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1. RECENT CORPORATE LAW AND CORPORATE GOVERNANCE DEVELOPMENTS

(A) MAJOR SURVEY ON NOT-FOR-PROFIT COMPANIES

Ms Susan Woodward and Professor Ian Ramsay (Centre for Corporate Law and Securities Regulation, The University of Melbourne) in conjunction with Philanthropy Australia have conducted a large-scale survey of not-for-profit (NFP) companies limited by guarantee - 1,688 NFP companies completed the detailed survey. The numerical data has been entered and much of the analysis is compete. A Summary of Preliminary Findings is now available at <http://cclsr.law.unimelb.edu.au/activities/not-for-profit>

This is the first time national, large-scale profile data on NFP companies has been collected. This data provides a solid baseline for future reform and comparison. Understanding this data is a necessary first step in considering the particular (and often overlooked) needs of not-for-profit companies.

An article outlining the results and preliminary suggestions for law reform in more detail will appear in March Vol 21 Company and Securities Law Journal. The Project's research report will be complete by early 2004.

It is hoped that this Summary of Preliminary Findings will help engender debate about the regulation of not-for-profit organisations, and feedback about the findings and draft recommendations is welcome: email <law-notforprofit@unimelb.edu.au> or contact Sue Woodward or Shelley Marshall, 7th Floor, Faculty of Law, University of Melbourne, Victoria 3010, Ph (+61 3) 8344 6938, Fax: (+61 3) 8344 5285.

(B) SEC ADOPTS ANALYST CERTIFICATION RULE

On 6 February 2003 the United States Securities and Exchange Commission voted to adopt Regulation Analyst Certification, requiring research analysts to certify the truthfulness of the views they express and to disclose compensation related to the specific views expressed in reports or appearances.

(1) Research reports

Under Regulation AC, research reports distributed by brokers, dealers, and certain covered persons will include:

(a) a statement by the research analyst certifying that the views expressed in the research report accurately reflect such research analyst's personal views about the subject securities or issuers; and

(b) a statement by the research analyst certifying whether the analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

If the analyst received related compensation, the statement will include the source, amount, and purpose of such compensation, and further disclose that such compensation may influence the recommendation in the research report.

(2) Public appearances

Under Regulation AC, broker-dealers will be required to make a record related to public appearances by research analysts. Specifically, a broker or dealer who publishes, circulates, or provides a research report by a research analyst will be required to make a record within 30 days after each calendar quarter in which the research analyst made the public appearance, that will include:

(a) a written statement by the research analyst certifying that the views expressed in each public appearance accurately reflected such research analyst's personal views about the subject securities or issuers; and

(b) a written statement by the research analyst certifying that no part of such research analyst's compensation was, is, or will be directly or indirectly related to any specific recommendations or views expressed in any public appearance.

In cases where the broker or dealer does not obtain a statement by the research analyst in connection with public appearances as described above, the broker or dealer will be required to disclose in all research reports prepared by that analyst for the next 120 days that the research analyst did not provide the certifications.

The regulation will be effective 45 days from the date of its publication in the Federal Register. The full text of the release is available on the SEC website at <http://www.sec.gov>

(C) APRA SURVEY PROBES SUPER INVESTMENT PERFORMANCE

On 5 February 2003 a working paper released by the Australian Prudential Regulation Authority (APRA) provided an in-depth assessment of the Australian superannuation industry's investment performance across all funds and sectors from June 1995 to June 2002 and highlights a number of key points relevant to the industry:  
  
(1) Investment returns net of expenses for all funds averaged 6.68 per cent per year

The paper shows significant differences by type of fund, ranging from corporate funds with an average net return of 6.96 per cent to retail funds with an average net return of 4.51 per cent per annum. There is evidence that larger funds have higher returns than smaller funds.  
  
(2) Estimated annual expenses for all funds were 1.28 per cent per year on equal weighted basis, and 1.07 per cent per year on an asset weighted basis

There is evidence of scale economies in superannuation: funds with over $500 million in assets generated an estimated 1.08 per cent in annual expenses, against an estimated 1.37 per cent per annum for funds with less than $10 million in assets. There is no evidence that superannuation expense ratios have decreased in recent years. There are substantial differences in estimated expenses by industry sector, with public sector funds the lowest on an asset weighted basis at 0.58 per cent per annum and retail funds the highest at 1.32 per cent per annum.  
  
(3) There is substantial variation in volatility between fund types

The paper revealed a substantial difference between fund types, with retail funds returning the lowest volatility and corporate funds the highest volatility.  
  
(4) Retail funds have produced the lowest net returns in each of the past seven years

Given their apparent lower investment risks, retail funds would have been expected to under-perform in the good investment years from 1996 to 2000, and outperform other sectors in the less rewarding 2001 and 2002 years. The fact that retail funds have underperformed in each year is an area for future APRA research.  
  
(5) There is no evidence that funds which incur higher expenses generate better investment outcomes for superannuation fund members

The data, in fact, indicate that the higher the estimated expenses incurred, the lower the expected investment return.  
  
In preparing the paper, an in-house APRA team headed by Dr Neil Esho compared total returns, estimated expenses and volatility of returns across corporate, industry, public sector and retail funds of varying sizes.  
  
APRA has released for consultation expanded data collection forms intended to commence from June 2004. The regulator will use the expanded data set to further refine its supervisory analysis and oversight of the Australian superannuation industry, particularly at the individual fund level.

A copy of the report is available on the APRA website at <http://www.apra.gov.au>

(D) UK SECRETARY OF STATE FOR TRADE AND INDUSTRY ANNOUNCEMENT ON CORPORATE GOVERNANCE REFORMS

On 29 January 2003 the United Kingdom Secretary of State for Trade and Industry, Ms Patricia Hewitt, announced the following corporate governance reforms:

(1) Boardrooms

Following Derek Higgs' proposals ([see Item 1(M)](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0066.htm#non-executivedirectors) in this Bulletin, the UK combined code on corporate governance will be strengthened to provide that:

- at least half the board (as well as the chairman) is to be independent - as should all members of the audit and remuneration committees, and a majority of the nomination committee;   
- the definition of an independent director is to be strengthened and clarified;   
- the separation of roles of chairman and chief executive is to be reinforced;   
- new descriptions given of the respective roles of the board, the chairman and non-executives.

Ms Hewitt stated: "Mr Higgs' report showed a startling picture of the way top level appointments are handled, with over half of directors being appointed through personal contacts and friendships. I welcome his proposals to promote meritocracy - through an open, fair and rigorous appointments process. As part of the follow up, a group led by Laura Tyson of London Business School will look at ways of bringing candidates from the non-commercial sector to greater prominence - including women - and will report to me in May."

In revising the combined code, the financial reporting panel will also implement the recommendations of Sir Robert Smith's group ([see Item 1(L)](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0066.htm#auditcommittees) in this Bulletin) that the audit committee should:

- consist entirely of independent members, with at least one having relevant financial experience;   
- monitor the auditor's performance, especially on independence and objectivity;   
- develop and implement policy on the purchase of non-audit services from the auditor, with reference to tough new ethical guidance.

Following well established practice, listed companies will be required either to comply with these provisions or to explain to their shareholders why they are not doing so.

(2) Accountancy profession

The second aspect of the reforms concern additional measures to underpin auditor independence.

Following the recommendations of the Co-ordinating Group, Ms Hewitt announced that - as well as an enhanced role for audit committees and a tightening of the provision of non-audit services by auditors:

(a) the professional bodies have already changed their regulations so that the lead audit partner has to be rotated within five years;

(b) partners and senior employees of audit firms will not be able to take up employment with a company they audit within two years of leaving their audit firm; and

(c) most of the UK's large audit firms have already agreed to:

(i) publish an annual report;   
(ii) provide management and financial information;   
(iii) reveal levels of dependency on single clients, including how the firm handles conflicts of interest and interdependence issues.

Ms Hewitt stated that if such disclosures do not work on a voluntary basis, the government will make such disclosures a condition of auditing listed companies.

(3) Regulators

The Financial Reporting Council will assume the functions of the Accountancy Foundation. This will create a unified, independent UK regulator with three clear roles:

- setting accounting and audit standards;   
- pro-actively enforcing and monitoring them;   
- overseeing the self-regulatory professional bodies.

Three further changes were announced.

- first, that the Auditing Practices Board should take over from the professional bodies responsibility for setting standards for independence, objectivity and integrity. Oversight of other ethical standards will become the responsibility of a new Professional Oversight Board. The Ethics Standard Board will be wound up in due course;   
- second, that a new independent inspection unit, located within the FRC, should take over from the professional bodies responsibility for monitoring audits of listed companies, major charities and pension funds;   
- third, that the long delayed Investigation and Discipline Board should come into operation quickly to provide a truly independent forum for hearing significant public interest disciplinary cases.

(E) UK REPORT ON AUDIT AND ACCOUNTING ISSUES

On 29 January 2003 the United Kingdom Department of Trade and Industry released its final report to the Secretary of State for Trade and Industry and the Chancellor of the Exchequer titled "Co-ordinating Group on Audit and Accounting Issues". Following is a list of some of the recommendations contained in the report relating to auditor independence.

Rotation of auditors

(1) There should be a maximum of five years for the audit engagement partner and seven years for other key audit partners.

(2) There should not be a requirement for the mandatory rotation of audit firms, nor for mandatory re-tendering for the audit engagement.

Auditor provision of non-audit services

(3) There should be a strengthening, within the principles-based framework, of the requirements on the provision of non-audit services. In particular:

- there should be a strong presumption against providing internal audit services other than in exceptional circumstances.   
- the standard setter should carefully review the circumstances in which it is permissible to provide the following services, with a view to further clarification, as appropriate, of when this is permissible and when safeguards are needed: valuation services (in particular actuarial services and litigation support services), taxation services, and the design and supply of IT and financial information technology systems.

Standard setting body

(4) Responsibility for setting standards to uphold auditor independence should be transferred to a body that is independent of the professional accountancy bodies.

Role of audit committees

(5) Audit committees should have a much enhanced role in overseeing auditor appointment and ensuring auditor independence. This should be achieved through revised Combined Code guidance proposed by the FRC-appointed group chaired by Sir Robert Smith.

(6) Listed companies should disclose in more detail in their annual report the information they give about the non-audit services provided by their statutory auditor.

Cooling off period

(7) The Co-ordinating Group welcomes the introduction by Institute of Chartered Accountants of England and Wales (ICAEW) of the requirement for a 2-year cooling off period where an audit partner wishes to join an audit client as a senior employee or director.

Improved disclosure and guidance

(8) The standard setter for auditor independence should develop improved qualitative guidance for audit firms to ensure that they are alert to the threats to auditor independence arising from fear of losing an economically significant client at the level of the audit firm, office or individual partner.

(9) Audit firms with listed and public interest clients should disclose the fees received from a client where these exceed 5% of the firm's total fees.

(10) Audit firms should make available information on their policies, procedures and processes for managing auditor independence within the firm, together with relevant management and reward structures.

The report is available on the Department of Trade and Industry website at <http://www.dti.gov.uk>

(F) GLOBAL VIEWS ON RISK MANAGEMENT PRESENTED IN NEW IFAC PUBLICATION

On 28 January 2003 the International Federation of Accountants (IFAC), the Financial and Management Accounting Committee (FMAC) and the Chartered Institute of Management Accountants (CIMA) jointly released a new book titled "Managing Risk to Enhance Stakeholder Value".

The book includes articles and case studies from around the world presenting a variety of perspectives from professional accountants in business together with risk managers, internal auditors, professional association leaders, and others in more than a dozen countries. Its release comes at a time when companies are challenged by volatile markets, increased shareholder concerns, and a competitive and unpredictable global environment. Topics covered include the following:

- Understanding risk management in the context of corporate governance;  
- Reporting risk to shareholders and others;  
- Striking a balance between too much and too little disclosure;  
- Risk management challenges in the public sector;  
- How to integrate risk management in the corporate planning process;  
- Developing risk profiles;  
- Changing internal audit processes; and  
- Business continuity planning.

Managing Risk to Enhance Stakeholder Value and other FMAC publications may be downloaded at no charge from IFAC's website by going to <http://www.ifac.org/store>

IFAC is the worldwide organization for the accountancy profession. Its mission is to develop and enhance the profession to enable it to provide services of consistently high quality in the public interest. Its current membership consists of 155 professional accountancy bodies in 114 countries, representing more than 2.4 million accountants in public practice, education, government service, industry and commerce.

(G) TRANSPARENCY INTERNATIONAL RELEASES GLOBAL CORRUPTION REPORT 2003

On 23 January 2003, Transparency International released its 2003 Global Corruption Report. Transparency International (TI) is the world's leading non-governmental organisation fighting corruption.

The report includes a section on corporate governance. Peter Eigen, Chairman of TI cites encouraging evidence that leading companies are beginning to clean up their business. "The TI Bribe Payers Index 2002 reveals that companies from leading industrial countries are seen as slightly less likely to bribe than they were in the first BPI, carried out in 1999. Companies from Britain and the United States, however, were notable exceptions to the trend. But many businesses understand that stopping bribery makes sound economic sense."

Wholesale reform is needed to improve corporate governance, according to TI Executive Director and CFO, Jermyn Brooks. "Truly independent directors should hold a majority on the board and should chair audit and remuneration committees," he argues in the GCR 2003. "All elements of directors' remuneration should be fully disclosed in the financial statements and be subject to separate voting at each annual general meeting." The audit committee, he continues, "should approve any non-audit work awarded to auditors".

"If auditors wish to avoid regular rotation of firms performing audits," concludes Brooks, "as a minimum they should develop standards for independent reviews of assignments following internal rotation and should document the results. So far, no country has specified such requirements." Auditors should be in a position "to demonstrate that they have reviewed their clients' anti-fraud and anti-bribery systems and recommended improvements", he writes.

TI recommends the adoption of codes of conduct and related compliance programmes, and that details of implementation and monitoring results be published in each annual report. Codes of conduct should include rules designed to combat bribery at home or by subsidiaries abroad. To this end, TI has developed, with companies including BP, General Electric, Shell and Tata, a set of Business Principles for Countering Bribery. These include training programmes with guidance for all employees to ensure that bribery - direct or indirect - is eliminated.

The report is available on the IT website at **[Error! Hyperlink reference not valid.](http://www.transparency.org%20)**

(H) SECURITIES AND EXCHANGE COMMISSION REQUIRES PROXY VOTING POLICIES, DISCLOSURE BY INVESTMENT COMPANIES AND INVESTMENT ADVISERS

On 23 January 2003 the United States Securities and Exchange Commission voted to adopt rule amendments that would require mutual funds and other registered management investment companies to disclose their proxy voting policies and procedures and their actual proxy votes cast. These amendments are designed to enable fund shareholders to monitor their funds' involvement in the governance activities of portfolio companies and to encourage funds to vote their proxies in the best interest of fund shareholders. These rule amendments were adopted by a four-to-one vote of the Commission, with Commissioner Paul Atkins casting the dissenting vote.

The Commission also voted unanimously to adopt a new rule and rule amendments that would require registered investment advisers to adopt proxy voting policies and procedures, including procedures to address material conflicts of interest that may arise between the adviser and its clients. The rule and rule amendments are designed to ensure that advisers vote proxies in the best interest of their clients and provide clients with information about how their proxies are voted.

(1) Investment company amendments

The amendments the Commission approved with respect to mutual funds and other registered management investment companies require the following:

- Investment company proxy voting policies and procedures. The amendments will require a fund to disclose in its registration statement the policies and procedures that it uses to determine how to vote proxies relating to portfolio securities. This disclosure would include the procedures that a fund uses when a vote presents a conflict between the interests of fund shareholders, on the one hand, and those of the fund's investment adviser, principal underwriter, or certain of their affiliates, on the other. Disclosure of proxy voting policies and procedures will apply to filings made on or after July 1, 2003.

- Investment company proxy voting record. The amendments will require a fund to file new Form N-PX, containing its complete proxy voting record for the 12-month period ended June 30 by no later than August 31 of each year. Funds will be required to disclose the following information for each matter with respect to which a fund was entitled to vote: information identifying the matter voted on; whether the matter was proposed by the issuer or by a security holder; whether and how the fund cast its vote; and whether the fund cast its vote for or against management. Funds will be required to make their first proxy voting disclosures not later than August 31, 2004, for the 12 months ending June 30, 2004.

- Availability of proxy voting information to fund shareholders. A fund will be required to state in its reports to shareholders that information about the fund's proxy voting policies and procedures is available without charge, upon request, by calling a specified toll-free (or collect) telephone number; on the fund's Web site, if applicable; and on the SEC's website. A fund will be required to state in its registration statement and reports to shareholders that the fund files its proxy voting record with the SEC and that the record is available on the SEC's Web site and from the fund. A fund will be permitted to make the proxy voting record available either on its Web site or upon request.

(2) Investment adviser amendments

The amendments that the Commission adopted with respect to investment advisers will require the following:

- Investment adviser proxy voting policies and procedures. The new rule will require investment advisers that exercise proxy voting authority over client securities to adopt and implement written policies and procedures for voting client proxies. The policies and procedures must be reasonably designed to ensure the adviser votes client securities in the best interests of clients, and they must address how the adviser addresses material conflicts of interest that may arise between the adviser and its clients.

- Proxy voting information for advisory clients. The new rule will require investment advisers to describe their proxy voting policies and procedures to clients, and furnish a copy of them to clients upon request. The rule also requires investment advisers to tell clients how they can obtain information from the adviser on how the clients' securities were voted.

Investment advisers must have their proxy voting policies and procedures in place, and must have informed their clients of those policies and procedures, within 180 days of the publication of these rule amendments in the Federal Register.

The full text of detailed releases concerning each of these items is available on the SEC website at <http://www.sec.gov>

(I) SEC ADOPTS ATTORNEY CONDUCT RULE UNDER SARBANES-OXLEY ACT

On 23 January 2003 the United States Securities and Exchange Commission adopted final rules to implement Section 307 of the Sarbanes-Oxley Act by setting "standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers." In addition, the Commission approved an extension of the comment period on the "noisy withdrawal" provisions of the original proposed rule and publication for comment of an alternative proposal.

On 6 November 2002 the Commission voted to propose the standards of professional conduct in a new Part 205 of 17 CFR. That proposal defined who is appearing and practicing before the Commission in the representation of an issuer. Attorneys were required to report evidence of a material violation "up-the-ladder" within an issuer. In addition, under certain circumstances, these provisions permitted or required attorneys to effect a so-called "noisy withdrawal" - that is, to withdraw from representing an issuer and notify the Commission that they have withdrawn for professional reasons.

The rules adopted by the Commission will:

- require an attorney to report evidence of a material violation, determined according to an objective standard, "up-the-ladder" within the issuer to the chief legal counsel or the chief executive officer of the company or the equivalent;   
- require an attorney, if the chief legal counsel or the chief executive officer of the company does not respond appropriately to the evidence, to report the evidence to the audit committee, another committee of independent directors, or the full board of directors;  
- clarify that the rules cover attorneys providing legal services to an issuer who have an attorney-client relationship with the issuer, and who have notice that documents they are preparing or assisting in preparing will be filed with or submitted to the Commission;  
- provide that foreign attorneys who are not admitted in the United States, and who do not advise clients regarding U.S. law, would not be covered by the rule, while foreign attorneys who provide legal advice regarding U.S. law would be covered to the extent they are appearing and practicing before the Commission, unless they provide such advice in consultation with U.S. counsel;  
- allow an issuer to establish a "qualified legal compliance committee" (QLCC) as an alternative procedure for reporting evidence of a material violation. Such a QLCC would consist of at least one member of the issuer's audit committee, or an equivalent committee of independent directors, and two or more independent board members, and would have the responsibility, among other things, to recommend that an issuer implement an appropriate response to evidence of a material violation. One way in which an attorney could satisfy the rule's reporting obligation is by reporting evidence of a material violation to a QLCC;  
- allow an attorney, without the consent of an issuer client, to reveal confidential information related to his or her representation to the extent the attorney reasonably believes necessary (1) to prevent the issuer from committing a material violation likely to cause substantial financial injury to the financial interests or property of the issuer or investors; (2) to prevent the issuer from committing an illegal act; or (3) to rectify the consequences of a material violation or illegal act in which the attorney's services have been used;   
- state that the rules govern in the event the rules conflict with state law, but will not preempt the ability of a state to impose more rigorous obligations on attorneys that are not inconsistent with the rules; and   
- affirmatively state that the rules do not create a private cause of action and that authority to enforce compliance with the rules is vested exclusively with the Commission.

In addition, the final rules modify the definition of the term "evidence of a material violation," which defines the trigger for an attorney's obligation to report up-the-ladder within an issuer. The revised definition confirms that the Commission intends an objective, rather than a subjective, triggering standard, involving credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing or is about to occur.

The Commission voted to extend for 60 days the comment period on the "noisy withdrawal" and related provisions originally included in proposed Part 205. Given the significance and complexity of the issues involved, including the implications of a reporting out requirement on the relationship between issuers and their counsel, the Commission decided to continue to seek comment and give further consideration to these issues.

The Commission also voted to propose an alternative to "noisy withdrawal" that would require attorney withdrawal, but would require an issuer, rather than an attorney, to publicly disclose the attorney's withdrawal or written notice that the attorney did not receive an appropriate response to a report of a material violation. Specifically, an issuer that has received notice of an attorney's withdrawal would be required to report the notice and the circumstances related thereto on form 8-K, 20-F or 40-F, as applicable, within two days of receiving the attorney's notice. Accordingly, the proposal includes proposed amendments to forms 8-K, 20-F, and 40-F to require issuers to report an attorney's written notice under the proposed rule. The proposing release also will seek comment on whether there are circumstances in which an issuer should be permitted not to disclose an attorney's written notice.

The proposed rules also would permit an attorney, if an issuer has not complied with the disclosure requirement, to inform the Commission that the attorney has withdrawn from representing the issuer or provided the issuer with notice that the attorney has not received an appropriate response to a report of a material violation.

The final rules will become effective 180 days after publication in the Federal Register to provide issuers, attorneys, and law firms sufficient time to put in place procedures to comply with their requirements, and to allow the Commission the opportunity to consider the adoption of the proposed noisy withdrawal provision or the alternative disclosure procedure proposed.

The full text of detailed releases concerning each of these items can be found on the SEC's website at <http://www.sec.gov>

(J) SEC ADOPTS RULES STRENGTHENING AUDITOR INDEPENDENCE

On 22 January 2003 the United States Securities and Exchange Commission voted to adopt rules to fulfill the mandate of Title II of the Sarbanes-Oxley Act of 2002, strengthen auditor independence and require additional disclosures to investors about the services provided to issuers by the independent accountant.

The Commission approved measures that will:

- revise the rules related to the non-audit services that, if provided to an audit client, would impair an accounting firm's independence;  
- require that certain partners on the audit engagement team rotate after no more than five or seven consecutive years, depending on the partner's involvement in the audit, except that certain small accounting firms may be exempt from this requirement;  
- establish rules that an accounting firm would not be independent if certain members of management of that issuer had been members of the accounting firm's audit engagement team within the one-year period preceding the commencement of audit procedures;  
- establish rules that an accountant would not be independent from an audit client if any "audit partner" received compensation based on the partner procuring engagements with that client for services other than audit, review and attest services;  
- require the auditor to report certain matters to the issuer's audit committee, including "critical" accounting policies used by the issuer;  
- require the issuer's audit committee to pre-approve all audit and non-audit services provided to the issuer by the auditor; and  
- require disclosures to investors of information related to audit and non-audit services provided by, and fees paid to, the auditor.

(1) Non-audit services

Section 201 of the Sarbanes-Oxley Act lists nine non-audit services that, if provided by the accounting firm, impair the firm's independence. The rules approved for adoption by the Commission, will define the prohibited services as follows:

(a) Bookkeeping or other services related to the accounting records or financial statements of the audit client

The rules will prohibit an accountant from auditing the bookkeeping work performed by his or her accounting firm.

(b) Financial information systems design and implementation

Consistent with the SEC's previous rules, these rules will prohibit the accounting firm from providing any service related to the audit client's information system, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements. These rules will not preclude an accounting firm from working on hardware or software systems that are unrelated to the audit client's financial statements or accounting records as long as those services are pre-approved by the audit committee.

(c) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports

Appraisal and valuation services include any process of valuing assets, both tangible and intangible, or liabilities. Fairness opinions and contribution-in-kind reports are opinions and reports in which the firm provides its opinion on the adequacy of consideration in a transaction. These rules will prohibit the accountant from providing such services unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.

(d) Actuarial services

These rules will prohibit an accountant from providing to an audit client any actuarially oriented advisory service involving the determination of amounts recorded in the financial statements and related accounts for the audit client unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements. The accountant, however, may assist a client in understanding the methods, models, assumptions and inputs used in computing an amount.

(e) Internal audit outsourcing services

These rules will prohibit the accountant from providing any internal audit service that has been outsourced by the audit client that relates to the audit client's internal accounting controls, financial systems or financial statements unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.

During the conduct of the audit or when providing attest services related to internal controls, the auditor evaluates the company's internal controls and, as a result, may make recommendations to the audit client for improvements to the controls. Doing so is a part of the accountant's responsibilities under GAAS or applicable attestation standards and, therefore, is not a prohibited service.

(f) Management functions or human resources

Consistent with the SEC's proposal, the final rules will prohibit the accountant from acting, temporarily or permanently, as a director, officer or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.

These rules also will provide that an accountant's independence is impaired with respect to an audit client when the accountant seeks out prospective candidates for managerial, executive or director positions; acts as negotiator on the audit client's behalf; or undertakes reference checks of prospective candidates. Under the rule, an accountant's independence also will be impaired when the accountant engages in psychological testing or other formal testing or evaluation programs, or recommends or advises the audit client to hire a specific candidate for a specific job.

(g) Broker or dealer, investment adviser, or investment banking services

Acting as a broker-dealer (registered or unregistered), promoter or underwriter on behalf of an audit client and similar activities will make the accountant an advocate for the audit client and will impair the accountant's independence.

(h) Legal services

An accountant will be prohibited from providing to an audit client any service that, under circumstances in which the service is provided, could be provided only by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided.

(i) Expert services unrelated to the audit

These rules will prohibit an accountant from providing expert opinions or other expert services to an audit client, or a legal representative of an audit client, for the purpose of advocating that audit client's interests in litigation or in a regulatory or administrative proceeding or investigation. An accountant's independence will not be impaired, however, by an accountant providing factual accounts or testimony or explaining the positions taken or conclusions reached during the performance of any service by the accountant.

(2) Audit Committee pre-approval of services provided by auditor

Sections 201 and 202 of the Sarbanes-Oxley Act provide that an issuer's audit committee must pre-approve allowable services to be provided by the auditor of the issuer's financial statements. The rules will implement those sections of the Act by requiring that the audit committee pre-approve all services. In doing so, the audit committee may establish policies and procedures for pre-approval provided they are consistent with the Act, detailed as to the particular service, and designed to safeguard the continued independence of the accountant.

Consistent with the Act, the rules also will reflect a de minimis exception solely related to the provision of non-audit services for an issuer. This exception waives the pre-approval requirements for non-audit services provided that all such services (1) do not aggregate to more than five percent of total revenues paid by the audit client to its accountant in the fiscal year when services are provided; (2) were not recognized as non-audit services at the time of the engagement; and (3) are promptly brought to the attention of the audit committee and approved prior to the completion of the audit by the audit committee or one or more designated representatives.

(3) Disclosures to investors of services provided by the auditor

Section 202 of the Sarbanes-Oxley Act will require disclosure in periodic reports of non-audit services approved by the audit committee. The rules will require that issuers provide, in their annual reports, fees paid to the independent accountant for (1) audit services, (2) audit-related services, (3) tax services, and (4) other services. Additionally, the disclosures must include the audit committee's policies and procedures for pre-approval of services by the independent accountant as well as the percent of fees paid subject to the de minimis exception.

(4) Permitted non-audit service - tax service

Section 201 of the Sarbanes-Oxley Act specifically provides that "a registered public accounting firm may engage in any non-audit service, including tax services," that is not expressly prohibited, after audit committee pre-approval. Accordingly, accountants will be able to continue to provide tax compliance, tax planning and tax advice to audit clients, subject to audit committee pre-approval requirements. There are, however, some circumstances where providing certain tax services to an audit client would impair the independence of an accountant, such as representing an audit client in tax court or other situations involving public advocacy.

(5) Audit partner

The rules will define a new term-audit partner-for purposes of the requirements for partner rotation and partner compensation. An audit partner will be defined as a partner who is a member of the audit engagement team who has responsibility for decision-making on significant auditing, accounting and reporting matters that affect the financial statements or who maintains regular contact with management and the audit committee. The term audit partner will include the lead and concurring partners as well as partners who serve the client at the issuer level, other than a partner who consults with others on the audit engagement team regarding technical or industry-specific issues, and the lead partner on subsidiaries of the issuer whose assets or revenues constitute 20% or more of the consolidated assets or revenues of the issuer.

(6) Partner rotation

Section 203 of the Sarbanes-Oxley Act specifies that the lead and concurring partner must be subject to rotation requirements after five years. The rules will specify that the lead and concurring partner must rotate after five years and be subject to a five-year "time out" period after rotation. Additionally, certain other significant audit partners will be subject to a seven-year rotation requirement with a two-year time out period.

(7) Compensation

The new rule will provide that an accountant is not independent if, at any point during the audit and professional engagement period, any audit partner earns or receives compensation based on that partner procuring engagements with the audit client to provide any services other than audit, review or attest services.

(8) Cooling off period

Section 206 of the Sarbanes-Oxley Act establishes a one-year cooling off period before a member of the audit engagement team may accept employment in certain, designated positions with an issuer. The rules, therefore, will provide that an accounting firm is not independent if a member of management involved in overseeing financial reporting matters was the lead partner, the concurring partner, or any other member of the audit engagement team who provided more than ten hours of audit, review or attest services for the issuer within the one year period preceding the commencement of the audit of the current year's financial statements.

(9) Auditor communication with audit committee

Section 204 of the Sarbanes-Oxley Act directs the Commission to issue rules requiring timely reporting of specific information by accountants to audit committees. In response to the Act, the rules will require the accounting firm to report, prior to the filing of its audit report with the Commission, to the audit committee (1) all critical accounting policies and practices used by the issuer; (2) all material alternative accounting treatments of financial information within GAAP that have been discussed with management, including the ramifications of the use of such alternative treatments and disclosures and the treatment preferred by the accounting firm; and (3) other material written communications between the accounting firm and management.

(10) Small business/small firm considerations

The SEC recognizes that some of these provisions may impose an undue burden on certain smaller accounting firms. Accordingly, the rules will provide that firms with fewer than five audit clients and fewer than ten partners may be exempt from the partner rotation and compensation provisions, provided each of these engagements is subject to a special review by the Public Company Accounting Oversight Board at least every three years.

(11) Foreign considerations

Foreign accounting firms or foreign private issuers may face additional issues in implementing certain rules. Changes to the proposed rule relating to the depth of partner rotation and the scope of personnel subject to the "cooling off" period apply to foreign accounting firms. Moreover, additional time is being afforded to foreign accounting firms with respect to compliance with rotation requirements. The release also provides guidance on the provision of non-audit services by foreign accounting firms, including the treatment of legal services and tax advice. The SEC also stands ready to work with other regulatory bodies on these issues.

These measures will be effective 90 days after their publication in the Federal Register, with appropriate transition periods for various provisions.

(K) SEC ADOPTS RULES ON DISCLOSURE OF OFF-BALANCE SHEET ARRANGEMENTS AND AGGREGATE CONTRACTUAL OBLIGATIONS

On 22 January 2003 the United States Securities and Exchange Commission voted to adopt amendments to implement the mandate of Section 401(a) of the Sarbanes-Oxley Act of 2002. Section 401(a) added Section 13(j) to the Securities Exchange Act of 1934, which requires the Commission to adopt final rules by 26 January 2003, to require each annual and quarterly financial report required to be filed with the Commission, to disclose "all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses."

The amendments approved by the Commission will require a registrant to provide an explanation of its off-balance sheet arrangements in a separately captioned subsection of the "Management's Discussion and Analysis" (MD&A) section in its disclosure documents. The amendments also will require registrants (other than small business issuers) to provide an overview of certain known contractual obligations in a tabular format.

The amendments will include a definition of "off-balance sheet arrangements" that primarily targets the means through which companies typically structure off-balance sheet transactions or otherwise incur risks of loss that are not fully transparent to investors. The definition of "off-balance sheet arrangements" will employ concepts in accounting literature in order to define the categories of arrangements with precision. Generally, the definition will include the following categories of contractual arrangements:

- certain guarantee contracts;  
- retained or contingent interests in assets transferred to an unconsolidated entity;  
- derivative instruments that are classified as equity; or  
- material variable interests in unconsolidated entities that conduct certain activities.

The amendments will require disclosure of off-balance sheet arrangements that either have, or are reasonably likely to have, a current or future effect on the registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors. That disclosure threshold is consistent with the existing disclosure threshold under which information that could have a material effect on financial condition, changes in financial condition or results of operations must be included in MD&A.

The amendments will require disclosure of the following specified information to the extent necessary to an understanding of off-balance sheet arrangements and their material effects:

- the nature and business purpose of the registrant's off-balance sheet arrangements;  
- the importance to the registrant for liquidity, capital resources, market risk or credit risk support or other benefits;  
- the financial impact and exposure to risk; and  
- known events, demands, commitments, trends or uncertainties that implicate the registrant's ability to benefit from its off-balance sheet arrangements.

Consistent with the existing MD&A requirements, the amendments will contain a principles-based requirement that a registrant provide such other information that it believes is necessary for an understanding of its off-balance sheet arrangements and their specified material effects.

In addition, the amendments will include a requirement for registrants to disclose, in a tabular format, the amounts of payments due under specified contractual obligations, aggregated by category of contractual obligation, for specified time periods. The categories of contractual obligations to be included in the table are defined by reference to the applicable accounting literature.

Registrants will be required to comply with the disclosure requirements for off-balance sheet arrangements in Commission filings that are required to include financial statements for the fiscal years ending on or after 15 June 2003. Registrants will be required to comply with the disclosure requirements for the table of contractual obligations in Commission filings that are required to include financial statements for the fiscal years ending on or after 15 December 2003. Registrants could voluntarily comply with the new disclosure requirements before the compliance dates.

(L) UK REVIEW OF AUDIT COMMITTEES

On 20 January 2003, the United Kingdom Financial Reporting Council (FRC) published the report it had commissioned titled "Audit Committees Combined Code Guidance".

Following the major corporate failures in the US last year, the FRC was asked to set up an independent group to clarify the role and responsibilities of audit committees and to develop the existing Combined Code guidance. The role of audit committees in reinforcing the independence of the auditor was a major concern. Sir Robert Smith, Chairman of The Weir Group PLC and a member of the FRC, was invited to chair the group.

The key points in the report, to be reflected in the Combined Code and the detailed guidance, are:

(1) Composition of the audit committee

- Committee to include at least three members, all independent non-executive directors.   
- At least one member to have significant, recent and relevant financial experience, and suitable training to be provided to all.

(2) Role of the audit committee

- To monitor the integrity of the financial statements of the company, reviewing significant financial reporting judgements;   
- To review the company's internal financial control system and, unless expressly addressed by a separate risk committee or by the board itself, risk management systems;   
- To monitor and review the effectiveness of the company's internal audit function;   
- To make recommendations to the board in relation to the external auditor's appointment; in the event of the board's rejecting the recommendation, the committee and the board should explain their respective positions in the annual report;   
- To monitor and review the external auditor's independence, objectivity and effectiveness, taking into consideration relevant UK professional and regulatory requirements;   
- To develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm.

In addition the Code will require that the committee should be provided with sufficient resources, that its activities should be reported in a separate section of the directors' report (within the annual report) and that the chairman of the committee should be present to answer questions at the AGM.

The report is available on the FRC website at <http://www.frc.org.uk/publications>

(M) UK REVIEW OF NON-EXECUTIVE DIRECTORS

On 20 January 2003 the United Kingdom Department of Trade and Industry published Derek Higgs' report into the role and effectiveness of non-executive directors. The report sets out an agenda for change, building on the existing framework of UK corporate governance. It envisages a more demanding and important role for non-executive directors.

The report focuses directly on the effectiveness of non-executive directors in promoting company performance as well as on issues of accountability. The recommendations aim to increase rigour and transparency in the appointment process to foster meritocracy and widen the spread of experience in UK boardrooms. These include:

- Proposals to promote meritocracy in the boardroom through an open, fair and rigorous appointments process and to widen the pool of candidates;  
- Proposing a new, clear description of the role of the non-executive director;  
- That the roles of chairman and chief executive should be separated, and that the chief executive should not go on to become chairman of the same company;  
- A new definition of "independence" that addresses both relationships that would affect a director's objectivity and also those that could appear to do so. At least half the board would need to meet the new test, as would all members of the audit and remuneration committees and a majority of the nomination committee;  
- Promoting closer relationships between non-executive directors and major shareholders;  
- Significantly improved induction and professional development for directors;  
- Recommending that the performance of individual directors and of the board as a whole should be evaluated at least annually;  
- Proposals to clarify the liabilities of non-executive directors;  
- Recognising that some of the new Code provisions may be less relevant or manageable or take longer to achieve for smaller companies.

Rejecting a legislative approach, Derek Higgs' recommendations build on the current framework of UK corporate governance and the "comply or explain" nature of the Combined Code.

The full report is available at <http://www.dti.gov.uk/cld/non_exec_review>

(N) HONG KONG STOCK EXCHANGE PUBLISHES CONSULTATION CONCLUSIONS ON PROPOSED AMENDMENTS TO THE LISTING RULES RELATING TO CORPORATE GOVERNANCE ISSUES

On 17 January 2003 the Stock Exchange of Hong Kong Limited (the Exchange), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx), published Consultation Conclusions on Proposed Amendments to the Listing Rules Relating to Corporate Governance Issues.

The following are summaries of some of the conclusions:

(1) Voting by poll

The Exchange will require voting by poll for connected transactions and all transactions that require controlling shareholders to abstain from voting. The Exchange will also extend the requirement of voting by poll to transactions requiring any interested shareholders to abstain from voting.

(2) Placing of shares using the general mandate

The Exchange will retain the existing 20 per cent limit on the issue of securities under the general mandate and will not impose any restriction on the number of refreshments of the general mandate.

To protect minority shareholders' interests and address respondents' concerns about the placing of shares using the general mandate, the Exchange will amend the Main Board Rules to require independent shareholders' approval for any refreshments of the general mandate after the annual general meeting (AGM).

However, all issuers will be required to establish an independent board committee and appoint independent financial advisers to provide an opinion on the reasonableness of the refreshments of the general mandates subject to independent shareholders' approval. All issuers will also be required to disclose information on their past general mandates, including the amount raised and how it was used, in their announcements and/or circulars to shareholders.

To further protect minority shareholders' interests, the Exchange will limit the placing of shares under a general mandate at a substantial discount to the market price. Issuers will only be able to issue shares at a discount of 20 per cent or more if they can satisfy the Exchange that they are in severe financial difficulty. Issuers will be required to issue an announcement on any placing of shares, once the shares are placed, if the placing price is at a discount of 20 per cent or more to the market price. The announcement shall disclose, among other things, a generic description of the 10 largest placees who in aggregate subscribe to 50 per cent or more of the total number of shares placed, and the number of shares subscribed by each of the placees.

(3) Minimum number of independent non-executive directors

The Exchange will amend the Main Board and GEM Rules to require issuers to appoint at least three independent non-executive directors (INEDs), as a move toward its long-term aim to increase the number of INEDs on the board. In addition, the Exchange will recommend as a good practice in the revised Code of Best Practice that INEDs comprise at least one-third of the board, with the one-third rounded down when it is not a whole number.

There will be a one-year transitional period for issuers to comply with the new INED requirement, and the requirement will be reviewed two or three years after implementation.

To ensure that INEDs are able to properly discharge their responsibility to provide an objective view on the assessment of issuers' financial statements and participate in the audit committee, the Exchange will amend the Rules to require issuers to appoint at least one INED who has appropriate professional qualifications or experience in financial matters.

(4) Directors' contracts and remuneration

The Exchange will amend the Rules to require shareholders' approval for a service contract that is to be granted to a director of the issuer or its subsidiaries for a duration exceeding three years. A service contract that requires the issuer to give a period of notice of more than one year or to pay compensation of more than a year's remuneration (other than solely on account of an early termination by the issuer of a fixed term contract) will also be subject to shareholders' approval.

(5) Code of Best Practice

The Code of Best Practice will contain two tiers of recommendations. The first tier will contain minimum standards of board practices. The second tier will be the recommended good practices serving as guidelines for issuers' reference. Issuers will be required to include a report on corporate governance in their annual reports and disclose information relating to their corporate governance practices in the report. They will also be required to disclose any deviation from the minimum standards in their report on corporate governance.

Consultation Conclusions: <http://www.hkex.com.hk/library/listpaper/cc-e.pdf>;   
Profile of Respondents and Analysis of Responses: <http://www.hkex.com.hk/library/listpaper/pr-e.pdf>

(O) NEW CORPORATE GOVERNANCE STANDARDS RELEASED FOR PUBLIC COMMENT

On 15 January 2003 Standards Australia released for public comment new draft corporate governance Standards designed to assist all Australian organisations. The draft Standards, which have been developed around the OECD Principles of Corporate Governance, the IFSA Blue Book and the ASX Listing Rules, are designed to provide an all encompassing platform from which organisations can implement an effective corporate governance strategy.

The draft Standards have 5 parts:

Part 1 - Good Governance Principles - outlines how to implement a corporate governance framework which would include the development of a governance policy outlining; Board Charter, Board Protocol, a statement of matters reserved for the Board, Board delegations of authority, letters of appointments for Board members and code of conduct.

Part 2 - Fraud and corruption control - outlines the processes for implementing a fraud and corruption control plan and the establishment of a Fraud Control Officer to develop detection systems.

Part 3 - Organizational Codes of Conduct - outlines the process for developing an organisational code of conduct, which calls for the establishment of an Ethics Committee chaired by an independent Director and a statement of commitment to adhere to applicable Laws and Standards. It should also address issues such as conflict of interest, improper use of company information, insider trading, gifts and entertainment, and equal employment opportunities.

Part 4 - Corporate Social Responsibility - sets out the essential elements for establishing, implementing and managing an effective Corporate Social Responsibility Program. The program should consider issues such as profitability, ethics, employment, health and safety, environmental impacts, impacts on a host community, regulatory compliance systems and stakeholder communication. The Standards also calls for effective internal and external reporting and third party verification.

Part 5 - Whistleblowing Systems for Organizations - calls the development of a whistleblowing policy, the establishment of a hotline, and the implementation of a Whistleblowing Protection Officer to maintain the confidentiality of the Whistleblower.

The final versions of the Standards will be published later this year and will be submitted to the International Organisation for Standardization [ISO] for consideration as a possible International Standard. If you would like to download the draft guidelines please visit the Standards Australia website at <http://www.Standards.com.au> or for hard copies contact the Customer Service Centre on 1300 65 46 46.

(P) SEC ADOPTS RULES ON AUDIT COMMITTEE FINANCIAL EXPERTS AND CORPORATE CODES OF ETHICS

On 15 January 2003 the United States Securities and Exchange Commission voted to adopt rules implementing Sections 406 and 407 of the Sarbanes-Oxley Act of 2002. These rules will require public companies to disclose information about corporate codes of ethics and audit committee financial experts.

The rules will require a company subject to the reporting requirements of the Securities Exchange Act of 1934 to include the following two new types of disclosures in their Exchange Act filings.

- Pursuant to Section 407, a company will be required to annually disclose whether it has at least one "audit committee financial expert" on its audit committee, and if so, the name of the audit committee financial expert and whether the expert is independent of management. A company that does not have an audit committee financial expert will be required to disclose this fact and explain why it has no such expert.  
- Pursuant to Section 406, a company will be required to disclose annually whether the company has adopted a code of ethics for the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. If it has not, the company will be required to explain why it has not. The rules also will require a company to disclose on a current basis amendments to, and waivers from, the code of ethics relating to any of those officers.

(1) Audit committee financial experts

The rules will expand the proposed definition of the term "financial expert" and also substitute the designation "audit committee financial expert" for "financial expert." The rules will define "audit committee financial expert" to mean a person who has the following attributes:

(a) an understanding of financial statements and generally accepted accounting principles;

(b) an ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;

(c) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities;

(d) an understanding of internal controls and procedures for financial reporting; and

(e) an understanding of audit committee functions.

A person can acquire such attributes through any one or more of the following means:

(a) education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;

(b) experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions, or experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or

(c) other relevant experience.

An individual will have to possess all of the attributes listed in the above definition to qualify as an audit committee financial expert. Furthermore, the rules will eliminate the proposed requirement that a person's experience applying generally accepted accounting principles in connection with accounting for estimates, accruals and reserves be "generally comparable" to the estimates, accruals and reserves used in the registrant's financial statements.

The rules also will provide a safe harbor to make clear that an audit committee financial expert will not be deemed an "expert" for any purpose, including for purposes of Section 11 of the Securities Act of 1933, and that the designation of a person as an audit committee financial expert does not impose any duties, obligations or liability on the person that are greater than those imposed on such a person as a member of the audit committee in the absence of such designation, nor does it affect the duties, obligations or liability of any other member of the audit committee or board of directors.

(2) Codes of ethics

Under the rules, a company will be required to disclose in its annual report whether it has a code of ethics that applies to the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. The rules will define a code of ethics as written standards that are reasonably necessary to deter wrongdoing and to promote:

- honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;  
- full, fair, accurate, timely, and understandable disclosure in reports and documents that a company files with, or submits to, the Commission and in other public communications made by the company;  
- compliance with applicable governmental laws, rules and regulations;  
- the prompt internal reporting of code violations to an appropriate person or persons identified in the code; and  
- accountability for adherence to the code.

A company will be required to make available to the public a copy of its code of ethics, or portion of the code that applies to the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. A company can make the code of ethics available to the public by filing it as an exhibit to its annual report, providing it on the company's Internet Web site, or as otherwise set forth in the final rule.

A company, other than a foreign private issuer or registered investment company, also will be required to disclose any changes to, or waivers of, the code of ethics within five business days, to the extent that the change or waiver applies to the company's principal executive officer or senior financial officers. A company can provide this disclosure on Form 8-K or on its Internet Web site. Foreign private issuers and registered investment companies will be required to disclose changes to, and waivers of, such codes of ethics in their periodic reports or on their Internet Web sites.

The new rules will be effective 30 days from the date of their publication in the Federal Register. Companies will be required to provide the new disclosures in annual reports for fiscal years ending on or after 15 July 2003. Small business issuers will be required to provide the new audit committee financial expert disclosure in annual reports for fiscal years ending on or after 15 December 2003.

2. RECENT ASIC DEVELOPMENTS

(A) NEW DEPUTY CHAIRMAN OF THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

On 21 February 2003, the Federal Treasurer, the Hon Peter Costello MP announced that Mr Jeffrey Lucy AM has been appointed by the Governor-General in Council as the new Deputy Chairman of the Australian Securities and Investments Commission.

Mr Lucy replaces Ms Jillian Segal who resigned in June 2002 to take up a position on the Trade Practices Act Review Committee. Mr Lucy is currently Chairman of the Financial Reporting Council. He is a Chartered Accountant and experienced financial consultant. He is a Fellow of the Institute of Chartered Accountants in Australia, CPA Australia, the National Institute of Accountants, and the Australian Institute of Company Directors. Mr Lucy was made a Member of the Order of Australia for his contribution to corporate and taxation reform. He is a former member of the Business Regulation Advisory Group, a former National President of the Institute of Chartered Accountants in Australia, and a former Managing Partner of PricewaterhouseCoopers, Adelaide.

The Treasurer stated that Mr Lucy's mix of skills and experience will be of particular benefit to ASIC in the context of the proposed reforms to the accounting and auditing regulatory framework in CLERP 9. Mr Lucy took up his position on 24 February and be based in Sydney.

(B) ASIC CALLS FOR COMMENT ON TAKEOVER RELIEF

On 20 February 2003 ASIC released a policy proposal paper (PPP) on a range of takeover relief, for public comment. ASIC has released the paper in the course of finalising Interim Policy Statement Takeovers: discretionary powers (IPS 159), and seeks comments by Friday 4 April 2003.

IPS 159 is an omnibus policy statement on the takeovers, compulsory acquisition and substantial holding provisions of the Corporations Act. It discusses issues that ASIC expects to be the subject of applications for relief.

ASIC originally released IPS 159 at the time the Corporate Law Economic Reform Program (CLERP) Act 1999 commenced, with the intention of reviewing it after the CLERP Act had operated for a reasonable time. IPS 159 will now be amended to become a final policy statement.

The PPP discusses:

- Relief for companies who enter into an escrow agreement with a holder. Without relief, an escrow may put the company in breach of the takeover provisions;  
- Relief so that employee share scheme securities that are non-transferable can be compulsorily acquired;  
- Relief so that a bidder may exercise options it has acquired under a takeover bid for the options. Without relief, a bidder that exercises the options may breach the takeover provisions; and  
- Clarifying when a partly-paid share is considered to be in the same class as a fully paid share.

Copies of the PPP are available from the ASIC website at <http://www.asic.gov.au> or the ASIC Infoline on 1300 300 630.

(C) ASIC PROVIDES GUIDANCE ON REQUIRED CONTENTS OF PRODUCT DISCLOSURE STATEMENTS

On 13 February 2003 ASIC announced the results of its ongoing surveillance and compliance program under the new product disclosure regime, which came into effect with the introduction of the Financial Services Reform Act (FSRA) on 11 March 2002.

Under FSRA, a Product Disclosure Statement (PDS) must be provided to all retail clients for all financial products, other than shares and debentures. Existing financial products, that is those that were available before 11 March 2002, must comply with this requirement from 11 March 2004 unless they elect to opt in to the FSRA regime earlier.

A PDS must contain all the information consumers need to make an investment decision including information on risks, costs, features of the product and tax information. Financial product issuers must give retail consumers a PDS before making a binding agreement and advisers must give a PDS to retail consumers prior to or at the same time as they give advice.

As part of the surveillance program, to date ASIC has conducted preliminary reviews of 87 PDSs and full reviews of 47, including derivatives, insurance and superannuation PDSs and has identified a number of deficiencies in the information provided to consumers.

General deficiencies in the PDSs provided to investors included:

- the use of undefined or unexplained terms;  
- the use of terms in an unfamiliar way;  
- the product issuer's ability to participate to a greater or lesser extent in the profits (at its discretion); and  
- the ability of the issuer to vary fees at its discretion.

As a result of full reviews of PDSs ASIC has issued 13 interim stop orders. Of these, nine issuers prepared supplementary PDSs and the remaining four withdrew and issued replacement PDSs after ASIC made final stop orders.

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(D) FINANCIAL PLANNER SURVEY RESULTS RELEASED

On 11 February 2003 ASIC and the Australian Consumers' Association (ACA) released their joint survey of the quality of advice provided by financial planners.

In the third survey of its kind in the past eight years, genuine customers were recruited and obtained 124 financial plans from advisers around the country. Panels of industry experts then assessed whether the plans met legal requirements and 'good practice' standards for a comprehensive financial report.

'The overall results of the survey show that many people aren't getting the quality of advice they deserve. This is a wake-up call to the financial advisory industry that significant improvements are needed', ASIC Executive Director of Consumer Protection, Mr Peter Kell said.

'The "good practice" standards which were part of the assessment of the plans are in fact standards that have been developed by the industry itself. They should be in everyday use, given that the industry handles many millions of dollars of people's savings. It's disappointing to see that these standards are not being achieved consistently', Mr Kell said.

'In the past two years, ASIC has removed 62 financial advisers from the industry, and a further 10 have received jail terms. We are carefully assessing the information from the survey to identify what future actions we will take', Mr Kell said.

'ASIC is implementing a range of strategies to address the shortcomings identified by the survey. For example, the survey showed that, on average, the plans given by stockbrokers scored poorly compared to other industry sectors. As a result, ASIC is announcing a campaign designed to improve advice standards in the stockbroking industry', Mr Kell said.

Mr Kell said that ASIC is also:

- meeting with all the firms who gave a 'Very Poor' plan to ensure that weaknesses are promptly rectified;  
- requiring some licensees to certify their compliance with relevant legal obligations (including the 'know your client' rule and commission disclosure); and  
- working with the Financial Planning Association to address some of the poor communication standards that the survey has revealed.

A copy of ASIC's detailed report on the survey is available from <http://www.asic.gov.au>

(1) Overall grades

|  |  |
| --- | --- |
| **Grade** | **No of plans** |
| Very good | 2 (2%) |
| Good | 23 (19%) |
| OK | 36 (29%) |
| Borderline | 30 (24%) |
| Poor | 21 (17%) |
| Very poor | 12 (10%) |
| **Total** | **124 (100%)** |

(2) Problem areas

'Poor' and 'Very Poor' were clearly inadequate. 'Borderline' plans had some significant weaknesses. Common deficiencies in plans included:

- failing to provide an Advisory Services Guide (15% of planners);  
- failing to show how the recommended strategy and action was appropriate for the client;  
- being hard to read and 'padded' with reams of generic information;  
- some planners ignored key client requirements and didn't explain why;  
- higher-fee investments (such as some wrap accounts and master trusts) were recommended without showing why these were better than cheaper alternatives; and,  
- recommending a switch without showing how new investments would be better than existing investments.

Some firms produced both good and poor plans. This inconsistency clearly indicates that firms need to pay more attention to training, compliance procedures and quality control.

(3) Positive outcomes

Some improvements have been made since the last survey in 1998, including small improvements in the areas of disclosing commission and assessing client risks.

The survey findings also reinforce the messages in the ASIC/FPA free booklet Don't Kiss Your Money Goodbye that contains invaluable advice for choosing and using a financial planner. It's available from ASIC's Infoline on 1300 300 630 or on our consumer website at <http://fido.asic.gov.au>.

Don't Kiss Your Money Goodbye outlines how people can get better advice if they:

- do some preparation about their needs and goals,  
- are prepared to pay a fee for advice, and  
- ask why the recommended action is better than other options.

(4) Implications for the Financial Services Reforms

While plans were assessed against existing legal requirements and not the FSRA legislation, ASIC notes that many planning firms will need to improve their written advice to meet upcoming requirements under the new Financial Services Reform Act, as some good practice standards will become legal requirements by March 2004.

(E) ASIC FINDS SOME TAX-DRIVEN MASS-MARKETED SCHEMES HAVE POOR COMPLIANCE

On 7 February 2003 ASIC released a report into the quality of advice and disclosure provided for primary production managed investment schemes, "Compliance with advice and disclosure obligations: ASIC report on primary production schemes".

ASIC's report examines the correlation between the receipt of high commissions by financial advisers and the provision of inappropriate or misleading advice to encourage investors to invest in such schemes.

'Our surveillance found that there were low levels of compliance amongst promoters of tax-driven mass-marketed schemes', said Mr Ian Johnston, ASIC's Executive Director, Financial Services Regulation.

'ASIC found that there was often poor disclosure of commissions and there were a number of instances of people being put into these schemes as a result of poor advice', Mr Johnston said.

ASIC also found that:

- there was a low level of compliance with the record keeping that is required by law  
- there were difficulties in assessing whether sufficient capital was being maintained and contributed to the activities of the scheme  
- responsible entities frequently outsourced important functions and engaged inexperienced managers.

The report can be found on the ASIC website at <http://www.asic.gov.au> at the Financial Services Reform page.

(F) RESPONSIBLE ENTITIES MUST ACT APPROPRIATELY

On 29 January 2003, as part of an ongoing campaign to improve compliance with the law by responsible entities (REs) of managed investments schemes, ASIC warned REs that they must take full responsibility for their schemes.

An RE is a public company licensed to operate a registered managed investment scheme. Under the Corporations Act, an RE is required to take full responsibility for operating its schemes, as set out in s601FB(1) and (2). The rights of investors are only fully protected when a scheme fully complies with the law.

In action stemming from the review, ASIC has required a Western Australia-based RE to restructure seven schemes. ASIC had the following concerns regarding the management structure:

- the scheme manager was a separate and unrelated entity to the RE;  
- the scheme members rather than the RE appointed the manager, under agreements drafted by the responsible entity;  
- the RE claimed it was not liable for any acts or omissions of the manager; and  
- a scheme manager carried out substantial activities as part of the schemes, including all agricultural or tree farming activities.

While an RE has the power to appoint an agent to the scheme, the RE nevertheless remains legally liable for the behaviour of that person or agent, even if the person or agent acts fraudulently or outside the scope of their authority.

Scheme members can appoint a manager for the scheme, however this breaches the law if the manager effectively becomes 'responsible' for operating the scheme. As a result, the rights and interests of investors can be diminished, as the scheme members may not be able to rely on the RE for redress in the event of loss caused by an act or default of the manager.

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(G) UPDATED POLICY STATEMENT 146: TRAINING OF FINANCIAL PRODUCT ADVISERS

On 22 January 2002 ASIC released a number of updates to Policy Statement 146 Licensing: Training of financial product advisers (PS 146). The policy sets out minimum training standards for people providing financial product advice to retail clients.

PS 146 has been updated to take account of requests from industry for further clarification; and comments made by the Parliamentary Joint Committee on Corporations and Financial Services, in its October 2002 report on regulations and ASIC policy made under the Financial Services Reform Act 2001.

In particular, the amendments address two particular areas of PS 146:

- ASIC's requirements for advisers on basic deposit products and related non-cash payment products (BDPs); and  
- ASIC's requirements for advisers who only provide general advice.

While Tier 2 training is required for people who advise on BDPs, the revised policy provides greater flexibility by removing the need for BDP training courses to be assessed by an authorised assessor and placed on the ASIC Training Register. This will relieve licensees of having to arrange a course assessment by a registered training organisation (RTO).

If a person provides financial product advice in relation to other financial products as well as BDPs, training courses for those other products will still need to be assessed by an authorised assessor.

ASIC agrees that the skills required to provide general advice vary greatly from the skills required to provide personal advice, and the updates to PS 146 clarify that there is no need to assess skills requirements of general advisers in accordance with Appendix B of PS 146.

Further updates to PS 146 include:

- the exemption for customer service representatives (eg front desk staff) who provide advice from a script or under supervision. In this regard the meaning of 'script' and 'supervision' has been clarified;  
- the requirement to obtain a Statement of Attainment on completion of an approved training course; and  
- the minimum training compliance dates for advisers on consumer credit insurance (CCI).

Copies of the updated policy are available from the FSR policy page via the Financial Services homepage of the ASIC website at <http://www.asic.gov.au>. Copies can also be obtained by emailing ASIC's Infoline on infoline@asic.gov.au, or by calling 1300 300 630. Any technical questions should be addressed to FSRProjectOffice@asic.gov.au.

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3. RECENT ASX DEVELOPMENTS

(A) ASX CORPORATE GOVERNANCE COUNCIL

On 20 February 2003 the ASX Corporate Governance Council held its fifth meeting. The meeting reaffirmed its earlier commitment to release the Principles of Good Corporate Governance and Best Practice Recommendations of the Council at the end of March this year.

ASX has amended its Listing Rules so as to require listed entities to adopt the new Principles and Recommendations or to disclose to their shareholders why they had not adopted them. This Listing Rule takes effect for the first full year after the introduction of the Principles and Recommendations - that is, for the 2003-04 financial year.

The Council noted that the Principles and Recommendations are being issued in good time for companies to consider reporting against them for the present financial year. The Council also noted that the Principles and Recommendations are evolutionary in nature. The Council has expressed its commitment to monitoring and reviewing the Recommendations in the light of experience, and will develop a mechanism to facilitate feedback from listed companies in relation to implementation.

(B) SHARE OWNERSHIP SURVEY - 2002 FINDINGS

Half of all adult Australians - more than 7 million people - own shares, according to the latest national survey of share ownership released by the Australian Stock Exchange on 5 February 2003. And 37% of the adult population - more than 5 million Australians - continue to own and manage their own share portfolio.

While the level of share ownership has declined slightly in the past two years, the vast majority of shareholders have not only remained in the market but also have increased their level of activity and involvement.

According to the latest Share Ownership Survey, carried out in November 2002, Australian shareholders remained steadfast as the long bull market drew to a close and the market overall recorded its first annual downturn in eight years.

The survey found that since the previous update survey conducted in November 2000, total share ownership had declined by just two percent - driven by the three percent decrease in the ranks of those directly owning shares (in their own name, as opposed to through a managed fund or DIY super).

As at November 2002, an estimated 50% of Australian adults (7.3 million people) owned shares in their own name or through a managed fund. An estimated 37% (5.4 million) owned a direct shareholding.

The survey found that compared with the previous survey, the "average shareholder" still owns shares, but is more likely to be male, to own more shares, to have a portfolio of higher value and to trade more often.

While overall ownership numbers changed only slightly, there has been a considerable shift in the composition of those totals. One significant change has been an apparent widening of the "gender gap" in share ownership, after several years in which the gap closed. The survey found that 33% of women own shares in their own name, down from 36% in previous surveys. This compares to 41% of men who directly own shares.

Also of significance was the decline in the number of shareholders in the age groups between 25 and 54, probably reflecting the residential investment property boom. This was somewhat offset by a substantial increase in the number of investors in the 55-plus bracket and a smaller increase in the 18-24 group. As with previous surveys, the 2002 study suggests a relationship between the levels of direct share ownership and the level of education and household income earned.

From a geographic perspective, the survey found considerable variation in the levels of direct share ownership. In New South Wales the level declined from the previous national high (48 to 40%), probably reflecting the previous survey's timing immediately following the NRMA float. In other states the levels remained either steady or, in the case of Victoria and South Australia in particular, increased significantly.

The 2002 survey has highlighted a number of positives in terms of shareholder behaviour. Chief among these is the range of companies held in the typical portfolio, and the value of investments in the market. While the mean-average has remained steady at six companies per portfolio, the survey found that considerably fewer investors held shares in just three or less companies.

In addition to this trend towards diversification, the survey also found that the average amount directly invested in the sharemarket had risen by just over 25% to $35,800, following several years where the average portfolio was valued at approximately $28,500. Significantly, this has occurred at a time when market valuations were down on previous years.

The level of trading has also increased significantly with investors now completing on average 3 trades per annum. The proportion of investors not trading at all over this period has also fallen considerably.

Continuing this overall trend, there has been a decline in trading activity at the lower end of the market, especially for trades worth less than $5,000, and an increase at the higher end, particularly the $10,001 to $25,000 bracket. The average value of each sharemarket transaction has increased from $5,700 in 1999 to $8,800 in 2002.

One in two shareholders use just one broker, and increasingly that relationship will take place on the Internet. In many cases the broker will provide transaction execution only, with the main source of investment advice being financial planners and newspapers, followed closely by family and friends. But only two in five investors consider a professional adviser to be their main source of advice.

The 2002 survey also captured shareholders' attitudes toward their investments, and found owners still believed they needed to take responsibility for their own financial future, and that shares form an essential part of a balanced investment portfolio.

However, market conditions have undoubtedly affected immediate behaviour. Investors felt time-poor and less enthusiastic about being involved. However, more were considering investing in blue chip shares. These are all characteristics of a bear market.

While the survey revealed a growing maturity and level of understanding of the market, this was not always evident. For example, three in four direct investors either did not know if they paid stamp duty on share transactions, or believed that they still did. This belief was held across all types of shareholders, including the more confident and experienced share owners. The Federal Government abolished stamp duty on share transactions in July 2001.

The survey is available on the ASX website at <http://www.asx.com.au>

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4. RECENT CORPORATE LAW DECISIONS

(A) ASSESSING THE FAIR VALUE OF SECURITIES IN A COMPULSORY ACQUISITION  
(By Rebecca Grapsas, [Mallesons Stephen Jaques](http://www.mallesons.com))

Bromley Investments P/L v Elkington [2002] QSC 427, Supreme Court of Queensland, Muir J, 13 December 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/qld/2002/december/2002qsc427.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

Bromley Investments Pty Ltd ("Bromley") held 11,819,098 out of 11,828,850 (99.92%) of the issued shares in Carrington Cotton Corporation Limited ("Carrington"). Carrington was involved in cotton growing and ginning and was the owner operator of grain farms in Queensland. Carrington was a listed company prior to its delisting in 1998.

Bromley sent notices of compulsory acquisition in accordance with section 664A of the Corporations Act 2001 (Cth) ("Corporations Act") to the remaining 12 shareholders in Carrington, who held 9,752 shares between them. The compulsory acquisition notice stated a price of $5.87 per share and was accompanied by a copy of an experts' report prepared by Price Waterhouse Coopers Securities Limited ("PWC") dated 11 April 2002 ("Report").

The Report was prepared as an independent expert's report pursuant to section 667A of the Corporations Act and expressed the opinion that the price of $5.87 per share was fair because it exceeded $4.77, which was stated to be the "upper end of a reasonable value range". The figure of $4.77 was derived from a valuation on the basis of an orderly realisation of assets which adopted real property valuations prepared by Taylor Byrne Pty Ltd ("Taylor Byrne") and which took into account selling and marketing costs and capital gains tax. An alternative valuation of $3.79 per share was arrived at using the discounted cash flow methodology (adjusted for surplus assets and debt). The Report noted that shares in Carrington had been offered for $5.75 pursuant to a buyback scheme in October 2001.

PWC revised its valuation to $4.86 per share on a discounted cash flow basis in a letter to the directors of Bromley dated 7 October 2002 ("October Letter"). The October Letter took into account the fact that actual cotton sales were higher than the projections set out in the Report. The October Letter affirmed the opinion of PWC that the price of $5.87 per share was fair.

Bromley received notices of objection to compulsory acquisition from seven shareholders. In response, Bromley brought an application for approval of compulsory acquisition under section 664F(3), which required it to establish that the terms set out in the compulsory acquisition notice gave a fair value for the securities. The objecting shareholders who became respondents to the application were ordered by the court to serve on Bromley a statement setting out the grounds on which they opposed the application.

(2) Consideration of stated grounds on which application opposed

Two shareholders served statements setting out the grounds on which they opposed the application. Justice Muir considered each of the stated grounds on which the application was opposed in deciding whether or not to make an order approving compulsory acquisition under section 664F(3) of the Corporations Act.

(a) First ground - evidence does not establish that the price offered is fair

The respondent shareholders criticised sections of the Report as being "incomprehensible" and lacking in justification. Justice Muir rejected this argument as some of the contentions in the Report were matters of opinion based on intangible factors, including the experts' experience, and the respondents had not effectively challenged the competence or objectivity of the experts. In dispensing with an argument as to the fairness of the Taylor Byrne valuation, Muir J stated that the fact that valuations were obtained for mortgage security purposes was of no practical significance. Moreover, Muir J noted that the valuation in the Report which utilised the upper range of cotton price predictions in the discounted cash flow method was consistent with Dixon J's comment in Commissioner of Succession Duties (SA) v Executor Trustee & Agency Co of SA Ltd (1947) 74 CLR 358 at 374 that "in a case of compensation doubts [with respect to valuation] are resolved in favour of a more liberal estimate, in a revenue case, of a more conservative estimate" (cited with approval by Warren J in Capricorn Diamonds Investments v Catto (2002) 168 FLR 146, 161-2).

(b) Second ground - undervaluation of water licences held by Carrington

The argument that the valuation in the Report was incorrect because water licences held by Carrington were undervalued was rejected by Muir J because there was nothing to suggest that the methodologies used to value the water licences were flawed. Justice Muir noted that the water licence valuations were comprehensive and directly compared the value of the subject properties with the value of other properties sold in nearby areas.

(c) Third ground - criticism of relevance of share buyback scheme offer price

The third argument advanced by the respondents was that the offer price in the share buyback scheme was not at arms' length because it was negotiated in connection with litigation with a minority shareholder who was under "significant duress" and included a franked dividend component which was not present in the compulsory acquisition price.

Justice Muir held that the buyback offer price should be treated with caution in light of the circumstances surrounding the negotiation of the purchase price. Moreover, in light of the limited consideration given by PWC to the dividend component, Muir J attributed little weight to the opinion of PWC that the buyback price supported the argument that the compulsory acquisition price of $5.87 per share was a fair value, although he considered that it was unlikely that PWC would have increased their valuation even if detailed analysis had been undertaken.

Justice Muir noted that the evidence did not disclose any inequality of bargaining power between the minority shareholder (which held 27% of the issued shares in Carrington) and the majority shareholder. He noted further that any pressure on the minority shareholder to accept a lower price for their shares may have been matched or exceeded by pressure on the majority to remove a troublesome minority.

Justice Muir held further that the fairness of the compulsory acquisition price must be assessed by reference to the total consideration for the shares, rather than the composition of the consideration. In particular, the respondents were only entitled to a minimal amount of any dividend declared due to the size of their shareholding so whether or not a dividend had been declared or paid had little bearing on the experts' valuations. Moreover, the fact that the offer price under the buyback scheme included a fully-franked dividend component did not necessarily mean that the dividend should be regarded as providing a benefit above and beyond the buyback offer price because the benefit to each shareholder would vary from shareholder to shareholder.

Justice Muir noted that other sales of securities in Carrington over the previous two years were relevant, however, they were to be given little weight because of the small number of shares involved.

(d) Fourth ground - orderly realisation of assets valuation incorporating selling and marketing costs

In response to the argument that PWC should not have taken into account selling and marketing costs when valuing Carrington on an orderly realisation basis, Muir J held that it was proper to take into account the costs of realisation of assets because these expenses would necessarily be incurred in realising the assets of Carrington. He rejected the argument that the Corporations Act required valuations on the basis of continued trading rather than the sale of assets.

(3) Submission of additional grounds of opposition

The respondent shareholders attempted to argue grounds of opposition in addition to those set out in the statements provided to Bromley. Justice Muir stated that consideration of those additional arguments would be unfair to Bromley, but nevertheless expressed his views on their merits.

Justice Muir noted that PWC had adopted an "oddly casual" approach in compiling the Report as the persons who had contributed data and forecasts had not been identified. However, Muir J was content to rely on the evidence as set out in the Report as he was of the view that the forecasts were not seriously in dispute and to require strict proof would cause unnecessary or unreasonable expense, delay and inconvenience, particularly as the sums involved were modest. He also rejected the argument that the valuation should have been adjusted on account of "abnormally high" legal fees and noted that the failure to include books of account in the Report did not affect its validity.

The argument of the respondent shareholders that PWC should have taken into account events occurring after the assessment date in the October Letter was rejected as there was nothing in the evidence to indicate that the conclusions of PWC would have been any different had they taken into account all the available information. Justice Muir noted that the cases in relation to the consideration of subsequent events in determining compensation for the compulsory acquisition of land should be treated with caution when applied to compulsory acquisitions of shares in light of the myriad factors affecting share prices.

(4) Securities offered at a fair value - compulsory acquisition approved

After considering all of the above, Muir J held that the price of $5.87 per share gave a fair value and approved the compulsory acquisition in accordance with section 664F(3) of the Corporations Act. Justice Muir further held that the Report complied with section 667C of the Corporations Act.

(5) Order with respect to costs

Justice Muir ordered Bromley to bear the costs of the hearing in accordance with section 664F(4) of the Corporations Act, except for the costs of appearances on the second day of the hearing. These costs were to be borne by the respondent shareholders because the attempts by the shareholders to go outside the stated grounds of opposition were unreasonable.

(B) BACKDOOR GREENMAIL? THE RELEVANCE OF ADMINISTRATION COSTS TO THE FAIR VALUE OF SECURITIES TO BE COMPULSORY ACQUIRED  
(By Tom Webb, Solicitor, [Mallesons Stephen Jaques](http://www.mallesons.com))

Pauls Limited v Dwyer [2002] QCA 545, Supreme Court of Queensland, Court of Appeal, Davies and Jerrard JJA and Jones J, 13 December 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/qld/2002/december/2002qca545.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

This judgment makes life even more difficult for that increasingly endangered species, the corporate greenmailer. Recent developments in corporate law have attempted to restrict the practice of greenmailing, in which majority shareholders are forced to pay an extravagant premium to minority shareholders, above what would otherwise be a fair value, to purchase those shares and thus acquire control over all of the company's shares.

In particular, where a 90% shareholder seeks to exercise its powers under Part 6A of the Corporations Act 2001 (Cth) ("Act") compulsorily to acquire the remaining shares at fair value, that value is to be calculated on a pro rata basis within each class of securities in the company, without allowing a premium or discount for particular securities in each class: see section 667C of the Act.

Where the minority interests to be acquired are a collection of small shareholders and the acquirer holds all the company's remaining shares, the company will obviously save money following the compulsory acquisition through economics of scale in administration costs. The company will report to only one shareholder, rather than a diverse, unrelated group. Can these economics of scale be taken into account in calculating the fair value of the minority shareholding to be acquired? Or is this, by a different guise, the awarding of a greenmail-style premium to minority shareholders?

(1) Facts

Pauls Limited and its wholly-owned subsidiary ("the majority shareholders") together owned all of the ordinary shares and one third of the preference shares in Pauls Victoria Limited ("the company"). The remaining two thirds of the company's preference shares were owned by various other shareholders. The majority shareholders sought compulsorily to acquire those preference shares as a 90% shareholder under Part 6A of the Act. Some of the minority preference shareholders objected to the acquisition. A valuation of the preference shares was conducted in accordance with section 667C of the Act, which concluded the amount offered in the compulsory acquisition notice represented a fair value for the shares.

The minority shareholders challenged the compulsory acquisition on two principal bases:

(i) that the valuation had failed to take into account the administrative savings produced by the compulsory acquisition; and

(ii) that the compulsory acquisition was invalid as it represented an acquisition of property other than on just terms, and was thus beyond the legislative power of the Commonwealth under section 51(xxxi) of the Constitution.

The Court at first instance dismissed these objections, approved the acquisition of the shares and made a declaration that the amount offered in the compulsory acquisition notice represented a fair value for the preference shares. The minority shareholders appealed to the Queensland Court of Appeal, which unanimously upheld the decision of the primary judge.

(2) Failure to take into account administrative savings

The criteria for determining the fair value of shares to be compulsorily acquired are set out in section 667C of the Act:

"To determine what is fair value for securities for the purpose of this Chapter:

(i) first, assess the value of the Company as a whole; and

(ii) then allocate that value among the classes of issued securities in the Company (taking into account the relative financial risk, and voting and distribution rights, of the classes); and

(iii) then allocate the value of each class pro rata among the securities in that class (without allowing a premium or applying a discount for particular securities in that class)."

The valuation was performed by calculating the value of the company as a whole, then valuing the preference shares on the basis of capitalisation of maintainable earnings for those shares. The value of the preference shares, thus calculated, was subtracted from the value of the Company as a whole and the remainder allocated as the value of the ordinary shares of the Company.

The minority shareholders argued not only that the administrative cost savings should be taken into account, but that between 50% and 100% of those savings should be attributed to the value of the preference shares, as opposed to the ordinary shares.

The Court of Appeal (Davies and Jerrard JJA and Jones J) accepted that administrative cost savings would result from the proposed acquisition, and that this would make the preference shares more valuable to the majority shareholders than to other potential purchasers. However, the Court concluded that this was not relevant to the criteria for valuation of the shares provided in clause 667C of the Act. Davies JA (with whom, on this point, Jerrard JA and Jones J agreed) said at [22]-[23] that the argument for taking into account the administration cost savings rested on:

"… an assumption about the nature or the consequence of the hypothetical sale in respect of which such valuation must be made. It assumes either that the company's undertaking is purchased by an entity which is not a company with two or more classes of shareholders; or that the company's shareholding will be purchased by one entity rather than two or more independent entities which may wish to maintain an independent preference shareholding. I do not think that, in valuing the company, any assumption should be made about what shareholding hypothetical purchasers may adopt for the company, or may already have. That would be to speculate as to the manner or consequence of its hypothetical sale rather than to value the company as it is.

"[The valuer] did not think that a hypothetical purchaser would pay more for the company as a whole because of the possibility that, after the purchase, there might be, effectively, only one shareholding resulting in an administration cost saving. He thought that would depend on the nature of the purchaser and, for that reason he did not think that it should affect its value to a hypothetical purchaser of whatever nature. That seems to me to be correct and I would accept his opinion as the learned primary judge did."

Davies JA also remarked that there was no rational reason why the administrative cost savings, even if they could legitimately be taken into account, should be allocated to the preference shareholders in particular. Rather, section 667C limited the factors which could be used to distinguish the value of different classes of shareholding to the factors stated in the section, namely relative financial risks and voting and distribution rights, to the exclusion of other factors.

The Court also remarked that section 667C should be interpreted keeping in mind that one of the purposes of the section "was to provide a method of valuation which would discourage greenmailing" (see at [20]; see also Capricorn Diamonds Investments Pty Ltd v Catto (2002) 41 ACSR 376 at [23]-[28]).

(3) Constitutional challenge

The minority shareholders also challenged the constitutionality of the compulsory acquisition, as being an acquisition of property other than on just terms and thus beyond the legislative power of the Commonwealth under section 51(xxxi) of the Constitution. The Court also dismissed this ground of appeal.

Although the Court's reasoning on this point does not call for extensive discussion in this note, its reasons may be summarised as follows:

- the compulsory acquisition was not an acquisition of property within the meaning of section 51(xxxi), but rather was an incident of the Commonwealth's referred power under section 51(xx) to enact the Corporations Bill 2001 (Jerrard JA dissenting on this point);  
- even if the compulsory acquisition was an acquisition of property in the relevant sense, the legislature must be allowed some discretion in deciding what represents just terms and the Parliament had decided just terms were represented by "fair value" calculated in accordance with section 667C of the Act; and  
- the criteria for determining fair value in section 667C of the Act represented just terms such that any acquisition of property effected by the compulsory acquisition was, in any event, on just terms.

(C) WHEN CAN A SUBSCRIBER SEEK REVIEW OF A DECISION BY ASIC REGARDING A PROSPECTUS?   
(By Alastair Macphee and Puneh Vahdat, [Phillips Fox](http://www.phillipsfox.com))

Owen Noel Sullivan v ASIC [2002] AATA 1331, Administrative Appeals Tribunal, P J Lindsay, 23 December 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/aata/2002/december/2002aata1331.htm> or or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

Mr Sullivan, the applicant, applied to the Administrative Appeals Tribunal for review of several decisions of ASIC: first, in relation to ASIC's decision to register 3 prospectuses, and secondly, regarding ASIC's decision not to investigate the applicant's complaint concerning those prospectuses. Mr Sullivan also lodged an application for an extension of time to lodge the above application, as the Registry had rejected his initial application on the grounds that it was out of time.

The 3 prospectuses had been prepared by Howard Funds Management Limited. Each related to a unit trust that aimed to invest any capital raised in commercial buildings.

The applicant alleged that the content of each prospectus was misleading regarding the proposed termination of the trust and consequent return of investor capital and accrued income, and that ASIC therefore should not have registered the prospectuses.

Mr Sullivan also alleged that his personal data in one of the prospectuses was forged, and that ASIC had failed to investigate his complaint concerning this forgery. He sought an order from the AAT that investors in each of the trusts be entitled to have their investment capital returned to them on the first working day after the 5 year period on which their investment expired or expires.

ASIC opposed the applicant's application for an extension of time and submitted that the AAT did not have jurisdiction to grant the relief sought by Mr Sullivan or to review ASIC's decision not to investigate his complaint. ASIC argued that a decision by ASIC whether to investigate a complaint is not a decision in respect of which the AAT has jurisdiction under section 244 ASIC Act 2001 (Cth). ASIC also claimed that Part 9.4A of the Corporations Law (as it then was), which concerns review by the AAT of certain decisions, was inapplicable to the decisions in question.

Senior Member Lindsay dismissed Mr Sullivan's application for want of jurisdiction. The Tribunal identified a number of matters relevant to its decision.

First, Senior Member Lindsay noted that the Tribunal lacks the power to make an order returning invested capital, as sought by the applicant. It was noted that ASIC takes no responsibility for the content of prospectuses. In addition, there are a number of remedies available at general law and under the Corporations Act to investors who consider that they have been misled by the contents of a prospectus or by a promoter's actions. The AAT was not the appropriate forum to seek such relief.

Second, Senior Member Lindsay held that the Tribunal has no jurisdiction to review ASIC's decision whether to investigate Mr Sullivan's complaint. This is because such a decision is not included in the list of reviewable decisions contained in section 244 of the ASIC Act.

Finally, Senior Member Lindsay gave detailed consideration to the issue of whether it has jurisdiction to review a decision by ASIC to register a prospectus. This involved 3 separate questions:

(a) whether ASIC's decision to register a prospectus is a 'decision' for the purposes of the AAT Act 1975 (Cth);

(b) if it is, whether an enactment provides for applications to be brought to the AAT for review of the decision; and

(c) if so, whether the applicant's interests have been affected by ASIC's decision to register the prospectuses such that he would have standing to apply to the AAT for review of the decision.

Senior Member Lindsay answered the first 2 questions in the positive, but found that the applicant did not have standing to apply for review by the AAT.

In relation to the first issue, it was not disputed that ASIC had registered the prospectuses. However, there was no evidence as to whether ASIC had made any enquiries regarding the content of the prospectuses before registering them. It was held that ASIC's decision to register a prospectus fell within the definition of 'decision' in section 3(3) AAT Act, as it had the 'quality of finality' required by that word (Australian Broadcasting Tribunal v Bond (1990) 170 CLR 321).

Secondly, Senior Member Lindsay noted that, notwithstanding ASIC's argument concerning the applicability of Part 9.4A of the Corporations Law, ASIC had not submitted that a decision to register a prospectus was not a decision made by ASIC under the Corporations Law. The registration of prospectuses is clearly an important issue. At the relevant time, the Corporations Law prohibited persons from offering securities for subscription or issuing invitations to subscribe for securities unless the prospectus (if registrable) had been registered by ASIC.

Further, although the Corporations Law obliged ASIC to register a registrable prospectus, ASIC was also required to examine certain matters before proceeding to register the prospectus, and could refuse to register a prospectus if it considered that it did not comply with content requirements. In light of a number of authorities, the Tribunal found that ASIC's decision to register a prospectus is a decision made by ASIC under the Corporations Law, and that accordingly an application may be made to the AAT for review of the decision to register a prospectus (section 1317B Corporations Law).

Finally, Senior Member Lindsay turned to the issue of the applicant's standing. ASIC submitted that at the time of registration of each prospectus, the applicant had no interests in the relevant unit trusts. Following the decision of the High Court in Allan v Transurban City Link Ltd (2001) 183 ALR 380, the Tribunal considered the nature of the reviewable decision in order to determine whether Mr Sullivan was a person affected by that decision.

Senior Member Lindsay began by noting that at all material times Chapter 7 of the Corporations Law contained a number of provisions aimed at protecting investors. These included:

(a) regulating the conduct of market participants;

(b) prohibiting misleading and deceptive conduct in connection with dealing in securities and prospectuses;

(c) creating a number of offences relating to prospectuses; and

(d) conferring a statutory cause of action on persons who suffer loss in consequence of another person's actions in contravention of Part 7.11 or Part 7.12.

Importantly, under section 1021(14)(c) of the Corporations Law, ASIC assumed no responsibility for the content of prospectuses. Also, section 1317D(3) qualified ASIC's obligation to notify persons and classes of persons affected by a decision of their rights of review before the AAT. Senior Member Lindsay noted that such a notification requirement would be difficult to administer, as registration occurs prior to an investor's subscription. The provision had greater relevance to promoters and issuers, who would be able to take appropriate action in their own interests in relation to ASIC's deliberations regarding registration applications.

In light of the above factors, Senior Member Lindsay decided that a subscriber's interests are not affected by the decision to register. The Tribunal referred with approval to the decision in Edwards v Australian Securities Commission (1997) 72 FCR 350 (which concerned a decision to register a foreign company), and decided that it was not intended that a single subscriber, whose interests may not be representative of the interests of other subscribers, could at any time during the trusts' existence apply for review of the decision to register the relevant prospectuses.

Senior Member Lindsay therefore accepted ASIC's submission that a subscriber for trust units has no interest in the decision effected by the act of registration. A subscriber's interest is in the post-registration effect of the wording of the offer, the trust deeds, and other relevant matters. Accordingly, Mr Sullivan's application was dismissed.

(D) WHEN IS THE STATUTORY DEFENCE IN SECTION 588FG(2) OF THE CORPORATIONS ACT AVAILABLE IN AN ACTION TO RECOVER UNFAIR PREFERENCE PAYMENTS?   
(By Julie Haylett, [Phillips Fox](http://www.phillipsfox.com))

Whitton v Konemann Australia [2002] NSWSC 1137, New South Wales Supreme Court, Austin J, 28 November 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/november/2002nswsc1137.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

This was an appeal by Whitton, the liquidator of Chittagong Pty Ltd ('Chittagong') to the Supreme Court of New South Wales from the decision by Magistrate, Mr P Gould, to dismiss Whitton's claim to recover payments Chittagong made to Konemann Australia Pty Ltd ('Konemann') under the unfair preference provisions of the Corporations Act 2001 (Cth) ('the Act').

During the period from November 1996 to August 1998, Chittagong had a credit account facility with Konemann for the supply of books. Chittagong had been indebted to Konemann for varying amounts through out the business relationship. On application by another unrelated creditor the Federal Court made an order winding up Chittagong in insolvency on 27 August 1998.

The relation back day for the purpose of section 9 and Part 5.7B of the Act was the date of filing the application for winding up, being 28 November 1997. The payments that Whitton brought the proceedings to recover were made by Chittagong during the relation back period (the 6 month period before the date Chittagong was wound up). Accordingly, the payments made were unfair preference payments pursuant to section 588FA of the Act, were insolvent transactions by Chittagong for the purposes of section 588FC of the Act, and were voidable transactions. Those payments would therefore be recoverable pursuant to an order under section 588FF of the Act if Konemann did not have a defence.

Magistrate Gould found that the evidence led by Konemann satisfied the elements of the section 588FG(2) defence and dismissed Whitton's claim. Section 588FG(2) of the Act confers a statutory defence on a party to a voidable transaction who would otherwise be liable to be affected by an order under section 588FF of the Act, such as an order invalidating the transaction.

(2) The proceedings

The issues on appeal related to the availability of the statutory defence to a recovery action based on a voidable transaction under section 588FG(2) and the application of the "running account" provisions of section 588FA(3), in the event that the section 588FG(2) defence was unavailable.

The appellant, Whitton, argued that Konemann did not act in good faith and that there were reasonable grounds for it to suspect that Chittagong was insolvent during the whole of the relevant period. The facts Whitton relied upon included the following:

- Chittagong had not paid any money to Konemann for a period of nearly 8 months;  
- Chittagong was always in excess of its credit limit;  
- One of the directors of Konemann, Mr Eisenbeis, had a conversation with Mr Savvas, a director of Chittagong, in which Mr Eisenbeis asked Mr Savvas whether his company was going bad and whether he would get his money;   
- On the same occasion Konemann accepted a credit account application from another of Mr Savvas' companies, 'Suchoy Pty Ltd'; and,  
- From that point on the remainder of business between Chittagong and Konemann was transacted through 'Suchoy Pty Ltd's' account.

Konemann did not make an appearance on appeal and relied on its written submissions in the Magistrates' Court proceedings. Konemann had argued that any concerns it had regarding Chittagong related to cash flow problems only and that Mr Eisenbeis' concern for the company were concerns for Suchoy Pty Ltd not Chittagong.

(3) The decision

Austin J held that the elements of the defence in section 588FG(2) of the Act that must be established by the defendant are as follows:

(a) the defendant entered the transaction in good faith;

(b)(i) the defendant had no reasonable grounds for suspecting insolvency;

(b)(ii) a reasonable person in the same circumstances as the defendant would have no grounds for suspecting insolvency; and

(c) valuable consideration must have been provided under the transaction.

There was no issue regarding element (c) on appeal, and it was common ground that elements (a) and (b)(i) were subjective tests and element (b)(ii) was an objective test.

In respect of the subjective elements of the section 588FG(2) defence, his Honour followed the decision of Santow J in Sutherland v Eurolinx Pty Ltd (2001) 37 ACSR 477 in finding that the test of 'suspicion' as it applies to section 588FG(2) is 'a question of looking through the contemporary eyes of the parties at the commercial circumstances then prevailing between them.'

After close examination of the evidence presented to the Magistrate, Austin J concluded that Mr Eisenbeis' evidence that he had no reasonable grounds for the suspicion of insolvency was too implausible. However, his Honour held that his disagreement with the Magistrates' finding on the subjective tests was in essence a disagreement with the learned Magistrates' evaluation of the evidence. His Honour could not say that the evidence was incapable of justifying the finding of the Magistrate.

Austin J did find that the learned Magistrate made an error of law in the application of the objective test to the evidence. On the evidence before the Magistrate his Honour held that 'the inescapable conclusion ought to have been that a reasonable person in the defendant's circumstances would have suspected the insolvency of Chittagong through out the period.' His Honour held that when the evidence was assessed together, the learned Magistrate reached a conclusion which the facts were incapable of justifying. As such the section 588FG(2) defence was not available to Konemann in this case.

His Honour went on to decide the issue of whether there was a 'running account' between the parties pursuant to section 588FA(3) of the Act.

Section 588FA(3) of the Act provides that where a transaction is part of a continuing business relationship (for example a running account) and there is an expectation that it will continue, in circumstances where the level of indebtedness to the creditor varies during the relationship because there has been a series of transactions, then the series of transactions can be taken as one for the purpose of recovering an unfair preference.

The practical application of section 588FA(3) is that once it is established that there was a running account, the end sum of indebtedness is subtracted from the highest level of indebtedness during the running account period. The resultant sum is the amount of the unfair preference payment. If the plaintiff establishes that there was not a running account, each of the payments received by the creditor (Konemann in this case) would be an unfair preference payment and capable of being recovered.

The appellant, Whitton, argued that there was no expectation that the relationship would continue because of the credit application by Suchoy Pty Ltd. Austin J dismissed this argument and held that section 588FA(3) expressly contemplates a business relationship to which persons other than the debtor company and the creditor are parties. His Honour found that there was evidence that there had been a continuing mutual assumption of payment and reciprocal supply and as such, the elements of section 588FA(3) were made out.

If the elements of section 588FA(3) were not made out then each payment received by Konemann from Chittagong during the relevant period would have been individual transactions all of which would have been capable of being recovered as an unfair preference. In this case the total amount of monies received by Konemann was $36,811.20. As the elements of a running account were established the amount of the unfair preference payment capable of being recovered was calculated as follows:

- The highest point of Chittagong's indebtedness to Konemann during the relevant period of their business relationship, being $37,889.10; and  
- The closing balance of the account between the parties, (the debt owing to Konemann by Chittagong), being $11,878.90.

The net difference between the two was the amount of the unfair preference payment capable of being recovered by Whitton, the sum of $26,010.20.

(4) Conclusion

Austin J held that the appellant, Whitton, had established that the learned Magistrates' judgment was 'erroneous in point of law', to the extent that he found that the section 588FG(2) defence was made out. His Honour set aside the order of the Magistrate and in its place ordered that Konemann pay the appellant an amount equal to the amount of the unfair preference given by Chittagong to Konemann, that amount being $26,010.20. A further order of costs and interest was made in favour of the appellant.

(E) LANDLORD PROTECTION AND CARRYING ON A FINANCIAL SERVICES BUSINESS  
(By Nick Harrison, [Freehills](http://www.freehills.com.au))

The Barclay MIS Group of Companies Pty Ltd v Australian Securities and Investment Commission [2002] FCA 1606, Federal Court of Australia, Dowsett J, 23 December 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/federal/2002/december/2002fca1606.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

The Federal Court of Australia in Barclay was required to consider four plans marketed by the Barclay MIS Group of Companies (Barclay). The details of the plans were contained in a number of documents: a brochure used before 1 July 2001 (Document 1), a second brochure used after that date (Document 2) and an explanatory brochure (Document 3). The plans were marketed to real estate agents using a document (Document 4) that, amongst others things, contained a certificate for issue to landlords who were covered under the Barclay plans.

The four plans comprised the Basic Plan, the Rent Guarantee Plan, the Damage Guarantee Plan and the Total Guarantee Plan. The Basic Plan provided a number of services, in particular, access to the Barclay MIS National Tenancy database. The Rent Guarantee plan provided for the benefits of the Basic Plan and payment for up to 52 weeks of lost rent arising, amongst other things, out of damage to the premises by the tenant. The Damage Guarantee plan provided for the benefits of the Basic Plan and, in addition, protection for damage up to $50,000 and the landlord's contents up to $10,000. The Total Guarantee plan provided for the benefits of the Basic Plan and in addition the protection for loss of up to 52 weeks rent and loss to the landlord because of malicious or accidental damage.

Barclay commenced proceedings on 22 April 2002, after learning that ASIC was interested in its activities, seeking declarations, injunctions and writs of prohibition and mandamus. ASIC cross-claimed seeking a determination that Barclay's conduct in conjunction with the plans was or would be unlawful and seeking to restrain Barclay.

(2) Carrying on a financial services business

ASIC alleged that Barclay, in marketing the four plans, had breached section 911A(1) of the Corporations Act 2001 (Cth)('the Act'), which requires a person who carries on a financial services business to hold an Australian financial services licence covering the provision of the financial services. Barclay did not have a financial services licence. The court was therefore required to determine if Barclay was carrying on a financial services business.

Financial services business is defined in section 761A of the Act to mean 'a business of providing financial services'. Under section 766A(1)(b) of the Act a party provides a financial service if they deal in a financial product. Under section 766C(1)(b) of the Act a party deals in a financial product if they issue a financial product. Section 763A(1)(b) defines a financial product as 'a facility through which, or through the acquisition of which, a person manages financial risk', which includes, under section 763C, managing the financial consequences to (a person) of particular circumstances happening. Whether a product is a financial product for the purposes of section 763A is limited by section 763E which provides, in summary, that if something (the Incidental Product) is an incidental component of, or incidental facility of, another facility, which when considered as a whole does not have a financial product purpose, then the Incidental Product is not a financial product.

Bowlett J in deciding whether each of the plans was a financial product considered whether each plan was a facility for managing the risk of tenant default. With regard to the Basic Plan, Bowlett J noted that the plan sought to prevent tenant default, as the main benefit of the plan was access to the Barclay tenancy database. In addition, if a tenant defaulted Barclay undertook to do a variety of things including seeking to locate the tenant and using its reasonable endeavours to recover outstanding amounts. However, from a practical point of view, it appeared the real purpose of the plan was to avoid default, rather than to manage the consequences of default. This meant the plan offered a financial product and access to the tenancy database. Bowlett J concluded that, as the annual payment for the Basic Plan was $33 and the real benefit provided to landlords was access to the tenancy database, then the purpose of the Basic Plan was not managing financial risk or any other financial product purpose prescribed in section 763E(2). The Basic Plan was not, therefore, a financial product.

The three additional plans were considered differently to the Basic Plan. Although all three plans offered substantial financial compensation, Bowlett J concluded that the principal objective of each plan was to minimize the landlord's financial exposure in the event of tenant default and, as such, it would be unreasonable to assume that the main purpose of the plans was other than for managing financial risk.

(3) Contract of insurance

ASIC further alleged that the four plans were contracts of insurance and came within section 764A(1) of the Act which provides that certain facilities, including insurance, are financial products. Bowlett J considered Australian Health Insurance Association Ltd v Esso Australia Ltd (1993) 41 FCR 450 where Sheppard J referred to Channell J in Prudential Insurance Co v Inland Revenue Commissioners [1904] 2 KB 658 at 663 who discussed the essential characteristics of a contract of insurance, namely:

- a contract for the payment of a sum of money (or for some corresponding benefit);  
- payment of a sum of money (or corresponding benefit) to become due on the happening of an event;  
- a degree of uncertainty about the event; and  
- the event must be of a character more or less adverse to the interests of the person effecting the insurance.

Sheppard J in Prudential also referred to the 7th Edition of MacGillivray and Parkington which notes that a characteristic of a contract of insurance is that the amount of the premium is not intended to be equivalent to the value of the insurer's actual performance.

Applying these principles to the Barclay plans, Dowlett J concluded that all the plans, except the Basic Plan, were designed to enable the landlord to recover arrears of rent or an amount necessary to repair damage to property. Each of these plans therefore satisfied the tests prescribed by Channell J and could be considered insurance. As the Basic Plan was only a contract providing for access to the Barclay tenancy database it did not constitute an insurance contract.

(4) Misleading and deceptive conduct

In addition to the alleged breach of section 911(1)(A), ASIC asserted that Barclay had engaged in 'conduct which is or is likely to mislead and deceive' contrary to section 12DA of the Australian Securities and Investments Commission Act and section 1041H of the Act. ASIC alleged that the words 'the Barclay MIS Risk Management Plans are NOT INSURANCE, in fact they are BETTER THAN INSURANCE' were misleading or deceiving or likely to mislead or deceive because the plans were actually contracts of insurance. Bowlett J noted that there may be a distinction between the legal and everyday usage of the word 'insurance', and that a reader would not attribute to the word insurance in Document 2 its legal meaning. Furthermore, considered in context, the words did not deny that the plans are contracts of insurance, merely that they are better than insurance because they seek to avoid loss as well as compensate for it. The words were therefore not misleading or deceptive.

ASIC further alleged that the words of Document 4 stating that 'They [property managers] do not receive any financial gain, either now or in the future' are also, or likely to be, misleading and deceptive. Evidence was lead that showed that property managers received free access to the tenancy database when 90% of their portfolio was covered by Barclay plans. However, as it could not be shown that a particular agent was entitled to a benefit at the time of the representation, it could not be shown that there was a misleading or deceptive statement, or a statement that was likely to mislead or deceive.

(5) Public liability insurance

Prior to 1 July 2001 it was advertised in Document 1 that public liability insurance was available with each of its plans. At the time, persons involved in arranging insurance were regulated by the Insurance (Agents and Brokers) Act 1984 (Cth). ASIC made an application alleging that Barclay had breached that Act. However, as that Act had been repealed, Bowlett J did not consider it necessary to consider ASIC's application.

(6) Barclay Basic and Total Assistance plans

Throughout proceedings it became apparent that in lieu of the four plans Barclay would provide a Basic Assistance and a Total Assistance plan. The terms of each plan allowed Barclay the absolute discretion, to be exercised reasonably, to provide the facilities under each plan, which involved pursuing or purchasing the decision of the relevant tribunal against a tenant. In considering whether the Basic Plan was a financial product Bowlett J noted that the Basic Assistance plan was focused on recovery of money and not on avoidance. Because of this distinction section 763E had no application. Similarly, the Total Assistance Plan, which provided for Barclay to purchase the value of any tribunal order, was also focused on the recovery of money. Therefore, both plans were financial products.

ASIC asserted that both the Basic Assistance and the Total Assistance plans were contracts of insurance. Bowlett J applied Megarry VC's decision in Medical Defence Union Ltd v Department of Trade [1980] 1 Ch 82 that a right to have an application considered, albeit not by whim or caprice did not constitute a contract of insurance, and held that the plans were not contracts of insurance. The requirement that Barclay act reasonably was not a sufficient basis for distinguishing the decision of Megarry VC.

(7) Australian Prudential Regulation Authority

The Australian Prudential Regulation Authority sought relief alleging breaches of section 21(2) (repealed) and section 10(1) of the Insurance Act 1973 (Cth), which requires a body corporate that carries on insurance business to be authorised. Section 3 of the Insurance Act, which defines insurance does so according to the general law definition of insurance. Applying the same principles applied for the ASIC application Bowlett J concluded that the Basic Plan, the Basic Assistance and the Total Assistance plans were not contracts of insurance, while the three guarantee plans were.

Bowlett J adjourned the matter to allow the parties to formulate and propose appropriate orders.

(F) APPOINTMENT OF A RECEIVER AND A MANAGER OF PROPERTY OF A CORPORATION BY INTERIM ORDER TO PROTECT THE INTERESTS OF ACTUAL OR POTENTIAL CLAIMANTS   
(By Jay Buckley, [Corrs Chambers Westgarth](http://www.corrs.com.au))

ASIC v Marshall Ben Hawkins Ltd [2002] FCA 1511, Federal Court of Australia, Merkel J, 6 December 2002.

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/federal/2002/december/2002fca1511.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Principle

Where an order is sought for the appointment of a receiver or manager under section 1323(3) of the Corporations Act 2001 (Cth) ("Act") to protect the interests of persons whose assets or funds are at risk due to the conduct of a third party which is the subject of an action under the Act, the Court must consider the following in deciding whether such an appointment is appropriate:

- the "drastic nature" of the appointment;  
- whether there have been serious and persistent breaches of trust which have lead to a diminution in value of the funds or interests of the aggrieved person;  
- whether there is real doubt about the existence and location of assets such as investments, and about the number and identity of claimants and their claims; and  
- whether the proceedings against the third party under the Act are more than "merely speculative."

(2) Background

This case dealt with sections 1323(1)(h) and 1323(3) of the Act, which give the court power to appoint a receiver and manager. The appointment is made to protect the interests of "aggrieved persons" from "relevant persons" who are the subject of an investigation, a prosecution or a civil proceeding under the Act.

This case concerned the operation of certain companies under the directorship and control of Tony Marshall Bell ("Companies"). Mr Bell used the companies to advise potential investors in relation to investments in securities and loans. Two of the Companies engaged in investment activities on behalf of investors who were persuaded by Mr Bell to invest monies in entities established by him or in investments which he advised them to make.

ASIC commenced proceedings seeking an urgent interim order to appoint a receiver and manager under s 1323(3) of the Act on the grounds that the investments and their control by Mr Bell was likely to put the investors' realisation of the investments at great risk.

(3) Issues

The central issues were:

(a) principles applicable to the appointment of a receiver and manager under s 1323(3); and

(b) whether the power to appoint should be applied.

(4) Decision

(a) Principles applicable to the appointment of a receiver and manager under s 1323(3)

His Honour Justice Merkel considered the decision of Finn J in Australian Securities Commission v AS Nominees Ltd (1995) 18 ACSR 459, where it was held that in considering whether to appoint a receiver and manager, the Court must consider the "drastic nature" of such an appointment.

AS Nominees also gave rise to the principle (particularly relevant in this case) that an appointment of a receiver and manager may be appropriate where there have been serious and persistent breaches of trust resulting in the funds being subject to both depredation and dissipation.

Justice Merkel also referred to ASIC v Burke [2000] NSWSC 694, where Austin J held that an interim order for the appointment of a receiver and manager may be made despite the concurrent existence of a Mareva injunction in circumstances where "there is real doubt about the existence and location of assets such as investments, and about the number and identity of claimants and the nature of their claims.." (at [8]). Austin J also re-inforced the principle that the receiver appointed "has powers of investigation for the purpose of getting in and preserving assets, rather than for the purpose of establishing some breach of the law" (at [6]).

His Honour Justice Merkel also noted, that as a general principle of equity, the Court must consider whether there is a serious question to be tried as to whether ASIC is entitled to such an order by way of final relief and that the balance of convenience is in favour of the making of the order it seeks.

Finally Merkel J noted that, in determining whether there is a serious question to be tried, section 1323 does not require that the issue be considered in the context of whether a prima facie case has been made out in respect of the relevant corporation to persons who may be aggrieved as a result of its conduct. However, his Honour also highlighted the observation of Finn J in AS Nominees (at 511) that the extent to which the evidence tends to establish actual or potential liability on the part of the relevant corporation is a circumstance that can be of significance in determining whether a receiver and manager should be appointed as, in the usual course, the Court may be less likely to make an appointment if the liability is merely speculative.

(b) Whether, given the circumstances of the current case, the power to appoint should be applied

Merkel J found that the investments made on Mr Bell's advice had now significantly diminished in value. Further there were some problems as to the recording of the investments (some of which were convertible notes), with discrepancies between the amounts invested and the dollar value of the notes issued and recorded in the Companies accounts.

Some loans were also made to other Companies within the group using the funds invested. In several instances these loans had been written off as bad debt and "the evidence suggests that there is a serious risk that the loans to PEAM (one of the Companies) are also unlikely to be fully realisable" [at 30]. The misuse of invested funds in this case left Merkel J with "little confidence about the safety of investors' funds under his (Mr Bell's) control" [at 34].

Due to the existence of the following circumstances:

- the prima facie breaches by Mr Bell of his contractual, legal and statutory duties;  
- Mr Bell's apparent failure to reveal adequately the commissions he or his Companies were to receive;  
- the lack of information regarding the identity and amount of investments;  
- the conflict of interests outlined above; and  
- the general manner in which Mr Bell exposed investor's funds to high risks,

Merkel J held that it was not safe to leave the funds in Mr Bell's control and that a receiver and manager should be appointed to those Companies in which funds were invested.

(G) DERIVATIVE ACTION BY SHAREHOLDERS  
(David Fuelling, [Blake Dawson Waldron](http://www.bdw.com.au))

Brightwell v RFB Holdings [2003] NSWSC 7, New South Wales Supreme Court, Austin J, 29 January 2003

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/january/2003nswsc7.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Summary

RFB Holdings Pty Ltd ("RFB") was an investment company that had made a large loan to its Managing Director prior to being placed into a members' voluntary liquidation. The Managing Director held one of the 1620 issued shares with most of the remaining shares held by his children and former wife. The liquidator, a former accountant of RFB and friend of the Managing Director did not take action to recover the debt owed by the Managing Director and instead distributed RFB's assets to the shareholders in specie, with the vast majority of the assets going to the Managing Director. There was nothing in the constitution to indicate that there were particular rights or entitlements attaching to any particular shares. Shortly after the distribution was made the Managing Director passed away and his estate passed to his wife as executrix and sole beneficiary.

Various actions were commenced by the majority shareholders against the liquidator, the wife of the late Managing Director and RFB Holdings Pty Ltd (in liquidation). In the process, the court appointed a new liquidator. These actions had largely been ill conceived with a major problem being that RFB was a defendant and not a plaintiff. This interlocutory application sought leave to further amend the further amended statement of claim and leave under section 237 of the Corporations Act 2001 (Cth) ("the Act"). Leave to amend the amended statement of claim and leave under section 237 of the Act was granted.

(2) Leave under section 237 of the Act

Sections 236 and 237 are contained in Part 2F.1A of the Act and provide that a member of a company may apply to the Court for leave to bring or intervene in a proceeding on behalf of that company. The Court must grant the application if it is satisfied of a number of matters as follows:

(a) It is probable that the company will not itself bring the proceedings, or properly take responsibility for them, or for the steps in them; and

(b) the applicant is acting in good faith; and

(c) it is in the best interests of the company that the applicant be granted leave; and

(d) there is a serious question to be tried; and

(e) either the applicant gave written notice to the company of the intention to apply for leave and the reasons for doing so, at least 14 days before making the application, or it is appropriate to grant leave even though that notice requirement was not satisfied.

Turning to each matter Austin J determined that:

Requirement (a) was satisfied because the court appointed liquidator provided in affidavit evidence that he did not propose to cause the company to bring proceedings as there was no funding to do so. Further, he consented to the plaintiffs bringing proceedings in the company name.

Requirement (b) was satisfied because there was no reason for doubting the good faith of the plaintiffs.

Requirement (c) was satisfied because:

- RFB was in liquidation, therefore ongoing business operations would not be affected;  
- redress could only be achieved if action was in the name of RFB;  
- the first appointed liquidator and the wife of the late Managing Director were not so devoid of assets that they were unlikely to meet the costs of any judgments against them; and  
- there appeared a prima facie case for a derivative action against the first appointed liquidator.

Requirement (d) was satisfied because there were serious questions to be tried that were raised in the further amended statement of claim.

Requirement (e) was satisfied because, although the 14 day notice requirement did not appear strictly to have been met, it was appropriate in the case to grant leave.

After concluding that all of the matters in section 237 were satisfied Austin J granted leave and went on to consider a number of related issues.

First, because the relevant facts occurred prior to the commencement of Part 2F.1A his Honour had to determine whether a general law derivative action under the exceptions to the rule in Foss v Harbottle (1843) 2 Hare 461 was initially available. His Honour determined that the original statement of claim was not properly constituted as a derivative action at general law because RFB was not a plaintiff in those proceedings.

Second, his Honour considered whether the Court retained an inherent power to permit a derivative proceeding to assert a claim by a company in liquidation, notwithstanding Part 2F.1A. His Honour concluded that the Court did retain this power.

Third, his Honour considered whether Part 2F.1A applied to a company in liquidation and held that it did. His Honour noted the that there had been disagreement between judges of the Supreme Court on this issue and he therefore based his ultimate finding in granting leave under section 237 on the inherent jurisdiction of the Court.

(3) Leave to amend

In deciding whether to grant leave to amend the statement of claim Austin J said the principal question was whether such amendment would cause serious injustice to the defendants. After examining all relevant facts his Honour determined that orders as to costs were a more appropriate way of dealing with the delay and hardship experienced by the defendants rather than refusing the plaintiff's application to amend. Another issue considered was whether any limitation period may have expired in bringing certain actions against the defendants. His Honour found that the limitation period had not expired because the commencement period had not changed because RFB had always been a party to the proceedings.

(H) COMPANY ALLOWED TO SUE TO RECOVER MONEY AFTER A PERIOD OF VOLUNTARY ADMINISTRATION  
(Simon Ellis, [Blake Dawson Waldron](http://www.bdw.com.au))

Arcfab v Boral, Arcfab v Flyash [2002] NSWSC 1188, New South Wales Supreme Court, Austin J, 11 December 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/december/2002nswsc1188.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Summary

Arcfab Pty Ltd ("Arcfab") sought to recover money owed from Boral Ltd and its subsidiary Flyash Australia Ltd ("Boral"). Arcfab had been through a process of voluntary administration under a deed of company arrangement ("the deed") which had incorporated the set-off provisions in section 553C of the Corporations Act 2001 (Cth) ("the Act"). Boral sought a preliminary determination of whether Arcfab's claims had been extinguished by section 553C. Boral's argument was based on public policy and legislative intention.

Austin J disagreed with Boral. His Honour based his finding on a literal meaning of the words in section 553C, which his Honour did not believe was outweighed by public policy considerations or presumed legislative intentions. His Honour therefore held that the provisions of the deed and the Act, including section 553C, did not preclude Arcfab from pursuing any net claims after termination of the deed.

(2) Facts

Arcfab is a design and engineering firm which undertook three separate building projects for Boral. Arcfab commenced this action to recover money owed under these projects. All three projects were the subject of contracts entered into before September 1995. The directors of Arcfab resolved to appoint a voluntary administrator on 15 September 1995. A deed of company arrangement was entered into on 14 December 1995, and following a process of administration the deed was terminated on 29 June 1998.

Section 444A(5) of the Act states that a deed of company arrangement is taken to include "prescribed provisions" unless it indicates otherwise. The deed under consideration did not indicate otherwise so the prescribed provisions were incorporated into the deed. These provisions include section 553C of the Act, which provides for a set-off where there are mutual credits or mutual debts between the insolvent company and another party, with the balance of the account being payable.

Arcfab's claim was for approximately $410,000, which purported to include a set-off calculation for some of Boral's claims against Arcfab.

Boral sought a preliminary determination that Arcfab's claim was extinguished by section 553C. This was based on the argument that following the termination of the deed there was "no right of action in law in either the plaintiff company or the defendant to claim the balance" following a set-off under section 553C.

(3) Findings

Austin J dismissed Boral's application and held that section 553C of the Act did not extinguish Arcfab's claim.

In his Honour's reading of the appropriate sections under the Act, there was nothing to indicate that the termination of the deed extinguished Arcfab's right to make a claim against Boral. The administrator appointed under the deed had not pursued the claim during the period of administration, but his Honour could not find a reason why this would prohibit Arcfab's present action.

Boral made an analogy between section 553C of the Act and section 86(1)(c) of the Bankruptcy Act 1966 (Cth), which only allows a trustee in bankruptcy and not a discharged bankrupt to make a claim for a set-off amount. Boral contended that as they are comparable sections, Arcfab should not be allowed to make a claim after a period of voluntary administration.

Austin J rejected this argument due to the differences in the wording of the sections. Section 553C of the Act refers to payments to "the company". As the company still exists, any amount payable to the company under section 553C remains payable even after a period of voluntary administration.

Boral also submitted that it was against public policy and the intention of the legislature to allow a company to make a claim following a period of administration. This is because it would permit "directors or administrators to effect a fraud on creditors, and allow shareholders post-administration to be unjustly enriched". Arcfab countered this with the argument that the objective behind the voluntary administration provisions of the Act, compared with those concerning company liquidation, was to allow a company to emerge from voluntary administration with its business intact.

His Honour disagreed with Boral's argument and held that the literal meaning of the section permits Arcfab to recover monies owed to it, and his Honour held that this outcome is not against public policy or the presumed intention of the legislature.

(I) THE RELEVANCE OF FAIRNESS AND REASONABLENESS IN SCHEMES OF ARRANGEMENT  
(By Fiona Mondello, [Clayton Utz](http://www.claytonutz.com))

Permanent Trustee Company Limited (Application of) [2002] NSWSC 1177, New South Wales Supreme Court, Barrett J, 6 December 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/december/2002nswsc1177.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Summary

This case concerned an application by Permanent Trustee Company Limited ("Company") for orders approving a scheme of arrangement between the Company and its members, under section 411(4)(b) of the Corporations Act ("Scheme"). It is of interest for the Court's comments on its consideration of the reasonableness of the Scheme and the Court's attitude to its judgment being relied on to satisfy an exception under the Securities Act of the United States of America. The Scheme was approved by the requisite majorities at a meeting convened and held in accordance with orders previously made by the Court. Of the members voting in person or by proxy or representative, 97.25% voted to approve the Scheme. The positive votes represented 99.15% of all votes cast.

In addition to the Scheme, a general meeting was held, and there were certain contractual arrangements between the Company and Trust Company of Australia Limited ("Trust Company").

The effect of the Scheme and the incidental arrangements with Trust Company was that the Company would become a wholly-owned subsidiary of Trust Company. All the shares held by each member of the Company were to be transferred to Trust Company. In consideration for the transfer, each member of the Company would receive 1.1856 shares in Trust Company for each Company share held. Prior to the transfer, the Company would pay each member of the Company a special dividend of $1 per share.

The Court confirmed that all procedural requirements under section 411 had been satisfied, including the receipt by the Court of a statement of "no objection" to the Scheme from the Australian Securities and Investments Commission, as required under section 411(17)(b).

The Court made orders approving the Scheme. However, the majority of the Court's judgment was concerned with the reasonableness of the Scheme and the fact that the Court's judgment would be relied upon for the purposes of section 3(a)(10) of the Securities Act 1933 of the United States ("Securities Act").

(2) Reasonableness of the Scheme

The Court, by way of obiter, commented that in ex parte applications of this type the applicant has a heightened duty and carries the responsibility of bringing to the Court's attention all matters that could be considered relevant to the exercise of the discretion.

In the context of section 411 applications, the Courts have historically refused to make any exhaustive statement of the matters which must be proven before the Court will approve a scheme of arrangement. However, it has long been recognised that the Court must come to the view that the scheme of arrangement is reasonable: Re Alabama, New Orleans, Texas and Pacific Junction Railway Company [1891] 1 Ch 213; Re Dorman, Long and Company Limited [1934] Ch 63 5; Street J in Re Landmark Corporation Limited [1968] 1 NSWR 759 at 766; O'Loughlin J in Re ACM Gold Limited; Re Mt Leyshon Gold Mines Limited (1992) 7 ACSR 231 at 263; Hayne J in Re Sonodyne International Limited (1994) 15 ACSR 494 at 499; Nicholson J in Re Challenge Bank Ltd (1995) 19 ACSR 421 at 422; and Santow J in Re NRMA Ltd (2000) 33 ACSR 595 at 607.

The Court stated that it must be satisfied that the proposal is fair and reasonable from the viewpoint of an intelligent and honest person, being a proposal which can be regarded as beneficial to those on both sides who are making it. The Court must also be satisfied that the majority have acted bona fide and that the minority is not being overridden by a majority having interests of its own clashing with those of the minority whom they seek to coerce.

The Court's inquiry as to fairness and reasonableness in this case was also relevant for the purposes of section 3(a)(10) of the Securities Act.

(3) Section 3(a)(10) of the Securities Act of the United States

Unless an exception applies, the issue of shares by Trust Company to members of the Company with addresses in the United States of America could not be made without registration under the Securities Act, which can increase the time and cost of a transaction. Section 3(a)(10) of the Securities Act provides an exception that may be relied upon for schemes of arrangement if the process for approving the scheme meets certain prerequisites.

That section provides as follows:

"Except with respect to a security exchanged in a case under title 11 of the United States Code, any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court or by any official or agency of the United States or by any State or Territorial banking or insurance commission or other governmental authority expressly authorised by law to grant such approval".

Therefore, in order to avoid the registration requirement under the Securities Act, Trust Company was seeking to rely on section 3(a)(10).

In order for Trust Company to rely on section 3(a)(10), several prerequisites would need to be satisfied, including:

(a) the issuer (ie: Trust Company) must advise the Court that its order will be relied upon for the purposes of section 3(a)(10);

(b) the Court must have sufficient information before it to determine the value of the securities to be surrendered and those to be issued in the proposed transaction;

(c) the Court must hold a hearing to determine whether the terms and conditions of the transaction are fair to all those who will receive securities and to approve the terms of the exchange; and

(d) the hearing must be open to everyone to whom the securities would be issued in the proposed exchange and a notice of the hearing in appropriate terms must have been provided in a timely manner.

Barrett J referred to two recent cases which relied on the Court's approval under section 411(4)(b) for the purposes of section 3(a)(10) of the Securities Act, namely, Re Central Pacific Minerals NL [2002] FCR 239 and Re Simeon Wines Limited (2002) 42 ACSR 454.

In Re Simeon Wines Limited (supra), Lander J stated that it was not up to the Court to determine whether the prerequisites listed above would satisfy the US regulators in relation to the exemption under section 3(a)(10) of the Securities Act, but that the Court's reasons would be made available to any regulator which may wish to rely upon them.

In the present case, without expressing an opinion as to whether the section 3(a)(10) exemption was made out, Barrett J went on to confirm that it seemed that all the necessary prerequisites had been met in this case and that the Court's observations as to its approach at the approval stage, as well as the role of the independent expert's report (see below) would no doubt assist in establishing the exemption.

Barrett J agreed with and adopted the reasoning of Emmett J and Lander J in Re Central Pacific Minerals NL (supra) and Re Simeon Wines Limited (supra). However, Barrett J noted that some of Lander J's reasoning was dictated by the particular circumstances of the case:

"... when his Honour refers... to a court exercising the section 411 approval jurisdiction having an obligation to consider the fairness and reasonableness of the proposed scheme of arrangement, he is not, I think, in any sense suggesting that the court in some way actively enters into matters of valuation or embarking upon an examination of the question whether a particular price or consideration is or is not a fair and reasonable quid pro quo. The court does not act as a valuer".

His Honour went on to state, in the context of the inquiry as to fairness and reasonableness, that he derived considerable assistance from the independent expert's report included in the explanatory statement, which concluded that the Scheme was in the "best interests of members", taking into account the overall commercial effect of the transaction, including the payment of the special dividend to the members of the Company and the exchange ratio of Trust Company shares for Company shares.

His Honour acknowledged that the "best interests of members" test was technically a different test to a "fair and reasonable" test but referred to the Australian Securities and Investment's Commissions view (as stated in Policy Statement 75) that the two tests were in essence equivalent.

Therefore, the Court decided to approve the Scheme taking into account:

(a) the conclusion in the independent expert's report that the Scheme was in the "best interests of members";

(b) the fact that members voted to approve the Scheme by overwhelming majorities; and

(c) the fact that no members sought to oppose the Scheme.

His Honour also referred to the fact that the form of scheme approved differed in certain respects from the form sent to members in accordance with the Court's previous orders. Section 411(6) states that the Court may grant its approval subject to such alterations or conditions as it thinks just. His Honour noted that the differences were of a minor or technical nature and that their effect was to improve the smooth working of the Scheme. As such, he concluded that the differences were appropriate to be dealt with under section 411(6).

(J) DOES THE COURT HAVE JURISDICTION TO WIND UP A COMPANY INCORPORATED BY AN ACT OF PARLIAMENT (AND NOT THE CORPORATIONS ACT)?  
(By Elizabeth O'Donovan, [Deacons](http://www.deacons.com.au))

Lunn v Cardiff Colco [2002] NSWSC 1247, New South Wales Supreme Court, Barrett J, 20 December 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/December/2002nswsc1247.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Summary

The Cardiff Coal Company ("CCC") was incorporated by an Act of the Parliament of New South Wales known as the Cardiff Coal Company's Incorporation Act of 1863 ("Act of 1863"). CCC was created under the Act of 1863 as "one body politic corporate" with the powers typically possessed by bodies corporate.

CCC had been dormant for many years although it continued to hold a considerable amount of money and was in possession of several assets. As a result of the fraudulent appointment of directors to CCC in 1917, there were no directors validly in office and an order was granted in 1996 to place CCC into receivership.

The plaintiff, who was the only traceable member of CCC, applied for an order to wind up CCC pursuant to section 583 of the Corporations Act 2001 (Cth) ("Corporations Act") or alternatively, pursuant to the Court's inherent equitable jurisdiction.

Barrett J dismissed the plaintiff's application on the basis that the Court did not have jurisdiction to wind up CCC under section 583, or any other provision, of the Corporations Act. Barrett J also held that, in the absence of any dissolution provisions in the Act of 1863, the Court had no inherent jurisdiction to wind up CCC.

(2) Findings

Barrett J considered the plaintiff's application for winding up CCC in terms of whether the Court had jurisdiction to wind up CCC either pursuant to section 583 of the Corporations Act or alternatively, pursuant to the Court's inherent equitable jurisdiction.

(a) "Part 5.7 body" under the Corporations Act

The plaintiff initially submitted that the appropriate jurisdiction for winding up CCC was conferred by section 583 of the Corporations Act on the basis that CCC was a "Part 5.7 body" under the Corporations Act. Although the plaintiff did not press his application that CCC was a "Part 5.7 body", Barrett J recorded his conclusions on the matter.

Section 583 of the Corporations Act provides that a "Part 5.7 body" can be wound up on various grounds, including if the Court is of the opinion that it is just and equitable that the Part 5.7 body should be wound up.

The expression "Part 5.7 body" is defined by section 9 of the Corporations Act to mean:

(a) a registrable body that is a registrable Australian body and:

(i) is registered under Division 1 of Part 5B.2; or  
(ii) is not registered under that Division but carries on business in this jurisdiction and outside its place of origin; or

(b) a registrable body that is a foreign company and;

(i) is registered under Division 2 of Part 5B.2; or  
(ii) is not registered under that Division but carries on business in Australia; or

(c) a partnership, association or other body (whether a body corporate or not) that consists of more than 5 members and that is not a registrable body.

Barrett J concluded that CCC was not a "foreign company" or a "partnership, association or other body" under the definition of "Part 5.7 body" in section 9 of the Corporations Act. Therefore, the only possibility of CCC being a "Part 5.7 body" was if CCC fell within the definition of a "registrable body that is a registrable Australian body" under paragraph (a) of the definition of "Part 5.7 body" in section 9 of the Corporations Act 2001.

A "registrable Australian body" is defined under section 9 of the Corporations Act to include a body corporate that is neither a company, or an exempt public authority or a corporation sole.

Barrett J held that CCC was a body corporate due to its creation under the Act of 1863 and since it was neither a company, an exempt public authority or a corporation sole, it was a "registrable Australian body" for the purposes of section 9 of the Corporations Act.

In addition, to be a "Part 5.7 body" in section 9 of the Corporations Act, CCC must not only be a "registrable Australian body", but must also either be registered under Division 1 of Part 5B.2 of the Corporations Act or, if it is not registered under that Division, it must carry on business in this jurisdiction and outside its place of origin.

(b) Registration under Division 1 of Part 5B.2 of the Corporations Act

The requirement for registration arises out of section 601CA of the Corporations Act. Barrett J held that section 601CA of the Corporations Act precludes a registrable Australian body from carrying on business within the constituent's State or Territory of "this jurisdiction" unless that constituent's State or Territory is its place of origin or the location of its head office or principal place of business.

CCC's place of origin was New South Wales. Barrett J held that there was no evidence that CCC had been registered under Division 1 of Part 5B.2 of the Corporations Act or under any corresponding previous provisions.

(c) Carrying on business in this jurisdiction and outside its place of origin

Barrett J next considered whether CCC "carried on business in this jurisdiction outside its place of origin". His Honour found that CCC was arguably not carrying on a business at all and in any event was not carrying on a business outside of New South Wales. Consequently, CCC was not a "Part 5.7 body" for the purposes of the Corporations Act and section 583 of the Corporations Act could not be invoked as a basis for winding up CCC.

(d) Inherent jurisdiction to wind up CCC

The plaintiff further submitted that a court of equity may, in the exercise of its inherent jurisdiction, wind up or dissolve corporations.

Barrett J disagreed with the plaintiff's proposition. His Honour noted that the Court's inherent jurisdiction was not unlimited and the Court was not permitted to do things which were either expressly or by necessary implication precluded by Parliament.   
His Honour distinguished the case of Clements v Bowes (1852) 21 LJ Ch 306 in which the Court intervened to dissolve the bonds of an unincorporated company that the parties themselves had created. His Honour held that if Parliament had caused a company or body of proprietors to be incorporated as "one body politic incorporate", as was the case with CCC, then a new and separate bond was superimposed by the Legislature and was unable to be dissolved by the Court.

(3) The decision

Barrett J's decision that the Court did not have jurisdiction to wind up CCC rested upon two main propositions. First, Barrett J concluded that CCC was not a "Part 5.7 body" under the Corporations Act and therefore the Court therefore had no jurisdiction to wind up CCC under section 583, or any other provision, of the Corporations Act. Second, his Honour was of the view that the Court had no inherent jurisdiction to wind up CCC, as a company which is incorporated by an Act of Parliament can only be dissolved pursuant to that same Act or by another Act of Parliament.

5. RECENT CORPORATE LAW JOURNAL ARTICLES

Insolvency Law Journal, Vol 10 No 4, December 2002. Articles include:

- The Contrasting Approach of Law and Accounting to the Definition of Solvency and Associated Directors' Declarations  
- Personal Recovery Actions by Creditors Against Company Directors  
- The Addition of Uncommercial Transactions to s 588G and Its Implications for Phoenix Activities  
- Sidestepping the Statutory Demand: Is Solvency a Solution?

Journal of Banking and Finance Law and Practice, Vol 13 No 4, December 2002. Articles include:

- Recovery of Mistaken Payments Under the Liggett Doctrine  
- Thailand's Securities Market: Plotting New Directions  
- Banks' Liability for Receiving Misdirected Payments: The Knowledge Requirement

Securities Regulation Law Journal, Vol 30 No 4, Winter 2002. Articles include:

- The Sarbanes-Oxley Act of 2002: What It Means for Business Litigators  
- A Critique of the NYSE's Director Independence Listing Standards  
- The Puffery Defence: From Used Car Salesmen to CEO  
- Has Sarbanes-Oxley Killed the Broker-Assisted Cashless Exercise of Section 16 Insiders?

M Kahan, 'Rethinking Corporate Bonds: The Trade-off Between Individual and Collective Rights' (2002) 77 New York University Law Review 1040

H McVea, 'Creditors and the Public Interest - The "Big Four" and Multi-disciplinary Practices' (2002) 65 Modern Law Review 811

The International Lawyer, Vol 35 No 4, Winter 2001. Special Symposium Issue on the International Monetary and Financial Law. Articles include:

- The World Bank and the IMF Relationship - Quo Vadis?  
- Evolving Role and Challenges for the International Monetary Fund  
- Cyber Corporation Law - Comparative Legal Semiotics/Comparative Legal Logistics  
- International Financial Institutions and the Movement Toward Greater Accountability and Transparency: The Case of Legal Reform Programs and the Problem of Evaluation  
- Globalisation of Financial Markets: An International Passport for Securities Offerings?  
- Regional Financial Institutionalisation and the Creation of a Zone of Law: The Context of Financial Stability/Regulation in East Asia

W Ebke, 'The "Real Seat" Doctrine in the Conflict of Corporate Laws' (2002) 36 The International Lawyer 1015

L Joyce, 'Company Charges Under Singapore Law: Legal and Practical Implications' (2003) 14 International Company and Commercial Law Review 1

O Arowolo, 'Unclaimed Dividends in Nigeria: A Case of Contending Interests' (2003) 14 International Company and Commercial Law Review 33

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- Enforcement Methods and Sanctions in Banking Regulation and Supervision  
- The New German Takeover Law: An Overview of the New Regime  
- Directors' Fiduciary Duties and Management Agreements: A Comment on ICP v CEPCO  
- Professional Indemnity Insurance: International Demand, Affordability and the Insurance Market

Comparative Labor Law and Policy Journal, Vol 22 No 1, Fall 2000. Special Issue on Employees and Corporate Governance. Articles include:

- Corporate Governance in Comparative Perspective: Prospects for Convergence  
- The German Model of Corporate and Labor Governance  
- A Comparative Analysis: Corporate Governance and Labor and Employment Relations in Japan  
- Labor's Role in the American Corporate Governance Structure  
- Employee Representation and Corporate Law Reform: A Comment From the United Kingdom  
- Fluid Relationships in Transitional Times: A Comment on Employees and Corporate Governance  
- Variety and Change in the Role of Employees in Corporate Governance

J Coffee, 'Racing Towards the Top?: The Impact of Cross-listings and Stock Market Competition on International Corporate Governance' (2002) 102 Columbia Law Review 1757

J Naftalis, '"Wells Submissions" to the SEC as Offers of Settlement Under Federal Rule of Evidence 408 and Their Protection From Third-Party Discovery' (2002) 102 Columbia Law Review 1912

P Omar, 'Centros Redux: Conflict at the Heart of European Company Law' (2002) 13 International Company and Commercial Law Review 448

K Mwaura, 'Regulation of Directors in Kenya: An Empirical Study' (2002) 13 International Company and Commercial Law Review 465

Stanford Journal of Law, Business and Finance, Vol 8 No 1, Autumn 2002. Special Symposium Issue on Enron: Lessons and Implications. Articles include:

- Punctuated Equilibria in the Evolution of United States Securities Regulation  
- Lawyers, Ethics and Enron  
- Post-Enron Reform: Financial Statement Insurance and GAAP Revisited  
- Plundering America: How American Investors Got Taken for Trillions by Corporate Insiders  
- The Rise of the New Corporate Kleptocracy  
- Preventing Future Enrons: Implementing the Sarbanes-Oxley Act of 2002  
- What We Have Learned From the Recent Corporate Scandals That We Did Not Already Know

R James and P Morris, 'The Financial Ombudsman Service: A Brave New World in "Ombudsmanry"?' (2002) Public Law 640

T Hazen, 'Silencing the Shareholders' Voice' (2002) 80 North Carolina Law Review 1897

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