that broker handling fees may promote the principle set out in section 602(a) of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) of having efficient, competitive and informed markets if they encourage brokers to alert and inform their clients about a bid.

There are, however, concerns that arise if broker handling fees are excessively high, or are only available for a limited period of time. In these circumstances, broker handling fees have the potential to cause brokers to place unacceptable pressure on shareholders to accept an offer under the bid before they have had a reasonable time and adequate information to assess the merits of a bid.

The Guidance Note proposes limits on a broker handling fee of 0.75% of the consideration payable to an accepting target shareholder and $750 for each acceptance. A minimum payment should generally not exceed $50 for each acceptance.

The Panel also said that:

(a) once a broker handling has been made, it should generally be available for the balance of the bid period; and

(b) broker handling fees should always be disclosed fully to the market and to the offeree shareholder.

The Panel wishes to thank the sub-committee members, Mr Simon Mordant, Mr Braddon Jolley and Ms Carol Buys. The Panel is especially grateful for the input and assistance received from external sub-committee members, Mr Bruce Skelton and Mr Paul Masi.

Comments are sought on the policy until Friday 9 May 2003. The policy is available on the Panel's website at [http://www.takeovers.gov.au/Content/guidance/broker.asp](http://www.takeovers.gov.au/Content/guidance/broker.asp" \t "_new)

5. RECENT CORPORATE LAW DECISIONS

(A) FORECASTERS BEWARE: INDEPENDENT EXPERT LIABILITY FOR NEGATIVE ASSURANCES  
(By Damien Bruce, Freehills)

Reiffel v ACN 075 839 226 Ltd [2003] FCA 194, Federal Court of Australia, Gyles J, 14 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/march/2003fca194.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/march/2003fca194.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Overview

In the recent decision of the Federal Court of Australia in Reiffel v ACN 075 839 226 Ltd [2003] FCA 194, the court held that independent experts can be liable for misleading and deceptive conduct in relation to negative assurances given on financial forecasts in a prospectus.

(2) The facts

The named applicant in the representative proceeding was the part-owner of an apartment in a real estate development. In late 1996, a prospectus was issued which, in broad terms, enabled an owner of an apartment to lease their apartment to an apartment hotel business in return for an interest in the pooled revenue and expenses of the business. The structure was intended to operate as a unit trust, with the apartment owners retaining ownership of their leased apartments and receiving their "profits" from the business in the form of rental receipts under the lease.

An independent expert had been engaged to prepare a report in respect of the trading forecasts in the prospectus and a sensitivity analysis on the trading forecasts. The forecasts had been prepared by Genitron 2000 Pty Limited ("Genitron"), the principal of which was also a director of the manager of the scheme.

In its report, the independent expert provided several negative assurances, namely, statements to the effect that nothing had come to the attention of the independent expert which caused it to believe that a state of affairs existed that was not the case. Specifically, these negative assurances were that nothing had come to the attention of the independent expert which caused it to believe that the:

(a) directors' assumptions did not provide a reasonable basis for the trading forecasts;

(b) trading forecasts had not been calculated properly on the basis of the directors' assumptions;

(c) trading forecasts were not consistent with the Australian accounting standards; or

(d) trading forecasts were not reasonable.

The independent expert also concluded that the underlying assumptions accompanying the sensitivity analysis were reasonable (a positive opinion).

The applicant applied for, and was issued, units under the prospectus.

The forecasts turned out to be inaccurate and the applicant sustained significant losses. The applicant brought an action alleging misleading or deceptive conduct on the part of the independent expert.

Evidence led indicated that the independent expert had disagreed with the methodology that had been used by Genitron to calculate figures for occupancy and room rates which were used in preparation of the trading forecasts. In forming their conclusions, the independent expert had used their own method to determine figures for occupancy and room rates, but did not make this clear in the opinion. The figures which the independent expert arrived at led the expert to conclude that Genitron's figures fell within a range which was not unreasonable, which the independent expert understood to be the scope of their role.

The independent expert argued in response that:

(a) their negative assurance should be interpreted literally and was therefore not misleading and deceptive; and

(b) the positive opinion as to the reasonableness of the sensitivity analysis was not misleading as they had merely verified the arithmetic involved in the sensitivity analysis.

(3) The decision

The court disagreed with the independent expert, holding instead that:

(a) assurances are to be interpreted objectively as they would ordinarily be understood. Specifically, the court held that the independent expert "did not hold the opinions it expressed in the manner those opinions would be understood by the reader"; and

(b) the independent expert's reasonableness opinion related to the reasonableness of the assumed variations in the variables that affect the forecast, as the role of the sensitivity analysis was to show a range which would properly account for the subjective judgements and business risks involved.

The court also stated that, although an independent expert need not guarantee that the opinion given is correct, they must form and express the opinion with "care, skill and due diligence" appropriate to their expertise. The court did not find any breach of such duty in this case.

However, the court held that the independent expert, in providing only negative assurances and failing to note the differences between their methodology and that used by Genitron, had engaged in misleading and deceptive conduct. The court noted that the independent expert should have been skeptical given Genitron's association with the manager of the scheme.

The court stated that the independent expert should have at least:

(a) disclosed the disagreement that they had with the methodology adopted by Genitron;

(b) noted the effect of the disagreement upon the forecast tables;

(c) explained what they had independently done by way of investigation and methodology; and

(d) in that light, expressed their opinion as to whether the forecasts were within a reasonable range.

Such an approach would have been consistent with ASIC Information Release dated 7 February 2001, IR 01/05 "ASIC provides guidance for preparers and reviewers of prospective financial information included in disclosure documents".

The court also considered whether section 1318 of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) should apply. This section provides the court with a broad discretion to excuse a defendant where the defendant had acted honestly and ought fairly to be excused for their conduct. In this instance, the court did not exercise its discretion on the basis that the independent expert had accepted a conventional professional assignment, which was undertaken for reward and under circumstances where the expert expressly consented to the use of its report in its context.

(4) Implications

This decision illustrates the need to ensure forecasts are formed with a reasonable basis and do not mislead investors. Indeed, in its reasons, the court stated that "acceptance of responsibility by an expert for the opinion expressed is an important aspect of the protection for investors".

The two key points to arise from the case may be summarised as follows:

(a) where an independent expert disagrees with the information in a prospectus that relates to its engagement, it should make this clear; and

(b) statements made by independent experts in prospectuses will be assessed objectively by how an ordinary reader would understand them, in the context of the entire document.

(B) WHEN AVAILABLE INDEMNITY UNDER INSURANCE POLICY IS CONSIDERED TO BE EXAMINABLE AFFAIRS OF COMPANY  
(By Marianthe McLiesh, Mallesons Stephen Jaques)

In the matter of Re Clutha Limited (in liquidation) [2003] NSWSC 235, New South Wales Supreme Court, Gzell J, 31 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc235.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc235.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Background

The liquidator obtained a summons for the examination of an insurance officer and an order for production directed to the Insurer to produce records. These records concerned all costs charged against a directors' and officers' liability corporate reimbursement insurance policy issued by it in favour of the former officers of Clutha Ltd (in liquidation). The policy was issued by Pacific Indemnity as agent for CGU Insurance Ltd. The liquidator and Clutha brought proceedings against its former officers. The liquidator sought the summons for examination and order for production in order to assess the extent of the available indemnity of the defendants.

(2) The arguments

(a) The applicants argued that the summons for examination relating to ascertaining the level of indemnity available, for the purpose of enabling the liquidator to decide whether or not to pursue the claim, should not be allowed because in Kelly v Murphy (1993) 12 ACSR 365 the Court of Appeal in NSW had previously decided to the contrary.

(b) Secondly, it was argued that the investigation was not for the benefit of the liquidator but for the benefit of a creditor funding the liquidator and constituted an abuse of process.

(3) The decision

(a) Examinable affairs - available indemnity under Insurance Policy

Justice Gzell stated that prima facie the liquidator was entitled to conduct an examination and to require the production of documents with respect to the level of indemnity available to the former officers of Clutha. In support of this, Justice Gzell referred to section 596B(1)(b)(ii) of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), which provided for the examination of persons who may be able to give information about examinable affairs of the corporation. In addition, his Honour referred to section 53(a) which included in the examinable affairs, the property of the corporation. Finally, he referred to the definition of property in section 9, which included a thing in action.

Consequently, his Honour held that the indemnity available was a chose in action against the former officers of Clutha and formed part of the property of the corporation. Its relative value was therefore an important aspect. The available level of indemnity under the policy was a matter going to the value of the property of the corporation. Accordingly, his Honour held that documents relating to policies of professional indemnity insurance formed part of the examinable affairs of the corporation. In his Honour's opinion, the decision of the Court of Appeal, relied on by the applicants, did not stand for the proposition that an inquiry as to the existence of insurance cover and its quantum were never an examinable affair, or that such an inquiry was always oppressive.

(4) Abuse of process

There was evidence before Justice Gzell that a creditor was funding the liquidator's examination and acquiring debts from other creditors, which was argued to be an abuse of process. His Honour rejected the applicant's submission. He held that it did not follow that because the funder of the liquidator was advancing its own interests, that the liquidator sought to conduct the examination solely in the interests of that party.

In addition, it was submitted that the liquidator had indicated that, if the solicitors of the former officers of Clutha revealed the available level of indemnity under the insurance policy, the examination and order for production would be abandoned. It was submitted that this too was an abuse of process. The solicitors refused to reveal that amount. In rejecting the applicant's submission, his Honour held that where details of the available level of indemnity were not obtainable, then the liquidator was entitled to ascertain the value of the chose in action and the remaining available level of indemnity under the insurance policy. His Honour concluded that the liquidator was entitled to have the insurance officer examined and the Insurer produce the documents that were relevant to the ascertainment of that amount.

(5) Conclusion

His Honour held that documents relating to policies of professional indemnity insurance formed part of the examinable affairs of the corporation. However, his Honour found that the summons issued to the insurance officer was unlimited, and ordered that the examination be limited to the balance remaining under the insurance policy.

With respect to the purpose of the examination, his Honour followed earlier decisions. His Honour agreed that it was within the contemplation of section 596B of the Corporations Act to conduct an examination for the purpose of ascertaining what amount was likely to be recovered from an insurer.

It was not an abuse of process for a creditor to fund a liquidator's examination. His Honour held that it did not follow that, because the funder of the liquidator was advancing its own interests, the liquidator should be presumed to be conducting the examination solely in the interests of that party.

(C) WHEN ACTION FOR RECOVERY OF A LOAN ARISES AND WHETHER AN ANNUAL RETURN CONSTITUTES ACKNOWLEDGMENT OF DEBT OWED TO A COMPANY  
(By Timothy Cleary, Mallesons Stephen Jaques)

VL Finance Pty Ltd v Legudi [2003] VSC 57, Supreme Court of Victoria, Nettle J, 13 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/march/2003vsc57.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/march/2003vsc57.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Introduction

This case involves the question of when the right of action for recovery of a loan arises. This is relevant in the context of the [Limitations of Actions Act 1958 No. 6295 (Vic)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=455" \t "default), section 5 of which will prevent recovery where the limitation period has expired. The case also concerns whether a company's annual return constitutes an acknowledgment of debts owed to the company for the purpose of causing the limitation period to begin again. A further, minor, issue is whether a loan can be created solely by oral agreement and journal entries in a company's books.

(2) The facts

The Legudi Group of Companies was comprised of a holding company, Legudi Holdings Pty Ltd ("Holdings"), an operating company, Legudi & Sons Pty Ltd ("Sons"), and a land holding company, Legudi Freehold Properties Pty Ltd ("Properties"). The defendants were directors of both Sons and Properties. Sons owed debts of approximately $2 million to the plaintiffs, VL Finance Pty Ltd ("VL"), secured by a charge over the assets of Properties. During 1990, it became apparent that Sons was approaching insolvency. To prevent this, a plan was enacted to shore up the balance sheet of Sons.

Sons assigned the debt it owed to VL to Properties by a contract of novation. Sons then owed $2 million to Properties. Properties loaned $2 million to various members of the Legudi family, including the defendants, who used these funds to subscribe for new preference shares in Sons. Sons then used the proceeds from the share issue to repay Properties. The result of these transactions was that Sons' debt had been repaid, meaning that it was no longer in danger of insolvency, and Properties' new debt to VL was offset by the loans it had made to the family members.

These transactions were completed solely by journal entries in the accounts of Sons and Properties. No written contracts were entered into, and no money changed hands between either company, or between the companies and members of the family. No date was set for repayment of the loans and no interest payments were made to Properties by the family members. Instead, interest was allowed to accrue as an increase in the obligations of the family members to Properties, reflected by further journal entries in the company's accounts.

In 1994, a receiver was appointed to Sons, which triggered the security that VL held over Properties' assets. Properties' assets were insufficient to cover its debt to VL, and a liquidator was appointed to Properties. The liquidator purported to assign the debts owed to Properties by the defendants over to VL. VL then demanded payment of the debts.

(3) The issues

There were three grounds on which the defendants sought to avoid payment of the debts:

(a) that the debts did not, in fact, exist;

(b) that Properties had taken unconscientious advantage of the defendants; and

(c) that any action for recovery was statute-barred by the Limitations of Actions Act 1958 (Vic). In response to this argument, the plaintiffs argued that the annual return of Properties constituted an acknowledgment of the debts causing the limitation period to begin again.

(4) The existence of the debts

The defendants contended that no loans had been created from Properties to the family members because none of the family members received any cash in their hands. Nettle J dismissed this argument and noted that "there is no reason why loans agreed to by [sic] made by a family company to members of the family cannot be created orally or by conduct and sufficiently evidenced by book entry" (at para 30) (see also Valoutin Pty Ltd v Furst (1998) 154 ALR 119; Hancock Family Memorial Foundation Ltd v Porteous (1999) 32 ACSR 124). He referred to Spargo's case (1873) LR8 ChApp 407 at 414 as establishing that obligations may be set off against each other without the need for money to change hands (at para 30).

(5) Unconscientious advantage

The defendants also contended that they did not understand the nature of the plan, in particular that it would make them debtors of Properties. They argued that they suffered from a lack of education, had only a limited ability to read and write English and a limited involvement in the management of the companies (at para 34). Nettle J did not accept that these disadvantages were made out in the case of either defendant (at paras 35-38).

However, even if Nettle J had accepted that the defendants had been under a disadvantage, it is unlikely that they would have succeeded on this ground. Nettle J framed this argument as one of non est factum (at para 32). As such, he considered that the argument was misconceived. A plea of non est facum arises where a document signed by a party is radically different from what that party believes it to be, and therefore operates to make the document void or voidable. It does not invalidate a transaction that is not in writing. Therefore, it may be that the documents by which the new shares were issued could have been avoided, but not the undocumented loans that accompanied them (at para 32).

(6) Limitation of actions

The defendants argued that recovery of the debts was statute-barred by section 5 of the Limitations of Actions Act 1958 (Vic). This argument depended upon determining when the action for recovery of the debts arose. Nettle J referred to the judgment of Fullagar J in Ogilvie v Adams [1981] VR 1041 in which it was established that, unless a contract provides to the contrary, the obligation to repay a debt (and therefore the cause of action) arises instantly upon the creation of the debt (at para 40).

Nettle J did accept, following Fullagar J in Ogilvie, that it is not necessary for the contract to contain specific words preventing the obligation to repay a debt from arising immediately. It may be that it is an implied term of the contractual relationship between the parties that the obligation to repay does not arise until some period of notice is given. However, any such implication must arise from the contractual relationship (that is, the loan) itself. As Fullagar J put it in Ogilvie, the implication "must (in order to effect the alteration) be found in the contractual relationship between the parties, not in some purpose or motive, real or supposed, by reason of which the loan was made and with respect to which the contract is silent" (Ogilvie at 1050, quoted at para 41). Nettle J held that there was nothing in the contractual relationship between the defendants and Properties to imply that the action for recovery would not arise immediately upon making the loans (at para 42).

The plaintiffs argued that the rule in Ogilvie v Adams no longer represented all the law on this subject, as a result of the decisions in Gleeson v Gleeson [2002] NSWSC 418 and Brooker v Pridham (1986) 10 ACLR 428. Nettle J rejected this argument, and considered that both these cases actually supported the principle in Ogilvie. In Gleeson, the express terms of the contract yielded a clear implication that notice must be given (at para 49), while in Brooker the contract had to be interpreted in that way or else it would "fly in the face of all that the parties had done" (at para 53).

In the context of this case, Nettle J held that the loan had to become immediately repayable if the restructuring plan was to provide any real increase equity as a result of the issue of shares in Sons (at para 57). The result of this finding was that the cause of action for recovery of the loans arose immediately after they were created. They were therefore statute-barred by section 5 of the Limitations of Actions Act 1958 (Vic) by the time this action was brought.

The final issue for consideration was whether there had been any acknowledgment of the debts owed by the defendants, thereby causing the limitation period to begin again. Nettle J discussed the authorities on the requirements of acknowledgment and held that "a document does not constitute an acknowledgment unless it is in substance expressive of the debtor's intention to admit the debt and to have the document produced and used for that purpose" (at para 63).

The plaintiffs argued that the reference to the debts owed by the defendants in Properties' annual return should be treated as an acknowledgment for the purpose of causing time to begin again. The annual return did not identify the individual loans made to each of the defendants, merely the total amount of money owed to Properties. Nor was it signed by the defendants as individuals, but rather by one of the defendants in his capacity as a director of Properties. Nettle J rejected this submission for two main reasons. First, even if an annual return could constitute an acknowledgment (and Nettle J considered that that might be possible), in this case it could only be a statement of the debts owed to the company, made by the company itself, not by those owing the debts, and therefore could not be taken as expressing an intention by them to acknowledge those debts (at para 67). Secondly even if the annual return could be regarded as an acknowledgment of the debts of the director who had signed it, it could not also constitute an acknowledgment of the debts owed by the other defendant (at para 69). Therefore, there had been no acknowledgment of the debts for the purposes of section 24(3) of the Limitations of Actions Act 1958 (Vic).

(7) Conclusions

The findings of Nettle J may be summarised as follows:

(a) A valid loan may be created by oral agreement between the parties, reflected in journal entries in the company's books, even though no money changes hands.

(b) The defendants were not the victims of unconscientious advantage.

(c) In the absence of any explicit provision for when a loan is to be repayable, the right of action for recovery arises immediately upon its creation. In this case, recovery was therefore statute-barred by the time this action was brought. Reference to the existence of the debts owed to a company in its annual return does not constitute an acknowledgment for the purpose of causing time to start running again.

(D) ALLEGED BREACH OF TRADE PRACTICES ACT

Australian Competition and Consumer Commission v IMB Group Pty Ltd [2003] FCAFC 17 Federal Court of Australian, Full Court, Cooper, Kiefel and Emmett JJ, 20 February 2003  
(By Rebecca Preston, Blake Dawson Waldron)

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/february/2003fcafc17.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/february/2003fcafc17.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Summary

The Australian Competition and Consumer Commission ("ACCC") instituted proceedings against IMB Group Pty Ltd ("IMB"), Logan Lions Limited ("LLL") and a number of individuals associated with IMB and LLL, seeking remedies for breaches of sections 52 and 47 of the [Trade Practices Act 1974 No. 51 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6426" \t "default) (the "Act").

The ACCC claimed that the breach of section 47 occurred by the establishment of a scheme that made the future purchase of shares in a company and life membership of a rugby club (neither of which existed at the time the scheme was communicated) conditional on the prior purchase of an insurance policy from IMB. IMB acted as an agent of Legal & General Life of Australia Limited ("Legal & General") and National Mutual Life Association of Australasia ("National Mutual") in the sale of certain insurance policies. The ACCC further claimed that a number of misleading representations had been made in promoting the scheme in breach of section 52 of the Act.

In relation to the contravention of the prohibitions against exclusive dealing, the issues on appeal were essentially legal ones, whereas those relating to misleading and deceptive conduct were factual. There was no evidence to support a claim that any of the representations made were in breach of section 52. As regards section 47 the Full Court of the Federal Court held that there was no breach of section 47(6) or (7) of the Act. If a benefit or privilege was conditional on anything, it was conditional on the purchase of an insurance policy

(2) Facts

The proceeding arose out of a scheme for the development of a sports and entertainment complex to be established in Logan City, near Brisbane. The scheme involved entering a local rugby league team into the national competition under the name "the Logan Lions" and constructing a sporting complex around the team.

The construction was to be funded by subscriptions for shares in LLL, the construction company. The plan was that participants in the scheme were to purchase insurance policies through IMB and then borrow against the value of the policies and apply the proceeds to payment of LLL shares. IMB was also to provide, free of charge, all information including a feasibility study, in relation to the development concept. In late 1990 Messrs Ivers, who conceived the scheme, acquired shares in IMB. In early 1991 they entered an agency agreement with National Mutual and subsequently Legal & General to solicit investment in insurance policies to be issued by the two insurers. LLL was incorporated in June 1994. Though initially it was thought that the policies would be able to generate sufficient finance to fund the construction, it later became clear that this was not the case and the capital value of the policies then came to be seen as a means of raising finance from external lenders. The capital value of the policies, together with the proposed centre, would be security for such external borrowing. About 3,200 insurance policies were sold by IMB in the period March 1991 - September 1993, mostly as a result of people attending seminars conducted by IMB.

The scheme was launched on 15 September 1993 at a function where certain representations were made as to the intention of IMB Group to fund the initial stage of the project through a private placement of $20m. On 20 September 1993, as a result of communications with the ACCC, Legal & General instructed IMB to cease selling insurance policies for promotion of the Logan Lions Football Club, bringing the scheme promoted by IMB to an end.

(3) Findings

The ACCC alleged that in selling the insurance policies the respondents offered to supply services, namely the benefit or privilege of an opportunity to acquire shares in a company and an opportunity to become a foundation life member of a club, on the condition that those persons acquired services, namely, rights and benefits under either the National Mutual or Legal & General policies, in breach of section 47(6) and (7) of the Act. The Full Court of the Federal Court noted that neither IMB nor any of the individual respondents were in a position to offer either options or club memberships given that neither the company in which options were said to be offered, nor the club, were in existence at the time. The most that could be said was that the respondents offered to use their best endeavours to bring about a framework which facilitated these opportunities.

In any event, there could be no breach of section 47 because the relevant subsections therein require the benefit or privilege offered to be conditional on the purchase of services from a third party. The scheme required the insurance policies to be taken out with IMB not just because IMB would then get the commissions involved, but to ensure that IMB would be in a position, in the future, to offer the opportunities in question. If there was a condition, it was that that services be acquired from IMB, not Legal & General or National Mutual. It was of no interest to any of the respondents for participants to take out insurance otherwise than through the established agency arrangements.

On the facts, it was held that none of the representations made by the respondents fulfilled the requirements of section 52. It was alleged that the offer of benefits conditional on the purchase of an insurance policy was misleading and deceptive. No particulars were given as to why this was so, however, on appeal the ACCC argued that the offer was misleading and deceptive because the benefits offered could not be supplied. The Court was not prepared to entertain this allegation because it was raised for the first time in the appeal proceedings.

Other representations that came under scrutiny by the Court were representations as to the future value of the insurance policies. The Court held that participants understood through the representations of the respondents that an estimate as to the future value of the insurance policies was not guaranteed, but rather was subject to market influences. Accordingly, value estimates derived in a model prepared by National Mutual and communicated to potential participants were not considered to be misleading. It was also noted that although the National Mutual model estimated the ten year value of the policies to be $24,369, the rounding up of this figure by the respondents to $25,000 and subsequent communication of this figure was not misleading or deceptive. On the contrary, the rounding up made it less likely that the figure conveyed certainty, thereby decreasing the potential for people to be misled.

It was also alleged statements regarding the commencement and completion of the complex, the attributes and value of the complex and future value of shares were misleading as there were no reasonable grounds for thinking the necessary funding could be obtained. The Court held that the respondents had feasibility studies undertaken and no reason suggested that the proposal would be unattractive to a lender and it was not unreasonable to accept that without approval in principle a lender would not be likely to view the proposal seriously.

In terms of accessorial liability the Court held that in assessing such liability, unless wilful blindness can be shown, it is necessary to establish actual knowledge on the part of the person alleged to have been liable as an accessory of each of the essential elements of contravention. In this case, no evidence was led as to actual knowledge held by any of the individual respondents and therefore declarations were not made stating that the respondents were knowingly concerned in or party to any contraventions of the Act.

(E) RESIDUAL POWERS OF DIRECTOR TO DEFEND A WINDING-UP OF THE COMPANY AFTER AN INTERIM RECEIVER HAS BEEN APPOINTED  
(Sarah Lang, Blake Dawson Waldron)

Australian Securities and Investments Commission v Australian Investors Forum P/L [2003] NSWSC 130, Supreme Court of New South Wales, Austin J, 7 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc130.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc130.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Summary

Casabanca Pty Ltd was placed in interim receivership by the court to protect its assets. Mr Luvara, the sole director of Casabanca, retained Tzovaras Legal to act for himself personally, and for Casabanca, in defending an application for winding-up on just and equitable grounds.

Tzovaras Legal then sought to recover costs and disbursements incurred in defending the winding-up application, out of the funds held by the receiver, Mr Macintosh. Mr Macintosh refused to pay Tzovaras Legal, on the grounds that Mr Luvara had no authority to instruct lawyers on Casabanca's behalf, without the consent of the receiver.

Austin J found that the board of directors does have a residual power to defend a winding-up application, where the company has been placed in interim receivership by the court. Mr Luvara was therefore entitled to instruct lawyers to defend Casabanca's winding-up. This is primarily because it is inappropriate for the receiver appointed by the court on the application of ASIC to defend a winding-up, as the receiver should remain disinterested between the parties.

His Honour therefore made an order for Mr Macintosh to release funds to pay Tzovaras Legal's costs and disbursements relating to Casabanca.

(2) Facts

Mr Luvara was the sole director of Casabanca Pty Ltd. ASIC brought proceedings that Mr Luvara be disqualified from managing a corporation, and that Casabanca be wound up under section 461(1)(k) of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the "just and equitable grounds").

During the proceedings, the court had made interim asset preservation orders against Mr Luvara, on the application of ASIC. These orders allowed Mr Luvara to pay ordinary expenses up to a certain amount, and to pay costs reasonably incurred in the legal proceedings, up to $25,000 (this was later increased to $75,000). On 2 November 2001, the court made orders under section 1323 Corporations Act 2001 (Cth) appointing Mr Macintosh to be interim receiver and manager of the property of Casabanca.

In April 2002, Mr Luvara and Casabanca engaged Tzovaras Legal to act for them.

Tzovaras Legal subsequently submitted two tax invoices totalling $43,111.13 for professional costs and disbursements directed to Casabanca, which were accepted by the court as being accounts for work done on behalf of the company. Other tax invoices were directed to Mr Luvara personally.

Mr Macintosh had paid approximately $500,000 into court in the course of his receivership. Tzovaras Legal sought payment of its costs and disbursements out of these funds. Mr Macintosh declined to make the payment on the basis that:

(a) he had not instructed the lawyers to act on behalf of the company;

(b) Mr Luvara had no authority to instruct solicitors, once a receiver had been appointed; and

(c) there was no good reason for the company to be represented as it was impecunious.

(3) Findings

The question for the court was "whether the appointment of an interim receiver under section 1323 deprived the sole director of the company of all of his management powers, so that thereafter he had no power to instruct lawyers to act on the company's behalf - even for the purpose of defending the proceeding to wind the company up, and even though the appointment of the interim receiver was made by interlocutory application in that very proceeding".

Austin J held that the Mr Macintosh had only those particular receiver's powers which the court had previously conferred on him, and not all the powers of a receiver under section 420. Specifically, the listed powers did not confer the power to "make or defend an application for the winding up of the corporation" under section 420(2)(u).

His Honour then cited Moss Steamship Company Ltd v Whinney [1912]AC 254 which held that the appointment of a receiver does not "dissolve or annihilate a company". Austin J interpreted this to indicate that although a company may be in receivership, not every power of the board of directors has been superseded.

Austin J then compared interim receivership with a situation of provisional liquidation. He found that, until it was abolished by section 471A of the Corporations Act 2001 (Cth), directors had a residual power to appeal against the winding up of a company, after a provisional liquidator had been appointed.

His Honour stated that the rationale behind this residual power was that it would be inappropriate to give the liquidator, "the carriage, on behalf of the company, of the defence to the winding-up proceeding in the course of which he was appointed". His Honour held that the same reasoning could be used to show that where an interim receiver has been appointed, on the application of ASIC, in a proceeding brought by ASIC, it is not appropriate for the receiver to defend the winding-up. Since the company is entitled to a defence, it follows that the board of directors have a residual power to defend the winding-up, even without the consent of the interim receiver. Mr Luvara was therefore entitled to authorise Tzovaras Legal to act for Casabanca in defending the winding-up.

In accordance with this finding, Austin J made an order directing Mr Macintosh to release out of the receivership sufficient funds to pay costs and disbursements incurred by Tzovaras Legal in defending the winding-up of Casabanca.

(F) SECTION 588F OF THE CORPORATIONS ACT OPERATES TO DENY A CHARGEE THEIR INTEREST IN NON-SPECIFIC PROPERTY  
(By Michael Jackson, Phillips Fox)

Tolcher v National Australia Bank [2003] NSWSC 207, Supreme Court of New South Wales, Palmer J, 14 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc207.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc207.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Background

On 6 November 1998, Lloyd Scott Enterprises Pty Ltd ('LSE') entered into a first ranking debenture with the National Australia Bank ('the Defendant'). The debenture was subject to a charge in favour of the Defendant ('the Charge'). The Charge was fixed as to 'all the present and future estate, right, title and interest' of LSE in all its real and personal property, and was floating as to whatever property, if any, was not the subject of the fixed charge.

On 20 July 2001, Raymond George Tolcher was appointed liquidator of LSE ('the Plaintiff'). As a result of his investigations the liquidator made claims against Key Equipment Finance Australia Pty Ltd ('Key') in respect of an unfair preference under section 588FA of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) ('the Act') and insolvent trading as a shadow director of LSE against under section 588M of the Act.

The liquidator's claims against Key were the subject of mediation. On 5 December 2001 a settlement was reached and a deed was executed ('the Settlement Deed'). The Settlement Deed provided that upon the payment of $2,500,000 by Key to the liquidator, the liquidator covenanted not to sue Key in respect of his claims. Key then covenanted not to sue the liquidator in respect of any claim it might have or might have had 'by reason or related to or connected with' the liquidator's claims.

The question that therefore came before the Court was whether the $2,500,000 recovered from Key under the Settlement Deed was property of LSE which was subject to the Charge, or was property which was available to LSE's unsecured creditors in the administration of the winding up.

(2) Judgment

Justice Palmer began by noting the principle that where there has been a charge over specific property and that property is recovered by the liquidator that property will not be available for distribution to the company's unsecured creditors. However, his Honour further stated that the position is otherwise where non-specific property which would have been subject of a floating charge (such as money of the company) has come into possession of a liquidator as a result of proceedings taken or claims made by the liquidator.

To clarify this position, Palmer J had regard to the decision in N A Kratzmann Pty Ltd (in liq) v Tucker (No 2) (1968) 123 CLR 295. In that case, the High Court ruled that where security has been given over the assets of a bankrupt and a payment made by that person is subsequently declared void for being a preference payment, the moneys recovered are not subject to the charge. This is because that money is no longer the same as the money of the bankrupt, but rather is the money of the liquidator, whose title to it does not depend upon any succession to any title that the bankrupt had.

Counsel for the Defendant argued that the decision in Kratzmann was no longer good law. Relying on section 558FF(1)(a) of the Act, Counsel submitted that the section allowed the court to make an order directing a person to pay the company rather than the liquidator (as the section's predecessor allowed and in relation to which Kratzmann was decided).

However, Palmer J dismissed that submission, referring to SJP Formwork (Aust) Pty Ltd (in liq) v Deputy Commissioner of Taxation (2000) 35 ACSR 604 which affirmed that section 588FF(1)(a) has not altered the law as was laid down by the High Court in Kratzmann. In Formwork, the Supreme Court of New South Wales could find no legislative intent in support of the argument raised by the Defendant.

In this case, Palmer J held that despite the fact that section 588FF(1)(a) includes the phrase 'pay the company' the company was in liquidation and as such was being controlled by the liquidator, who was bound to apply the money in accordance with the law as stated in Kratzmann.

Even though the above decisions relate to recovery of preferences, Palmer J held their reasoning to be equally applicable to recoveries for claims for insolvent trading under section 588M of the Act. His Honour's decision was based on section 588Y(1) which provides 'an amount paid to a company under section...588M...is not available to pay a secured debt of the company unless all the company's unsecured debts have been paid in full'.

Palmer J observed that this construction of section 558Y(1) further illustrates there is no legislative intention that the property recovered by a liquidator in exercise of the statutory right conferred by section 588M should be regarded as property of the company so as to be available to a secured creditor and contrary to the principle established in Kratzmann. Evidence for this was the use of the words 'an amount paid to a company' in section 558Y, whereas under section 588M(2) only the liquidator is empowered to commence proceedings under the section to recover a debt due 'to the company'.

His Honour held that the Plaintiff was entitled to the following declarations: first, that the money paid to him as liquidator of LSE pursuant to the Settlement Deed was not the subject of the Charge; and second, that the Plaintiff was to apply the money paid under the Settlement Deed in accordance with Subdivision D of Division 6 Part 5.6 of the Corporations Act 2001 as to the priorities therein in the payment of unsecured debts or claims provable in the winding-up of LSE. The Defendant was ordered to pay the Plaintiff's costs.

(G) AUTHORITY OF DIRECTORS TO INSTITUTE PROCEEDINGS IN THE NAME OF THE COMPANY AFTER APPOINTMENT OF RECEIVERS  
(By Michael Jackson, Phillips Fox)

Gartner v Ernst & Young [2003] FCA 152, Federal Court of Australia, Mansfield J, 14 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/march/2003fca152.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/march/2003fca152.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Background

In early 2001, relying upon the advice of Ernst & Young ('the accountants'), the Gartners and the Gartner Companies ('the applicants') decided they would construct their own winery rather than purchase a pre-existing one. The finance necessary for the construction of the winery and working capital was sought through the National Australia Bank ('the bank'). This also was done on the advice of the accountants. On 11 October 2001, the bank offered finance to the applicants and that offer was accepted.

The security for the financing arrangements was to be the assets of the Gartner Family Group. Being guided by the accountants, financial guarantees were given by the Gartners and the Gartner companies granted debentures to the bank on 23 November 2001.

Each of the applicants was aware in November 2001 that there was still a shortfall in funding of $3 million. The subsequent application to the bank for additional funding was refused. As a consequence, the proposed development did not go ahead as planned and on 9 August 2001 the bank appointed receivers to each of the Gartner companies. However, on 8 August 2001, the applicants had purportedly rescinded their respective financing agreements and the various securities and guarantees.

The applicants alleged that the representations made by the accountants and the bank amounted to breaches of sections 52 and 51AA of the [Trade Practices Act 1974 No. 51 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6426" \t "default). They further alleged that the advice given by the accountants was negligent and in breach of their retainer, and hence that the applicants' loss was recoverable from them. In addition, the applicants sought to set aside the various loan security instruments.

(2) The accountants' application

The accountants applied under Order 9 rule 7(1)(a) of the [Federal Court Rules 1979 No. 140 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=8830" \t "default) ('the Rules') to set aside the application and statement of claim insofar as they related to the accountants or alternatively for an order under Order 20 Rule 2. They argued that the directors of the Gartner companies could only bring the action if they had received the express prior consent of the receiver to do so. Furthermore, the accountants argued that such consent could only be given if the receivers had secured a satisfactory indemnity for any costs liability and that the assets subject to the debentures were not exposed to risk of reduction in the event of an adverse costs order.

(3) The bank's action

On 16 August 2002, the bank through its solicitors informed the solicitors for the applicants that the Gartner companies had not sought the authority of the receivers to commence proceedings. They asserted that 'under no circumstance do any of the directors of those companies have any authority to pledge any asset of a company or incur any liability in respect of those proceedings'. However, Mansfield J held that there was no evidence to suggest that the bank (or the receivers or managers) had formally objected to the institution and maintenance of proceedings.

(4) The judgment

Mansfield J considered the debentures granted by the Gartner companies to be relevantly identical with the 'mortgaged property' being the whole of the undertaking and assets and property of each Gartner company. A fixed charge existed on all the present and future estates and interests in the assets of each Gartner company and a floating charge was created over the remaining property. His Honour found that, subject to whether or not the debentures had been validly rescinded (in which case the receivers would not have been validly appointed), the floating charges crystallised prior to the institution of proceedings with the bank's written notice dated 6 August 2002.

Mansfield J noted that the choses in action that the Gartner companies were pursuing were part of the 'mortgaged property' in the debentures which were now, if not validly rescinded, all subject to a fixed charge. His Honour further observed that under the terms of each debenture and the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), the receivers would be entitled to bring the present proceedings in the name of each of the Gartner companies, again subject to the several debentures not having been validly rescinded.

In relation to the accountant's two-stage submission regarding the directors' ability to bring an action when receivers have control of the company, his Honour dealt with the second stage first. Mansfield J held that whether or not an indemnity was sought was a matter of commercial judgment for the receivers, not for the court. Referring to Deangrove Pty Ltd (Receivers and Managers Appointed) v Commonwealth Bank of Australia (2001) 108 FCR 77 and Newhart Developments Ltd v Co-operative Commercial Bank Ltd [1978] 1 QB 814 at 819, Mansfield J held that it is for the receivers to judge the terms upon which they might consent to the directors bringing such proceedings, as there may be good reason why the receivers may consent to the institution of proceedings without a full indemnity for costs. It was therefore irrelevant in the circumstances that no indemnity had been given.

In relation to the first stage of the accountant's submission, Mansfield J held that the receivers had not been aware of the proceedings prior to them being instituted and upon learning of them had not taken any steps to bring them to an end. His Honour therefore concluded from this evidence that the receivers consented to the continuation of proceedings. In light of the authorities, Mansfield J held that there was no legal impediment to the directors having instituted the proceedings against the accountants, or to the maintaining of the proceedings.

Turning his attention to the debentures, Mansfield J noted that it was obviously more convenient that the claim against the accountants should be able to proceed at this point rather than await the determination of the status of the debentures, as that determination may take some time to resolve. The parties had earlier consented to the issue of the bank's liability being heard separate from other issues.

Mansfield J then dismissed an application by the accountants for an order for security of costs. His Honour considered that such an order would be inappropriate where there is no apparent clash between what the directors regard as being in the best interest of the company and what the receivers regard as being in the best interest of the bank. Additionally, where this position is maintained there is no reason why the directors should be held to have no power to institute and maintain the proceedings against the accountants.

In conclusion, his Honour referred to the judgment of Thomas J in Brooklands Motor Co Ltd (In Receivership) v Bridge Wholesale Acceptance Corporation (Australia) Ltd [1993] MCLR 448 where it was held that the directors of a company had the residual power to commence proceedings in the name of a company to enforce a financing agreement accepted by the managing director after the appointment of receivers by an earlier financier. In this case, as the receivers had not objected to the directors commencing proceedings it was assumed that the receivers did not consider those proceedings to be prejudicial to the obligation under the debentures. Mansfield J therefore dismissed the application to dismiss the Gartner companies' proceedings against the accountants.

(H) SETTLEMENT OF ASIC PROCEEDINGS INVOLVING MULTIPLE DEFENDANTS - ONE DEFENDANT OBJECTING TO SETTLEMENT BETWEEN ASIC AND ANOTHER DEFENDANT  
(By Felicity Slater, Clayton Utz)

ASIC v Rich [2003] NSWSC 186, Supreme Court of New South Wales, Bryson J, 21 March 2003.

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc186.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc186.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

Can one of several defendants to proceedings instituted by ASIC intervene to prevent a settlement between ASIC and another defendant who makes admissions about a course of conduct involving both of the defendants?

(1) Facts and arguments

It was argued for Mr Rich, one of the executive directors of the failed company One.Tel Ltd, that he was entitled to have restrictions imposed on the terms of a statement of agreed facts which formed the basis of a settlement between ASIC and another executive director, Mr Keeling, in which Mr Keeling made various admissions as to the cause of the losses suffered by the company.

These admissions were to be made by agreement as part of a compromise in which Mr Keeling admitted to a liability for damages and consented to being disqualified from acting as a director of a company for a decade. They were not the result of any finding by the court on the basis of evidence before it. They were, however, to be the subject of section 1317 declarations made by the Court, by consent of ASIC and Mr Keeling, which are given the status of "conclusive evidence" by section 1317F of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default).

Mr Rich contended that, although the declarations were made pursuant to a settlement between Mr Keeling and ASIC, to which they alone were party, the declarations sought could have legal or practical effect on other parties who did not consent to them, and for that reason they ought not to be made without a hearing on the merits. He argued that the Court should not give its imprimatur to agreed declarations of fact where the facts which, on their face, the declarations establish, were actually hotly in dispute (for example, as to the financial circumstances of the One.Tel Group).

Added force was given to this concern by the inclusion in the terms of settlement of a clause (clause 20) which recorded that the admissions and consent orders "will not constitute full satisfaction of ASIC's claims made in these proceedings and that ASIC is at liberty to pursue its claims against the other defendants and any other persons." In Baxter v Obacelo Pty Ltd (2001) 205 CLR 635 the High Court had held that such a term, taken with the conduct of the parties, "plainly indicate that the [plaintiffs] and [the settling co-defendant] contemplated that the [plaintiffs] would pursue their claims against the [other co-defendant]. There was no acceptance of the sum paid under that settlement as full satisfaction of the loss or damage...suffered."

In recognition of this concern, ASIC and Mr Keeling added a clause to the agreed declarations "that they are intended to be operative only between the plaintiff and the second defendant and are not intended to be binding on or in any way affect any other defendant in the proceedings."

Despite this exclusion from the agreed terms of the declarations, counsel for Mr Rich resisted the making of the declarations. He argued that whether or not section 1317F makes such a declaration conclusive evidence as against Mr Rich of any facts, those facts would be seen to be obtaining the Court's imprimatur or token of approval of their correctness when the Court made the declarations. He referred to possible litigants other than ASIC (for example, a liquidator, creditors, or insurers of the defendants seeking to avoid liability) who, it might be anticipated, might rely or seek to rely on section 1317F to contend that the declarations against Mr Keeling were conclusive evidence of some of the facts set out in the declarations.

(2) Decision

Bryson J rejected the challenge.

As to the common law position, he held that principles of res judicata and issue estoppel had no application other than between ASIC and Mr Keeling, or persons whose interests were so closely related to theirs as to be in privity with them.

As to the effect of section 1317F (which provides that "A declaration of contravention is conclusive evidence of the matters referred to in subsection 1317E(2)"), his Honour held that section 1317F makes evidence conclusive only where it is evidence of matters referred to in section 1317E(2); it would not be correct, nor would it be reasonably arguable, that circumstances so referred to would be conclusively established for the purposes of establishing the circumstances of anyone else's conduct.

His Honour concluded:

"While I cannot guard effectively against insubstantial arguments being put in some future case, I am of the view that the availability of conclusive evidence about the conduct of Mr Keeling imposes no risk on any other person such as Mr Rich...that the circumstances of his conduct might be held to have been conclusively established. No reasonable person would regard facts as objectively established against Mr Rich...by the position achieved in Mr Keeling's litigation. There is no rational basis for a fear that a Court addressing claims against them would misunderstand the position, or would treat the declarations to which Mr Keeling had consented as establishing anything. Mr Keeling is exposed to reliance on declarations adverse to him in other litigation which his conduct is relevant. It cannot...be supposed that the declarations could ever be available against them."

His Honour proceeded to accept the settlement, and concluded that in the circumstances the proposed penalty of $92 million and ten years' disqualification from participation in the management of a company was appropriate.

(I) REJECTING PROOFS OF DEBT AT A CREDITORS' MEETING  
(By Elizabeth O'Donovan, Deacons)

Mario Michael Spiteri v John Ross Lindholm [2003] VSC 42, Supreme Court of Victoria, Hansen J, 13 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/march/2003vsc42.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/march/2003vsc42.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Summary

Mario Spiteri ("Spiteri") and Econ Industries Pty Ltd ("Econ") ("Plaintiffs") brought proceedings to appeal against the decision of an administrator ("Lindholm") of Waleri Nominees Pty Ltd ("Company") who acted as Chairman of the second meeting of creditors of the Company and rejected the proofs of debt lodged by the Plaintiffs for voting purposes at the second meeting of creditors.

Spiteri was the sole director, secretary and shareholder of the Company and Econ as well as the sole director, secretary and shareholder of Valecave Pty Ltd ("Valecave").

The Plaintiffs had both claimed to be creditors of the Company and lodged proofs of debt at the second creditors' meeting and objected to Lindholm's decision to reject the proofs of debt on the basis that Lindholm should have followed the procedure in reg 5.6.26(2) and marked the Plaintiffs' informal proof of debt thereby allowing the Plaintiffs' to vote in respect of the amount claimed.

Lindholm rejected the Plaintiffs' proofs on the basis that he had not received the books and records of the Company despite repeatedly requesting Spiteri to deliver them and was therefore unable to verify the figures contained within the Plaintiffs' proofs.

Hansen J held that Lindholm was entitled to reject the Plaintiffs' proofs and he could not be expected to have followed the procedure set out in reg 5.6.26(2) as he had been unable to refer to the books and records of the Company and was not in a position to make a just estimate of the proofs.

(2) Background

The Company, Spiteri and some of Spiteri's other companies, including Valecave, had banking facilities with the National Australia Bank Limited ("NAB").

The Company fell into financial difficulties and NAB demanded that the Company pay its outstanding debts and demanded payment from Spiteri and Valecave under their guarantee as well as payment of the sum owed by Valecove under its mortgage. Valecave paid that amount but the Company still owed a considerable amount to NAB.

Shortly thereafter, NAB appointed Lindholm and Georges jointly as administrators of the Company. The first meeting of creditors was convened and Lindholm was provided with proofs of debt by, amongst others, NAB for a secured debt and an unsecured debt from Spiteri for loans to the Company.

At the meeting, Lindholm reported to the creditors and noted that he had not received a report of the affairs from Spiteri as required by the Corporations Act 2001 and that Spiteri had not delivered up the books and records of the Company.

Spiteri's solicitor submitted that the proof of debt claimed by NAB was subject to a pre-existing dispute and NAB's proof should not be admitted nor should NAB be admitted to vote. Lindholm disagreed and allowed NAB to vote in respect of the amount claimed. Lindholm admitted Spiteri's proof of debt for $1 only because of the lack of supporting documentation.

The Plaintiffs then sought an order to object to Lindholm's decision to admit NAB's proof of debt for voting purposes and to remove Lindholm as administrator. The proceeding was dismissed and the second meeting of creditors took place.

Before the second meeting of the creditors, Lindholm received some draft financial accounts for the company but still had not received the books and records of the Company.

At the second meeting Lindholm accepted all the proofs of debt except the Plaintiffs' proofs were rejected on the basis that Lindholm was unable to verify the figures contained in the proofs without having access to the books and records of the Company.

The Company was then wound up by resolution of the creditors.

(3) Submissions by Spiteri

Spiteri and Econ appealed against Lindholm's decision to reject the proofs of debt of the plaintiffs and relied on the approach in Vincent, White & Associates Pty Ltd v Vouris (1998) 28 ACSR 93 by Hodgson CJ in Eq by submitting that the court was justified in exercising its supervisory power as the administrator's action had such importance so as to warrant intervention by the Court.

The Plaintiffs submitted that the materials put before Lindholm at the second creditors meeting sufficiently verified the proofs of debts claimed. Further, the Plaintiffs submitted that Lindholm should not have rejected the proofs outright as Lindholm could only have had some doubt as to whether they should be admitted or rejected and therefore ought to have followed the procedure set out in reg 5.6.26(2). That procedure requires that Lindholm mark the proofs as objected to and allow the plaintiffs to vote.

(4) Submissions by Lindholm

Lindholm submitted that since he did not have the books and records of the Company to enable him to verify the proofs he was not in "in doubt" as required by reg 5.6.26(2) as to whether to admit or reject the proofs and was therefore not required to follow the procedure set out in reg 5.6.26(2).

It was further submitted by Counsel for Lindholm that since the Plaintiffs had deliberately withheld information contrary to the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), it was unreasonable to expect that Lindholm should have exercised his judgment to accept the proofs of the Plaintiffs as reasonable and sufficient evidence of the claimed debts.

(5) Voting procedures at creditors' meetings

The regulations relating to voting at a creditors' meeting are as follows:

Reg 5.6.23(1) provides that a person is not entitled to vote as a creditor unless his or her debt or claim has been admitted in whole or in part by the administrator, or he or she has lodged with the chairperson of the meeting particulars of the debt or claim or a formal proof of that debt or claim.

Reg 5.6.23(2) provides that:

"A creditor must not vote in respect of:

(a) an unliquidated debt; or  
(b) a contingent; or  
(c) an unliquidated or a contingent claim; or  
(d) a debt the value of which is not established;

unless a just estimate of its value has been made."

Reg 5.6.26 provides:

"5.6.26(1) [Chairperson may admit or reject] The chairperson of a meeting has the power to admit or reject a proof of debt or claim for the purposes of voting.

5.6.26(2) [Cases of doubt] If the person is in doubt whether a proof of debt or claim should be admitted or rejected, he or she must mark that proof as objected to and allow the creditor to vote, subject to the vote being declared invalid if the objection is sustained.

5.6.26(3) [Appeal] A decision by the chairperson to admit or reject a proof of debt or claim for the purposes of voting may be appealed against to the Court within 14 days after the decision."

Counsel for the Plaintiffs relied on Re Oriel Homes Pty Ltd (1997) 15 ACLC 564 in which Thomas J considered the interpretation of reg 5.6.23(1) and (2) and reg 5.6.26 and held that if the chairperson is in genuine doubt then the claim must be allowed at the amount claimed and should be marked as "objected to" and the creditor be allowed to vote at that value.

However, Hansen J preferred the interpretation given to reg 5.6.26(1) by Hodgson CJ in Vincent, White & Associates Pty Ltd v Vouris (1998) 28 ACSR 93 at 100, who considered the views of Thomas J in Re Oriel Homes Pty Ltd (1997) 15 ACLC 564 and held:

"I do not interpret Thomas J as saying that wherever there is genuine doubt as to the correct amount of the debt, the chairperson must allow the creditor to vote in the amount claimed. Such a view would in my opinion be contrary to the intention of Part 5.3A and the regulations, and in particular to reg 5.6.23(2)."

Hansen J took the view that since Lindholm was not able to make any just estimate of the proof of debt, he was not "in doubt" as to whether to admit the proofs and therefore was not obliged to comply with reg 5.6.26(2).

(6) Conclusion

Hansen J emphasised that Spiteri had demonstrated a deliberate, tactical and wrongful refusal to comply with the lawful request to produce the books and records of the Company.

Hansen J dismissed the Plaintiffs' claim and held that due to the refusal of Spiteri to deliver up the books and records of the Company, and other deficiencies in the proofs, Lindholm was entitled to reject the proofs of Spiteri and Econ. Hansen J also commented that the decision was warranted since the books and records may not have verified the debts and may have confirmed the existence of voidable transactions. The administrator was not obliged to comply with reg 5.6.26(2).

(J) UNJUST MORTGAGES: FAMILY ACQUIRED DEBT  
(By John Corbett, Corrs Chambers Westgarth)

St George Bank Limited v Trimarchi [2003] NSWSC 151, Supreme Court of New South Wales, Dunford J, 14 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc151.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc151.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Introduction

The plaintiff, St George Bank, sued the defendants (an elderly Italian couple) to recover moneys owing after they had defaulted on their mortgage and the bank had mortgaged the properties. The bank made a further claim; that if the mortgage was void or unenforceable, the plaintiff be subrogated to the rights of a previous mortgagee, National Mutual. The defendants argued that the loan agreement and mortgage with both St George Bank and National Mutual were 'unjust' within the meaning of the [Contracts Review Act 1980 No. 16 (NSW)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=10771" \t "default) and therefore should be set aside. Additionally, the second defendant (Mrs Trimarchi) relied on the principle of 'unconscionable conduct to enforce guarantees', which was expounded in Garcia v National Australia Bank Limited (1998) 194 CLR 395.

(2) Facts

The defendants were elderly Italian immigrants, Domenico and Lucia Trimarchi, who had limited English. Domenico had worked for many years as a self-employed builder and Lucia had been a housewife. Their son Anthony was a solicitor, involved in property investment.

In 1994, the defendants mortgaged their home and two investment properties to National Mutual as security to finance Anthony's property investments. On the evidence, the defendants trusted their son implicitly; they knew very little about the arrangement other than it was to help his business and that everything would 'be all right'. On 4 March 1995 Global Funds Management, manager of the National Mutual mortgage, notified Anthony that the loan facility would not be extended beyond its maturity date of 29 June 1995. The loan was not repaid. The defendants were served with notices under section 57(2)(b) of the [Real Property Act 1900 No. 25 (NSW)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=4197" \t "default). Anthony told his parents not to worry as he would 'fix it up'.

Anthony failed to disclose his financial state to his parents; in evidence tendered to the Court, he described how he started drinking heavily and defalcating from his firm's trust account. In August 1995 St George Bank, through its lending official Chris Brigg, provided a temporary overdraft facility of $25,000 for Anthony Trimarchi. By 5 October it was overdrawn and Anthony began seeking alternative refinancing options. He contacted Chris Briggs, who was apparently aware of Mr Trimarchi's difficult financial position. Briggs approved the refinancing loan, based partly on security of the mortgage from Mr Trimarchi's parents, with a condition precedent being a 'recommendation' (as distinct to a condition) that Domencio and Lucia receive independent advice. Communication between St George Bank and the defendants was always through Anthony; the defendants never personally received addressed correspondence or met any bank officials.

Mr and Mrs Trimarchi received legal advice from their son's legal partner, Adrian Matiussi. That advice, Druman J held, was totally meaningless to the defendants, who were, his honour suggested, in the habit of slavishly following what their son told them when it came to money and legal matters. The Court was satisfied the solicitor did not tell them in clear and specific terms that they could lose all their property, that the mortgage was for only a one year term and that at the end of that term it would be necessary to either sell the properties or re-finance the loan. Mr and Mrs Trimarchi also received financial advice from Aldo Demasi, who did not explain the total financial effect of the mortgage, the wisdom of entering into the transaction or how they were going to obtain the money to meet the huge repayments.

In the loan application, Anthony misrepresented the true financial state of his parents; he claimed they had no liabilities (when in fact they were liable for the full amount of the National Mutual mortgage), failed to provide details of his parents income and expenditure and forged his parents' signatures.

On 20 December 1995, the defendants accepted an offer of a finance facility from St George Bank. On 19 January 1996, a twelve-month mortgage was executed over the couples' three properties. Other properties owned by Anthony and his wife were used as security for the loan. On 22 January 1996 St George Bank paid out the National Mutual mortgage of $2,675,000.

The money owing to St George Bank was not repaid by the due date. St George Bank obtained possession of the properties owned by Anthony and his wife; the proceeds of sale reducing the debt. A sum of $1,148,075, however, remained outstanding.

The defendants argued that the Contracts Review Act 1980 (NSW) provided a comprehensive doctrinal framework to deal with 'unjust' contracts and should be interpreted liberally. The defendants argued that a party's understanding of the nature and effect of the documents being signed is relevant to whether the contract is 'unjust'. 'Unjust', within the meaning of the Act, includes unconscionable, harsh or oppressive. 'Injustice' is to be construed in a corresponding manner: West v AGC (Advances) Limited (1986) 5 NSLWR 610 at 620. The defendants further argued that a contract may also be unjust because of the way in which it was made (procedural injustice) or because of the way in which it operates (substantial injustice). Unfairness by the other party to the contract is not essential to a finding that the contract was unjust or to the granting of relief, nor is knowledge on the part of the other party.

Section 6(2) of the Act excludes relief for contracts 'entered into in the course of or for the purpose of a trade, business or profession'. The Bank argued that the defendants were carrying out a business and were therefore unable to rely on the Act. Dunford J held that even if it could be argued that the defendants had a beneficial interest in the properties, the loans they entered into were not 'in the course of' a business carried on by Mr. and Mrs. Trimarchi.

(3) Decision

The court set aside the loan agreement and mortgage of St George Bank and made judgment for the defendants. Anthony Trimarchi's conveyancing transactions were described by counsel as being more complex than the theory of relativity! Dunford J held that the proposition, by St George Bank, that two semi-literate Italian migrants could have had a full or sufficient understanding of what was involved in the transaction defied credibility. Although the Trimarchis knew what a mortgage was, the Court held that they had no meaningful appreciation of a mortgage of such complexity. There was a huge difference between a simple housing loan for a fixed amount, secured by a mortgage over the relevant housing property and a mortgage to secure a business loan raised to fund an investment or series of speculative investments, undertaken with others and secured by mortgages over properties not the subject of the investment. The Court held that neither of the defendants knew or had any meaningful appreciation of what they had entered into.

The Bank submitted that the defendants were borrowers or principal debtors. The Court held that they were, in substance and in fact, merely guarantors for the debts incurred by their son in his property speculation business. The defendants had no real understanding of what they were letting themselves into, were not consulted by St George Bank, received inadequate advice and the contract they signed with St George Bank was unjust, within the meaning of the Contracts Review Act 1980 (NSW).

In relation to the National Mutual mortgage, the Court held that the defendants had little if any knowledge of what they were entering into, or of their sudden increase in liabilities. National Mutual had only dealt with Anthony Trimarchi. Under such circumstances, the National Mutual mortgage was also held to be unjust, within the meaning of the Contracts Review Act 1980 (NSW).

Having found both the St George Bank and National Mutual mortgage agreements unjust, the Court held that the only way injustice to the defendants could be rectified was by discharging the loan agreement and mortgage. Based on the circumstances of the case, the Court held that it need not rely on Garcia v National Australia Bank. Judgment was entered for the defendants and the plaintiff ordered to pay the defendants' costs.

(4) Conclusion

This case highlights the difficulties which can arise when parties engage in complex financial arrangements without receiving adequate legal or financial advice. The case is an excellent example of the pitfalls that can occur when parties enter into financial arrangements out of a sense of duty or family obligation. It also indicates how Courts are reluctant to sanction financial arrangements entered into between parties with disproportionate bargaining power and which are manifestly 'unjust'.

(K) CAN LEAVE TO COMMENCE LEGAL ACTION AGAINST A COMPANY BEING WOUND UP BE GIVEN BY A COURT THAT DID NOT GRANT THE WINDING UP ORDER?  
(By Klay Brown, Corrs Chambers Westgarth)

Sihota v Pacific Sands Motel [2003] NSWSC 119, New South Wales Supreme Court, Austin J, 3 March 2003

The full text of the judgment is available at:

[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc119.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/march/2003nswsc119.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)

(1) Summary

In this case, it was held that leave to begin proceedings against a company in liquidation under section 471B of the [Corporations Act 2001 No. 50 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (Act) could be granted by a "Court" (as defined in section 58AA of the Act) other than the actual court that made the winding up order.

Accordingly, it was held that a broad construction of the words "Court" in section 58AA(1) of the Act, in comparison to the definition of "court" in section 9 of the Act, should be adopted to reflect the legislature's intention in establishing a national corporations law scheme in Australia.

(2) Facts

The proceedings began on 20 December 2002, when limited extensions of a caveat over a development property in Kingscliff in New South Wales were granted in favour of Mr Sihota. At that time the Mr Sihota made an interlocutory application to the Supreme Court of New South Wales under section 471B of the Act for leave to commence proceedings against Pacific Sands Motel Pty Limited (Pacific Sands) seeking to extend the caveat. However, the Supreme Court of Queensland had earlier in March 2002 made an order that Pacific Sands be wound up.

(3) Relevant law

In this case, Austin J was required to consider whether leave under section 471B of the Act could be granted by a "Court" (as defined in section 58AA of the Act) other than the court that made the winding up order.

Under section 471B of the Act no person can begin or proceed with:

(a) a proceeding in a court against the company or in relation to property of the company; or

(b) enforcement process in relation to such property;

except with the leave of the Court and in accordance with such terms (if any) as the Court imposes while a company is being wound up or while a provisional liquidator is acting.

Section 471B of the Act makes a distinction between a "court" and a "Court".

The term "Court" is defined in section 58AA of the Act as meaning the Federal Court, the Supreme Court of a State or Territory, the Family Court of Australia or a court to which section 41 of the [Family Law Act 1975 No. 53 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6863" \t "default) applies because of a proclamation made under subsection 41(2) of that Act.

(4) Decision

Austin J was referred to Barrett J's observation as to the distinction between "Courts" and "courts" in Re FAI General Insurance Co Limited [2002] NSWSC 262, where his Honour Barrett J stated:

"...it is plain that the proceedings in relation to which the prohibition upon proceeding without leave applies are proceedings in any court whatsoever; but that the Court from which the necessary leave is to be obtained is the Court by which the order for winding up was made."

Barrett J's view was consistent with the observations of McLelland CJ in Re Sydney Formworks Pty Ltd [1965] NSWR 646 that "the Court administering the liquidation may give leave" and the observations of von Doussa J in State Bank of South Australia v Clockwork Motors Pty Ltd (1991) 101 ALR 402.

Austin J, however, did not follow that line of reasoning for several reasons.

First, his Honour noted that Barrett J's observations in Re FAI General Insurance were obiter. Secondly, Re Sydney Formworks could be distinguished from the present case due to the different legislative arrangements that were in operation at the time that case was heard. Namely, prior to 1979, as company law was administered by each State and Territory, there were no co-operative or cross vesting arrangements to cause amendments to the companies law in force in the Australian Capital Territory to be automatically applied in other States and Territories. In particular, before cross-vesting legislation was enacted the general position was that only the Supreme Court of the State of Territory whose legislation was in question had jurisdiction to make orders to give effect to statutory rights and liabilities or with respect to a statutory procedure.

Austin J considered that the Full Federal Court decision in Acton Engineering Pty Limited v Campbell (1991) 103 ALR 437 was authority for the notion that any Court having jurisdiction under the [Corporations Law](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=7375" \t "default) (as it was then referred to), including the Federal Court, had jurisdiction to grant leave to commence or continue proceedings against a company in liquidation under what was then section 471(2) of the Corporations Law (Cth) so that no Court had primacy over any other. Further, Part 9.6A of the Act establishes jurisdictional arrangements for the Federal Court and the Supreme Courts under which, generally speaking, their jurisdiction is concurrent and no Court is given primacy over another. Accordingly, Austin J considered that the structure of the current statutory scheme suggests a legislative intention that any "Court" should have jurisdiction to make orders consequent upon orders made by any other "Court".

Based on these findings Austin J stated that the definition of "Court" in section 58AA(1) of the Act should be substituted with the words "the Court" whenever the latter words appear in section 471B of the Act and granted leave for the plaintiff to commence the relevant proceedings.

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