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Bulletin No. 191

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 Proposed requirements for banks' disclosure of liquidity coverage ratio

On 19 July 2013, the Basel Committee on Banking Supervision issued for consultation liquidity coverage ratio (LCR) disclosure standards. Following the publication of the LCR standard in January 2013, the Basel Committee indicated its intention to develop associated disclosure standards. Public disclosure improves transparency, reduces uncertainty in the markets and strengthens market discipline. To promote the benefits of disclosure the Committee believes that it is important that banks adopt a common disclosure framework to help market participants consistently assess the liquidity risk position of banks. Moreover, to promote consistency and ease of use of disclosures related to the LCR, the Basel Committee has agreed that internationally-active banks across Basel member jurisdictions will be required to publish their LCR according to a common template.

The liquidity coverage ratio disclosure standards are available on the Bank for International Settlements website.

1.2 IASB publishes discussion paper on the conceptual framework for financial reporting

On 18 July 2013, the International Accounting Standards Board (IASB) published for public comment a discussion paper exploring possible changes to the IASB's *Conceptual Framework for Financial Reporting*. The discussion paper is the first step towards issuing a revised Conceptual Framework. The Conceptual Framework sets out the concepts that underlie the preparation and presentation of financial statements. It identifies principles for the IASB to use when it develops and revises its IFRS.

The issues addressed in the discussion paper include:

- definitions of assets and liabilities;
- recognition and derecognition;
- the distinction between equity and liabilities;
- measurement;
- presentation and disclosure; and
- other comprehensive income.

The discussion paper is available on the IASB website.

1.3 Report on the Australian OTC derivatives market

On 17 July 2013, the Reserve Bank of Australia, the Australian Prudential Regulation Authority, and the Australian Securities and Investments Commission (the regulators) published their report on the Australian OTC derivatives market. The report constitutes the latest advice from the regulators to the Minister regarding mandatory requirements for trade reporting, central clearing and platform trading of over-the-counter (OTC) derivatives.

The report focuses primarily on the case for mandatory central clearing. Based on an assessment of current activity and practices in the Australian OTC derivatives market, and overseas developments, the regulators have reached the following conclusions:

- it is recommended that the government consider a central clearing mandate for US dollar, euro, British pound and yen denominated interest rate derivatives, primarily on international consistency grounds. The initial focus of such a mandate should be dealers with significant cross-border activity in these products;
- the regulators do not see a case for mandating North American and European referenced credit derivatives at this time. However, in the lead up to the regulators' next market assessment, further information will be sought about Australian market participants' counterparty exposures in these products and the breadth of central clearing of these products; and
- the regulators will monitor for a further period Australian banks' progress in implementing appropriate clearing arrangements for Australian dollar denominated interest rate derivatives, before recommending mandatory central clearing.

The regulators have not made a specific recommendation regarding a mandatory platform trading obligation at this time. However, they will continue to monitor developments in other jurisdictions and seek more detailed information on activity in the Australian market. Similarly, the regulators will continue to monitor developments in market participants' risk management practices - including collateralisation, trade compression and portfolio reconciliation.

The report also notes that with the finalisation of ASIC's trade reporting and trade repositories rules, Australia has introduced a broad-based mandatory trade reporting obligation for OTC derivatives.

The report is available on the Council of Financial Regulators website.

1.4 IOSCO publishes principles for financial benchmarks

On 17 July 2013, the International Organization of Securities Commissions (IOSCO) published its final report on "Principles for Financial Benchmarks", which provides an overarching framework of principles for benchmarks used in financial markets. The principles form an integral part of IOSCO's work in leading efforts to enhance the integrity, the reliability and the oversight of benchmarks by establishing guidelines for benchmark administrators and other relevant bodies in the following areas:

- governance: to protect the integrity of the benchmark determination process and to address conflicts of interest;
- benchmark quality: to promote the quality and integrity of benchmark determinations through the application of design factors;
- quality of the methodology: to promote the quality and integrity of methodologies by setting out minimum information that should be addressed within a methodology. These principles also call for credible transition policies in case a benchmark may cease to exist due to market structure change.
- accountability mechanisms: to establish complaints processes, documentation requirements and audit reviews.

The principles provide a framework of standards that might be met in different ways, depending on the specificities of each benchmark. In addition to a set of high level principles, the framework offers a subset of more detailed principles for benchmarks having specific risks arising from their reliance on submissions and/or their ownership structure.

The principles provide for benchmark administrators to publicly disclose their compliance with the principles within 12 months of the publication of the report, with the intention of IOSCO reviewing within an 18 month period the extent to which the principles have been implemented.

The principles are available on the IOSCO website.

1.5 FSB consultation on principles for an effective risk appetite framework for financial firms

On 17 July 2013, the Financial Stability Board (FSB) published a public consultation on its draft "Principles for an Effective Risk Appetite Framework".

The Principles are aimed at enhancing supervisory oversight of firms, in particular of systemically important financial institutions (SIFIs), by establishing minimum expectations for the key elements contained in an effective risk appetite framework, such as:

- an actionable risk appetite statement;
- quantitative risk limits; and
- clearly defined roles and responsibilities of the board of directors, senior management and business lines.

The Principles also aim to establish a common nomenclature for terms used in the risk appetite framework, which will help to facilitate a common understanding between supervisors and firms and to narrow any gaps between supervisory expectations and firms' practices.

According to the FSB, an effective risk appetite framework is the foundation of good risk management. A firm's risk appetite represents the aggregate level and types of risk a firm is willing to assume within its risk capacity to achieve its strategic objectives and business plan, and this should be set out in written form in a risk appetite statement. The firm's risk appetite statement, in particular, should be linked to the firm's short- and long-term strategic, capital and financial plans, as well as remuneration programs. It should assess the firm's material risks under both normal and stressed market and macroeconomic conditions, and set clear boundaries and expectations by establishing quantitative limits and qualitative statements for risks that are difficult to measure.

The consultative document is available on the FSB website.

1.6 IOSCO paper on cyber-crime, systemic risk and global securities markets

The research department of the International Organization of Securities Commissions (IOSCO) published a joint Staff Working Paper with the World Federation of Exchanges (WFE) on 16 July 2013, titled "Cyber-crime, securities markets and systemic risk". The paper explores the evolving nature of cyber-crime in securities markets and the threat it poses to the fair and efficient functioning of markets. Importantly, it highlights the urgent need to consider cyber-threats to securities markets as a potential systemic risk.

The first part of the paper assesses what is known of the cyber-threat so far. It also presents a framework for monitoring the extent of cyber-crime in securities markets going forward. The second part of the paper provides the results of a survey of the world exchanges. The survey explores the experiences of exchanges in dealing with cyber-crime and perceptions of the risk. The survey revealed that a significant number of exchanges are already under attack with 53% having suffered an attack in the last year.

Attacks tend to be disruptive in nature, rather than motivated by financial gain. This distinguishes these cyber-crimes from traditional crimes in the financial sector such as fraud and theft.

The paper is available on the IOSCO website.

1.7 Discussion paper on enhancing transparency and trust in companies

On 15 July 2013, the UK Department for Business, Innovation and Skills published a discussion paper titled "Transparency and trust - Enhancing the transparency of UK company ownership and increasing trust in UK business".

(a) Ownership and control of companies

The paper invites views on the following proposals and questions:

- that the registry should hold information on the beneficial owners (i.e. on individuals with significant control or influence) of all UK companies, but consideration be given to whether companies already subject to stringent disclosure rules should be exempt;
- to give all companies statutory tools to identify their beneficial ownership;
- what additional requirements might be required to ensure beneficial ownership information on all companies is obtained;
- what information should be provided to the registry, how frequently it should be updated, and how to ensure that it is as accurate as possible;
- whether information in the registry should be made public - noting the strong case for openness but recognising that there may be concerns;
- that the creation of new bearer shares should be prohibited, and that existing bearer shares should be converted to ordinary registered shares;
- options to enhance transparency around the use of nominee directors; and
- whether companies should be prohibited from being appointed company directors.

(b) Ensuring that the UK is a trusted place to do business and invest

The paper invites alsoviews on the following proposals:

- following the Parliamentary Commission on Banking Standards' recommendation that directors of banks should have a primary responsibility to ensure the safety and stability of their firms, whether to amend directors' statutory duties in key sectors such as banking and whether to allow sectoral regulators to disqualify directors in their sector;
- what additional factors the Court might take into account in director disqualification proceedings, such as the nature and number of previous company failures a director has been involved in;
- options to help creditors receive compensation when they have suffered from a director's fraudulent or reckless behaviour;
- that the time limit for bringing disqualification proceedings in insolvent company cases should be extended from two to five years;
- that directors who have been disqualified should be offered education or training to equip them with the skills they need to go on to run a successful company;
- whether individuals subject to foreign restrictions should be prevented from being a director of a UK company, and whether directors convicted of a criminal offence in relation to the management of an overseas company should be able to be disqualified in the UK.

The discussion paper is available on the UK Government website.

1.8 APRA stakeholder survey

On 12 July 2013, the Australian Prudential Regulation Authority (APRA) released the results of its third survey of stakeholders. The survey collected responses from two groups of stakeholders using a similar questionnaire: one of regulated institutions and a shorter one of industry representatives and other knowledgeable observers.

The results of the stakeholder survey are available on the APRA website.

1.9 Report on encouraging equity investment

On 11 July 2013, the Association of British Insurers (ABI) published a report titled "Encouraging Equity Investment - Facilitation of Efficient Equity Capital Raising in the UK Market". The report examines the functioning of the IPO market and secondary capital raisings for companies listed in the UK and what can be improved.

The recommendations for IPOs include:

- publishing the prospectus earlier in the IPO process;
- removing the research black-out window;
- increasing publication of unconnected research;
- reducing syndicate sizes;
- greater fee transparency;
- delaying payment of any discretionary fees in connection with the IPO until three months after closing (or the release of the issuer's first quarterly results if later);
- making any controlling shareholder responsible for the prospectus and liable to the UK Listing Authority in relation to any relationship agreement;
- retaining a 25% free float requirement for premium and standard listings; and
- boards being fully constituted at least one month before launch and board independence post-IPO being a requirement.

For secondary capital raisings, the ABI has said it will clarify its existing guidance on non-pre-emptive placements, open offers and rights issues. In particular it says clarity is required on limits for placements, the acceptability or otherwise of a cash box structure when not used as directly acquisition linked financing and acceptable levels of capital raised and associated discounts for open offers.

The report is available on the ABI website.

1.10 SEC approves JOBS Act requirement to lift general solicitation ban on certain private securities offerings

On 10 July 2013, the US Securities and Exchange Commission adopted a new rule to implement a *Jumpstart Our Business Startups Act* (JOBS Act) requirement to lift the ban on general solicitation or general advertising for certain private securities offerings.

Companies seeking to raise capital through the sale of securities must either register the securities offering with the SEC or rely on an exemption from registration. Most of the exemptions from registration prohibit companies from engaging in general solicitation or general advertising - that is, advertising in newspapers or on the Internet among other things - in connection with securities offerings. Rule 506 of Regulation D is the most widely-used exemption from registration. In an offering that qualifies for the Rule 506 exemption, an issuer may raise an unlimited amount of capital from an unlimited number of "accredited investors" and up to 35 non-accredited investors. Under SEC rules, accredited investors are individuals who meet certain minimum income or net worth levels, or certain institutions such as trusts, corporations, or charitable organisations that meet certain minimum asset levels.

Congress passed the JOBS Act in April 2012. Section 201(a)(1) of the JOBS Act directs the SEC to remove the prohibition on general solicitation or general advertising for securities offerings relying on Rule 506 provided that sales are limited to accredited investors and an issuer takes reasonable steps to verify that all purchasers of the securities are accredited investors. By requiring the SEC to remove this general solicitation restriction, Congress sought to make it easier for a company to find investors and thereby raise capital.

Further information about the rule is available on the SEC website.

In connection with this new rule, the SEC voted to issue a Rule proposal requiring issuers to provide additional information about these securities offerings to better enable the SEC to monitor the market with that ban now lifted. The proposal also provides for additional safeguards as this market changes and new practices develop.

Further details about this proposal are available on the SEC website.

The SEC also adopted Rules that disqualify felons and other "bad actors" from participating in certain securities offerings as required by the *Dodd-Frank Act*.

Further details of these rules are available on the SEC website.

1.11 ESMA consultation on implementation of credit rating agencies regulation

On 10 July 2013, the European Securities and Markets Authority (ESMA) published a discussion paper dealing with the implementation of the *Credit Rating Agency 3 Regulation*, which entered into force on 20 June 2013.

The Regulation, which complements the existing regulatory framework for credit rating agencies (CRAs), requires ESMA to draft Regulatory Technical Standards (RTS) on:

- disclosure requirements on structured finance instruments (SFIs);
- the European Rating Platform (ERP); and
- periodic reporting of fees charged by CRAs.

(a) Draft RTS on information on structured finance instruments

The draft RTS aims to facilitate the provision of adequate information to investors on SFIs and their underlying assets, in order to improve their ability to make informed assessments on the creditworthiness of SFIs, reduce reliance on external credit ratings, promote competition between CRAs and facilitate the assignment of unsolicited credit ratings.

The draft RTS will specify:

- the information that issuers, originators and sponsors of structured finance instruments established in the European Union must publish;
- the frequency with which the information is to be updated; and
- the presentation of the information by means of a standardised disclosure template.

(b) Draft RTS on the European Rating Platform (ERP)

The Regulation requires ESMA to establish the ERP where CRAs will report up-to-date ratings and outlooks, together with data on the historical performance of their ratings. This information will be publicly available, allowing investors to compare all credit ratings that exist regarding a specific rated issuer/instrument, and assist in their decision-making, thereby contributing to increased investor protection and improving the visibility of smaller CRAs.

The draft RTS will specify:

- the content and format of ratings data periodic reporting to be requested from registered and certified CRAs for the purpose of on-going supervision; and
- the content and the presentation of the information, including the structure, format, method and timing of reporting that credit rating agencies are to disclose to ESMA.

(c) Draft RTS on fees charged by CRAs to their clients

The draft RTS aims to mitigate conflicts of interest and facilitate fair competition in the credit rating market, by ensuring that CRAs' fees are cost-based, non-discriminatory and non-dependent on any result or outcome of the work performed, or on the provision of ancillary services.

The discussion paper focuses on gathering information on CRAs' fees and cost structure, as well as their pricing policy. The draft RTS will specify the content and the format of periodic reporting on fees charged by credit rating agencies for the purpose of on-going supervision by ESMA.

The discussion paper is available on the ESMA website.

1.12 FRC advice on conducting effective audit tenders

On 9 July 2013, the UK Financial Reporting Council (FRC) published advice to help companies undertake an effective process when they put their audit contracts out to tender. The document is titled "Audit tenders - Notes on best practice".

Following the introduction in the *Corporate Governance Code* in October 2012 of the provision for FTSE 350 companies to put their audit contract out to tender every ten years on a "comply or explain" basis, the FRC was asked by Audit Committee chairmen and others to provide some practical examples of how a tender might be conducted. The FRC's publication has been produced following a series of roundtables which involved Audit Committee chairpersons, investors, finance directors and auditors, all of whom shared their views and experiences of the audit process.

The key steps identified to conduct an effective tender are to:

- establish clearly the objectives for the tender, why it has been initiated and engage with major investors on these points;
- choose which firms to invite to tender based on clear criteria and the views of investors;
- ensure the process is led by the Audit Committee chairperson;
- provide audit firms with adequate information for them to understand the company's needs;
- make the decision based on audit quality not price and to not rule out the incumbent auditor without good reason;
- manage an orderly transition to ensure a seamless handover;
- ensure that the regulatory requirements such as independence rules are met; and
- make use of audit inspection reports.

The advice document is available on the FRC website.

1.13 First set of prudential practice guides for superannuation

On 8 July 2013, the Australian Prudential Regulation Authority (APRA) released eight final prudential practice guides (PPGs) for APRA-regulated superannuation funds, accompanied by a response paper, "Prudential guidance for superannuation". The PPGs support the implementation of prudential standards for superannuation and commence the consolidation of existing superannuation guidance material.

The response paper explains that two draft PPGs released in December 2012, draft Prudential Practice Guide SPG 530 "Investment Strategy - Formulation" and draft Prudential Practice Guide SPG 531 "Investment Strategy - Implementation", will be finalised once consultation on the second set of superannuation PPGs, released in May 2013, is complete.

The PPGs are available on the APRA website.

The response paper is also available on the APRA website.

1.14 UK Government publishes response to banking standards report

On 8 July 2013, the UK Government published its response to the Parliamentary Commission on Banking Standards' (PCBS) report that was titled *Changing banking for good*.

The government endorses the principal findings and intends to implement the PCBS's main recommendations to address the failings the Commission identified on individual accountability, corporate governance, competition, and long term financial stability.

As a result of the proposals, the government intends to strengthen standards in banking by:

- introducing a criminal offence for reckless misconduct for senior bankers;
- working with the regulators to ensure bankers' pay is aligned with their performance, including allowing bonuses to be deferred for up to ten years and enabling 100% claw-back of bonuses where banks receive state aid;
- introducing a new regime governing the behaviour of senior bank staff and new rules to promote higher standards for all bank staff;
- reversing the burden of proof so that bank executives are held accountable for breaches within their areas of responsibility; and
- working with the regulators to strengthen corporate governance to ensure that firms have the correct systems in place to identify risks and maintain standards on ethics and culture.

Competition in the banking sector will also be strengthened by:

- providing the Prudential Regulation Authority (PRA) with a secondary competition objective to strengthen its role in ensuring there are banking markets with effective competition that deliver good outcomes for consumers. This will be in addition to the Financial Conduct Authority's existing competition objective; and
- on top of introducing seven day account switching from September 2013 the government will ask the new payments regulator, once established, to urgently examine account portability and whether the big banks should give up ownership of the payments systems.

The government response is available on the UK Government website.

1.15 US House of Representatives votes to prohibit mandatory audit firm rotation

On 8 July 2013, the United States House of Representatives voted on the *Audit Integrity and Job Protection Bill* (the Bill) that would prohibit the US Public Company Accounting Oversight Board (PCAOB) from introducing a Rule that would require mandatory audit firm rotation for public companies or require public companies to use specific auditors. In 2011 the PCAOB issued a concept release in which views were sought on the introduction of mandatory rotation. The Bill will now be considered by the US Senate.

The Bill is available on the available Library of Congress website.

1.16 Basel Committee paper on balancing risk sensitivity, simplicity and comparability within the Basel capital standards

On 8 July 2013, the Basel Committee on Banking Supervision released a discussion paper on the balance between risk sensitivity, simplicity and comparability within the Basel capital standards.

In response to the financial crisis, the Basel Committee introduced a range of reforms designed to substantially raise the resilience of the banking system against shocks. In addition to these reforms, during 2012 the Committee commissioned a small group of its members (the Task Force on Simplicity and Comparability) to undertake a review of the Basel capital framework. The discussion paper discusses the reasons behind the evolution of the current framework, and outlines the potential benefits and costs that arise from a more risk-sensitive methodology. The paper also discusses ideas that could possibly be explored to further reform the framework with the objective that it continue to strike an appropriate balance between the complementary goals of risk sensitivity, simplicity and comparability.

In its announcement about the discussion paper, the Committee states that it remains firmly of the view that full, timely and consistent implementation of Basel III remains fundamental to building a resilient financial system, maintaining public confidence in regulatory ratios and providing a level playing field for internationally active banks. Adopting the Basel III reforms (higher and better quality capital, improved risk coverage, capital buffers, and liquidity and funding requirements) in accordance with the internationally-agreed transition period deadlines is itself an important step in improving the consistency of bank regulation globally.

The discussion paper is available on the Bank for International Settlements website.

1.17 Consultation paper on corporate responsibility

On 27 June 2013, the UK Department for Business, Innovation and Skills (BIS) published a consultation paper on corporate responsibility. The paper defines corporate responsibility (sometimes known as corporate social responsibility) as the responsibility of an organisation for the impacts of its decisions on society and the environment above and beyond its legal obligations, through transparent and ethical behaviour. The topics discussed in the paper include reporting and disclosure, responsible supply chains, corporate responsibility in small and medium sized business, business and human rights, and consumer awareness and trust.

The consultation paper is available on the BIS website.

1.18 Risk management guidelines related to anti-money laundering and the financing of terrorism issued by the Basel Committee

On 27 June 2013, the Basel Committee on Banking Supervision published for public comment its proposed "Sound management of risks related to money laundering and financing of terrorism".

The Basel Committee states that it has a long-standing commitment to promote the implementation of sound policies and procedures to combat money laundering (ML) and the financing of terrorism (FT). Prudent management of risks related to ML and FT along with effective supervisory oversight are critical in protecting the safety and soundness of banks and the integrity of the international financial system. The inadequacy or absence of sound management can increase the exposure of banks to serious risks, especially reputational, operational, compliance and concentration risks. According to the Committee, recent developments, including enforcement actions taken by regulators and the corresponding direct and indirect costs incurred by banks due to their lack of diligence in applying appropriate risk management policies, procedures and controls, have highlighted those risks. These costs and damage could probably have been avoided had the banks maintained effective risk-based policies and procedures to protect against risks arising from ML and FT.

The consultative document is available on the Bank for International Settlements website.

1.19 APRA releases final package on disclosure of composition of capital and remuneration

On 26 June 2013, the Australian Prudential Regulation Authority released its response paper and final Prudential Standard APS 330 Public disclosure relating to Pillar 3 disclosures on the composition of capital and on remuneration by authorised deposit-taking institutions in Australia. The standard came into effect on 30 June 2013; however, as noted in the letter to authorised deposit-taking institutions on 3 June 2013, APRA will accept entities meeting the new disclosure requirements on a "best endeavours" basis for the June 2013 reporting period. For this purpose, "best endeavours" will, at a minimum, require disclosures that are consistent with draft APS 330 released in April 2013.

The response paper and Prudential Standard APS 330 are available on the APRA website.

1.20 Financial stability report

On 26 June 2013, the Bank of England published the latest issue of its semi-annual financial stability report. The matters examined in the report are:

- the global financial environment;
- short-term risks to financial stability;
- medium-term risks to financial stability;
- macroprudential policy since the November 2012 report; and
- prospects for financial stability.

The report is available on the Bank of England website.

1.21 Proposals for international leverage ratio and associated disclosure requirements released by the Basel Committee

On 26 June 2013, the Basel Committee on Banking Supervision published its "Revised Basel III Leverage Ratio Framework and Disclosure Requirements" for consultation.

As well as strengthening the regulatory capital base and enhancing risk coverage, the Basel III reforms introduced a leverage ratio into the regulatory framework. The leverage ratio was designed to serve as an important backstop to the risk-based capital measures by constraining the build-up of leverage in the banking system and providing an extra layer of protection against model risk and measurement error. Since the Basel III reforms were announced, the Committee has been working to formulate a leverage ratio requirement that is not only robust, but also internationally consistent given the underlying differences in national accounting standards.

It was agreed in the Basel III package that banks should start disclosing their leverage ratio, calculated on a common basis, from the beginning of 2015. The consultative document sets out a specific formulation for calculating the leverage ratio by banks subject to the Basel III framework, as well as a set of public disclosure requirements. Final adjustments to the definition and calibration of the leverage ratio will be made by 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.

The consultation document is available from the Bank for International Settlements website.

1.22 New EU investment fund framework for long-term investment

On 26 June 2013, the European Commission proposed a new investment fund framework designed for investors who want to put money into companies and projects for the long term. These private European Long-Term Investment Funds (ELTIFs) would only invest in businesses that need money to be committed to them for long periods of time.

The new Funds would be available to all types of investor across Europe subject to certain requirements set out in EU law. These requirements include the types of long-term assets and firms that the ELTIFs are allowed to invest in, for example infrastructure, transport and sustainable energy projects, how they have to spread their money to reduce risks and the information they have to give to investors. Any ELTIF manager would also have to comply with all of the requirements of the Alternative Investment Fund Managers Directive.

Under the proposal, ELTIFs would have to meet a set of common rules so that they:

- always have a depositary to keep assets safe;
- comply with rules on spreading assets to prevent too much money going into one asset;
- only use derivatives to manage currency risks in relation to the assets they hold, and not for speculation; and
- obey limits on the amount they can borrow.

ELTIFs would invest in illiquid assets which are difficult to buy and sell. Investors would not be able to withdraw money until the specified end date of their investment (this could be a date ten years or more after the money is invested).

Further information is available on the European Commission website.

1.23 IOSCO publishes principles for the regulation of exchange traded funds

On 24 June 2013, the International Organization of Securities Commissions published its final report on "Principles for the Regulation of Exchange Traded Funds", containing nine principles intended to guide the regulation of exchange traded funds (ETFs) and foster industry best practices in relation to these products.

Investor interest in ETFs has increased worldwide as evidenced by the sharp increase in funds invested in these types of products. Assets managed under ETF structures totalled almost US$1.9 trillion at end January 2013, representing roughly 7% of the global mutual fund market.

The principles address ETFs that are organised as Collective Investment Schemes (CIS) and do not apply to other, non-CIS, exchange traded products (ETPs). The report is structured in two main sections. The first section concerns ETF classification and relevant disclosures for investors, including principles intended to clearly differentiate ETFs from other non-CIS ETPs, as well as from other CIS. Important in this regard is that investors are able to appreciate both the similarities and differences of ETFs with other competing products, as well as the way ETFs achieve their investment objective and the quality of their performance typically vis-à-vis a reference index.

Further principles encourage the disclosure of related fees and expenses, including the eventual impact of securities lending on these, as well as complete, accurate and understandable disclosure to address the types of risks investors may be exposed to, particularly through ETFs, using complex strategies that may involve the use of leverage (or reverse leverage).

The second section addresses concerns tied to the structuring of ETFs, including the management of potential inherent conflicts of interest and of counterparty risks arising from the two main types of replication methods: physical and synthetic. IOSCO encourages regulators to consider imposing requirements to ensure that ETFs appropriately address risks raised by counterparty exposure and collateral management. The final section of the report addresses ETFs in a broader market context, underscoring the importance of intermediaries' disclosure and conduct requirements (particularly in terms of product suitability) and referring to other work that may be relevant.

The report is available on the IOSCO website

1.24 Amendments to Corporations Regulations

The Corporations and Related Legislation Amendment Regulation 2013 (No 1) 2013 (Cth) amends the Corporations Regulations 2001 (Cth) (the principal Regulations).

According to the explanatory statement, the objectives of the amending Regulation are to:

- change the name of the National Institute of Accountants to the Institute of Public Accountants in the principal Regulations;
- prescribe remuneration disclosure requirements following the removal of these requirements from the relevant accounting standards; and
- remove references to the Financial Reporting Panel as the Panel has been abolished.

The amending Regulation commenced on 1 July 2013.

The Corporations Amendment (Derivative Trade Repositories) Regulation 2013 (Cth) amends the Corporations Regulations 2001 (Cth).

According to the explanatory statement, the amending Regulation:

- allows for interim reporting of derivatives contracts to repositories that are licensed in other jurisdictions prior to the establishment of licensed trade repositories in Australia; and
- lists a number of facilities, including DTCC Data Repository (U.S.) LLC, as being prescribed if they are registered to operate as a derivative trade repository under a law of a foreign jurisdiction.

The amending Regulation commenced on 30 June 2013.

The Corporations (Fees) Amendment Regulation 2013 (No 1) 2013 (Cth) amends the Corporations (Fees) Regulations 2001 (Cth).

According to the explanatory statement, the amending Regulation sets out the cost recovery arrangements for the period beginning 1 July 2013 and ending 30 June 2015, which will enable the federal government to recover over the period:

- costs incurred by ASIC in the performance of its market supervision functions and the implementation of market competition; and
- costs associated with the Enhanced Market Supervision (EMS) measure announced in the 2012-13 Budget to replace ASIC's integrated market surveillance system, enhance its market surveillance and supervision systems and tools, and deliver improvements to those ASIC portals and registers accessed by market participants.

Specifically, the amending Regulation:

- details amounts, or the formulae used to calculate such amounts, to be charged to various classes of market operators and participants, including small financial markets, wholesale markets, a number of designated market operators including the ASX and Chi-X Australia (Chi-X), and participants in the cash equity markets operated by the ASX and by Chi-X;
- introduces a fixed fee component of $1,835 per quarter for cash equity market participants;
- increases message-related fees to reflect the increased costs incurred by ASIC in supervising the large volumes of messages generated by computer-based trading;
- makes changes to the late payment fees to make them administratively more efficient; and
- inserts minor consequential and transitional amendments.

The amending Regulation commenced on 1 July 2013.

1.25 OECD research paper - making stock markets work to support economic growth

On 11 July 2013, the OECD published the latest in its research paper series on corporate governance titled "Making Stock Markets Work to Support Economic Growth: Implications for Governments, Regulators, Stock Exchanges, Corporate Issuers and their Investors".

The authors provide evidence that the primary determinant of long-term sustainability of IPO markets and, as a consequence, an important driver of economic growth, is the relative size of aftermarket economic incentives. Low aftermarket incentives (defined as tick sizes that are less than 1% of share price for sub US$500 million market value stocks) and low numbers of small public companies lead to low levels of IPO activity. Broker-dealers, who are the facilitators of capital formation, must have adequate incentives in order to support small company IPO activity. The combination of higher tick sizes and larger numbers of small public companies, on a gross domestic product (GDP) weighted basis, combine to sustain the critical mass infrastructure and services required to support a vibrant domestic IPO market.

While the IPO decline is most extreme in the US, the world supply of IPOs has also suffered a material decline with the proliferation of electronic markets. Work by the OECD shows that the global number of IPOs has declined from over 2,000 per year in the early 1990s to less than 750 IPOs in 2012. Two thirds of this decline comes from outside of the US.

The authors explore reasons for the decline including the role of certain investors and what they refer to as "one-size-fits-all" regulation. Hedge funds and other hyper trading institutions have become the dominant force in the one-cent tick size market, at the expense of long-term fundamental investors and liquidity providers (intermediaries). When trading interests overwhelm fundamental investor interests, price distortions occur, the marketing of individual stocks is displaced by derivatives (including exchange traded funds) and capital formation and allocation become less effective. In turn, economic cycles are made more extreme and long-term economic growth may be stunted.

The authors argue that "one-size-fits-all" is a poor basis for regulation. Large cap stocks are inherently liquid and benefit from the interest of many investors looking to buy and sell the stocks at the same time. By contrast, small cap stocks typically are less liquid, with asymmetrical or one-sided order-book markets. Unlike their large cap brethren, small cap stocks require broker-dealers to support liquidity, sales and equity research in order to sustain active markets. One-size fits-all stock market structures will underperform markets that are optimized separately to meet the needs of large cap and small cap stocks and their respective constituencies.

The paper is available on the OECD website.

2. Recent ASIC Developments

2.1 Review of debt consolidation sector highlights weaknesses in industry practice and risks for consumers

On 18 July 2013, ASIC published a review of debt consolidation providers which found that Australian credit licensees which provide these services are at risk of not complying with their responsible lending obligations.

ASIC is concerned about the standard of record-keeping practices in the 82 client files that were reviewed across 17 licensed providers.

Report 358 "Review of credit assistance providers' responsible lending conduct relating to debt consolidation" found:

- in 30% of files reviewed, the credit assistance provider failed to record or keep sufficient information to identify the consumer's pre-existing credit contracts;
- credit assistance providers in general did not appear to document in their client file whether potential significant risks and costs of debt consolidation had been discussed with consumers;
- inadequate recording of the consumer's requirements and objectives;
- inquiries about and verification of the consumer's financial situation not being recorded properly;
- some assessments of loan suitability being made on credit terms that were different from the eventual loan application; and
- some assessments of loan suitability where the amount recorded for consumer expenses was contradicted by other information on the licensee's file.

Commonly, all existing loans, credit cards and other debts are rolled into a new loan with a longer term (often 30 years) and secured over the family home.

Significant risks and costs of this include:

- higher long-term costs of repayment resulting from extending the loan term;
- transferring default risk of previously unsecured debt onto the family home;
- moving consumers to an interest-only loan without an appropriate exit strategy;
- leaving pre-existing contracts open, enabling a consumer to redraw on them at a later stage and fall further into debt problems; and
- additional costs such as broker fees and new loan establishment fees.

Report 358 is available on the ASIC website.

2.2 OTC derivatives reform - reporting regime

On 11 July 2013, ASIC published final rules for over-the-counter (OTC) derivatives trade reporting obligations of financial institutions and the regulation of derivative trade repositories.

The regime is set out in a package of rules and guidance released by ASIC on a new OTC derivatives reform webpage - including the *ASIC Derivative Transaction Rules (Reporting) 2013*, *ASIC Derivative Trade Repository Rules 2013*, Regulatory Guide 249 "Derivative trade repositories" (RG 249), and explanatory statements and FAQ material.

ASIC states that the Australian reforms have been designed to ensure, as far as possible, consistency with international requirements as well as to maximise the prospects of substituted compliance or sufficient equivalence judgments being reached by foreign regulators. This will help ensure that global markets remain open to Australian participants and infrastructures.

The reporting rules establish which entities will need to report to trade repositories, what information will need to be reported, and when the reporting obligation will start for different classes of reporting entities and different instrument types.

Derivative trade repositories, or data warehouses, maintain electronic databases of records of derivative transactions. The rules for these repositories cover issues such as application requirements and conditions, the manner in which they must provide their services, and ASIC's approach to regulation of overseas-based repositories.

End users of OTC derivatives (i.e. those that are not financial institutions or intermediaries) will not be covered by the reporting regime. ASIC will consult on their reporting obligations later this year.

Further information is available on the OTC derivatives reform section of the ASIC website.

2.3 Surveillance of analyst briefings

On 7 July 2013, ASIC announced that this reporting season it will be focusing on communications between companies and the investment analysts that cover their stock.

This reporting season is the first since ASX issued its revised Guidance Note 8 which assists listed entities in understanding their continuous disclosure obligations and particularly the requirement to disclose market sensitive information to the ASX.

ASIC will be working to raise awareness of the risks of selective disclosure when listed companies brief analysts. ASIC will be reminding key gatekeepers, company officers, individual analysts and their firms of their obligations.

In addition, ASIC will look to conduct spot checks with selected companies so it can hear how companies brief analysts and understand their procedures. If standards can be improved ASIC will consider providing additional guidance on this topic. ASIC's Regulatory Guide 62 "Better disclosure for investors" (RG 62) suggests a number of practical steps that a listed company should take to ensure the widest audience of investors has access to material information about the company.

Further information is available on the ASIC website.

2.4 Follow-up term deposit report

On 4 July 2013, ASIC released a report that highlights improved industry practice and better outcomes for investors in relation to the automatic rollover of term deposits. The report reveals that consumer outcomes on rollovers of term deposits have improved by billions of dollars.

ASIC Report 353 "Further review of term deposits" (REP 353) follows an earlier review and report ASIC released in February 2010, Report 185 "Review of term deposits" (REP 185), that found aspects of disclosure that were of concern to ASIC.

The key risk for investors is that at the end of the term, their term deposit can roll over automatically from a high interest rate to a much lower interest rate. This is a result of the combination of the practice of dual pricing by authorised deposit-taking institutions (ADIs) and the automatic rollover of term deposits. Dual pricing is when ADIs promote their term deposits by advertising the high rates available on a limited number of term deposit periods, while maintaining significantly lower rates for all other deposit periods.

REP 353 found that:

- the eight ADIs reviewed have generally implemented ASIC's recommendations to improve disclosure. All eight now disclose the risk of dual pricing in terms and conditions documents and in at least one mode of investor communications. All eight also disclose the existence of grace periods in pre-maturity and/or post-maturity letters, and most also tell investors the actual or indicative interest rate that will apply to their new term deposit before it rolls over;
- ADIs still use dual pricing so the risk of rolling over into a low interest rate remains. However, now, more of the available terms (one month, two months etc) have high interest rates applicable, so even on an automatic rollover, the risk of rolling over into a low rate is reduced;
- there were fewer default rollovers from "high" to "low" interest rates. In the seven months of the review, 11% of default rollovers involving a total of $1.9 billion rolled into low interest rate deposits. In ASIC's earlier review, which covered a 14 month period, 47% of default rollovers, involving $7.88 billion rolled into low rate deposits; and
- investors made significant use of grace periods with a total of $97 billion of investors' funds being re-lodged or cancelled during the grace periods which are available and are now better disclosed.

2.5 Focuses for 30 June 2013 financial reports

On 2 July 2013, ASIC announced its areas of focus for 30 June 2013 financial reports and released the results of its reviews of 31 December 2012 financial reports of listed entities and of unlisted entities with larger numbers of users.

(a) Focuses for 30 June 2013

ASIC's surveillance of financial reports at 30 June 2013 will include entities with shadow banking activities such as unlisted debenture issuers. ASIC will also review the financial reports of selected larger proprietary companies.

At 30 June 2013, directors should focus particularly on:

- ensuring that the operating and financial review for listed entities provides more useful and meaningful analysis and information for members;
- the impact of new accounting standards on consolidated financial statements and joint arrangements;
- impairment of goodwill and other non-current assets;
- the value of financial instruments that are not traded in an active market;
- going concern assessments, and
- revenue recognition and expense deferral policies.

ASIC's surveillance continues to focus on material disclosures of information useful to investors and other users of financial reports. ASIC does not pursue immaterial disclosures that may add unnecessary clutter to financial reports.

(b) Findings at 31 December 2012

ASIC's reviews at 31 December 2012 covered 150 financial reports of listed entities and of unlisted entities with larger numbers of users. ASIC continues to identify deficiencies in some key areas.

These include the impairment of goodwill and other non-current assets, non-consolidation of controlled entities, and key disclosures about going concern and the assumptions underlying asset valuations. ASIC has made enquiries of a number of entities and a number of material adjustments have been made to their financial reports.

Further information about focuses for 30 June 2013 financial reports and the findings of ASIC's reviews of the financial reports of listed entities and of unlisted entities with larger numbers of users are available on the ASIC website.

Findings from ASIC's review of the 30 June 2012 and 31 December 2012 financial reports of 200 proprietary companies are also available on the ASIC website.

2.6 New financial requirements for custodians

On 28 June 2013, ASIC announced that it has strengthened the financial requirements for custodial and depository service (custody) providers. The new rules also apply to asset holders for registered schemes or investor directed portfolio services (IDPS).

Custody providers and asset holders are key service providers in the financial services industry and play a significant role in the safekeeping of client assets. As at 31 December 2012, approximately $2.065 trillion of assets of Australian investors were held in custody. This figure is expected to more than triple over the next 15 years to $6.4 trillion.

Under the changes, custodians (not including incidental providers) and asset holders will be required to hold net tangible assets (NTA) amounting to the greater of:

- $10 million; or
- 10% of average revenue.

Providers who meet the definition of "incidental provider" will be required to hold NTA amounting to the greater of:

- $150,000;
- 10% of average revenue.

All custody providers and asset holders will be subject to new requirements regarding the preparation of cash flow projections and liquidity.

The changes are outlined in updated Regulatory Guide 166 "Licensing: Financial requirements" (RG 166) and implemented through a class order.

Background

The new financial requirements will apply from 1 July 2013 for new licensees. For existing licensees, there will be a one year transition period and compliance will be required from 1 July 2014.

The requirements form part of ASIC's wider review of the financial requirements applicable to Australian financial services (AFS) licensees, and follow ASIC's report on the custody industry. ASIC consulted on the requirements in November 2012.

Most custody providers in Australia are major domestic and international banks or specialised trustee companies. The industry is highly concentrated, with a small number of major custodians holding a significant portion of assets in custody.

The following documents are available on the ASIC website:

- RG 166;

- Consultation Paper 194 "Financial requirements for custodial or depository service providers" (CP 194);
- Report 352 "Response to submissions on CP 194 Financial requirements for custodial or depository service providers" (REP 352);
- [CO 13/760] "Financial requirements for responsible entities and operators of investor directed portfolio services"; and
- [CO 13/761] "Financial requirements for custodial or depository service providers".

2.7 New guidance for investment platforms

On 28 June 2013, ASIC announced that it has moved to require investment platform operators to explain how they choose the different products on offer to investors through their platforms. The strengthened disclosure requirements are part of a suite of new requirements following a review of the sector, which now has around $90 billion funds under management.

Platforms can assist retail investors to manage their investment portfolios, including through their advisers.

Further requirements include ensuring they have adequate resources to conduct their financial services businesses, having appropriate corporate structures and compliance arrangements, having additional policies like voting policies and policies when consumers do not opt in to continuing to receive advice, and improved disclosure through a consumer warning acknowledgment.

Investors will also have access to a product issuer's internal dispute resolution system when they have concerns about investments made through platforms and product issuers agree to do so. ASIC will give further consideration to extending this requirement to cover external dispute resolution and corresponding compensation arrangements.

The revised guidance is contained in Regulatory Guide 148 "Platforms that are managed investment schemes" (RG 148) and accompanied by new class orders.

Background

The revised requirements apply from 1 July 2013 to Australian financial services licensees that are licensed to operate a platform from that date. Existing operators have until 1 July 2014 to comply with the requirements or can opt in earlier by providing a written notification to ASIC, together with notification on their website.

Platform operators that provide custodial functions should also be aware of revised financial requirements for custodians, released on 28 June 2013. See item 2.6 of this Bulletin for further details.

2.8 Information sheets on involvement in private court proceedings and providing information to private litigants

On 25 June 2013, ASIC released two information sheets that explain how it decides whether to become involved in private litigation and how it can assist private litigants by providing them with non-public information and documents.

Information Sheet 180 "ASIC's approach to involvement in private court proceedings" (INFO 180) outlines ASIC's approach when deciding whether to become involved in private proceedings. This includes intervening as a party, or applying to appear as *amicus curiae* or "friend of the Court".

ASIC's decisions on whether to intervene are made consistently with ASIC's decisions on whether to take enforcement action.

They are based on:

- importance and impact of the matter from the perspective of strategic regulatory significance;
- cost versus regulatory benefit; and
- available alternatives to intervention.

INFO 180 also discusses ASIC's ability to commence proceedings on behalf of persons who have suffered loss, where this is in the broader public interest.

Information Sheet 181 "Providing information and documents to private litigants" (INFO 181) explains when ASIC will provide non-public information and documents to private litigants, or people contemplating litigation.

The sheet covers:

- release of transcripts and books;
- responding to subpoenas and summonses;
- responding to discovery notices and notices to produce; and
- limitations on release of information, including legal limitations and the rights of third parties.

Regulatory Guide 4 "Intervention" is withdrawn as a result of ASIC's publication of INFO 180.

2.9 Consultation on enhancements to training standards

On 24 June 2013, ASIC released a consultation paper proposing enhancements to the training standards for people who provide financial product advice.

Consultation Paper 212 "Licensing: Training of financial product advisers - Updates to RG 146" (CP 212) outlines proposed changes to the training standards that are set out in Regulatory Guide 146 "Licensing: Training of financial product advisers" (RG 146).

CP 212 proposes to retain the current training standards in RG 146 as "base level" standards, and to introduce two further regimes of training. These are proposed to come into effect in 2015 and 2019.

CP 212 proposes increases in the:

- generic knowledge requirements;
- specialist knowledge requirements for financial planning, securities and superannuation;
- skill requirements for personal advice; and
- educational level requirements.

CP 212 is also seeking feedback on the timeframe for implementation of the proposed new training standards, and the appropriate training standards for personal sickness and accident insurance and consumer credit insurance.

2.10 Consolidated guidance on takeovers

On 21 June 2013, ASIC released four new regulatory guides updating and consolidating its policies on takeovers. The new regulatory guides cover takeover bids, substantial holdings, compulsory acquisition and buy-outs, and will also address some discrete issues ASIC has identified in its administration of the law.

The guides consolidate the bulk of ASIC's policies that cover Chapters 6 - 6C of the Corporations Act 2001 (Cth).

The new guides are:

- Regulatory Guide 5 "Relevant interests and substantial holding notices" (RG 5);
- Regulatory Guide 6 "Takeovers: Exceptions to the general prohibition" (RG 6);
- Regulatory Guide 9 "Takeovers bids" (RG 9); and
- Regulatory Guide 10 "Compulsory acquisition and buyouts" (RG 10).

The release of the RGs is accompanied by 11 new class orders referred to in ASIC's guidance, as well as associated forms.

ASIC also released Report 350 "Response to submissions on CP 193 Takeovers, compulsory acquisitions and substantial holdings: Update to ASIC guidance" (REP 350).

REP 350 highlights the key issues which arose from the submissions ASIC received in response to Consultation Report 193 "Takeovers, compulsory acquisitions and substantial holdings: Update to ASIC guidance" (CP 193).

3. Recent ASX Developments

3.1 ASX launches OTC Interest Rate Derivatives Clearing

As part of ASX's effort to build world-class financial market infrastructure tailored for Australian financial markets, on 1 July 2013 ASX launched the ASX OTC Interest Rate Derivatives Clearing Service (OTC Derivatives Clearing Service). The OTC Derivatives Clearing Service will allow for the central clearing of standardised Australian dollar denominated interest rate swaps. The notional value of transactions in this market was almost A$18 trillion last financial year.

In 2012 ASX undertook extensive market consultation on the viability and optimal design of a domestic central clearing service for standardised Australian dollar interest rate swaps. As part of those consultations, ASX led a design study with nine Australian and international banks active in the Australian dollar interest rate swap market. Participating banks provided transaction data to ASX that enabled ASX to model the costs and benefits to participants of an ASX-operated domestic clearing service. Seven Australian and international banks worked with ASX to develop the OTC Derivatives Clearing Service. A number of other banks active in the Australian market have also expressed an interest in supporting the OTC Derivatives Clearing Service.

ASX's OTC Derivatives Clearing Service will provide the basis for the delivery of a client clearing service, which is scheduled for the end of 2013.

For further information see the ASX OTC Interest Rate Derivatives Clearing page.

3.2 Reports

On 4 July 2013, ASX released the following for June 2013:

- the ASX Group Monthly Activity Report;

- the ASX 24 Monthly Volume and Open Interest Report; and
- the ASX Compliance Monthly Activity Report.

4. Recent Takeovers Panel Developments

4.1 Laneway Resources Limited - Panel declines to make declaration

On 8 July 2013, the Takeovers Panel announced that, following the announcement of the withdrawal of the entitlement offer, the Panel has declined to make a declaration of unacceptable circumstances in response to an application dated 11 June 2013 from the Australian Securities and Investments Commission in relation to the affairs of Laneway Resources Ltd.

The Panel considered that the entitlement offer and the underwriting and sub-underwriting arrangements did not comprise normal commercial arrangements, but effectively ensured a conversion of Bizzell Nominees' loan to Laneway into equity without shareholder approval and was likely to have a substantial control effect on Laneway. The Panel also considered that there appeared to be information deficiencies in Laneway's prospectus. The Panel was minded to make a declaration of unacceptable circumstances in relation to the affairs of Laneway and orders including that the entitlement offer not proceed unless any conversion of the debt owed to Mr Bizzell and to entities controlled by him was approved by Laneway shareholders under item 7 of section 611 of the Corporations Act 2001 (Cth).

However, Laneway announced on 1 July 2013 that the entitlement offer had been withdrawn. The Panel decided that Laneway's withdrawal of the entitlement offer had removed the ground on which it was minded to declare unacceptable circumstances.

The reasons for the Panel's decision are available on the Takeovers Panel website.

5. Recent Research Papers

5.1 The twilight zone: OTC regulatory regimes and market quality

The authors analyse a sample of more than 10,000 US stocks in the OTC market. As little is known about this market, they first characterise OTC firms by trading venue and provide evidence on survival, success, frequency of venue changes, reporting status, and trading activity. A large number of new firms appear on the OTC market each year. With few exceptions, these new firms exhibit poor performance and rarely rise to trade on traditional exchanges. The authors analyse how market liquidity, price efficiency and crash risk, all of which capture aspects of market quality, differ across OTC venues and firms subject to different regulatory regimes, including federal securities and state blue sky laws. They show that OTC firms that are subject to stricter regulatory regimes have higher market liquidity and price efficiency, and lower return skewness. They also analyse OTC market features that are potential substitutes for SEC registration, such as publication in a securities manual or state merit reviews, and provide evidence on their capital-market effects. This evidence is relevant in light of the JOBS Act and the ensuing relaxation of SEC registration requirements. Overall, the results suggest that investors consider information and regulatory differences when trading OTC stocks.

The paper is available on the SSRN website.

5.2 Should we be afraid of the dark? Dark trading and market quality

Growth in trading without pre-trade transparency or "dark trading" has caused considerable concern among regulators and exchanges worldwide about its impact on market quality. These concerns recently prompted Canadian regulators to implement novel restrictions on dark trading. The authors exploit this natural experiment, which reduced the level of dark trading by more than one third literally overnight, together with proprietary trade-level data from dark trading venues to examine the impact of dark trading on liquidity and informational efficiency. They find that low levels of dark trading, as exist in Canada, are largely beneficial, reducing quoted, effective and realised spreads and increasing informational efficiency. Their results are consistent with the notion that, to a point, dark trading increases competition among informed traders who seek to capture rents from liquidity provision while minimising leakage of their information. They do not find any evidence that the Canadian restrictions caused migration of dark trading to the US in cross-listed stocks.

The paper is available on the SSRN website.

5.3 Crowdfunding securities

A new US federal statute authorises the online "crowdfunding" of securities, a new idea based on the concept of "reward" crowdfunding practiced on Kickstarter and other websites. This method of selling securities had previously been banned by federal securities law but the new *CROWDFUND Act* overturns that prohibition.

This article introduces the CROWDFUND Act and explains that it can be expected to have two primary effects on securities law and capital markets. First, it will liberate startup companies to use peer networks and the Internet to obtain modest amounts of capital at low cost. Second, it will help democratise the market for financing speculative startup companies and allow investors of modest means to make investments that had previously been offered solely to wealthy, so-called "accredited" investors.

The article also offers two predictions as to how securities crowdfunding will play out in practice. First, it predicts that companies that sell equity via crowdfunding may find themselves the subject of hostile takeovers (though the founders of such companies can easily avoid that outcome if they act with a little foresight). Second, it predicts that issuers may prefer to crowdfund debt securities, such as bonds, rather than equity. The article concludes with a few thoughts on the SEC's implementation of the Act in light of the potential for fraud.

The paper is available on the SSRN website.

5.4 The shareholder value myth

Shareholder primacy theory is suffering a crisis of confidence. In this article the author discusses how the traditional managerial focus on the shareholder's interest can be harmful for the corporation and even for shareholders themselves and how it is more valuable to spread the focus over several objectives.

The paper is available on the SSRN website.

5.5 Adapting to the new shareholder-centric reality

After more than eighty years of sustained attention, the master problem of US corporate law - the separation of ownership and control - has mostly been brought under control. This resolution has occurred more through changes in market and corporate practices than through changes in the law. This article explores how corporate law and practice are adapting to the new shareholder-centric reality that has emerged.

Because solving the shareholder-manager agency cost problem aggravates shareholder-creditor agency costs, the author focuses on implications for creditors. After considering how debt contracts, compensation arrangements, and governance structures can work together to limit shareholder-creditor agency costs, the author turns to available legal doctrines that can respond to opportunistic behaviour that slips through the cracks: fraudulent conveyance law, restrictions on distributions to shareholders, and fiduciary duties. To sharpen the analysis, the author analyses two controversies that pit shareholders against creditors: a hypothetical failed LBO, and the attempts by shareholders of Dynegy Inc to divert value from creditors through the manipulation of a complex group structure. The author then considers some legal implications of a shareholder-centric system, including the importance of comparative corporate law, the challenges to the development of fiduciary duties posed by the awkward divided architecture of US corporate law, the challenges for Delaware in adjudicating shareholder-creditor disputes, and the potential value of reinvigorating the traditional "entity" conception of the corporation in orienting managers and directors.

The paper is available on the SSRN website.

5.6 Fixing multi-forum shareholder litigation

Shareholder litigation in the US is systematically malfunctioning. This article presents new empirical evidence demonstrating that serious intra-corporate disputes at public companies now attract lawsuits in multiple fora. No existing mechanism can reliably coordinate shareholder litigation in different court systems, and the resulting disorder generates uniformly negative consequences for shareholders. The multi-forum character of shareholder litigation can undermine its deterrent effect by aggravating the disjunction between settlement values and merit. At the same time, the multi-forum pattern can diminish the quality of US corporate law over time by depriving incorporation states of important cases.

This article proposes to fix multi-forum shareholder litigation by creating a clear and simple mechanism for coordinating similar cases in different court systems. This proposal would require federal Courts to stay proceedings in shareholder litigation before them when a similar case is pending in the state of incorporation. It would also allow suits filed in states other than the state of incorporation to be removed to federal Court, where they would be subject to the same stay of proceedings. Such a system would neutralise the ability of any plaintiff to file a case that could compete for settlement with a case in the incorporation state. The result is an ordered solution to the problem of multi-forum shareholder litigation that prioritises the state of incorporation when suits are filed in competing fora but otherwise does nothing to restrict the venue options of shareholders.

The paper is available on the SSRN website.

5.7 Unsettledness in Delaware corporate law: Business judgment rule, corporate purpose

This article revisits two fundamental issues in Delaware corporate law. One is that the central role of the business judgment rule in fiduciary litigation involves a great deal of seemingly settled law. The other issue of whether there is a mandated corporate purpose has very little law. Using the emergent question of whether the business judgment rule should be used in analysing officer and controlling shareholder fiduciary duties, the latter issue having recently been addressed by Chancellor Strine in the widely-heralded MFW decision, this article proposes a fundamental rethinking of the rule's analytical preeminence. For a variety of reasons, it is suggested that fiduciary duties should be made more prominent and the business judgment rule should be dramatically de-emphasised. The policy rationales for the rule are sound, but they have no relevance for shareholders, and introduce needless doctrinal and analytical complexity. For directors, the policy rationales do not apply in the loyalty setting, so the duty of loyalty should not analytically be considered a "component" of the rule; and in the care setting, the rationales can be achieved simply by recalling that there is no substance to judicial review in that context.

As to corporate purpose, the article advocates that Delaware law permits a pluralistic approach in the for-profit corporate sector. Long agnostic about ultimate corporate objective, Delaware law may have turned unnecessarily toward a strict shareholder primacy focus in the 2010 eBay decision. To bring clarification and to foster flexibility, this article recommends a legislative default provision, with an opt-out feature. Importantly, this feature should be in the business of corporation statute itself. Delaware's new benefit corporation law laudably advances the goal of institutional pluralism, but does so at the ironic risk of reinforcing a belief that traditional business corporations themselves are legally permitted only to maximise profits. Judges in a democratic society should not dictate institutional goals.

The paper is available on the SSRN website.

5.8 Corporate insolvency and the protection of lost employee entitlements: Issues in enforcement

This article gives an overview of the enforcement by the Australian Securities and Investments Commission (ASIC) and the Fair Work Ombudsman (FWO) of laws for the protection of the entitlements of employees of insolvent corporate employers. It begins by explaining the types of actions available under the Corporations Act 2001 (Cth), including provisions inserted in 2000 specifically designed to protect employee entitlements in the context of corporate restructuring and insolvency. It looks at ASIC's response to this legislation and what the government proposed as part of its "Protecting Workers' Entitlements" package, announced prior to the 2010 federal election. The article then considers the actions of the FWO in prosecuting corporate employers and their officers for underpayment and non-payment of entitlements under the Fair Work Act 2009 (Cth), and whether more could be done. It concludes with some thoughts about overcoming the difficulties faced by ASIC and the FWO.

The paper is available on the SSRN website.

6. Recent Corporate Law Decisions

6.1 The meaning of "artificial price" within the s. 1041A market manipulation provision of the Corporations Act

(By Clementyne Rawlyk of Corrs Chambers Westgarth)

Director of Public Prosecutions (Cth) v JM [2013] HCA 30, High Court of Australia, French CJ, Hayne, Crennan, Kiefel, Bell, Gageler and Keane JJ, 27 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/HCA/2013/30.html

(a) Summary

This case considered the meaning of "artificial price" within s. 1041A of the Corporations Act 2001 (Cth) (the Act). In particular, the Court looked at whether buying or selling shares on the securities exchange operated by ASX Ltd (ASX) for the sole or dominant purpose of creating or maintaining a particular price, created an "artificial price" for those shares, which is in breach of the s. 1041A market manipulation provision.

The respondent, JM, had pleaded not guilty to 39 counts of market manipulation and to two counts of conspiring with others to commit market manipulation contrary to s. 1041A of the Act.

Overturning the construction of the provision given by the Victorian Court of Appeal, the High Court held that s. 1041A is not confined in its application to the creation or maintenance of an artificial price by a dominant market participant exercising that participant's market power. It confirmed that a purchase of listed shares made on the ASX for the sole, or at least dominant, purpose of ensuring that a certain price of the shares was created or maintained is an artificial price for trading in those shares.

(b) Facts

JM was presented in the County Court of Victoria on an indictment charging him with 39 counts of market manipulation and two counts of conspiring with others to commit market manipulation. Upon application by JM, the case was transferred to the Supreme Court of Victoria and came before Weinberg JA in the Trial Division of that Court. The charges related to purchases of shares on the ASX in a company (referred to in the proceedings as X Ltd) which, it was alleged, were undertaken to prevent JM from facing a margin call on a loan he held.

The Commonwealth Director of Public Prosecutions (CDPP) alleged that the various actions which occurred between May 2006 and November 2006 amounted to market manipulation. Specifically, the CDPP alleged that an entity associated with JM had borrowed money to exercise a large number of call options for shares in X Ltd, and that JM's daughter had bought shares in X Ltd on 4 July 2006 - purchases made with the express purpose of ensuring that the price of the shares in X Ltd did not fall below a certain threshold which would have entitled the lender to make a margin call on the loan held by JM.

Section 1041A provides that:

[a] person must not take part in, or carry out (whether directly or indirectly and whether in this jurisdiction or elsewhere):
(a) a transaction that has or is likely to have; or
(b) [two] or more transactions that have or are likely to have;
the effect of:
(c) creating an artificial price for trading in financial products on a financial market operated in this jurisdiction; or
(d) maintaining at a level that is artificial (whether or not it was previously artificial) a price for trading in financial products on a financial market operated in this jurisdiction.

After a plea had been made by JM, but prior to the jury being empanelled, Weinberg JA reserved three questions of law for determination by the Court of Appeal:

- for the purpose of s. 1041A of the Act, is the price of a share on the ASX which has been created or maintained by a transaction on the ASX that was carried out for the sole or dominant purpose of creating or maintaining a particular price for that share on the ASX an "artificial price"?
- was the closing price of shares in X Ltd on the ASX on 4 July 2006 an "artificial price" within the meaning of s. 1041A(c) of the Act?
- was the price of shares in X Ltd on the ASX on 4 July 2006 maintained at a level that was "artificial" within the meaning of s. 1041A(d) of the Act?

The Court of Appeal held by a majority (Nettle and Hansen JJA, Warren CJ dissenting) that it was inappropriate for them to decide any of the questions as posed by Weinberg JA, as the questions could only be answered by reference to disputed facts. The majority instead remitted the case to Weinberg JA for amendment of the first question.

The amended question read:

Is the expression "artificial price" in [s.] 1041A of the Act used in the sense of a term having a legal signification (as opposed to its sense in ordinary English or some non-legal technical sense), and, if so, what is its legal signification?

Weinberg JA amended the question as directed and the Court of Appeal answered the reformulated question as follows:

The expression "artificial price" in [s.] 1041A of the Act is used in the sense of a term having a legal signification (as opposed to its sense in ordinary English or some non-legal technical sense), and that its legal signification is of market manipulation by conduct of the kind typified by US jurisprudential concepts known as "squeezing" and "cornering".

The CDPP sought special leave to appeal the decision of the Court of Appeal alleging that the answer given to the reformulated question was founded on a misconstruction of s. 1041A of the Act. The respondent sought special leave to cross-appeal, alleging that the reformulated question was hypothetical in nature and could not be answered in the valid exercise of the judicial power of the Commonwealth.

(c) Decision

The High Court granted both applications for special leave.

The Court upheld the appeal by the CDPP and allowed JM's cross-appeal in part. It set aside the reformulated question remitted to Weinberg JA by the Court of Appeal and the subsequent order answering the reformulated question.

In place of these orders, the Court provided affirmative responses to each of the three questions originally posed by Weinberg JA.

In particular:

- for the purpose of s. 1041A of the Act, the price of a share on the ASX which has been created or maintained by a transaction on the ASX that was carried out for the sole or dominant purpose of creating or maintaining a particular price for that share on the ASX is an "artificial price";
- the closing price of shares in X Ltd on the ASX on 4 July 2006 was an "artificial price" within the meaning of s. 1041A(c) of the Act; and
- the price of shares in X Ltd on the ASX on 4 July 2006 was maintained at a level that was "artificial" within the meaning of s. 1041A(d) of the Act.

In reaching its decision, the High Court determined that:

- contrary to the majority in the Court of Appeal, s. 1041A is not confined in its application to the creation or maintenance of an artificial price by a dominant market participant exercising that participant's market power; and
- in determining whether a transaction can be characterised as at least likely to have the effect of creating or maintaining an artificial price, it is not necessary to demonstrate by counterfactual analysis or otherwise that the impugned transactions did so create or maintain an artificial price. Rather, it is sufficient if it can be shown that the buyer or seller set the price with the sole or dominant purpose described.

6.2 Failure by owner of assets to establish priority over a financer who held an all asset security interest registered on the Personal Property Securities Register

(By Anthony Sciuto and Chantalle Toussaint, King & Wood Mallesons)

In the matter of Maiden Civil (P&E) Pty Ltd; Richard Albarran and Blair Alexander Pleash as receivers and managers of Maiden Civil (P&E) Pty Ltd v Queensland Excavation Services Pty Ltd [2013] NSWSC 852, Supreme Court of New South Wales, Brereton J, 27 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/852.html

(a) Summary

This case considered the application of the Personal Property Securities Act 2009 (Cth) (the Act) in respect of competing security interests between an earlier security interest which was not registered on the Personal Property Securities Register (PPSR) and a later security which was registered and had been perfected. As the later security interest was perfected, Justice Brereton held that it took priority over the earlier unregistered security interest pursuant to the priority rules under the Act.

It was further held that the earlier security interest did not take priority over the later security interest as a "transitional security interest", being a security interest that is perfected without registration for a period of 24 months after the commencement of the Act. This is because the transitional security interest was capable of registration on a state based asset register that existed before the commencement of the Act but had not been registered. Consequently, the transitional security interest was not perfected under the Act and did not take priority over the later perfected security interest.

(b) Facts

Queensland Excavation Services Pty Ltd (QES) purchased three Caterpillar vehicles (the Caterpillars) and leased them to Maiden Civil (P&E) Pty Ltd (Maiden) under a verbal lease agreement. QES did not register its interest as lessor of the Caterpillars on the Northern Territory Register of Interests in Motor Vehicles and Other Goods (the NT Register) (a state based asset register that existed prior to the commencement of the Act) or on the PPSR when it came into effect.

Maiden subsequently sought a loan from Fast Financial Solutions Pty Ltd (Fast). As part of the financing arrangements, Fast took security over all of Maiden's "present and after acquired property", which included the Caterpillars. Fast registered its security interest in Maiden's property on the PPSR.

Maiden later fell into financial difficulty and defaulted on the loan. As a consequence, Fast appointed receivers and managers over the assets of Maiden, including the Caterpillars. Fast claimed that it was entitled to take possession of the Caterpillars on the basis that its registered security interest had priority over QES's interest in the Caterpillars.

Notwithstanding Fast's security interest, QES claimed that it was the legal owner of the Caterpillars and therefore had a superior claim to those assets or, in the alternative, that its security interest in the Caterpillars took priority over Fast's registered security interest.

(c) Decision

The key issue to be decided by Justice Brereton was whether Fast was entitled to possession of the Caterpillars on the basis that its registered security interest took priority over Maiden's unregistered security interest. Ultimately, his Honour held that Fast's security interest took priority over QES's security interest and therefore Fast was entitled to claim possession of the Caterpillars.

His Honour reached this conclusion by considering the following three issues:

- whether Fast's registered security interest took priority over QES's unregistered security interest;
- whether QES's transitional security interest took priority over Fast's registered security interest; and
- whether Fast's claim to possession of the Caterpillars was defeated by s. 112 of the Act.

(i) Security interests in the Caterpillars

As a preliminary matter, his Honour concluded that both QES and Maiden held security interests in the Caterpillars within the meaning of the Act.

His Honour concluded that QES, as a lessor of a Personal Property Securities Lease (PPS Lease), was deemed to have a security interest in the underlying leased property by virtue of s. 12(3)(c) of the Act. It was held that the leases over the Caterpillars were PPS Leases within the meaning of the Act as they were continuous leases for a term of more than one year, gave Maiden uninterrupted possession of the Caterpillars for more than 90 days and were in respect of goods that may or must be described by serial numbers.

In determining whether Fast had a security interest in the Caterpillars, His Honour first considered whether Maiden had the power to grant security over the Caterpillars. Given Maiden was the lessee of a PPS Lease and in possession of the Caterpillars, His Honour held that s. 19(5) of the Act gave Maiden a proprietary right to grant a security interest over the Caterpillars. The security interest in the Caterpillars held by Fast attached to the Caterpillars when value was given for the security in the form of the loan funds.

In determining this issue, his Honour considered the personal property securities jurisprudence in both New Zealand and Canada. His Honour noted that, in each of those jurisdictions, it is a well-established principle that a lessee in possession could grant a security interest over the leased assets even though it was not the owner of those assets. Given the Act was modelled on the personal property securities legislation in those jurisdictions, his Honour held that the legislature should be taken to have intended the same approach in Australia. This differs from the position at common law. At common law, a lessee would generally have the right to grant a security interest in its leasehold interest but not in the assets themselves.

Having decided that the parties each held security interests, his Honour held that the dispute must be resolved according to the priority rules under the Act and not in accordance with common law principles of title and ownership.

(ii) Fast's registered security interest prevailed

Given QES and Fast both had competing security interests in the Caterpillars, it was left to his Honour to determine whose interest took priority.

In considering this issue, his Honour applied the default priority rules under s. 55 of the Act. Relevantly, s. 55(3) of the Act provides that "a perfected security interest in collateral has priority over an unperfected security interest in the same collateral".

The concept of perfection is dealt with under s. 21 of the Act. In the present case, his Honour applied the perfection rule under s. 21(2)(a) of the Act which provides that a security interest will be perfected if it is registered on the PPSR.

His Honour concluded that the security interest held by Fast was perfected given that it was registered on the PPSR and satisfied the other statutory requirements for perfection. However, QES's interest was not registered on the PPSR and therefore was an unperfected security interest for the purposes of the Act.

Having settled the issue of perfection, his Honour concluded that s. 55(3) of the Act applied so that Fast's perfected security in the Caterpillars took priority over QES's unperfected security interest.

(iii) QES's transitional security interest was not perfected under the Act

The leases over the Caterpillars were entered into before the commencement of the Act. Accordingly, QES's security interest in the Caterpillars was deemed to be a "transitional security interest" within the meaning of the Act.

Under the Act, transitional security interests are generally perfected pursuant to s. 322 even though they are not registered on the PPSR for a transitional period. The transitional period began on the commencement date of the Act and ends on 31 January 2014, being 24 months after the commencement date.

However, in the present case, the security interests held by QES did not receive the benefit of temporary perfection. This is because the Personal Property Securities Regulations 2010 (Cth) (the Regulations) prescribe that temporary perfection without registration is not given to a transitional security interest that was registrable on an asset register that existed prior to the commencement of the Act but was not registered on that register before the commencement of the Act.

His Honour held that the leases over the Caterpillars were registerable on the NT Register but had not been registered prior to the commencement of the Act.

Accordingly, QES's security interest fell within the exception prescribed by the Regulations and, as it was not perfected, did not take priority over Fast's perfected security interest.

(iv) Fast's right to possession of the Caterpillars was not defeated by the operation of s. 112 of the Act

Section 112 of the Act provides that, in exercising the rights and remedies under Chapter 4 of the Act, a secured party (in this case, Fast) may only deal with the assets to the same extent as the grantor (in this case, Maiden) would be entitled to deal with those assets.

Because Maiden was, according to QES, a mere lessee with no right to deal in the Caterpillars, QES argued that that Fast's right to deal with those assets should be limited to the same extent.

However, his Honour held that s. 112 of the Act properly constructed in the context of the Act as a whole does not affect the position that Fast's perfected security interest gives it a right to possession of the Caterpillars. His Honour concluded that s. 112 of the Act should not be read in a way that is inconsistent with s. 19(5) of the Act and the intention of the legislature that a lessee of a PPS Lease has, in certain circumstances, the proprietary right to grant a security interest over assets subject to a lease.

His Honour also held that even if s. 112 of the Act did apply, it was not relevant in the present case given Fast was not exercising any enforcement rights under Chapter 4 of the Act. Instead, Fast was pursuing its claim to the Caterpillars under the financing and security arrangements agreed with Maiden. His Honour concluded that those arrangements did not fall within the operation of s. 112 of the Act.

6.3 Court's ability to make freezing orders in aid of proceedings on a cause of action being tried in Singapore

(By Adam Katz, DLA Piper Australia)

BCBC Singapore Pte Ltd v BT Bayan Resources TPK [No 3] [2013] WASC 239, Supreme Court of Western Australia, Le Miere J, 26 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/wa/WASC/2013/239.html

(a) Summary

BCBC Singapore Pte Ltd (BCBCS) sought to have freezing orders against PT Bayan Resources TBK (Bayan) and Kangaroo Resources Ltd (Kangaroo) upheld, while proceedings were on foot in Singapore, which Bayan challenged for lack for inherent jurisdiction and authorisation. The orders against Bayan were ultimately upheld, however the amount they would have to pay into the Court for the orders to cease was reduced. The order against Kangaroo, a third party, was not continued.

(b) Facts

BCBCS was awarded interim freezing orders against Bayan and Kangaroo, pursuant to O. 52A of the Rules of the Supreme Court 1971 (WA), or in the exercise of the court's inherent jurisdiction, which restricted Bayan and Kangaroo in terms of dealing with shares.

(i) BCBCS arguments

BCBCS argued that the freezing orders made pursuant to O. 52A r. 5(1)(b)(ii) (which authorised the Court to make orders for the purpose of preventing the frustration of a prospective judgment in this Court resulting from the registration of a judgment on a cause of action being tried in Singapore) should be upheld as they were:

- within the Court's inherent jurisdiction (and thus within the rule making authority of s. 167(1)(a) of the Supreme Court Act 1935 (WA) (the Supreme Court Act);
- authorised by the power conferred on the court by section 16(1)(d)(i) of the Supreme Court Act; and

- authorised by s. 17 of the Foreign Judgments Act 1991 (Cth) (the Foreign Judgments Act).

(ii) Bayan arguments

Bayan argued that if section 167(1)(a) of the Supreme Court Act authorises the making of an O. 52A r 5(1)(b)(ii) freezing order, then O. 52A r. 5(1)(b)(ii) would be inoperative, for the purposes of s. 109 of the Commonwealth of Australia Constitution Act 1900 (Cth) (the Constitution), as it would be inconsistent with the Foreign Judgments Act.

Bayan argued that even if s. 17 of the Foreign Judgments Act authorises an O. 52A freezing order, O. 52A r. 5(1)(b)(ii) would be invalid for attempting to give the Court a function incompatible with its role as a repository of Federal jurisdiction for the purposes of Chapter III of the Constitution.

(iii) Order 52A freezing orders

Order 52A r. 5 applies if an applicant has a good case on a cause of action that is justiciable in another court and there is a sufficient prospect that the other Court will give judgment in favour of the applicant and there is a sufficient prospect that the judgment will be registered in, or enforced by, the Court.

The Court can make a freezing order (referred to as a Mareva order) against a judgment debtor if there is a danger that a judgment will be unsatisfied because the judgment debtor absconds, or the assets are removed from Australia or disposed of. The Court may make a freezing order against a third party if satisfied that the judgment will be unsatisfied because the third party is in possession or can dispose of assets of the judgment debtor.

(c) Decision

(i) Inherent jurisdiction

The Court stated that it had the power to make a freezing order via the inherent jurisdiction to prevent abuse or frustration of its processes (Wilson and Dawson JJ in *Jackson v Sterling Industries Ltd* [1987] HCA 23). Processes include the enforcement of a foreign judgment in an Australian Court. Granting a Mareva order extends to preserving the efficacy of the execution which would lie against the actual or prospective judgment debtor, including preserving assets, and also lie against third parties (Gaudron, McHugh, Gummow and Callinan JJ in *Cardile v LED Builders Pty Ltd* [1999] HCA 18).

Le Miere J enunciated legal principles in relation to freezing orders drawn from High Court decisions:

- the doctrinal basis of the freezing order is to prevent the abuse or frustration of the Court's processes and protect the proper administration of justice in relation to the enforcement of the judgment of the Court;
- a freezing order may be made against an actual or prospective judgment debtor. The purpose of a freezing order is to preserve the efficacy of the execution which would lie against an actual or prospective judgment debtor;
- a freezing order is not an interlocutory injunction. Freezing orders have a different basis in principle and doctrine to injunctions in aid of legal rights in pending litigation; and
- a freezing order may be made against a third party, assuming the existence of other relevant criteria and discretionary factors.

Le Miere J concluded that the Court did have jurisdiction or power to make a freezing order for the purpose of preventing the frustration of a prospective judgment in this Court resulting from the registration of a judgment on a cause of action being tried in a foreign jurisdiction.

While there are conflicting decisions of single judges regarding freezing orders where a party is sued abroad and has assets in Australia, Le Miere J accepted the decision of Hasluck J in *Celtic Resources Holdings Plc v Arduina Holdings BV* [2006] WASC 68, who stated that the Court has an inherent jurisdiction to grant Mareva relief in relation to assets in Australia where a foreign judgment has been or is to be obtained.

Le Miere J found that the Court has an inherent jurisdiction to make a freezing order against a prospective judgment debtor where there is a sufficient prospect that a foreign Court will give judgment in favour of the applicant and the judgment will be registered in or enforced by the Court.

(ii) Supreme Court Act s. 16

Section 16(1)(d)(i) of the Supreme Court Act empowers the Court to administer justice and do all things necessary for the due execution of its equitable jurisdiction.

Section 16(1)(d)(i) of the Supreme Court Act corresponds to s. 23 of the Supreme Court Act 1970 (NSW), which was used in *Riley McKay Pty Ltd v McKay* when there was a risk the defendant would deal with his assets such that judgment would be ineffective and the Court's jurisdiction would be impaired ([1982] 1 NSWLR 264). Le Miere J held that the power conferred by s. 16(1)(d)(i) is coextensive with its inherent power, and the jurisdiction granted by s. 16(1)(d)(i) is wide enough to encompass a transnational freezing order.

(iii) Order 52A r 5(1)(b)(ii) is authorised by Supreme Court Act s. 167(1)(a)

Le Miere J held that O. 52A r 5(1)(b)(ii) is authorised by the rulemaking power in s. 167(1)(a) of the Supreme Court Act.

The Constitution Act 1889 (WA) s. 2 and Australia Act (1986) 1985 (Cth) s. 2(1) provide a power to make laws that have extra territorial operation, provided there is sufficient nexus between the State and the extra territorial circumstances. A sufficient nexus existed here because O. 52A r. 5(3)(b) requires that there be a sufficient prospect that the judgment will be registered in or enforced by the Court.

(iv) Order 52A r 5(1)(b)(ii) is authorised by the Foreign Judgments Act

Order 52A prescribes matters necessary or convenient for giving effect to the Foreign Judgments Act.

The Foreign Judgments Act gives registration of foreign judgments the same force and effect "as if the judgment had been originally given in the Court in which it is registered and entered on the date of registration".

BCBCS submitted that an O. 52A r. 5(1)(b)(ii) freezing order is "necessary or convenient" for the carrying out or giving effect to the Foreign Judgments Act and therefore is authorised by the rule making power in s. 17 of the Foreign Judgments Act.

(v) Order 52A r 5(1)(b)(ii) is not inconsistent with the Foreign Judgments Act

Le Miere J found that O. 52A r 5(1)(b)(ii) is not inconsistent with the Foreign Judgments Act because the Foreign Judgments Act is not an exclusive and exhaustive code with respect to the enforcement of foreign judgments, and rather, provides for the registration and enforcement of only those judgments to which Part 2 of the Foreign Judgments Act applies.

(vi) Order 52A r 5(1)(b)(ii) does not confer on the Court a function incompatible with the role of a Chapter III court

Bayan argued that if O. 52A r 5(1)(b)(ii) fell within the grant of the rule making power contained in s. 17 of the Foreign Judgments Act, then it is invalid for attempting to confer upon the Court a function incompatible with the role of the Court as a repository of federal jurisdiction for the purposes of Chapter III of the Constitution.

Le Miere J rejected Bayan's argument as the Court has the inherent jurisdiction to make a freezing order in the circumstances addressed by O. 52A r. 5(1)(b)(ii). Exercising inherent jurisdiction to protect the administration of justice does not alter the character of the Court such that it ceases to meet the constitutional descriptions of a "[C]ourt of the state".

(vii) Court has power to make freezing orders

The Court held that it has jurisdiction, or power, to make a freezing order and to continue the orders against Bayan if the following is satisfied.

1. BCBCS has a good arguable case on an accrued cause of action that is justiciable in the High Court of Singapore (O. 52A r 5(1)(b)(ii)):

A good arguable case is one "which is more than barely capable of serious argument, and yet not necessarily one which the judge believes to have a better than 50% chance of success" (Musthill J in *Ninemia Maritime Corp v Trave Shiffahrtsgesellschaft GmbH & Co KG (the Niedersachsen)* [1984] 1 All ER 398). Le Miere J found that BCBCS has a good arguable case in the sense that it is reasonably arguable and is more than barely capable of serious argument. BCBCS also established a good arguable case that it is entitled to substantial damages.

2. There is a sufficient prospect that the High Court of Singapore will give judgment in favour of BCBCS (O. 52A r. 5(3)(a)):

Le Miere J believed BCBCS would receive judgment in its favour for US$138.

3.There is a sufficient prospect that the judgment will be registered in or enforced by this Court (O. 52A r. 5(3)(b)):

BCBCS intended to register any judgment in this Court.

4. The Court is satisfied that there is a danger that a prospective judgment in Singapore will be unsatisfied because the assets of Bayan are removed from Australia, disposed of, or devalued (O. 52A r. 5(4)(b)):

There must be facts from which a prudent, sensible, commercial person can properly infer a danger of default if assets are removed from the jurisdiction (Jawton LJ in Third Chandris Shipping Corporation v Unimarine SA [1979] QB 645). Le Miere J believed there is a real and sensible risk that a judgment obtained from the High Court of Singapore would be unsatisfied, because of the location of Bayan's only known assets and the company's previous behaviour.

(viii) Undertaking as to damages

Bayan submitted that the $2 million security offered by BCBCS as security for its undertaking as to damages was inadequate and a financier believed it should be $12.5 - $17.7 million. The Court needed to consider what amount of security is reasonably necessary to protect Bayan from any damages that BCBCS is likely to be liable for under its undertaking as to damages if it is ultimately unsuccessful in the Singapore proceedings. The Court observed that there are many uncertainties for assessing the damages that might be caused to Bayan and hence the appropriate amount of security cannot be calculated arithmetically.

The Court ordered that the freezing orders should be varied to provide that the freezing orders will cease if Bayan pays into Court an amount equal to the market value of the shares. As Kangaroo shares were worth approximately $5 million on 6 February, the sum of $2 million is adequate security on the basis that Bayan may be released from the freezing orders if it pays $52 million into Court.

(ix) Order against Kangaroo

O. 52A r. 5(5) allows the Court to make a freezing order against a third party in certain circumstances. However, as Kangaroo is not in a position of control or influence concerning the shares, the rule does not apply.

The Court, in certain circumstances also has inherent jurisdiction to make a freezing order against third parties, however none of the circumstances in the Cardile judgment apply here. While the Cardile circumstances might not be an exhaustive list, the fact that a prospective judgment debtor holds shares in the third party is not sufficient.

The orders against Kangaroo were not continued.

(x) Conclusion

Le Miere J held that the Court had jurisdiction to make the freezing orders:

- under its inherent jurisdiction to make freezing orders in aid of proceedings on a cause of action being tried in Singapore, pursuant to RSC O. 52A r. 5(1)(b)(ii); and
- by reason of the authorisation granted by s. 167(1)(a) of the Supreme Court Act and s. 17 of the Foreign Judgments Act.

Bayan's claims for relief were dismissed and the freezing orders against Bayan were to continue, provided BCBCS maintains its undertaking and security. The orders will cease if Bayan pays the sum of $52 million into Court.

The freezing orders against Kangaroo were not continued.

6.4 Target company's failure to provide audited accounts to its shareholders prior to a scheme meeting

(By Lily Zhang, Ashurst Australia)

PR Finance Group Limited, in the matter of PR Finance Group Limited (No 2) [2013] FCA 633, Federal Court of Australia, Jacobson J, 25 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/633.html

(a) Summary

PR Finance Group Limited (PRF) failed to make the following disclosures in relation to the availability of its audited financial accounts prior to a scheme meeting:

- failure to convey to the Court at the first hearing on 13 May 2013 that the audited accounts were unlikely to be available at the scheme meeting;
- failure to notify the Court at the end of May 2013 when the chief financial officer and a director of PRF were aware that the audited accounts would not be prepared before the scheme meeting was to be held; and
- failure to provide shareholders with the audited accounts at the scheme meeting.

The reasons given by the chief financial officer for failing to provide audited accounts at the scheme meeting were unsatisfactory and the audited accounts were material to the decision of shareholders to vote on the scheme.

Jacobson J held that in light of the non-disclosures, the application for approval of the scheme of arrangement be adjourned to August 2013 so that a further meeting of shareholders may be convened and the shareholders provided with the audited financial accounts of PRF prior to the meeting.

(b) Facts

On 13 May 2013, the Court ordered the convening of a meeting of shareholders of PRF on 14 June 2013 for the purposes of considering a scheme of arrangement under which Keybridge Capital Limited (Keybridge) was to acquire all the issued capital of PRF. On 12 June 2013, ASIC wrote to PRF indicating that it intended to withhold its "no objection" statement to the proposed scheme under s. 411(17)(b) of the Corporations Act 2001 (Cth) (the Corporations Act) as PRF had failed to disclose material information to its shareholders, that is, the audited financial accounts of PRF for the financial year ending 30 June 2012. The meeting of shareholders was held and a very large majority of shareholders approved the scheme despite the absence of the audited financial report. However, ASIC appeared at the second court hearing opposing the grant of approval for the scheme.

(c) Decision

(i) Failure to provide audited accounts of PRF

The chief financial officer of PRF (the CFO) gave unsatisfactory evidence as to why the accounts of PRF had not been completed ten days before the scheme meeting when the scheme booklet stated that the audited financial report of PRF would be lodged with ASIC not less than ten days before the date of the scheme meeting. Jacobson J held that the CFO knew, from various correspondences with PRF's auditors that the audited accounts would not be prepared before the scheme meeting and it was not appropriate for PRF to remain quiet about this issue until the evening before the scheme meeting given the CFO and a director of PRF would be aware of the importance of audited accounts.

(ii) Materiality of the non-disclosure of the audited accounts

Full disclosure of all material facts must be made to shareholders when shareholders are required to exercise discretion to approve a scheme. This is so that the shareholders are put in possession of information that will enable them to make an informed and critical assessment of the offer. The Court will consider whether there is any reasonable ground for supposing that the deficiency in disclosure would cause shareholders to vote, or to abstain from voting, under a serious misapprehension of the position.

Although the availability of the audited accounts may not assist the shareholders in coming to a view as to whether Keybridge may be prepared to pay more for the PRF shares, the attractiveness of the offer is dependent in a substantial part on the true value of PRF, which will be evidenced by the audited accounts. Further, even though the independent expert stated that if PRF is placed into receivership, the shareholders may receive less than the value of the scheme consideration or nothing at all, it is for the shareholders to have the opportunity to consider that question in light of the audited accounts.

(iii) Conditional approval

Jacobson J was prepared to order conditional approval to the scheme provided the following conditions were satisfied:

- the holding of a further meeting of shareholders when the audited accounts are available;
- the audited accounts are lodged with ASIC not less than ten days before the date of the further meeting of shareholders;
- the further meeting of shareholders is held no later than 15 August 2013; and
- the scheme consideration is not to be provided and the share transfer is not to take place until the further meeting of shareholders takes place and the shareholders vote in favour of the scheme.

ASIC was content with the above orders, but both PRF and Keybridge opposed conditional approval of the scheme.

(iv) Court order

Jacobson J ordered that the present application be adjourned to August 2013 and in the absence of any additional material facts emerging prior to the adjournment date, Jacobson J indicated he was prepared to approve the scheme provided the following conditions are satisfied before the date of the next hearing:

- a further meeting of shareholders is convened ratifying by majority as per s. 411(4)(a)(ii) of the Corporations Act the resolution to approve the scheme passed on 14 June 2014;
- the meeting is held after the audited accounts for the year ending 30 June 2012 are available;
- the audited accounts are lodged with ASIC not less than ten days before the meeting;
- any material matters in the audited accounts should be drawn to the attention of the shareholders by a supplementary scheme booklet; and
- the meeting is to be held no later than 15 August 2013 or such later date as the Court may approve.

6.5 Section 1322 of the Corporations Act may validate intentional acts

(By Brendan Groves, Partner, and Elissa Tobin, Senior Associate, Clayton Utz)

DUET Management Company 1 Limited; DUET Management Company 1 Limited as responsible entity of Diversified Utility and Energy Trust No 1; DUET Management Company 2 Limited as responsible entity of Diversified Utility and Energy Trust No 3 [2013] NSWSC 817, Supreme Court of New South Wales, Black J, 20 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/817.html

(a) Summary

The DUET Group requested that Black J make orders:

- convening a securityholder meeting for a proposed company scheme of arrangement; and
- advising the responsible entities of trusts within the DUET Group in respect of certain matters relating to proposed trust schemes of arrangement.

In the context of deciding whether to make the requested orders, Black J considered the availability of s. 1322 of the Corporations Act 2001 (Cth) (the Corporations Act) to remedy "intentional" breaches by members of the DUET Group of a number of provisions in the Corporations Act. The breaches related to the fact that the DUET Group did not propose to send the Meeting Booklet for the schemes to all relevant securityholders, as sending the Meeting Booklet to securityholders in Malaysia and Thailand could constitute an offer of securities in those jurisdictions.

While he did not make any final ruling on the matter, Black J indicated that s. 1322 of the Corporations Act may be available in respect of such intentional breaches of the Corporations Act.

(b) Facts

The DUET Group proposed to conduct a corporate restructure. The restructure involved a company scheme under section 411 of the Corporations Act and two trust schemes under s. 63 of the Trustee Act 1925 (NSW) (the Trustee Act), and included an issuance of securities to certain existing securityholders.

A Meeting Booklet including an Explanatory Memorandum was prepared and it was proposed that it be distributed to all registered securityholders other than those whose registered addresses were in Malaysia or Thailand, on the basis that it could constitute an offering of securities under the laws of those jurisdictions. The DUET Group planned to send a separate letter to these securityholders informing them of their ineligibility to receive the Meeting Booklet and of their right to object to the proposal, and directing them to additional information relating to the corporate restructure.

(i) Orders sought

Orders were sought under s. 411(1) of the Corporations Act to convene a meeting of securityholders for the purpose of considering the proposed scheme and approving the associated Explanatory Memorandum. Additionally, advice was sought under s. 63 of the Trustee Act that, in connection with the trust schemes, the responsible entities would be justified in:

- convening a meeting of unitholders to consider and, if thought fit, agree to a proposed trust scheme;
- distributing the Explanatory Memorandum to all registered unitholders, other than unitholders in Malaysia and Thailand; and
- proceeding on the basis that proposed amendments to the relevant constitutions would be within the powers of alteration conferred under such constitutions and s. 601GC of the Corporations Act.

In deciding whether to grant orders under section 411(1), Black J was required to consider whether the Court would be likely to approve the proposed company scheme on hearing an application that was not opposed.

(ii) Potential breaches

By failing to send the Meeting Booklet to all securityholders, entities in the DUET Group would potentially be in breach of the following sections of the Corporations Act:

- s. 601FC(1)(d), which requires responsible entities to treat members who hold interests of the same class equally;
- ss. 249J and 252G, which require written notice of a meeting of a company's members (or unitholders of a scheme) to be given individually to each securityholder entitled to vote at the meeting; and
- s. 412(1), which requires that with every notice convening a meeting that is sent to a member, an explanatory statement also be provided.

(iii) Reliance on s. 1322 of the Corporations Act

While ASIC had indicated it was inclined to grant relief from the requirements of s. 601FC(1)(d), it could not provide similar relief in respect of ss. 249J, 252G or 412(1) of the Corporations Act. On that basis, the DUET Group indicated that it intended to apply for orders under section 1322(4) of the Corporations Act in respect of its non-compliance with those sections.

Among other things, s. 1322(4) of the Corporations Act provides that the Court may, on application by any interested person, make an order "declaring that any act, matter or thing purporting to have been done, or any proceeding purporting to have been instituted or taken, under this Act or in relation to a corporation is not invalid by reason of any contravention of a provision of this Act or a provision of the constitution of a corporation".

(c) Decision

His Honour referred to the following requirements set out in s. 1322(6) of the Corporations Act, one of which must be satisfied in order for an order to be granted under s. 1322(4)(a) of the Corporations Act:

- the contravention is essentially procedural;
- the persons concerned acted honestly; or
- it is just and equitable that the order be made

in each case, provided that no substantial injustice has been or is likely to be caused to any person.

His Honour also noted that the discretion afforded to the Court under s. 1322(4)(a) of the Corporations Act is to be broadly construed, and quoted the observations of French CJ in *Weinstock v Beck* [2013] HCA 14; (2013) 93 ACSR 231 that "in accordance with its evident purpose, s. 1322(4)(a) is to be construed broadly and applied pragmatically, principally by reference to considerations of substance rather than those of form".

In this context, Black J also referred to the decision of Middleton J in *Nenna v Australian Securities and Investments Commission* [2011] FCA 1193; (2011) 1998 FCR 32, which provided that intentional acts may nonetheless be not invalid by virtue of s. 1322 of the Corporations Act. Black J concurred with this principle and suggested that, for the purposes of s. 1322(6) of the Corporations Act, an act may be taken honestly, or it may be just and equitable to validate it, notwithstanding that the relevant parties are aware of a technical defect at the time the act takes place.

While Black J indicated that it was not necessary for him to form a final view on the issue, he noted that for the purpose of granting the orders requested, it was sufficient for him to consider that it was likely that the Plaintiffs' conduct in respect of the securityholders in Malaysia and Thailand would be validated under s. 1322 of the Corporations Act.

On that basis, and on the basis of certain ancillary matters, Black J made the requested orders.

6.6 What is required to trigger a professional indemnity insurance policy?

(By Carrie Hui, Herbert Smith Freehills)

Michael Kyriackou v ACE Insurance Ltd [2013] VSCA 150, Supreme Court of Victoria, Court of Appeal, Harper and Tate JJA and Kyrou AJA, 20 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/vic/VSCA/2013/150.html

(a) Summary

This case was an appeal from a decision by Vickery J regarding a claim by Mr Kyriackou against ACE Insurance Limited (ACE) to indemnify him for legal costs incurred in respect of ASIC proceedings against him. The Victorian Court of Appeal upheld the trial judge's decision and held that the ASIC proceedings did not fall under the policy of professional indemnity insurance provided by ACE (the Policy).

(b) Facts

On 28 May 2007, ASIC commenced proceedings against Mr Kyriackou and others for being involved in an unregistered management investment scheme (Australvic Group). ASIC sought orders to wind up the scheme and that a liquidator be appointed to each of the companies within the Australvic Group.

On 22 July 2008, ASIC sought leave to discontinue the proceedings and leave was only granted three years later. As a result, Mr Kyriackou incurred substantial legal costs in defending the proceedings and sought to recover his costs through a claim under the Policy. The Policy would indemnify him against "Loss arising from any Claim in respect of civil liability for breach of a duty owed in a Professional Capacity". It also contained an exclusion clause excluding payment for loss arising out of a breach of duty owed by a director or secretary of a body corporate.

The trial judge, Vickery J, held that Mr Kyriackou was not entitled to indemnity under the Policy based on the following grounds:

- the ASIC proceeding was not a "Claim" within the meaning of the Policy given ASIC sought only declaratory and injunctive relief against Mr Kyriackou, and it did not constitute a claim for civil compensation or civil damages;
- the ASIC proceedings against Mr Kyriackou were not in his "Professional Capacity", but in his capacity as an entrepreneur in the management of the Australvic Group; and
- even if there is a Claim under the Policy, the exclusion clause will apply because ASIC suspected Mr Kyriackou and other directors had breached the Corporations Act 2001 (Cth) (the Corporations Act) through insolvent trading and appropriation of assets.

Mr Kyriackou appealed that decision to the Court of Appeal.

(c) Decision

The Court of Appeal unanimously dismissed the appeal (Tate JJA and Kyrou AJA agreeing with Harper J's reasons), finding that the ASIC proceeding did not fall within the ambit of the Policy. The following grounds were on appeal:

(i) Was the ASIC proceeding a claim for civil compensation or civil damages?

Mr Kyriackou argued that ASIC did seek orders to shut down the scheme and preserve assets, hinting that a claim of damages would be made, as there was no reason otherwise for ASIC to seek such orders. Mr Kyriackou also argued that ASIC made a written intimation of an intention to seek damages because the orders ASIC sought under s. 1324 of the Corporations Act incorporated means for seeking damages.

ACE contended that all ASIC sought to do with respect to the scheme was to provide the Court with information it needed as a part of the investigation process of any wrongdoing by Mr Kyriackou and other scheme operators. ACE also argued that ASIC's actions to shut down the scheme were not a written intimation but an "interim and protective step" to preserve the scheme's assets.

The Court agreed with ACE and noted that a "suggestion or hint" is not sufficient to trigger the policy and could not be regarded as a claim for damages or an intimation of an intention to do so. The

Court also pointed out that a claim for civil damages or compensation is not a claim in debt. If there was a claim by investors of the scheme, it will be a claim of debt payable under a breach of contract, not a payment of compensation or damages.

(ii) Was Mr Kyriackou acting in a professional capacity as a broker?

The Court disagreed with the trial judge's decision that Mr Kyriackou was acting as an entrepreneur and gave a broader reading to the term "professional". Harper J concluded that Mr Kyriackou was acting in his professional capacity based on the context of the overall activity involved in the group's business as a finance originator, finance intermediary or finance consultant. Although Mr Kyriackou was acting in his professional capacity, he was still not entitled to indemnity under the Policy because any loss he suffered did not arise from a Claim as discussed above.

6.7 Reinstatement of a company to investigate former directors

(By Stephanie De Vere, Minter Ellison)

Deputy Commissioner of Taxation v Australian Securities and Investments Commission [2013] FCA 594, Federal Court of Australia, Gordon J, 17 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/594.html

(a) Summary

This case provides an example of a situation where the Court will exercise its discretion to make an order under s. 601AH(2) of the Corporations Act 2001 (Cth) (the Corporations Act) to reinstate a company. This case also provides guidance on whether former directors should be heard in respect of an application to reinstate a company where the purpose of the reinstatement is to investigate potential claims against the former directors.

(b) Facts

Melren Farms Pty Ltd (Melren) was placed into liquidation on 20 July 2004 as a result of a voluntary winding up and was deregistered on 23 May 2007. John Rennie and Lisa Rennie (the former directors) were the only directors of Melren on deregistration.

The Deputy Commissioner of Taxation (DCT) applied pursuant to s. 601AH(2) of the Corporations Act to reinstate Melren (the Reinstatement Application).

Section 601AH(2) of the Corporations Act provides that the Court may make an order that the Australian Securities and Investments Commission (ASIC) reinstate the registration of a company if an application for reinstatement is made to the Court by a person aggrieved by the deregistration or a former liquidator of the company. The Court must be satisfied that it is just that the company's registration be reinstated.

The purpose of the Reinstatement Application was to enable the DCT to wind-up Melren so that a liquidator could carry out investigations in respect of possible claims against:

- the former directors for conversion and/or breaches of fiduciary duty and or trust for disposing of assets of Melren for no real consideration to the detriment of the company and its creditors;
- other members of the Melren Group of companies for knowingly assisting in breaches of fiduciary duties;
- those entities that received money and/or property of Melren for trespass, knowing receipt and unjust enrichment; and
- the former directors on the basis of voluntary conveyances made for the purpose of

defrauding creditors.

The former directors by an interlocutory injunction applied for leave pursuant to rule 2.13 of the Federal Court (Corporations) Rules (2000) 1999 (Cth) (the Rules) to be heard on the Reinstatement Application as former directors of Melren.

Rule 2.13 of the Rules provides that the Court may grant leave to be heard in a proceeding without becoming a party to the proceeding, to any person who is, or claims to be:

- a creditor, contributory or officer of a corporation;
- an officer of a creditor, or contributory, of a corporation; or
- any other interested person.

The former directors argued that in circumstances where the purpose of reinstatement is to bring an action against a former director, the former director is a person who is likely to be impacted by the reinstatement order and therefore, should be afforded the right to be heard. The former directors referred the Court to the New South Wales Court of Appeal decision in *Miltonbrook Pty Ltd v Westbury Holdings Kiama Pty Ltd* [2008] NSWCA 38 (Miltonbrook) where Chief Justice Spigelman stated that "when a statutory power like [s.] 601AH(2) is conferred on a [C]ourt, the legislature intends that procedural fairness will be accorded to all who may be affected by the order ...".

Further, the former directors also submitted that:

- the claims of the DCT would become statute barred and were therefore futile;
- the significant delay in bringing the Reinstatement Application was such that the passage of time was likely to have adversely affected the ability of there to be a fair trial of any action against them; and
- the DCT should have been aware of all of the transactions the subject of potential claim at least by 2005 or 2006 when Melren was in liquidation.

(c) Decision

Justice Gordon determined that the reinstatement of Melren was not unjust or futile. Consequently, the Court ordered that ASIC reinstate the registration of Melren. It was held that the new liquidators should be given an opportunity to investigate and pursue any necessary and appropriate legal actions on behalf of Melren.

Justice Gordon held that the Reinstatement Application was not the appropriate forum for the Court to determine the disputed factual matters the subject of potential proceedings by the liquidators against the former directors. Rather, if the new liquidators commence proceedings against the former directors, then the former directors will be able to raise any available defences in those proceedings. As a result, the interlocutory process filed on behalf of the former directors was dismissed.

In response to the former directors' reference to the decision in Miltonbrook, Justice Gordon noted that the right of all who may be affected by the order is not unlimited. Justice Gordon referred to the case of *Pilarinos v Australian Securities and Investments Commission* [2006] VSC 301 at 29 where it was held that:

as a general guideline ... if a judge formed the view that on the material that it was proposed to sue the company, and the cause of action was hopeless, it may be appropriate to require notice to be given to the potential litigant ... However it would only be in the clearest of clear cases that that should happen ... the proper venue for the cause of action to be heard and determined is a court of statutory tribunal. The parties will then have every opportunity to fight the case in a proper setting, to have the advantage of discovery, to test the other party's case, and to properly present their cases".

Justice Gordon determined that this was not a case of the clearest of cases where the potential causes of action were hopeless.

In respect of the desirability of bringing claims against former directors promptly, Justice Gordon held that that was beyond dispute. However, that statement is incomplete because it must be considered in the circumstances of each case. Justice Gordon referred to the case of *Deputy Commissioner of Taxation v ASIC* [2011] FCA 524 at 19 where it was held that "a Court of equity will not apply a statutory period of limitation by analogy if in the circumstances of the case it would be unjust to do so".

Justice Gordon also noted that it was not and is not the DCT's role to investigate claims. It remains the role of the liquidator to collect the assets of Melren which includes investigating the rights of action that Melren may have against its former directors.

It was ordered that the DCT must indemnify the new liquidators of Melren to investigate Melren's affairs with a view to obtaining a dividend for its creditors.

6.8 Piercing the corporate veil in family law proceedings

(By Erica Rathbone Bales and Anthony Hong, King & Wood Mallesons)

Prest v Petrodel Resources Limited [2013] UKSC 34, United Kingdom Supreme Court, Lords Neuberger (President), Walker, Hale, Mance, Clarke, Wilson and Sumption, 12 June 2013

The full text of this judgment is available at:

http://www.bailii.org/uk/cases/UKSC/2013/34.html

(a) Summary

This appeal considered whether the Court had power to order the transfer of properties to Ms Prest as part of a divorce settlement, in circumstances where those properties were legally owned by the Petrodel Group, seven companies which are controlled by her former husband. The United Kingdom Supreme Court considered a number of grounds on which a Court may have the power to do so.

As a starting point, the Supreme Court considered its power to pierce the corporate veil in detail. After an analysis of the authorities, the Court held that there is a limited principle which enables English Courts to pierce the corporate veil, which arises where a person deliberately evades or frustrates an existing legal obligation, liability or restriction by interposing a company under their control. However, this principle had no application in the present case as there was no evidence that the husband's improper actions were intended to evade a legal obligation owed to his former wife. The Court also rejected the argument that a special principle allowing courts to pierce the corporate veil in divorce proceedings applies under the Matrimonial Causes Act 1973 (UK) (the Matrimonial Causes Act).

Notwithstanding, the United Kingdom Supreme Court ultimately allowed the appeal on the basis that the husband beneficially held the properties through a resulting trust. Consequently, the Court was able to order that Mr Prest procure the transfer of the disputed properties to his former wife as he was "entitled" to them for the purposes of the Matrimonial Causes Act. The unanimous decision was based on the particular circumstances in which the properties came to be vested in the Petrodel Group companies and on the evidentiary presumptions that arose as a result of the husband's persistent obstructive behaviour.

(b) Facts

This appeal arose out of proceedings for ancillary relief following a divorce between Michael and Yasmin Prest. The appeal concerned the position of certain entities in the Petrodel Group - a group of seven companies wholly-owned and controlled by Mr Prest in a complex offshore shareholding structure. The Petrodel Group companies, two of which owned residential properties in the UK, were joined as additional respondents to Ms Prest's initial application for ancillary relief.

At first instance, Moylan J ordered that Mr Prest procure the conveyance of the matrimonial home, as well as seven additional UK properties legally owned by the Petrodel Group companies, to Ms Prest in partial satisfaction of the lump sum order awarded to her in the divorce proceedings. In making this decision, Moylan J concluded that in applications for financial relief in a divorce, a wide jurisdiction to pierce the corporate veil exists under s. 24 of the Matrimonial Causes Act.

This decision was appealed by three respondent companies on the basis that there was no jurisdiction to order their property to be conveyed to Ms Prest in satisfaction of the judgment debt. A majority judgment by the Court of Appeal (Rimer LJ and Patten LJ, with Thorpe LJ dissenting) found no grounds to grant the order and consequently held that such an order should not have been made.

(c) Decision

The Supreme Court set out three legal bases on which the assets of the Petrodel Group companies might be applied to satisfy the lump sum order against Mr Prest being:

i. where the court was empowered to disregard the corporate veil in order to give effective relief;
ii. on the basis that section 24 of the Matrimonial Causes Act confers a special power to disregard the corporate veil in matrimonial cases; or
iii. having regard to the particular circumstances of the case, the companies held the properties on trust for Mr Prest.

(i) Piercing the corporate veil

The Supreme Court recognised that there is no general doctrine of English law empowering Courts to pierce the corporate veil. Instead, there are specific guiding principles which may be relied upon to determine whether it is appropriate to do so in very specific circumstances.

Lord Sumption concluded that there is a limited principle which applies where a person is under a legal obligation, liability or subject to an existing restriction which is deliberately frustrated or evaded through abuse of the corporate veil. In this situation, "the [C]ourt may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality" (at paragraph 35). His Lordship also noted that if the facts of a case disclose a legal relationship between a company and its controller that would make it unnecessary to pierce the corporate veil (such as trustee-beneficiary or agent-principal), it would be inappropriate to do so.

The trial Court found that it was unable to pierce the corporate veil in this case without some relevant impropriety, and did not find any in this instance. The Supreme Court agreed with this view, finding that although Mr Prest acted improperly in many ways, there was no evidence of impropriety relevant to the divorce proceedings. That is, Mr Prest's actions did not evade or frustrate any legal obligation owed to his former wife, nor did he conceal or evade the law in relation to the distribution of assets of the marriage upon its dissolution.

(ii) Matrimonial Causes Act

The Supreme Court also considered whether s. 24(1)(a) of the Matrimonial Causes Act granted a special or wider principle that applies in matrimonial proceedings. This section empowers a Court to order one party to a marriage to transfer to the other "property to which the first-mentioned party is entitled, either in possession or reversion". The trial Court found that the properties were effectively Mr Prest's property as he was their controller and sole beneficial owner.

The Court of Appeal and Supreme Court did not accept this reasoning. The Supreme Court held that this section invokes concepts of the law of property with an established legal meaning which cannot be suspended or interpreted to mean something different in the context of matrimonial proceedings. There was "nothing in the Matrimonial Causes Act and nothing in its purpose or broader social context to indicate that the legislature intended to authorise the transfer by one party to the marriage to the other of property which was not his to transfer" (at paragraph 40).

Nevertheless, the Court subsequently found that Mr Prest was entitled to the properties on other grounds, as discussed below.

(iii) Beneficial ownership of the properties

Finally, the Supreme Court considered whether Mr Prest could be ordered, under the Matrimonial Causes Act, to procure a conveyance of the disputed properties to Mrs Prest on the basis that he was "entitled to them" because they belonged beneficially to him.

After analysing the known facts and evidence, the most plausible inference the Court could make was that each of the seven properties were held on resulting trust by the Petrodel Group companies for Mr Prest. In making this inference, a number of evidentiary presumptions as to his beneficial interest arose against Mr Prest as a result of his persistent obstructive and evasive behaviour. It was found that there was no reliable evidence to rebut the inference from the facts.

The Supreme Court unanimously agreed to allow the appeal and restore Moylan J's original judgment, so far as it required Mr Prest to procure the transfer of the disputed properties to his former wife.

6.9 Application of reinsurance proceeds where an insurer is in liquidation

(By Matthew Selth, Herbert Smith Freehills)

In the matter of HIH Casualty & General Insurance Ltd (in liquidation and subject to schemes of arrangement) [2013] NSWSC 741, Supreme Court of New South Wales, Nicholas J, 12 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/741.html

(a) Summary

This case considered an application under s. 562A(4) of the Corporations Act 2001 (Cth) (the Act) for an order that reinsurance proceeds paid to an insolvent insurer be applied to a specific insurance liability of that insolvent insurer and not to the insolvent insurer's insurance related liabilities as a whole. The Court held that in the circumstances of the case the application for the order should not be granted.

The judgment is significant in giving guidance on how the quantum of amounts received under contracts of reinsurance should be calculated for the purposes of s. 562A, especially when those reinsurance proceeds are subject to set-off for mutual dealings by virtue of s. 553C of the Act. The case also provides an example of the circumstances in which a Court is unlikely to grant an application under s. 562A(4).

(b) Facts

Sydney Water Corporation (SWC) sought an order pursuant to s. 562A(4) of the Act, which enables a Court to direct that reinsurance proceeds received by an insolvent insurer be paid directly to an insured creditor.

The general principle reflected in s. 562A is that in the winding up of an insolvent insurer, the reinsurance proceeds obtained by the liquidator are to be applied equally towards each claim arising from the insurer's liabilities under insurance contracts written before the winding up. However, s. 562A(4) gives the Court the discretion to displace this general principle where it considers that it would be just and equitable to do so in the circumstances.

SWC held policies of insurance with CE Health Casualty & General Insurance Ltd - now HIH Casualty & General Insurance Ltd (HIH). HIH had entered into contracts of reinsurance over SWC's policies. SWC had been active in assisting HIH with obtaining this reinsurance, meeting with potential reinsurers in London and Sydney on a regular basis. Prior to 27 August 2001, SWC made several claims under its policies of insurance with HIH. A small portion of these claims were paid out to SWC by HIH. However, on 27 August 2001 liquidators were appointed to HIH. HIH ceased to pay out claims.

In accordance with the contracts of reinsurance HIH held in relation to the SWC policies, HIH's liquidators received payments from reinsurers. Subject to the mutual credit and set-off provision - s. 553C of the Act - where there have been mutual dealings between an insolvent company and a person who wants to have a debt admitted against that company, the sum due from one party is to be set-off against any sum due from the other party. The liquidators therefore set-off against the reinsurance payments amounts owed by HIH to the reinsurers on unrelated claims.

In making their application under s. 562A(4), SWC objected to the set-off made by the liquidators in relation to the reinsurance proceeds. They submitted that, for the purposes of s. 562A(1)(b), the amount received in respect of a contract of reinsurance should be calculated without adjustment for set-off amounts. It was contended that s. 553C did not justify the set-off made by the liquidators. Section 562A(1)(b) states that s. 562A applies to amounts of reinsurance received "in respect of" contracts of insurance.

SWC submitted that the proceeds of reinsurance received by the liquidators were the direct product of the long term relationship it had nurtured and developed with the reinsurers. On this ground, they argued that it was "just and equitable" that they receive the benefit of the reinsurance contract.

(c) Decision

Justice Nicholas rejected the application.

On the basis of SWC's submissions, the issues considered by the Court in this proceeding were:

- what constitutes amounts received "in respect of" contracts of reinsurance for the purposes of s. 562A; and
- whether in the circumstances of the case it was "just and equitable" that an order applying the reinsurance proceeds to the specific insurance liability be made under s. 562A(4) of the Act.

(i) Calculating the quantum of the amounts received under contracts of reinsurance for the purposes of s. 562A of the Act

Justice Nicholas held that, for the purposes of s. 562A, amounts received under contracts of reinsurance should be calculated by reference to the liability of the company to a particular insured creditor. Thus, it was appropriate for the liquidator to use the balance of the reinsurance proceeds after set-offs as the amount received in respect of contracts of reinsurance for the purposes of s. 562A. The application of s. 553C of the Act was appropriate to calculations made under s. 562A(1)(b). On the facts of the case, where the amount received under the contracts of reinsurance was subject to set-offs in respect of mutual dealings pursuant to s. 553C of the Act, Nicholas J found that the set-offs made by the liquidator were appropriate.

In coming to this decision, Nicholas J reasoned that s. 562A(1) needs to be understood in the context of s. 562A as a whole. The operation of the section was considered to depend upon the identification of an amount received under the contract of reinsurance that is referable to the insolvent insurer's liability under a relevant contract of insurance. Thus, his Honour reasoned that the task of identifying the amount payable from the reinsurance proceeds in respect of the liability of an insured creditor was a preliminary step in determining the application of s. 562A.

(ii) Whether in the circumstances it was "just and equitable" that an order be made under s. 562A(4) of the Act

His Honour found that in the circumstances of this case, it was not just and equitable that an order be made under s. 562A(4) of the Act.

Applying the judgment in *Amaca Pty Ltd v McGrath* [2011] NSWSC 90; 92 ACSR 105 (Amaca No 1), Nicholas J considered that in deciding whether an order should be made, the Court must focus on the amount received under the contract of reinsurance itself, the circumstances prevailing at the time the Court is asked to make the order and what, in those circumstances, is "just and equitable" with respect to the application or disposition of the amount.

In Amaca No 1 the Court found that the nature of the relationship between the insured creditor and the reinsurers was extraordinary and unusual. The insurer in that case was considered to be merely a front or conduit to facilitate direct negotiations between the insured creditor and the reinsurer. Thus, it was found to be "just and equitable" that the reinsurance proceeds be directly applied to the insured creditor rather than shared equally amongst all insured creditors.

Unlike in Amaca No 1 and its related cases, Justice Nicholas noted that in this case:

- there was no direct participation by SWC with the reinsurers in the negotiations for the reinsurance;
- the provision of the reinsurance was the product of an ordinary transaction between insured, insurer and reinsurer;
- SWC paid a substantial premium to HIH;
- HIH's retentions were substantial; and
- there were no indications that the reinsurer was treated in effect as the primary insurer.

Therefore, distinguishing this case from Amaca No 1, his Honour considered that there was no extraordinary and unusual relationship between SWC and the reinsurers. Thus, it was not just and equitable that an order be made.

6.10 Considerations in determining the sentence for insider trading

(By Nadya Riitano of Corrs Chambers Westgarth)

R v Glynatsis [2013] NSWCCA 131, New South Wales Court of Criminal Appeal, Hoeben CJ at CL, Rothman J and McCallum J, 7 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWCCA/2013/131.html

(a) Summary

This appeal related to the sentencing proceedings of Nicholas Glynatsis (Glynatsis). In December 2012, Glynatsis was sentenced to two years' imprisonment which was to be served by way of an intensive correction order (ICO), in respect of nine counts of insider trading, under ss. 1043A(1) and 1311(1) of the Corporations Act 2001 (Cth) (the Act).

The Crown appealed this sentence on three grounds. First, Johnson J erred in assessing the seriousness of the offences by the approach taken to the sums invested, the profits obtained and who was to benefit from the illegal trading. Second, Johnson J erred in imposing sentences with an aggregate duration of two years imprisonment to be served by way of an ICO, as this failed to give proper effect to the need for general deterrence and the principles of totality. Third, the sentences imposed were manifestly inadequate.

The Crown's appeal was allowed and Glynatsis was sentenced to imprisonment for a total period of 21 months with a minimum term involving full time custody of 12 months. Taking into account the time Glynatsis had already served under the ICO since 12 December 2012, the Court ordered that he be taken into full-time custody immediately and remain there until 11 December 2013.

(b) Facts

Glynatsis commenced at PricewaterhouseCoopers (PwC) in February 2007 and by July 2009 was a senior consultant in the research and development section of their tax and legal department. During his employment at PwC, Glynatsis had access to a record management system called Documentum. Documentum housed confidential PwC documents which indentified proposed transactions, including corporate takeovers, involving PwC clients.

Between November 2009 and November 2010, Glynatsis accessed confidential PwC documents contained on Documentum and used the information contained in those documents to trade in shares and contracts for difference (CFDs). Glynatsis traded over the Internet through accounts held with CMC Markets Asia Pacific Pty Ltd in either his own name or in the names of three relatives, being Michael Glynatsis (his uncle), Irene Glynatsis (his sister) or in the joint names of Michael Glynatsis and his business partner, Peter Nicola. Glynatsis's relatives gave Glynatsis permission to trade through their accounts, but did not have specific knowledge of each of the individual trades made by Glynatsis on their behalf.

Over a 12 month period, Glynatsis acquired, either through his own account or on account of his relatives, shares, units or CFDs in respect of shares or units, in eight companies listed on the Australian Securities Exchange. These transactions formed the nine counts of insider trading on indictment, with:

- counts 1, 2 and 7 relating to trading by Glynatsis in his own account and those of his relatives;
- counts 4 and 4 relating to Glynatsis trading in his own account only; and
- counts 5, 6, 8 and 9 relating to Glynatsis trading in his relatives' accounts only.

The transactions yielded total gross profits of $50,826. Of that amount, Glynatsis derived on his own account a gross profit of $23,840 and on account of his relatives, $26,383. This yield was the result of investing a total amount of $371,507.

Johnson J sentenced Glynatsis to two years' imprisonment which was to be served by way of an ICO, taking into account the following factors:

- the effect of the conviction on Glynatsis's ability to work as a legal practitioner and in the area of financial services;
- Glynatsis was contrite and remorseful for his actions;
- Glynatsis had felt a level of pressure to assist his father during the serious financial difficulties which affected him in 2010;
- a 25% discount was appropriate because of an early guilty plea; and
- the gross benefit in this case was $50,826, with the total amount invested being $371,507.

(c) Decision

(i) First ground of appeal

The Crown submitted that Johnson J erred in concluding that Glynatsis's trading on behalf of his relatives was a significant factor that operated in his favour in relation to the assessment of the seriousness of the offences. Referring to Kirby J in *R v IR Hall [No 2]* (2005) NSWSC 890 at [86] where his Honour stated "the fact that the beneficiaries on count 2 and in particulars 1 and 2 of count 3 were family members is of no great warrant ... in all three instances, the position is similar to the offender receiving the benefits of the trades herself", the Crown argued that Glynatsis's trades on behalf of his relatives were of no particular importance in his culpability.

The Court, however, was not satisfied with the Crown's submission and held that the distinction between an offence committed for motives of personal greed and committed for the benefit of some other person is real. Hoeben CJ, in giving the principal judgment, clarified this position by stating that "this is not to say that such a circumstance is exculpatory, rather it can indicate a less serious level of criminality as it did in this case" (at [48]).

In regards to Johnson J's assessment of the seriousness of the offences, the Crown also submitted that his Honour erred in giving equivalent weight to the amount of profit earned and the amount invested. Rather, the Crown submitted that emphasis should be placed on the amount invested as the damage to the integrity of the market occurs when the investment is made, regardless of the profit ultimately realised.

The Court agreed that although profit and the amount invested should both be considered as factors relevant to criminality, the more important factor was the amount invested. However, despite acknowledging this, the Court did not believe that Johnson J's assessment of this issue significantly influenced his Honour's sentencing discretion.

(ii) Second ground of appeal

The Crown submitted that in imposing a sentence of imprisonment to be served by way of an ICO, Johnson J failed to give proper effect to the principle of totality by having regard to the seriousness of the offending conduct in respect of each of the nine separate offences. The Crown argued that his Honour did not indicate the basis on which an identical term of imprisonment was imposed in respect of counts 1 and 5, when the amount of the investment in count 1 ($70,921) was almost nine times that involved in count 5 ($7,975) and yielded a gross profit of $23,737 that was approximately 49 times the gross profit yielded in respect of count 5.

The Court, however, disagreed with "the application of mathematical precision" inherent in the Crown's submission. Rather, it was a discretionary exercise on the part of his Honour to consider the offences in total because of the similar nature of the offending.

A further point raised by the Crown related to the need for general deterrence. The Crown submitted that his Honour appeared to be overly influenced by the three decisions in which ICOs had been imposed on offenders by the Courts (*R v Bateson* [2011] NSWSC 643; *R v Dalzell* [2011] NSWSC 454; and *R v O'Brien* [2011] NSWSC 1553). The Crown submitted that in the present case the nature of the insider trading varied significantly to those in the cases cited above and as such an ICO did not properly acknowledge the importance of general deterrence.

The Court agreed, and in lieu of the sentence imposed by Johnson J, ordered that Glynatsis was to be sentenced to imprisonment for a total period of 21 months with a minimum term involving full time custody of 12 months.

6.11 Votes of acquirer's associates counted for scheme approval

(By Hector Williamson, Ashurst)

Kumarina Resources Limited, in the matter of Kumarina Resources Limited [2013] FCA 549, Federal Court of Australia, Gilmour J, 4 June 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/549.html

(a) Summary

The Federal Court of Australia approved Kumarina's scheme of arrangement, despite the fact that shareholder approval was only secured through the votes of associates of the acquirer, Zeta Resources (a wholly-owned subsidiary of LSE listed Utilco).

Court approval of the scheme was opposed by two shareholders, but not ASIC, which provided a "no objection" letter. Gilmour J accepted that Utilco and its associate ICM could vote in the same class as other shareholders. His Honour also concluded that there was no reasonable basis for the court to refuse to approve the scheme.

(b) Facts

Zeta Resources Ltd entered into a scheme of arrangement with Kumarina Resources Ltd (the Scheme). Under the Scheme Zeta and Kumarina would effectively merge, with Zeta acquiring all of the fully paid ordinary shares in Kumarina in exchange for Zeta shares.

Section 411(4) of the Corporations Act 2001 (Cth) (the Act) requires a resolution in favour of the Scheme to be passed by 75% of votes cast, and for the Court to approve the Scheme.

The Scheme was approved by 79% of votes cast on the resolution at the scheme meeting. Utilco and its associate ICM accounted for 23% of the votes cast. Peter Sullivan, chairperson and non-executive director of Kumarina and associate of Zeta (it was proposed that he occupy an equivalent position post-Scheme), held an 18.6% holding in Kumarina and also voted in favour of the scheme.

In a separate agreement (Sale Agreement) Zeta agreed to issue Zeta shares to Utilco in return for shares in Kumarina. After implementation of the Scheme, it was proposed that Kumarina would become a wholly-owned subsidiary of Zeta and would be delisted from the ASX.

On 8 April 2013 Gilmour J approved the Scheme without modifications. At a hearing on 24 May 2013, approval of the scheme was opposed by two shareholders, Aumex Mining Pty Ltd and Mr Wayne Van Blitterswyk (the Objectors), but not by ASIC, which provided a "no objection" letter.

The Objectors argued that ICM, Utilico and Peter Sullivan, as associates of the acquirer, must either be treated as constituting a separate class of shareholder, (with each class needing 75% approval of a resolution in favour of the Scheme) or have their votes discounted.

(c) Decision

Gilmour J held that the rights of all shareholders in Kumarina were identical, as were their rights in the proposed scheme, and that there was no reasonable basis to refuse to approve the Scheme.

(i) Utilco, ICM and Peter Sullivan were not a separate class of shareholder

The scheme meeting was convened on the basis that all shareholders were members of a single class. Citing *Re Opes Prime Stockbroking Ltd (No 2)* [2009] FCA 813, Gilmour J determined that "it is differences in *rights* and not *interests* which are relevant to determining if separate classes exist" [emphasis in original].

Gilmour J concluded that the Scheme effected a merger, in which existing Kumarina shareholders participated equally and would continue as shareholders of Zeta. In coming to this conclusion, his Honour distinguished a number of authorities relied on by the Objectors, including the English decision of *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123. In that case, the Court refused to approve a cash "cancellation" scheme where a wholly-owned subsidiary of the acquirer had voted its 53% shareholding in favour of the scheme. His Honour distinguished the present case on the basis that the scheme was an offer for scrip, and not a buy-out or cash "cancellation".

Gilmour J did not regard the separate issuing by Zeta of Zeta shares to Utilco in the Sale Agreement as constituting a collateral benefit, as the right to this "non-scheme" consideration arose independently from the rights of Utilco and ICM (as its associate) as shareholders of Kumarina. Moreover, the consideration received by Utilco and ICM was determined by an independent expert to be on arm's length terms.

Similarly, Gilmour J considered that while Peter Sullivan, whose annual salary was to increase from $48,000 at Kumarina to $50,000 at Zeta, would receive a contingent benefit from the Scheme, the sum was so immaterial that it did not require his shareholding being treated as a separate class.

(ii) No reasonable basis for Court to discount votes

In exercising its power of approval, the Court retains a residual discretion to withhold approval if not satisfied that the Scheme is fair and reasonable. In considering whether the Scheme was fair and reasonable, Gilmour J took a number of factual considerations into account:

- the Objectors initially said that they would support the Scheme, and changed their minds for unknown reasons;
- at the scheme meeting, the Objectors failed to raise any concern other than that James and Peter Sullivan should not be entitled to vote at the meeting (the objection concerning James Sullivan was not pressed before the Court);
- the independent expert expressed the opinion that the Scheme was fair and reasonable and in the best interests of Kumarina shareholders; and
- a "large majority" of Kumarina shareholders voted in favour of the Scheme, even if the votes of Utilco and ICM were excluded (73%).

In light of these facts, Gilmour J found that there was no reasonable basis, in the exercise of the Court's discretion, to refuse to approve the Scheme.

6.12 Factors considered by a court in terminating the winding up of a company subject to a deed of company arrangement

(By Lucy Witheriff, Minter Ellison)

In the matter of Living Creatively Exhibitions Pty Ltd (in liquidation) (subject to deed of company arrangement) [2013] NSWSC 717, Supreme of New South Wales, Black J, 4 June 2013.

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/717.html

(a) Summary

This case demonstrates the circumstances in which an order for the winding up of an entity that is subject to a deed of company arrangement can be terminated under s. 482(1) of the Corporations Act 2001 (Cth) (the Act) by an order of the Court.

(b) Facts

On 16 April 2013, the Plaintiff, Savluc Pty Limited (Savluc), sought an order from the Court that the winding up of Living Creatively Exhibitions Pty Limited (in liq) (subject to deed of company arrangement) (the Company) be terminated under s. 482(1) of the Act. Section 482(1) of the Act states that at any time during the winding up of a company, the court may make an order to terminate the winding up on a day specified in the order. Savluc had standing to make an application under s. 482(1A), as it was a creditor of the Company.

Savluc also sought an order that its costs of the application form part of the costs, charges and expenses of the winding up.

By way of background, the Company previously conducted stitches and craft show exhibitions throughout Australia. In July 2008 the Company entered into a sale agreement with Reed Exhibitions Australia Pty Ltd (Reed) to purchase intellectual property relevant to staging that show and granted Reed a fixed and floating charge as security for the payment.

The Company was wound up and Mr Godfrey was appointed as its liquidator on 18 August 2009. On 8 December 2009, Reed resumed title to the relevant exhibitions, due to a breach of the licence agreement arising from the liquidator's appointment.

In April 2012, the Company's creditors resolved that the Company execute a deed of company arrangement (DOCA) under s. 439C of the Act and Mr Godfrey was appointed as deed administrator. The DOCA was signed on 15 May 2012 and provided for Savluc to pay a contribution of $25,000 to the deed administrators within 35 days of the execution of the deed and to defer an unsecured claim of $600,000 against the Company. Savluc was also a creditor of the Company for an amount of $400,000 that was secured.

(c) Decision

In accordance with s. 482(2A) of the Act, the Court must have regard, inter alia, to whether the DOCA is likely to result in the Company becoming or remaining insolvent. Black J stated that the Court will not generally terminate a winding up unless a company will have additional financial strength and stability to provide confidence that it can continue without an appreciable risk of returning to liquidation. The Court will consider whether sufficient steps have been taken to restore the company's solvency so that its financial health is restored to a point where it can be released from external administration and, under the control of its directors, incur new debts that have to be paid as and when they fall due.

Savluc did not intend that the Company continue to carry on business or trade after the liquidation had been terminated and the purpose of extinguishing the liquidation was to avoid incurring additional costs in the liquidation.

The Court considered whether to accept an undertaking given to Mr Godfrey, in his capacity as deed administrator of the Company, by Mr Noack on his own behalf and as a director of Savluc. The undertaking stated that upon the termination of the winding up any liabilities incurred by the Company would be paid in full prior to the repayment of Savluc's secured debt.

Other relevant factors in an application to terminate a winding up under this section were summarised in the case of *Vero Workers Compensation (NSW) Ltd v Ferretti Pty Ltd* [2006] NSWSC 292; (2006) 57 ACSR 103 at [17], which included consideration of the interests of the Company's creditors, the interests of the liquidator, the interests of contributories and the interests of the public.

Where an application for termination of a winding up is brought in relation to a company the subject of a deed of company arrangement, the objects of Part 5.3A of the Act, regarding administration of a company's affairs with a view to executing a deed of company arrangement, are also relevant matters.

Black J stated that the evidence did not indicate that there was anything to stop the termination of the winding up by reason of the interests of the liquidator, who supported the application, or contributories or any public interest reason not to terminate the winding up. Further, the control and management of the Company is addressed by the appointment of a director of Savluc, Mr Noack, as a director of the Company. This was in accordance with clause 2.8(a) of the DOCA for Savluc to be responsible for the date to day trade, operations, management, control, supervision and administration of the business and affairs of the Company.

Black J ultimately concluded that an order should be made terminating the winding up on the basis that Savluc, within seven days, would provide an undertaking to the Court in the terms of the undertaking given to the deed administrator.

In relation to an order for costs by Savluc under s. 482(4) of the Act, Black J stated that such an order should not be made where it would have the result that other creditors would bear the costs of an application which appears to have been substantially brought so as to advance Savluc's interests. Section 482(4) provides that the costs of proceedings to terminate a winding up may, if the Court so directs, form part of the costs, charges and expense of the winding up.

6.13 Court approval under section 477(2B) of the Corporations Act for litigation funding and retainer agreements

(By Steven Grant, Minter Ellison)

In the matter of 7 Steel Distribution Pty Ltd (in liquidation) (receivers and managers appointed) [2013] NSWSC 669, Supreme Court of New South Wales, Black J, 17 May 2013.

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/669.html

(a) Summary

This cases demonstrates the judicial analysis undertaken when applications are made for Court approval under s. 477(2B) of the Corporations Act 2001 (Cth) (the Corporations Act) that liquidators of a company be authorised to enter into litigation funding agreements and retainer agreements for legal services.

(b) Facts

The applicants, Paul Weston and David Young, in their capacity as Liquidators (the Liquidators) of 7 Steel Distribution Pty Limited (in liq) (receivers and managers appointed) (the Company) applied for an order under s. 477(2B) of the Corporations Act that they, as liquidators of the Company, be authorised to enter into a Funding Agreement with 101 Capital Pty Ltd as trustee of the LCM Litigation Investment Fund, and a direction under s. 511 of the Corporations Act that they were justified in doing so. The Liquidators also sought an order under s. 477(2B) of the Corporations Act approving their entry into an agreement retaining Kemp Strang to act and continue acting as solicitors for the Liquidators and the Company in, or substantially in, the form of Schedule D to the Funding Agreement.

Section 477(2B) provides that except with the approval of the Court, of the committee of inspection or of a resolution of the creditors, a liquidator of a company must not enter into an agreement on the company's behalf if:

- without limiting the following bullet point, the term of the agreement may end; or
- obligations of a party to the agreement may, according to the terms of the agreement, be discharged by performance

more than three months after the agreement is entered into, even if the term may end, or the obligations may be discharged, within those three months.

Section 511(1) provides that a liquidator may apply to the Court:

- to determine any question arising in the winding up of a company; or
- to exercise all or any of the powers that the Court might exercise if the company were being wound up by the Court.

Section 511(2) provides that the Court, if satisfied that the determination of the question or the exercise of power will be just and beneficial, may accede wholly or partially to any such application on such terms and conditions as it thinks fit or may make such other order on the application as it thinks just.

Mr Weston and Mr Young were appointed as administrators of the Company on 1 March 2010, by its secured creditor, HSBC Bank Australia Ltd and receivers and managers were appointed and took control of the Company's assets and operations on the same day. The Company's creditors subsequently resolved that it be wound up at a second meeting of creditors on 2 August 2010, and Mr Weston and Mr Young therefore continued as Liquidators of the Company under a creditors' voluntary winding-up. The Company had priority unsecured creditors of approximately $1.25 million and ordinary unsecured creditors of approximately $38 million.

Mr Weston had formed the view, based on a review of the Company's books undertaken by the Liquidators and their staff, that the Company was insolvent from at least 1 September 2009, being a date six months prior to the relation-back day, namely, the date of appointment of the administrators on 1 March 2010.

Several creditors of the Company (Intervening Creditors) received payments during the relation-back period and, on 18 February 2013, immediately prior to the expiry of the three year period specified in s. 588FF of the Corporations Act, the Liquidators commenced proceedings against the Intervening Creditors in the Federal Court of Australia, which were yet to be served at the date of this decision. Mr Weston noted that no dividend would be distributed to the Company's unsecured creditors without recoveries from the Intervening Creditors and the Liquidators had no funds to conduct proceedings against the Intervening Creditors, absent the entry into the Funding Agreement.

There were three key issues to be considered, namely:

- the application for approval of the Funding Agreement under s. 477(2B) of Corporations Act;
- the application for direction under s. 511 in respect of the Funding Agreement; and
- the application for approval of the retainer agreement under s. 477(2B) of Corporations Act.

(c) Decision

(i) Application for approval of the Funding Agreement under s. 477(2B) of Corporations Act

Given the urgency of the matter before the court, Black J assumed, without deciding, that the requirement under s. 477(2B) applies in a creditors' voluntary winding up and considered whether to approve the Funding Agreement on that basis.

Black J noted that in granting an approval under s. 477(2B), the Court is not concerned with matters of commercial judgment but is concerned to be satisfied that the entry into the agreement is a proper exercise of power and not ill-advised or improper on the part of the liquidator.

Black J was satisfied as to the prospects of the success of the proceedings, having regard to the Liquidators' assessment of the insolvency of the Company in the period prior to the relation-back day, subject to the qualification that there was no information before the Court to assess whether good faith or running account defences would ultimately be established. Black J was also satisfied that the Liquidators had made at least some attempts to canvass other funding options, and there was no reason to think that the decision to enter the Funding Agreement involved an error of law or principle or a lack of good faith.

Accordingly, Black J approved the entry into the Funding Agreement under s. 477(2B) on the basis that it would not be an improper exercise of the Liquidators' power and there was no indication that the entry into the Funding Agreement would involve an error of law or principle or not be in good faith or that entry into the Funding Agreement would inappropriately extend the winding-up having regard to the prospective recoveries in the proceedings.

(ii) Application for direction under s. 511 in respect of the Funding Agreement

Black J formed the view that this was not a proper case to give the direction sought by the Liquidators for several reasons.

One reason was a lack of utility in a direction under s. 511. If the Liquidators had acted diligently and reasonably in reaching the position in which they found themselves, there could be little doubt that entry into the Funding Agreement on the only available terms would be of benefit to creditors, and a decision that the Liquidators could properly make, without the need for a direction under s. 511 of the Corporations Act. If, on the other hand, the Liquidators had not acted diligently or reasonably in reaching that position, then that matter had not been disclosed to the Court in seeking that direction and the Court would not protect them.

Black J also considered that the application for a direction in respect of the entry into the Funding Agreement concealed a further commercial question that the Liquidators would need to address. That question was whether the Liquidators should, as a matter of their commercial judgment, seek to renegotiate with the litigation funder to achieve better terms or allow additional time for the Intervening Creditors to put a funding proposal, seeking a further extension of time from the Federal Court to serve proceedings in order to do so. Black J considered that the Court should not make a direction which would potentially displace the need for the Liquidators to exercise their commercial judgment as to that matter.

In making this decision, Black J was conscious that it was unusual, in matters of this kind, for the result of an application under s. 477(2B) and an application under s. 511 to diverge. However, Black J noted that in this case, the entry into the Funding Agreement could be properly authorised under s. 477(2B), because the Court could accept the Liquidator's commercial judgment that that is the best course in the relevant circumstances. Black J did not believe that the Court should go further to make a direction under s. 511 that would potentially displace the need for the Liquidators' commercial judgment to be exercised in those circumstances or their responsibility for the exercise of that judgment.

(iii) Application for approval of the retainer agreement under section 4771(2B) of Corporations Act

Black J reviewed the retainer agreement and found that there was no reason to think that the entry into the retainer agreement was not a proper exercise of the Liquidators' powers. The Court's role, in that regard, was not to second guess the Liquidators' judgment as to that matter and there would be no reason to doubt that judgment in respect of the retainer agreement. Accordingly, Black J granted approval for entry into that agreement under s. 477(2B).

6.14 Delaware Court of Chancery judgment: Access to information by a dissenting director

(By Alexander E Moores, DLA Piper Australia)

Kalisman. v Friedman [2013] CA No 8447-VCL, Delaware Court of Chancery, Vice Chancellor J Travis Laster, 17 April 2013

The full text of this judgment is available at:

http://courts.delaware.gov/opinions/download.aspx?ID=188280

(a) Summary

The Delaware Court of Chancery upheld the motion to compel brought by Jason Kalisman (Kalisman), a director of Morgans Hotel Group Co (the Company), against the other directors (the

Defendants) to determine that the attorney-client privilege and work product doctrines ('the Issues') cannot be used to prevent directors from accessing privileged information created by external legal counsel for the Company while the director seeking the information was serving on the board.

(b) Facts

Kalisman was appointed as a director of the Company in April 2011. In December 2011, the board established a special committee to "evaluate potential strategic alternatives" for the Company and Kalisman was included in that committee along with three of the Defendants. The special committee retained Greenhill & Co, Inc and Richards, Layton & Finger, P.A. (RLF) as its financial and legal counsel respectively.

(i) Before the board meeting of 30 March 2013

It was alleged by Kalisman that the special committee's work stalled in November 2012 but resumed around 18 March 2013 when OTK Associates LLC (OTK), the Company's largest single common stockholder with approximately 13.9% of the outstanding common stock, announced that it would nominate an alternative slate of directors. Kalisman was a founding member of OTK and one of its nominees for director. In addition to the new ballot of directors, OTK planned to make business proposals at the Company's annual meeting, which at that time was scheduled for 15 May 2013.

The Company's legal counsel emailed Kalisman on 29 March 2013 notifying him that the board was to meet in a special session to discuss and then ultimately approve a recapitalisation plan. Until that point, Kalisman testified that he had not been made aware of any such proposal despite asking for any information about the activities of the Defendants. Kalisman alleged that the Defendants had failed to give adequate notice period as he only became aware of the imminent vote the day before. This was apparently very uncommon practice for the Company, as was the sizable number of documents attached to the email notification.

At 2:00pm on 30 March 2013, the special committee met and created a subcommittee, with only Kalisman voting against its formation, comprising all board members except Kalisman. At 4:30pm that same afternoon, the entire board met and voted in favour of the recapitalization plan, again with only Kalisman dissenting. Under the recapitalisation plan, the Company would transfer a significant asset and subsidiary to entities affiliated with a new group of investors (Yucaipa). Yucaipa was controlled by one of the Defendants and the deal, involving preference stock and a rights offering, would result in Yucaipa possessing a predicted 32% of common stock in the Company.

(ii) After the board meeting of 30 March 2013

On 1 April 2013, the Company announced the recapitalisation and postponed the annual meeting from 15 May to 10 July 2013 reportedly to allow new shareholders enough time to vote. Rights trading was to begin on 18 April 2013. In response, Kalisman filed a complaint challenging the postponement of dates and the recapitalisation itself. The Company attempted to move dates around but Kalisman persisted and on 3 April 2013 filed the first discovery request for information asking how the Company planned to deal with the Issues, to which he was told the Defendants were considering options.

Between 4 April 2013 and 12 April 2013, Kalisman served subpoenas on the law firms representing the Company, RLF representing the special committee, and associated counsel. During this time, on 11 April 2013, the Defendants responded regarding the Issues to say they were invoking the protections and would not supply the documents. On 15 April 2013, Kalisman filed a motion to compel, which would disallow the Defendants from preventing the disclosure of the information.

(c) Decision

The Court upheld the motion by Kalisman that he was entitled to the information generated by counsel retained by the Company during the time he was acting as a director.

(i) Access to information generally

The Court looked first at the fundamental rights of directors to information generally, finding that the right is "essentially unfettered in nature". This includes all information that is deemed to be "board material". With reference to various case law, such as *Accord Intrieri v Avatex* 1998 WL 326608 and *Hall v Search Capital Grp.* 1996 WL 696921, this right to access was also held to be equal among directors and "a sitting director is entitled to [.] receive whatever the other directors are given" and companies "cannot pick and choose which directors will receive [which] information". There have to be special circumstances (as discussed below) for a group of directors to prevent another director from accessing any and all information available to the majority of the board.

(ii) Access to privileged information

The right established in relation to information generally extends to privileged information. The Court cited *Moore Bus. Forms v Cordant Hldgs Corp.* 1996 WL 307444 as compelling authority for both the right to access board information equally and access to legal advice "furnished to the board during the director's tenure" not being subject to any privilege when accessed by one of those directors. The rationale for extending the right to information to privileged information is all directors can be held responsible for the proper management of the Company and "thus, should be treated as a "joint client" when legal advice is rendered to the corporation through one of its officers or directors". Once it was established that Kalisman was a client of the counsel retained by the board, the work product doctrine did not apply.

Accordingly, Kalisman was successful in having his right to access the requested information recognised through two avenues of standing, something which the Defendants argued he did not have.

It was recognised in his capacity as a Director of the Company at the time the information was generated. It was recognised in his capacity as a joint client of the subpoenaed law firms. His capacity as a designee of a stockholder on the board was not considered because he was successful through the other avenues, but the Court indicated that information to which the director is entitled is generally extended to the stockholder so he may have been successful on this ground as well.

(iii) Limitations on directors' right of access

The Court found there are three standard situations in which a director's right to information can be limited, and all were found not to be applicable to Kalisman:

Where there is an *ex ante* agreement among the contracting parties. The extent of this has not been fully developed, despite discussion in cases such as Moore, but there was no *ex ante* agreement in this case so it was not discussed.

Where a special committee has been established openly with the knowledge of the excluded director. In this event, the special committee can then retain separate counsel and this would attract attorney-client privilege. In this case, however, Kalisman was both a member of the special committee and a joint client of the retained counsel. In addition, the Defendants did not act openly until the board meeting on 30 March 2013.

Where there is sufficient adversity between the excluded director and the company or committee that there is a reasonable expectation the director is no longer a client of the board's counsel. In this case, the expectation did exist, but only from the board meeting onwards. While there may have been an adversarial atmosphere before then, the behaviour of the Defendants - namely their secretive and misleading representations to Kalisman - did not give rise to the expectation Kalisman was no longer a client until 30 March 2013.

(iv) Other potential limitations dependent on circumstances

The Defendants tried to argue other scenario specific exclusions to get around the three clear limiting categories. First, the issue of standing was raised (as discussed above). Second, the Defendants alleged Kalisman intended to misuse the information. To this submission, the Court held that there is a presumption of good faith and dealing, and the Company would have recourse in the event, not in the expectation, of a breach. If the Defendants had concrete evidence this was Kalisman's intention, the result may have been different but that was not established on the facts. Finally, it was alleged Kalisman's requests were too broad and numerous. On this claim, the Court held that the requests were reasonable and in fact removing concern about the Issues made discovery easier as there was no need to check privilege and prepare a privilege log.