SAI Global Corporate Law Bulletin No. 200>

Index info.regulatory@saiglobal.com

Bulletin No. 200

Editor: Professor Ian Ramsay, Director, Centre for Corporate Law and Securities Regulation

Published by SAI Global on behalf of Centre for Corporate Law and Securities Regulation, Faculty of Law, The University of Melbourne with the support of the Australian Securities and Investments Commission, the Australian Securities Exchange and the leading law firms: Ashurst, Clayton Utz, Corrs Chambers Westgarth, DLA Piper, Herbert Smith Freehills, King & Wood Mallesons, Minter Ellison.

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1. Recent Corporate Law and Corporate Governance Developments

1.1 Consultation on arrangements for an Asia Region Funds Passport

On 16 April 2014, the Australian Treasury published a consultation paper on the proposed Asia Region Funds Passport (the Passport). The passport is an Asia Pacific Economic Cooperation (APEC) initiative which aims to create a regulatory arrangement for the cross-border offer of collective investment schemes in participating economies. The Passport would enable fund operators in passport member economies to offer eligible schemes to retail investors in other member economies under a streamlined process.

The Passport working group (including representatives from Australia, South Korea, New Zealand, the Philippines, Singapore and Thailand) has prepared the consultation paper to seek views from the public on the details of the proposed arrangements. This follows the signing of a statement of intent on the Passport by finance ministers from Australia, South Korea, New Zealand and Singapore in September 2013, committing to jointly issue such a paper.

Following this consultation, economies that decide that they want to be Passport member economies will work to finalise the arrangements by early 2015 with a view to the Passport commencing in 2016.

The consultation paper is available on the Australian Treasury website and the Passport website.

1.2 IOSCO report on corporate bond markets

On 15 April 2014, the Research Department of the International Organisation of Securities Commissions published the report, *Corporate Bond Markets: A Global Perspective: Volume 1*.

The report presents findings from an in-depth study on the development and functioning of corporate bond markets globally, and focuses on both emerging and developed markets. Its findings underscore the importance of corporate bond markets

to economic growth, financial stability and economic recovery.

The main findings of the report are that:

- corporate bond markets are growing in terms of size and importance to the real economy, and are extending their global nature;
- since the onset of the crisis, corporate bond markets are beginning to fill a gap left by bank and long-term/infrastructure financing, and are showing potential for servicing small and medium enterprises (SMEs);
- these trends are in part fuelled by a search for yield. A changing interest rate environment may modify bond risks and raise new investor protection issues, especially from a retail investor perspective; and
- meanwhile, secondary markets are evolving to accommodate a new economic and regulatory environment. Understanding this change is key to identifying both potential systemic risks and opportunities to develop these markets.

The report is available on the IOSCO website.

1.3 OECD report on risk management and corporate governance

In April 2014, the OECD published a report on risk management and corporate governance. The report reviews the corporate governance framework and practices relating to corporate risk management in 27 of the jurisdictions that participate in the OECD Corporate Governance Committee. Against the background of the OECD *Principles of Corporate Governance*, it describes how various jurisdictions have chosen to implement the Principles relating to risk management.

The report analyses the corporate governance framework and practices relating to corporate risk management, in the private sector and in state-owned enterprises (SOEs). It is based upon a general survey of participating jurisdictions, complemented by three country studies illustrative of different aspects of risk management and corporate governance (Norway, Singapore and Switzerland).

The review finds that, while risk-taking is a fundamental driving force in business and entrepreneurship, the cost of risk management failures is still often underestimated, both externally and internally, including the cost in terms of management time needed to rectify the situation. Corporate governance should therefore ensure that risks are understood, managed, and, when appropriate, communicated.

The report is available on the OECD website.

1.4 BIS report on implementation of the Basel regulatory framework

In April 2014, the Bank for International Settlements (BIS) published a progress report on the implementation of the Basel regulatory framework. The report sets out the adoption status of Basel II, Basel 2.5 and Basel III regulations for each Basel Committee member jurisdiction at the end of March 2014. It updates the Basel Committee's previous progress reports published on semi-annual frequency since October 2011. In addition, the report contains an overview of recently completed assessments on the consistency of domestic capital regulations with respect to the Basel III standards.

The Basel Committee recently published assessment reports on Australia, Brazil and China regarding their implementation of Basel III risk-based capital regulations, following similar assessments of Switzerland, Singapore and Japan, and preliminary assessments of the European Union and the United States. The reports are available on the BIS website. Currently, assessments of Canada, the European Union and the United States are under way, and assessments of Hong Kong and Mexico will begin in 2014.

The progress report is available on the BIS website.

1.5 International Audit Regulators report persistent deficiencies in critical areas of audits of public companies

On 10 April 2014, the International Forum of Independent Audit Regulators (IFIAR) released a report that raises concerns about the persistent deficiencies of audits of public companies.

IFIAR's *Report on 2013 Inspection Findings Survey* summarises key inspection results from audits of public companies, including systemically important financial institutions, submitted by 30 IFIAR members.

The following results come from inspection reports issued during the members' most recent annual reporting periods that ended by July 2013:

- the leading areas of deficiency in inspected audits of listed public interest entities, or public companies, relate to auditing fair value measurements,

internal control testing, and procedures to assess the adequacy of financial statement presentation and disclosures;
- the leading areas of deficiency in audits of systemically important financial institutions, including global systemically important banks, relate to auditing of allowance for loan losses and loan impairments, internal control testing, and auditing of the valuation of investments and securities; and
- audit firms' own quality control systems had the highest number of inspection findings in the areas of engagement performance, human resources, and independence and ethics requirements.

The report is available on the IFIAR website.

1.6 Australia: Corporations legislation amendment published for consultation

On 10 April 2014, the Australian Treasury published an exposure draft and explanatory material for a proposed amendment to the corporations legislation. The draft Bill is a package of amendments to the Corporations Act 2001 (Cth) (the Corporations Act) and the Australian Securities and Investments Commission Act 2001 (Cth).

The draft Bill proposes to:

- remove the obligation to hold a general meeting on the request of 100 shareholders;
- enhance the disclosure of executive remuneration in Australia;
- relieve certain disclosing entities from the obligation to prepare a remuneration report;
- increase the flexibility of companies to pay dividends;
- remove the requirement for auditor appointment for certain companies limited by guarantee;
- extend the Remuneration Tribunal's remuneration-setting responsibility to certain Corporations Act bodies; and
- improve the efficiency of the Takeovers Panel.

The exposure draft and the explanatory material are available on the Australian Treasury website.

1.7 European Commission publishes governance proposals on remuneration, shareholder rights and disclosure

On 9 April 2014, the European Commission published a proposal for revising the Shareholder Rights Directive, a Recommendation on corporate governance reporting and a proposal for a Directive on single member private limited liability companies.

The proposed revisions to the Shareholder Rights Directive include changes to the disclosure obligations in respect of remuneration and the introduction of a binding vote on remuneration policy for certain companies. It also imposes new disclosure obligations on proxy advisors and the requirement for shareholder approval of certain related party transactions.

The purpose of the Recommendation is to provide guidance on improving the quality of corporate governance reporting for those companies required to publish a corporate governance statement under Article 20 of the relevant accounting Directive.

The proposed Directive on single member private limited liability companies would require European Union member states to make available, through their individual legal systems, a single member private limited liability company, with several harmonised features and a common name (Societas Unius Personae, or SUP).

The full text of the proposed directive is available on the European Commission's website.

1.8 Progress report on OTC derivatives reforms

On 8 April 2014, the Financial Stability Board (FSB) published its latest report on implementation of over-the-counter (OTC) derivatives market reforms. G20 Leaders agreed in 2009 to a comprehensive reform agenda for these markets, to improve transparency, mitigate systemic risk, and protect against market abuse.

To achieve these objectives, the G20 has agreed that:

- all OTC derivatives contracts should be reported to trade repositories (TRs);
- all standardised contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs); and
- non-centrally cleared contracts should be subject to higher capital requirements and minimum margining requirements should be developed.

The report finds that substantial progress has been made toward meeting the G20 commitments, through international policy development, jurisdictions' adoption of legislation and regulation, and expansion in the use of market infrastructure.

The report also discusses areas where further work is needed to complete the reforms and achieve the G20 objectives, including for authorities to:

- put in place their remaining legislation and regulation promptly and in a form flexible enough to respond to issues of cross-border consistency and other issues that may arise;
- provide clarity on their processes for making equivalency or comparability decisions (including whether additional authority may be needed to defer to other jurisdictions' regimes, where appropriate). The FSB will report to the G20 by September 2014 on jurisdictions' frameworks in this regard; and
- continue to closely coordinate and cooperate as needed to promptly seek to resolve cross-border regulatory issues when they are identified.

The report is available on the FSB website.

1.9 FSB releases a framework for assessing risk culture and progress report on enhanced supervision

On 7 April 2014, the Financial Stability Board (FSB) released a framework for assessing risk culture and a progress report on enhanced supervision. In the aftermath of the financial crisis, G20 Leaders and the FSB identified as a priority the need for more intense and effective supervision, particularly of systemically important financial institutions (SIFIs).

Increasing supervisory effectiveness remains a core element of the FSB's work to end the too-big-to-fail problem. To take this effort forward, the FSB published the following documents:

- a framework for assessing risk culture, which takes into account public responses received on the consultative document issued on 18 November 2013, and
- a progress report on enhanced supervision, which describes the changes in supervisory practices since the financial crisis and identifies areas where more work is needed.

Weaknesses in risk culture were a root cause of the global financial crisis, as they led to failures in compliance. The *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture* sets out a framework to assist supervisors in their

assessment of risk culture and has been revised in light of the comments received during the public consultation. The guidance forms a basis for supervisors and firms to promote and develop a shared understanding of the firm's risk culture and have informed conversations with the board and senior management who set the tone on culture from the top.

Both the framework for assessing risk culture and the progress report on enhanced supervision are available on the FSB website.

1.10 Corporate responsibility: UK government response

On 4 April 2014, the UK Department for Business Innovation and Skills (DBIS) published its response to the *Call for Views on corporate responsibility* that was released in 2013.

The government response indicates that:

- companies are going beyond legal requirements to manage and enhance economic, environmental and societal impacts;
- corporate responsibility is most effective when it is part of a strategic and responsible approach to driving long term success;
- the exact approach businesses take varies and is influenced by factors such as business size, sector and location; and
- established standards and guidance are already being used by companies and the role of government is not to issue more.

The original consultation paper and government response are available on the DBIS website.

1.11 APRA and Treasury submissions to 2014 Financial System Inquiry

On 4 April 2014, the Australian Prudential Regulation Authority (APRA) and Treasury have released their submissions to the 2014 Financial System Inquiry.

(a) Treasury submission

The Treasury submission responds to the Inquiry's terms of reference by canvassing

the performance of the Australian financial system and identifying key issues to be considered by the Inquiry.

The submission consists of:

- an Executive Summary, which highlights the priority issues discussed in more depth in the submission;
- Part 1, which outlines the objectives and functions of the financial system. This part considers some of the principles associated with the regulation of the financial system. The discussion of the underlying rationale for regulation and how current arrangements have evolved since the previous financial system inquiry assists in considering the appropriate regulatory arrangements for the financial system;
- Part 2, which highlights issues affecting the effectiveness of Australia's regulatory architecture. A discussion of the regulatory architecture complements previous sections dealing with the strengths of Australia's regulatory approach by highlighting areas that warrant further consideration;
- Part 3, which canvasses the priority sectoral issues affecting banking, superannuation, insurance and capital markets, drawing on the discussion of the objectives of the financial system and the principles of effective regulation in earlier parts; and
- the Appendix, which covers Australia's saving and investment balance, and highlights the important role Australia's open capital account plays in enabling the Australian economy to access global capital markets, facilitating investment that has boosted Australia's capital stock and productivity.

(b) APRA's submission

The promotion of financial system stability is the overarching objective in APRA's mandate. Australia's framework for financial stability, building on a history of close and effective collaboration between regulatory agencies in good times and under stress, was tested during the crisis and was found to be flexible and effective. Looking ahead, APRA has a range of macro prudential tools and would use them if and when necessary. APRA's legal powers to respond to situations of financial stress have been materially strengthened since the crisis began. Nonetheless, there are some areas where these powers could be further strengthened to align them more closely with international standards and best practice and enable APRA to respond more effectively to financial distress.

The performance of Australia's financial regulatory arrangements, and of APRA's role in particular, have been subject to a number of reviews by global bodies, particularly since the crisis began. These reviews, by the International Monetary Fund, the Financial Stability Board and global standard-setting bodies, provide an objective and independent assessment of APRA against internationally accepted standards. Overall, the reviews have provided strong endorsement of Australia's financial regulatory arrangements and of the effectiveness of APRA's supervision. At the same time, the

reviews have warned that the Australian financial system continues to face risks that will need to be carefully managed. APRA also publishes the results of regular stakeholder surveys and some quantitative indicators of its supervisory performance.

In APRA's view, the consistency of Australia's prudential framework with international standards is critical to ensuring the attractiveness of regulated institutions to providers of funding and capital. That attractiveness results in greater appetite for the debt and equity instruments of these institutions, lower costs in raising funding and capital in global markets, and business opportunities that rely on an institution's creditworthiness being readily transparent.

The submissions are available on the Treasury website and the APRA website.

1.12 Corporate reporting better but still room for improvement: study

On 2 April 2014, KPMG released a study on corporate reporting. The study of ASX 51-100 listed companies' annual reports shows a significant improvement in their disclosures of operations, financial positions, business strategies and future prospects, in the first year since ASIC introduced its Regulatory Guide (RG) 247 for Operating and Financial Reviews (OFR). However, the research concludes that there are still many areas for improvement, the research concludes.

Compared with a year earlier, more than 30% of companies included extra information on strategies and prospects, almost half included enhanced business risk information, and 30% either included a discussion of their financial position for the first time, or gave more in-depth analysis than previously.

But the study's observations also included many instances where further improvements could be made:

- there are many different types of corporate reporting. Some information in media releases would have been useful to include in OFRs;
- focus has been predominantly on revenue and income items, to the exclusion of key expense items like impairments, restructuring and operating costs;
- many companies' disclosures include only short-term focused prospects and strategies and boilerplate risk discussion; and
- fewer than 50% of the companies studied included their OFR in a single section in the annual report.

The report is available on the KPMG website.

1.13 Guidance on external audits of banks issued by the Basel Committee

On 31 March 2014, the Basel Committee on Banking Supervision published supervisory guidance on external audits of banks. The document enhances and supersedes the previous Basel Committee guidance published in 2002 on The relationship between banking supervisors and banks' external auditors and published in 2008 on External audit quality and banking supervision.

The evolution of bank practices, the introduction of new standards and regulations over the last 10 years and the recent financial crisis warranted a thorough revision of the Basel Committee's supervisory guidance on banks' external audits. The guidance sets out the Basel Committee's guidelines regarding an audit committee's responsibilities in overseeing the external audit function and the prudential supervisor's engagement with the external auditors of banks. It also sets out the Basel Committee's expectations and recommendations relevant to external audits of banks that banking supervisors believe will enhance the quality of these audits. While the previous documents provided guidance on how the relationship between bank auditors and supervisors could be strengthened to mutual advantage, the new guidance focuses primarily on factors that contribute to enhancing audit quality at banks.

In particular. the new guidance:

- reinforces the key role a board's audit committee plays in promoting quality bank audits through effective communication with the external auditor and robust oversight of the external audit process. As such, the document provides a framework to assist audit committees in the governance and oversight of the external audit function;
- highlights areas of common interest between the external auditor and banking supervisors and how the two can effectively interact via a strong, two-way dialogue, thereby contributing to both audit quality and financial stability; and
- describes the Basel Committee's expectations and recommendations on how internationally accepted auditing standards should be tailored to an audit in response to risks and issues specific to banks. This includes the external auditor's knowledge and competence in banking-related matters, and the identification of areas of banking where professional scepticism is particularly important for a high-quality audit. The Basel Committee also makes recommendations that go beyond current professional standards and highlights key areas where significant risks of material misstatement in banks' financial statements often arise.

The guidance is available on the BIS website.

1.14 Australian Shareholders Association releases new policy agenda

On 30 March 2014, the Australian Shareholders' Association (ASA) released a new policy platform for monitoring listed companies, following two years of internal debate, discussion papers and review of public submissions.

Some of the changes are detailed below.

(a) Capital raisings

The ASA will increasingly vote against directors at companies which conduct unfair capital raisings. Capital raisings launched after the global financial crisis saw retail investors heavily diluted through both non-participation in *pro rata* offers and selective discounted placements to institutional investors.

The ASA is already intensely engaging with companies during capital raisings on issues such as artificial caps on share purchase plans and unfair limitations on investors applying for additional shares. The new policy also requires companies to email shareholders in the final week of an in-the-money offer to maximise retail participation.

(b) Sharpening ASA focus on boards and directors

ASA supports board diversity, maximum disclosure about the backgrounds and credentials of directors, and stronger financial alignment between boards and shareholders. The new policy requires a director to invest one year's worth of board fees in shares by the end of their first three year term so there is real "skin in the game".

Director performance is another new key focus. For instance, any director who has contributed to very poor performance at two companies will potentially be encouraged to depart all public company boards. The same will apply for CEOs and Chairs of major public companies which led key strategic decisions that caused material losses or collapses.

(c) Remuneration

Executive remuneration remains a key focus of ASA policies and the ASA remains strongly supportive of the "two strikes" reforms in 2011.

Total Shareholder Return is ASA's preferred measurement for long-term incentive schemes. However, ASA still requires a second performance hurdle and requires

performance periods of at least four years.

The full text of the policy is available on the ASA website.

1.15 Consultation paper - Creating value through governance

On 28 March 2014, the UK Association of Chartered Certified Accountants (ACCA) released a consultation paper *Creating value through governance - towards a new accountability*.

Chapter 1 examines the conflicting interests of the company and its shareholders and other stakeholders, concluding that such conflicts are inherent in the system. Chapter 2 discusses the recent financial crisis and the lessons that can be learnt from it. The paper proposes, in Chapter 3, a new accountability framework to help firms to perform by informing, and being held to account by, their stakeholders. Each of the three framework elements is discussed in subsequent chapters.

The consultation paper is available on the ACCA website.

1.16 UK: Women on boards - publication of Davies Review annual report

On 26 March 2014, the Women on Boards Report (the Davies Review) released its annual report for 2013. The issues discussed in the report include the progress being made, changing business practices and the influence of EU regulation.

The report is available on the UK Government website.

1.17 Conference Board Report calls for investor engagement to rebuild corporate trust and drive economic growth

On 11 March 2014, the US Conference Board issued a report calling for investor engagement to rebuild corporate trust and drive economic growth. With the political and economic aftermath of the financial crisis still unfolding, trust and confidence in business remains lower today than it was in 2008. Yet according to a Conference

Board Governance Center Task Force, opportunities also abound to successfully recover public trust if companies are able to act decisively and with a unity of vision and responsibility shared by management, the board of directors and investors.

The Task Force has developed recommendations to address:

- why directors and investors must together reaffirm the principle that the interests of all stakeholders, including customers, employees, suppliers, communities, and the environment, are key to business success, and thus shareholder value in the long term;
- why board-centric, rather than shareholder-centric, governance remains the optimal model for corporate decision-making, and how directors can adapt this model to incorporate more investor input and build stronger collaboration while retaining primary oversight responsibility;
- how investors can most effectively, responsibly, and openly utilize the power of their votes to work with the board and management; and
- which regulatory changes may have a big impact in shaping a more accountable, effective, and transparent relationship between corporate boards, investors, and the public.

The report is available on the Conference Board website.

2. Recent ASIC Developments

2.1 OTC electricity derivatives report

On 17 April 2014, ASIC released Report 390 'Review of OTC electricity derivatives market participants' risk management policies' (REP 390).

REP 390 summarises the findings of ASIC's review of the written risk management policies of Australian financial services (AFS) licensed entities that trade in over-the-counter (OTC) derivatives in the wholesale electricity market in Australia.

REP 390 sets out ASIC's findings that:

- no areas of significant concern were identified;
- risk management policies appeared to be appropriate to the nature, size and complexity of the financial services business being conducted; and
- risk management practices varied amongst AFS licensees.

REP 390 is available on the ASIC website.

2.2 ASIC's submission to the 2014 Financial System Inquiry

On 8 April 2014, ASIC released its submission to the 2014 Financial System Inquiry.

The submission sets out:

- ASIC's role and how it has been shaped by the economic philosophy underlying the Australian financial services regulatory regime;
- why regulation is important to the participants and consumers of financial markets; and
- key considerations for the future regulatory system, regulatory architecture, alternative regulatory forms, and the importance of competition.

It also provides an overview of developments in the financial system in areas within ASIC's regulatory responsibility, and emerging challenges.

Further, ASIC outlines some issues for further consideration by the Inquiry, including:

- ensuring the superannuation system better meets the needs of the retirement phase;
- lifting standards in financial advice;
- strategic participation in global financial markets;
- managing systemic risk;
- improving conduct through a more flexible regulatory toolkit;
- ensuring that regulatory decision making better incorporates competition considerations;
- penalties that provide the incentive for better conduct; and
- a better funding model for ASIC.

The submission is available on the ASIC website.

2.3 ASIC reports on supervision of registered liquidators for 2013

On 8 April 2014, ASIC released its annual report for 2013 into the supervision of registered liquidators. Report 389 ASIC regulation of registered liquidators: January to December 2013 (REP 389) outlines the supervisory, enforcement, stakeholder liaison and educative work ASIC undertook in its commitment to continue improving regulation of the insolvency and restructuring sector. For example, at the end of

December 2013, 19 registered liquidators were subject to formal investigation or enforcement action, and ASIC made five applications to the Companies, Auditors and Liquidators Disciplinary Board during 2013.

The report also highlights an improvement in the disclosures made in declarations by registered liquidators about their independence.

REP 389 is available on the ASIC website.

2.4 ASIC launches small business stakeholder survey

On 7 April 2014, ASIC launched an online survey to gather feedback on its services and engagement with the small business sector.

This is ASIC's second small business survey. The last survey, conducted in late 2012, resulted in the establishment of ASIC's Small Business Engagement team which is focused on strengthening ASIC's relationship with key stakeholders such as business advisers and industry associations and developing resources to help small businesses better understand their compliance obligations.

Stakeholders are invited to complete the survey, which is anonymous and takes approximately five minutes to complete.

The survey will be available from 7 April to 26 May 2014, and is available on the ASIC website.

2.5 ASIC reports on penalties for corporate wrongdoing

On 20 March 2014, ASIC released Report 387 Penalties for corporate wrongdoing (REP 387).

REP 387 reviews penalties in Australia for corporate wrongdoing to assess whether they are proportionate and consistent. It compares ASIC's penalties with:

- those in other countries;
- those of other Australian regulators; and
- across ASIC's regime.

The key findings show that:

- on the international comparison:
  - while Australia's maximum criminal penalties - jail and fines - are broadly consistent with those available in other countries, there are significantly higher prison terms in the US and higher fines in some overseas countries for certain offences;
  - there is a broader range of civil and administrative penalties in other countries, which are higher, and include the ability to remove financial benefit obtained by wrongdoing (i.e. disgorgement);
- on the comparison with other Australian regulators, the maximum civil penalties available to ASIC are lower than those available to other regulators and are fixed amounts, rather than multiples of the financial benefits obtained from wrongdoing; and
- on the comparison across ASIC's regime, there are differences between the types and size of penalties for similar wrongdoing. For example, providing credit without a licence can attract a civil penalty up to ten times greater than the criminal fine for those who provide financial services without a licence.

The report is available on the ASIC website.

3. Recent ASX Developments

3.1 New rights issue timetables, shortened ex period on corporate actions and new dividend reinvestment plan election date rule

On 14 April 2014, new rights issue timetables (including a shortened ex period on corporate actions) and the Dividend Reinvestment Plan election date rule commenced.

A summary of the changes can be found in the following ASX consultation documents:

- Modernising the Timetable for Rights Issues: Draft ASX Listing Rules; and
- Timetable for Dividends and Distributions: A proposal to prescribe the last election date for a dividend reinvestment plan following the record date.

The transition to the new three day ex period will apply to the following corporate actions:

- dividends and distributions;
- interest payments;
- *pro rata* issues (renounceable entitlement offer);

- *pro rata* issues (non-renounceable entitlement offer);
- bonus issues;
- accelerated *pro rata* issues (in accordance with paragraphs 5, 6 and 7 of Appendix 7A under the ASX Listing Rules as amended from 14 April 2014);
- returns of capital;
- equal access schemes and off-market buy backs; and
- reorganisations capital that are security consolidations or splits (commonly referred to as reconstructions).

The transition will operate as follows:

- record dates on or before 17 April 2014 will follow the old timetable (5 business day ex period); and
- record dates on or after 22 April 2014 (ex date 16 April) will follow the new timetable (3 business day ex period).

3.2 ASX Corporate Governance Principles and Recommendations on diversity

On 10 April 2014, ASX released an independent report measuring the adoption of the Corporate Governance Council's gender diversity recommendations by listed entities. In the second full year of reporting on diversity, the research found that the benefits of diversity are now well recognised and articulated by listed entities. However, an entity's size is the primary predictor of whether it will take the next step of setting and monitoring measurable objectives or targets for female participation in leadership roles.

The Council's recommendations provide listed companies with a reporting framework for gender diversity. It is not mandatory to follow the recommendations, but ASX requires listed companies to disclose in their annual report or their website the extent to which they have followed them during the reporting period. Where companies have not followed all of the recommendations, they must provide an explanation as to why ("if not, why not" reporting).

The media release, including a summary of the data from the report and the key findings and conclusions, are available on the ASX website.

3.3 ASX exchange-traded options: Consultation on automatic exercise on expiry date and approach for exercise errors

On 4 April 2014, ASX released the consultation paper *ASX exchange-traded options: Consultation on automatic exercise on expiry date and approach for exercise errors*.

ASX is consulting market participants, clearing participants and interested stakeholders on the ASX Clear procedural framework for the automatic exercise of in-the-money cash settled and deliverable option contracts. The consultation also seeks feedback on ASX Clear's approach in circumstances where an option contract is inadvertently exercised, or where there has been a failure to exercise an option contract when the intention was to do so.

The purpose of this consultation is to explore ways to improve operational risk management and efficiency for customers and align procedures with global best practice.

The consultation paper is available on the ASX website.

3.4 ASX submission to the Financial System Inquiry

On 31 March 2014, ASX lodged its submission to the Financial System Inquiry. The submission states that the Inquiry comes at an important time, with the global regulatory and competitive environment evolving significantly in recent years. Choices can be made now to secure the future of Australia's financial markets and make the most of the opportunities in Asia.

ASX's submission and the media release are available on the ASX website.

3.5 Third edition of the Corporate Governance Principles and Recommendations

On 27 March 2014, the ASX Corporate Governance Council released the third edition of its Corporate Governance Principles and Recommendations. The new edition captures and reflects developments in corporate governance, both in Australia and internationally, since the second edition was published in 2007. The first edition was issued in March 2003.

The release of the third edition follows an extensive public consultation that began in August 2013.

The third edition of the Corporate Governance Principles and Recommendations is available on the ASX website. The media release, setting out the key changes in the third edition, is also available on the website.

3.6 Reports

On 3 April 2014, ASX released:

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

for March 2014.

4. Recent Takeovers Panel Developments

4.1 Panel publishes revised Guidance Note 2

On 2 April 2014, the Takeovers Panel published a revised version of *Guidance Note 2: Reviewing decisions*.

Guidance Note 2 deals with the Panel reviewing decisions - either on review of an initial Panel decision or of an ASIC decision regarding modification of Chapters 6 or 6C of the Corporations Act 2001 (Cth).

The main change to Guidance Note 2 relates to a recent amendment to the Australian Securities and Investments Commission Regulations 2001 (Cth), which removed an obligation on the Panel to provide reasons at the time the Panel advised parties that it was not conducting proceedings. Other changes involving the correction of minor inconsistencies and errors have also been made. The Panel did not publish a draft of the revised Guidance Note 2 for comment because the changes involve no major changes of Panel policy.

A copy of the revised Guidance Note 2, showing the changes made, is available on the Takeovers Panel website.

4.2 Argosy Minerals Limited - Panel declines to conduct proceedings

On 24 March 2014, the Takeovers Panel announced that it has declined to conduct proceedings on an application dated 18 March 2014 from Sunbreaker Holdings Pty Ltd (as trustee for the Lloyd Super Fund) and Graham Geoffrey Walker in relation to the affairs of Argosy Minerals Limited.

The application concerns a 2 for 1 renounceable entitlement offer by Argosy at $0.002 per share and the decision of Argosy's 88.6% shareholder, Discovery Africa Limited, not to participate in the entitlement offer (see TP14/22).

Discovery Africa made a scrip takeover bid for Argosy, which closed on 12 December 2013. The implied value of the bid, based on the last trading day before the announcement of the bid, was $0.038 per Argosy share. There has been thin trading in Argosy shares in the last six months between $0.020 and $0.045.

The Panel questioned the commerciality of the entitlement offer and Discovery Africa's decision not to take up its entitlement. However without evidence that another party or parties could acquire control by reason of or in connection with the entitlement offer, the Panel was unlikely to find the circumstances unacceptable.

The Panel has decided to refer the issues raised in this application to ASIC. If a change of control or potential control in Argosy arises, a fresh application could be made by ASIC or a person interested.

The Panel concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances. Accordingly, the Panel declined to conduct proceedings.

The reasons for the decision have been published on the Takeovers Panel website.

5. Recent Research Papers

5.1 Evasive shareholder meetings

The authors study the location and timing of annual shareholder meetings in the US. When companies move their annual meetings a great distance from headquarters, they tend to announce disappointing earnings results and experience pronounced stock market underperformance in the months after the meeting. Companies appear to schedule meetings in remote locations when the managers have private, adverse information about future performance and wish to discourage scrutiny by shareholders, activists, and the media. However, shareholders do not appear to decode this signal, since the disclosure of meeting locations leads to little immediate stock

price reaction. The authors find that voter participation drops when meetings are held at unusual hours, even though most voting is done electronically during a period of weeks before the meeting convenes.

The paper is available on the SSRN website.

5.2 US takeover litigation in 2013

Takeover litigation continues to be a much discussed issue in Delaware and among members of the US corporate bar. This report provides preliminary statistics for US-based takeover litigation in 2013. Based on preliminary statistics, takeover litigation continued to be brought at an extraordinarily high rate in 2013. 97.5% of all transactions experienced litigation. The average transaction attracted an average number of seven lawsuits - an all-time high. A total of 41.6% of all transactions experienced multi-jurisdictional litigation down from 51.8% in 2012. Median attorneys' fees for settlements remained relatively steady at US$485,000 per settlement. Further information and numbers are contained in the report.

The paper is available on the SSRN website.

5.3 Do foreign institutional investors enhance firm innovation?

The authors examine the effect of foreign institutional investors on firm innovation. Using firm-level data across 26 non-US economies for the 2000-2010 period, they show a positive relation between foreign institutional ownership and firm innovation. The authors explore three possible underlying mechanisms through which foreign institutional investors promote innovation: foreign institutions appear to act as active monitors, to provide insurance against innovation failures to firm managers, and to promote technology transfers from high-innovation countries.

The paper is available on the SSRN website.

5.4 Proxy advisor recommendations on auditor ratification: Who is listening?

The auditor ratification vote allows shareholders to voice their opinions on audit-related issues. Motivated by regulatory concerns about third party proxy advisors that provide summarised voting recommendations to shareholders, this study investigates: (i) the determinants of proxy advisors' recommendations on auditor ratification (for or against),(ii) whether these recommendations affect voting outcomes, and (iii) whether companies respond to an against recommendation with improved audit quality. The results indicate that proxy advisors are more likely to recommend that shareholders vote against auditor ratification when the auditor provides excessive non-audit services, when audit quality appears to be low, and when the engagement letter limits the auditor's liability to the company. While the association between proxy advisor recommendations and shareholder voting is statistically significant, it does not appear to be qualitatively significant when compared to prior studies examining the influence of proxy advisors in other settings. Finally, neither proxy advisor recommendations nor shareholder voting outcomes are associated with changes in audit quality, suggesting that companies do not respond to voiced concerns about the auditor. These findings should be of interest to researchers examining the impact of the auditor ratification vote and to regulators evaluating the involvement of proxy advisors in auditor ratification.

The paper is available on the SSRN website.

6. Recent Corporate Law Decisions

6.1 Rights of trustee and co-owner to sell a patent as a business asset

(By Elise Caldwell, Herbert Smith Freehills)

Re Bacchus Distillery Pty Ltd (Administrators Appointed) [2014] VSC 111, Supreme Court of Victoria, Judd J, 26 March 2014

The full text of this judgment is available online.

(a) Summary

The central issue in the case was whether the administrators of Bacchus Distillery Pty Ltd (Bacchus) had the power to sell a patent. It had been determined in a separate proceeding that Bacchus and the defendant Neobev Pty Ltd (Neobev) were co-owners of the patent and that Bacchus held the patent on trust for the co-owners. Neobev argued that this arrangement was properly construed as Bacchus being a bare trustee with no power of sale. The construction of the nature and terms of the trust was the central issue to determining whether there was a power of sale. Bacchus had commercialised the invention and incorporated it as part of its business to an extent that the business was dependent on the invention. Judd J determined that the trust included a term under which Bacchus was authorised as sole patentee to deal with the

invention and patent as its own business asset. As such, the administrators were able to exercise a power of sale.

(b) Facts

The administrators of Bacchus brought an action before the Supreme Court of Victoria claiming that they had a right to sell a patent. The patent was utilised in the manufacture of clean wine spirits and was developed as a result of collaboration between Max Scott and the Chief Executive of Bacchus.

Following the development of the patent, there was a successful application for a Commercial Ready Grant which was also a result of collaboration between Bacchus and Mr Scott but it was agreed that Bacchus would be the sole owner of the patent. Bacchus is the sole registered patentee and commercialised the asset as part of its business.

Neobev was assigned Mr Scott's interests as co-inventor of the patent. Following the assignment, Neobev commenced a Federal Court action claiming that Mr Scott was the sole inventor and Neobev was the owner. Bacchus commenced a cross-claim asserting that it was the sole legal owner of the patent.

Bacchus was the sole registered patentee and the administrators took the view that the invention was an asset of Bacchus which could be sold with other assets. The administrators sought declarations in relation to application of proceeds from any such sale.

The Federal Court determined with regard to the question of ownership of the patent that Mr Scott was the sole inventor, Neobev was the beneficial co-owner of the patent and that Bacchus was also a beneficial co-owner and held the patent on trust for itself and Neobev as co-owners in equity.

The administrators argued that they had a power of sale on the basis that the patent had been assigned to Bacchus along with all associated rights. Neobev argued that Bacchus held the patent as bare trustee without any power to sell or otherwise deal with the patent without its consent.

The administrators put forward alternative arguments that a power of sale arose under s. 437A of the Corporations Act 2001 (Cth) (the Corporations Act) which allows administrators to dispose of a business or any property of that business or that a power of sale arose under s. 63 of the Trustee Act 1958 (Vic) (the Trustee Act) which enables the court to make orders dealing with trust property.

The administrators also argued Bacchus could be indemnified as trustee for applying for, maintaining and commercialising the patent and that Bacchus should be entitled to recover its litigation costs.

(c) Decision

The assignment to Bacchus and its status as sole registered patentee informs the nature and terms of the trust. It would be artificial to distinguish between the commercial rights Bacchus had in relation to the patent and its role as trustee. The invention became inseparable from the business of Bacchus as Bacchus exploited the technology for commercial purposes and incurred expenditure in the course of doing so.

The parties' intention was that there would be full legal transfer of the invention and the patent rights to Bacchus. It was to benefit Mr Scott as well as Bacchus that Bacchus have unrestricted ability to commercialise the patent and exercise the patent rights.

Judd J determined that the trust included a term under authorising Bacchus to deal with the invention and the patent as its own business assets. As such, Bacchus was impliedly authorised to sell the patent with the business.

If the trust had not conferred a power of sale on Bacchus, the administrators would have been authorised to sell the patent pursuant to s. 437A of Corporations Act which provides administrators with the power to dispose of all or part of a business and any property of that business. This power was held to be sufficient to override the objection of a beneficial co-owner of an asset in circumstances where the full knowledge and consent of the other beneficial co-owner has been granted.

There was no power of sale under s. 63 of the Trustee Act as there was insufficient information about the value to be attributed to the patent on any proposed sale and the status of claims by secured creditors. The significance of claims will affect the willingness of the court to order a sale.

Bacchus did not have a right of indemnity as trustee to recover from the proceeds of sale, any costs and expenses incurred by it in relation to the patent application. Similarly, Bacchus could not recover its litigation costs.

6.2 Breach of directors' duties for payment of termination benefit

(By Samantha Loff, Herbert Smith Freehills)

In the matter of Cummings Engineering Holdings Pty Ltd [2014] NSWSC 250, Supreme Court of New South Wales, Brereton J, 26 March 2014

The full text of this judgment is available online.

(a) Summary

The case concerns a dispute over the termination benefit and other entitlements awarded to the managing director of a family-owned company. The company, Cummings Engineering Holdings Pty Ltd (Holdings), was incorporated in 1979 and was initially owned by Jack Cummings. Jack's children, Wendy, Sandra, Diane and Michael, each held shares in the company.

Each of the sisters, the company trustees of their respective family trusts, together with Holdings brought an action against their brother Michael and his wife Robyn. The seven plaintiffs claimed compensation for breach by the defendants of their duties as directors of Holdings in approving a "redundancy payment" of $250,000 to Michael. Michael cross-claimed for underpaid remuneration and other entitlements.

The Court found that while the defendants had not breached the statutory provisions of the Corporations Act 2001 (Cth) (the Corporations Act) in relation to Michael's redundancy payment, the payment was in breach of his general law and fiduciary duties. As a result, Michael and Robyn were ordered to repay the $250,000 back to Holdings.

In relation to the cross-claim, the Court ordered that Holdings pay Michael $122,522 and interest, and that Holdings pay Michael's trust $34,518 by way of bonus for the 2011-2012 financial year.

(b) Facts

Holdings owned and operated an engineering sheet metalworking business. Michael became a director shortly after incorporation. Following Jack's death, a dispute arose between the siblings. In 1993, the relevant parties entered into a deed agreeing to transfer units of the family trust equally among the siblings' trusts. The 1993 deed also provided that Holdings and Michael would enter into a management contract.

The Management Agreement provided for Michael to be employed as managing director for a minimum of five years. The Management Agreement also included in Michael's remuneration package other entitlements such as annual and long service leave, as well as a bonus payment. Both documents were amended in 1998.

In 2009, Michael sent a letter to his sisters stating that the company proposed to sell the business and building at the end of the 2011-2012 financial year. The letter included some terms, the most significant of which was that "prior to the distribution of funds to the shareholders from the sale/s and after the company has paid all debts and liabilities, a payment of $250,000.00 will be made to [Michael] in recognition of his service to the company".

The sisters did not reply to this letter until June 2011 when they wrote: "we find your request that we agree to a $250,000.00 golden handshake is excessive in the extreme".

Letters on this dispute between the sisters and Michael ensued.

By Christmas 2011, Holdings' machinery and land had been sold, the business was closed and the premises vacated.

In early 2012, Michael convened a meeting of the directors of Holdings - him and his wife Robyn - to, among other things, approve the termination payment of $250,000 to Michael. Michael did not inform his sisters of his intention to convene the meeting of directors.

After the payment had been approved by the directors, Michael sent a letter to his sisters stating that the $250,000 redundancy payment had been paid as well as $157,484 for long service leave and accrued annual leave.

The plaintiffs instituted proceedings in the New South Wales Supreme Court to recover the redundancy payment.

The defendants cross-claimed for:

- payment in lieu of notice;
- underpaid remuneration;
- underpaid annual leave entitlements;
- underpaid long service leave entitlements; and
- a bonus for the 2011-12 financial year.

(c) Decision

(i) Redundancy payment of $250,000

According to s. 200B of the Corporations Act, retirement benefits generally need membership approval unless the amount is below the threshold contained in s. 200G. However, the relevant threshold amount under s. 200G was amended in 2009. The previous provision allowed a payment for past services, without shareholder approval, if the value of the benefit did not exceed seven times the average total annual remuneration for the last three years of service. The applicable transitional provisions stipulated that for contracts that had not been varied or renewed since 2009, the previous threshold would continue to apply. Because Michael's contract had not been varied or renewed since 1998, and the payments awarded to Michael did not approach the relevant limit (which would have been in the order of $700,000), s. 200B of the Corporations Act was not contravened.

The plaintiffs also claimed that the redundancy payment was in contravention of Michael's and Robyn's duties as directors to act in good faith in the best interests of the company. Brereton J held that while sometimes "golden handshakes" may be justified in the interests of the company, this was not such an occasion. In this case, the company no longer existed, and there was therefore no goodwill to maintain and no

continuing employees to encourage. Further, the company was closely held by the four Cummings siblings so there was little occasion to develop a reputation of generosity to attract external directors. Other matters that the Court took into account were that Michael's sisters had objected to the payment, and that Michael had been instrumental in procuring it for his own benefit. There was clearly a conflict between his duty and his interest.

The Court concluded that the payment was in contravention of Michael and Robyn's general law fiduciary duties, and ss. 181 and 182 of the Act, which provide that a director must act in good faith in the interests of the company as a whole, and must not improperly use their position to gain an advantage for themselves. Michael and Robyn were found to be liable to compensate Holdings for the improper payment of $250,000.

(ii) Relief from liability

Section 1318 of the Act empowers the court to relieve a person from liability as an officer of a corporation if it appears that the person has acted honestly and that, having regard to all the circumstances of the case, the person ought fairly be excused for the default.

Brereton J concluded that while the directors had acted in accordance with legal advice, his Honour was not satisfied that the directors acted honestly.

His Honour stated that "the conflict of interest and duty was, or at least should have been, obvious. In addition, their decision was made in the face of protests from the other shareholders, at a time when the correspondence suggested that they would be given an opportunity to see the legal advice before it was acted on". Further, Brereton J stated that even if he were satisfied that they had acted honestly, he would still not be satisfied that they ought fairly be excused from liability because relieving the directors would prejudice the plaintiffs by depleting the equity which should be available for distribution.

(iii) Cross-claim

As a result of conflicting calculations and misapplication of the 1998 Management Agreement, Brereton J found that Michael was entitled to:

- $55,463 in respect of the previous six years' underpaid wages;
- $68,379 for long service leave; and
- $34,518 in bonus payments.

Applying calculations from the various evidence before him, Brereton J found that Michael had been overpaid $1,320 in respect of annual leave.

Brereton J found that payment in lieu of notice was not relevant on the facts because

the business was closed by Christmas 2011, while Michael continued to draw remuneration until May 2012. His failure to give himself notice in November 2011 was a breach of his duty of care under s. 180 of the Act, and as such he had no entitlement to pay in lieu of notice.

6.3 Whether a deed of company arrangement extinguishes claims made under a deed of guarantee

(By Adam Katz, DLA Piper)

Australian Gypsum Industries Pty Ltd v Dalesun Holdings Pty Ltd [2014] WASC 89, Supreme Court of Western Australia, Le Miere J, 21 March 2014

The full text of this judgment is available online.

(a) Summary

Le Miere J considered whether a deed of company arrangement (DOCA) in relation to the defendant, Dalesun Holdings Pty Ltd (Dalesun) extinguished claims made by Australian Gypsum Industries Pty Ltd, BGC (Australia) Pty Ltd, Lisson Nominees Pty Ltd and Buckridge Nominees Pty Ltd (together, the Plaintiffs) under two deeds of guarantee and indemnity entered into by Dalesun and the Plaintiffs prior to the DOCA (the Deed of Guarantee). Le Miere J ultimately decided that the DOCA had extinguished the claims pursuant to the Deed of Guarantee.

(b) Facts

The Plaintiffs manufactured and sold building products and services. The Plaintiffs and Newglen Nominees Pty Ltd entered into several supply agreements, pursuant to which the Plaintiffs would supply Newglen on credit. In order to guarantee the performance of the terms and conditions of the credit account, Dalesun entered into the Deed of Guarantee in favour of the Plaintiffs. Amongst other things, the Deed of Guarantee contained a charging clause by which Dalesun charged all land owned or acquired by Dalesun to secure payments of all moneys which may become owing under the Deed of Guarantee.

In March 2011, Dalesun executed a DOCA. The DOCA bound, in accordance with and subject to s. 444D of the Corporations Act 2001 (Cth) (the Corporations Act), all persons having a 'Claim', that is, any debt which arose before the appointment date of 3 December 2010 (Appointment Date), owing, whether then, presently, in future or contingently, by, or a claim subsisting against, Dalesun including a debt or claim arising pursuant to any guarantee. The DOCA provided that, upon termination of the

DOCA and unless otherwise preserved by the DOCA, all claims would be extinguished.

Following the termination of the DOCA, Newglen continued to acquire services from the Plaintiffs on credit. On 8 March 2012, the creditors of Newglen resolved that Newglen execute a deed of company arrangement. The Newglen administrators issued cheques to the Plaintiffs in relation to part of the amount owing to the Plaintiffs in relation to services provided.

The Plaintiffs sought to claim from Dalesun, pursuant to the Deed of Guarantee, the balance owing by Newglen for the goods and services provided by the Plaintiffs to Newglen after the DOCA was terminated. This case considered whether the DOCA operated so as to extinguish claims under the Deed of Guarantee by the Plaintiffs.

(c) Decision

In finding that the DOCA had extinguished the Plaintiffs' claims under the Deed of Guarantee, Le Miere J considered the following issues.

(i) Application of s. 444D of the Corporations Act

As noted earlier, the DOCA provided that:

- it bound, in accordance with and subject to s. 444D of the Corporations Act, all persons having a Claim; and
- upon its termination, it acted to extinguish all Claims (subject to a number of exceptions).

The Plaintiffs contended that the claims related to the supply of goods and services after the termination of the DOCA, and that the DOCA could not operate so as to bar claims of creditors arising from the company's conduct after the termination of the DOCA.

Le Miere J relied upon a number of prior decisions in concluding that the DOCA may bind all creditors, not only so far as it concerns debts which had become due and payable as at the specified date, but also as concerns future or contingent claims, the circumstances giving rise to which occurred before that date. The Deed of Guarantee generated a contingent liability to pay upon the Plaintiffs providing goods or services to Newglen on credit. The provision of the goods or services occurred after the DOCA was terminated. However, the "basal fact" necessary to bring the obligation into being was the making of the Deed of Guarantee by Dalesun, which occurred before the specified date in the DOCA (being the Appointment Date) and therefore the claims were extinguished upon termination of the DOCA.

(ii) Application of s. 444D(2) of the Corporations Act

Despite s. 444D(2) of the Corporations Act providing that a deed of company guarantee binds all creditors of a company so far as concerns claims arising on or before the day specified in the deed, s. 444D(2) of the Corporations Act provides that the deed does not prevent a secured creditor who did not vote in favour of the deed from realising or otherwise dealing with the security unless the court so orders. The Plaintiffs submitted that the security held by the Plaintiffs permitted the Plaintiffs to recover the outstanding amounts owing notwithstanding the DOCA.

Le Miere J agreed that a security interest did exist in favour of the Plaintiffs. However, Le Miere J disagreed with the Plaintiffs' argument that s. 444D(2) of the Corporations Act had the effect that a secured creditor is not bound by a deed of company arrangement. This section does not purport to preserve ongoing obligations outside the security which might ripen into future monetary liabilities. As such, despite s. 444D(2) preserving the Plaintiffs' rights at the date specified in the DOCA to realise or otherwise deal with the security, the future or contingent rights of the Plaintiffs arising pursuant to the guarantees were not prevented from being extinguished.

(iii) Application of s. 444J of the Corporations Act

The Plaintiffs finally claimed that s. 444J of the Corporations Act had the effect that a deed of company arrangement did not release the company from a debt arising under a guarantee or indemnity. In interpreting s. 444J, Le Miere J first considered the object of Part 5.3A of the Corporations Act, namely, to maximise the chances of a company continuing to exist or, if that is not possible, produce a better return for the company's creditors and members than would result from an immediate winding up of a company. In light of this object, Le Miere J interpreted 'guarantee' in section 444J to refer to a third party guarantee, as opposed to a guarantee or indemnity given by the company, as the latter interpretation would make it more difficult for the company to continue in existence as the deed of company arrangement would only apply to some claims against the company. Given this interpretation, s. 444J did not apply to the Deed of Guarantee given by Dalesun.

6.4 Construction of a legal charge and the meaning of 'debenture'

(By Annabel Humphreys, Minter Ellison)

Fons HF (in liquidation) v Corporal Ltd [2014] EWCA Civ 304, England and Wales Court of Appeal (Civil Division), Patten, Gloster and Sharp LLJ, 20 March 2014

The full text of this judgment is available online.

(a) Summary

This UK case considers the construction of a legal charge over "Shares". Specifically, the court looks at whether unsecured debts due under two Shareholder Loan Agreements fall within the meaning of "Shares" in the legal charge, which is defined to include, among other things, 'debentures'.

The process undertaken by the court when construing a legal charge is an objective exercise to be carried out by the court through the eyes of a notional reasonable man who is credited with all the background information which would reasonably have been available to the parties at the time of the contract.

A "debenture" in its ordinary sense is a document that creates or acknowledges a debt.

(b) Facts

Fons FH (Fons) and Kaupthing Bank Luxembourg S.A. (Kaupthing) entered into a legal charge on 29 September 2008 (the Charge) under which Fons agreed to charge in favour of Kaupthing:

- 3.1.1 by way of first legal mortgage, the Shares;
- 3.1.2 by way of first equitable mortgage, the Distribution Rights from time to time accruing to or on the Shares; and
- 3.1.3 to the extent not validly and effectively charged by way of mortgage pursuant to clauses 3.1.1 or 3.1.2, by way of first fixed charge, the Secured Property and all the Chargor's interest in the Secured Property.

"Shares" is defined as "all shares (if any) specified in Schedule 1, and also all other stocks, shares, debentures, bonds, warrants, coupons or other securities now or in the future owned by the Chargor in Corporal from time to time or any in which it has an interest".

Fons had previously entered into two Shareholder Loan Agreements with Corporal Limited (Corporal) dated 17 October 2007 (SLA1) and 15 February 2008 (SLA2) (collectively, SLAs).

Fons had advanced the loan to Corporal that was the subject of SLA1 prior to entering into SLA1. Fons advanced the loan to Corporal that was the subject of SLA2 after entering into SLA2.

The SLAs provided that the loan should become repayable:

- at any time on demand by Fons following the last day of the 'subordination period'; or
- if an "exit event" occurred, such as a listing of Corporal's shares or a business sale of Corporal.

Kaupthing argued that the rights of Fons under the SLAs were charged either as "debentures" or as "other securities" under the definition of Shares.

Fons argued that none of the descriptive terms included in the definition of "Shares" can be read, in the context of the Charge, as including the mere unsecured debt due under each of the SLAs. Fons contended the instrument in question needed to constitute more than a simple obligation to pay money.

The deputy judge of the High Court accepted Fons's argument, but gave Kaupthing permission to appeal.

(c) Decision

The court allowed the appeal and declared the rights of Fons under the two SLAs are included within the Charge because they are 'debentures', and accordingly fell within the definition of Shares.

Patten LJ delivered the primary judgment, and described the exercise of construing the Charge as follows:

> The construction of the Charge is an objective exercise to be carried out by the court through the eyes of a notional reasonable man who is credited with all the background information which would reasonably have been available to the parties at the time of the contract: see *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at p. 912F-913E. The background information includes anything which would have affected the way in which the reasonable man would understand the words used but does not extend to the negotiations or to evidence of the parties' subjective intent.

The task of the court is to determine what the parties meant by the language which they used. Consistently with that objective, the court will seek to give the words their natural and ordinary meaning derived from the context of the agreement and all other relevant facts indicating the nature and purpose of the transaction.

Patten LJ began by considering whether other provisions in the Charge shed light on the scope and meaning of "Shares". His Honour determined that if the SLAs can as a matter of ordinary language be treated as falling within the definition of "Shares", no other provision in the Charge expresses a clear contra-indication to the inclusion or narrows the meaning of the categories in the definition of 'Shares' so as to exclude the SLAs.

Patten LJ then considered the definition of "Shares", and determined the inclusion of the reference to 'debentures, bonds, warrants, coupons or other securities' indicated that the Charge covered a wider range of assets or investments than stocks or shares in their conventional sense.

To determine the ordinary meaning of "debenture", Patten LJ referred to the following principles set out in previous cases:

- there is no precise legal definition of the term "debenture". A debenture means a document which either creates or acknowledges a debt, and any document which fulfils either of those conditions is a "debenture": *Levy v Abercorris Slate and Slab Co* (1887) 37 Ch D 260 per Chitty J;
- a number of debentures may be issued as a series or, although less common, a single debenture may be issued to one person only: *Lemon v Austin Friars Investment Trust Ltd* [1926] CH 1 per Sir Frederick Pollock MR;
- it is not essential for a debenture to provide for the payment of a specific principal sum at a specified date: *Lemon v Austin Friars Investment Trust Ltd* [1926] CH 1 per Sir Frederick Pollock MR; and
- it is not essential for a debenture to contain a charge on the undertaking of the company: *Lemon v Austin Friars Investment Trust Ltd* [1926] CH 1 per Sir Frederick Pollock MR.

Patten LJ found that each of the SLAs created and acknowledged a debt owed by Corporal, and accordingly held the SLAs were debentures. Gloster LJ agreed with Patten LJ. In that regard, Gloster LJ rejected the Respondents argument that debt is created on drawdown and accordingly, because the debt under SLA2 was not advanced to Corporal prior to the SLA2 being entered into, SLA2 did not create or acknowledge a debt. Her Honour held the obligation to repay clearly arises on execution of the loan instrument itself, despite such an obligation being contingent on drawdown actually taking place.

Patten LJ considered there was nothing in the Charge or the relevant background which required the court to give "debentures" a narrower meaning. The reference in the definition to "other securities" did not narrow the meaning of "debentures" because "security" can be used to describe many instruments, including one which merely indicates or acknowledges a debt, such as a debenture.

The Respondents argued that a finding that any unsecured loan due from Corporal to its shareholders was covered by the Charge could catch a very wide range of debts, which may have serious consequences for the parties to those agreements. Patten LJ rejected this argument on the grounds that the primary judge had no evidence of this and the issue for the court was limited to interpreting the terms of the Charge.

Patten LJ held the following to be inadmissible on the question of construction:

- evidence about the drafting of the Charge and various minor changes in the definition of "Shares"; and
- that Kaupthing was unaware of the existence of the SLAs at the time the Charge was entered into.

6.5 Oppressive conduct in a company's 'affairs' in the context of parent and subsidiary companies

(By Katrina Sleiman and Arthur Kam, Corrs Chambers Westgarth)

Ubertini v Saeco International Group SpA (No 4) [2014] VSC 47, Supreme Court of Victoria, Elliott J, 18 March 2014

The full text of this judgment is available online.

(a) Summary

Mr Ubertini (the Plaintiff) and the first defendant, Saeco International Group SpA (the Defendant), were shareholders in the second defendant, Saeco Australia Pty Ltd (the Company). The Plaintiff wanted to resign as managing director and sell his shares. The Defendant was the majority shareholder in the Company and agreed to purchase the shares subject to negotiating a price. The parties' negotiations broke down, causing the Plaintiff to commence proceedings against the Defendant for oppressive conduct. The Defendant then placed the Company into administration over insolvency concerns.

The Court found that although both parties engaged in oppressive acts which were detrimental to the Company, the Defendant's response to the Plaintiff's behaviour was disproportionately unfair as it sought to destroy the Company and the value of the Plaintiff's shares. His Honour ordered the Defendant to purchase the Plaintiff's shares.

In arriving at this decision, Elliott J provided a useful summary of the extent to which a parent company's conduct, including its nominee directors' conduct, could be considered to be conduct in the affairs of its subsidiary.

(b) Facts

The Plaintiff ran a business selling imported coffee machines through the Company. In 2002, the Plaintiff sold 60% of the shares in the Company to the Defendant. The Defendant was a multinational company who sold products to the Company. The Plaintiff retained 18% of the shares himself and another 17% through an investment company. The Plaintiff, Defendant and other shareholders had signed an agreement that allowed the Defendant to nominate two "A" class directors and the Plaintiff to nominate one "B" class director. Quorum for a board meeting required the three directors to be present and the Defendant maintained majority board voting rights. The Plaintiff nominated himself as the "B" class director.

In April 2005, the Plaintiff informed the Defendant of his intention to step down from the Company and sell his shares. The Defendant agreed to buy his shares and the Plaintiff stayed on as managing director as they continued to negotiate a price. However, negotiations reached an impasse in August 2006. The Defendant refused to accept returned stock from the Company and the Plaintiff started to withhold payments owed to the Defendant under a supply contract.

In October 2006, the Plaintiff commenced proceedings for oppressive conduct and stopped attending board meetings. In January 2007, the Defendant and one of its wholly owned subsidiaries made demands on the Company for payment of outstanding debts. In February 2007, the Plaintiff was compelled by the Court to attend a board meeting at which the Defendant's nominee directors used their voting majority to place the Company in administration; thereby reducing the value of the Plaintiff's shares to nil. The Company entered into a deed of company arrangement with the Defendant under which a new subsidiary would acquire the assets of the Company and the Defendant would reduce the debt owed to it.

(c) Decision

The case concerned s. 232 of the Corporations Act 2001 (Cth) (the Corporations Act), which provides:

The court may make an order under s. 233 if:

> (a) the conduct of a company's affair; or
> (b) an actual or proposed act or omission by or on behalf of the company; or
> (c) a resolution or a proposed resolution of members or a class of members of a company;
> is either:
> (d) contrary to the interest of the members as a whole; or
> (e) oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity, or in any other capacity.

According to Elliott J, section 232 is to be interpreted broadly and the definition of "affairs" under s. 232(a) is non-exhaustively defined. His Honour differentiated sections 232(d) and 232(e), stating that while they may overlap, the words must be given a separate and independent operation. Following *Campbell v Backoffice Investments Pty Ltd* (2008) 66 ACSR 359, his Honour noted that s. 232(d) was not confined to commercial unfairness and extended not only beyond the disparate treatment of members, but also beyond conduct oppressive to the members as a whole. In contrast, s. 232(e) related to commercial unfairness upon a member or a class of members. The language of s. 232(e) is to be viewed as a whole to ascertain whether the degree of commercial unfairness is sufficient to justify an order being made under s. 233.

Citing the judgment of Brennan J in *Wayde v NSW Rugby League Ltd* (1985) 180 CLR 459, Elliott J stated that the test of "commercial unfairness" requires objective consideration and assumes that "reasonable directors weigh the furthering of the corporate object against the disadvantage, disability or burden which their decision will impose, and address their minds to the question whether a proposed decision is unfair". Further, assessing commercial unfairness requires a careful consideration of the conduct of both the plaintiff and defendant.

(i) Did the Defendant's conduct form part of the "affairs" of the Company?

Elliott J found that the conduct of the Defendant was "of the Company's affairs" as the Defendant's nominee directors were actively involved in, and had full knowledge of, the strategy implemented by the Defendant.

In coming to this conclusion, his Honour did not need to go beyond the narrow approach taken in *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324, or to consider the differing approaches of the Law Lords in that case, nor how those approaches have been treated in subsequent Australian cases. However, in deference to the submissions of the parties, his Honour addressed those matters.

His Honour explained that there were two contrasting approaches in the case, namely Viscount Simond's broad approach and Lord Morton's narrow approach. The broad approach allows the Court to treat the affairs of the parent company to be the affairs of the subsidiary without the need to examine the conduct of the nominee directors. On the other hand, the narrow approach requires the Court to look for wrongful conduct on the part of the nominee directors in order to establish the conduct of the parent as the conduct of the subsidiary.

By reference to subsequent Australian cases, his Honour noted that both the broad and narrow approaches have been adopted in Australia. His Honour did not consider the authorities to limit a court's approach, when considering whether conduct is "conduct of a company's affairs" in the context of a relationship of a holding company and a subsidiary, to the narrower approach taken by Lord Morton. His Honour concluded that the issue as to the extent of the meaning of "affairs" in this context is not settled.

(ii) Was the Defendant's conduct oppressive?

His Honour found that the Defendant's conduct was oppressive, most notably its actions in demanding payment from the Company and placing the Company into administration. While the Defendant was legally entitled to make the demand, the demand was made with the ulterior motive of breaking the stalemate between the Defendant and Plaintiff regarding the value of the Plaintiff's shares.

Further, placing the Company into administration was done for the sole purpose of depriving the Plaintiff of the value of his shares. His Honour found that the Defendant

did not have legitimate solvency claims as it continued to supply the Company with stock even though the Plaintiff withheld payments. This conduct was inconsistent with its demand. His Honour held the Defendant proceeded on grounds that were beneficial to itself and to the detriment of all remaining minority shareholders, including the Plaintiff.

(iii) Was the Plaintiff engaged in oppressive conduct and should this affect his entitlement to relief?

Elliott J found that while the Plaintiff had engaged in conduct that was oppressive, the Defendant's response was disproportionate and commercially unfair as it destroyed the Company's ability to operate a business in Australia as well as deprive the Plaintiff of the value of his shares. Therefore, the Plaintiff's oppressive conduct should not affect any entitlement to relief.

The Court rejected the Defendant's submission that the Company should be wound up. Echoing the words of Lord Keith in *Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324, his Honour said to do so in the circumstances would defeat the whole purpose of the section. The Court ordered the Defendant to purchase the shares of the Plaintiff at a price to be determined.

6.6 Director of Fishinthenet off the hook: Unsuccessful statutory derivative action application

(By Geoff Hoffman and Preeti Chugh, Clayton Utz)

In the matter of Fishinthenet Investments Pty Ltd and Coastal Waters Seafood Pty Ltd [2014] NSWSC 260, Supreme Court of New South Wales, Black J, 18 March 2014

The full text of this judgment is available online.

(a) Summary

This case concerns an unsuccessful application for leave to bring a statutory derivative action under the Corporations Act 2001 (Cth) (the Corporations Act). There are five crucial elements that must be met in order for a court to grant leave. In this case, the applicant failed to establish that a statutory derivative action was in the best interests of the companies and that there was a serious question to be tried.

(b) Facts

(i) Sale of business

In December 2011, Fishinthenet Investments Pty Limited (FITN) and its wholly owned subsidiary Coastal Waters Seafood Pty Ltd (CWS) resolved to sell its business. In August 2012, the shareholders of FITN resolved that Dennis G Pamplin Pty Ltd (DGP), a majority shareholder of FITN, would purchase the remaining shares in the company from Mr Jeff Hunt and his sister (the remaining shareholders), at a price which valued both companies at $2.5 million. There was no formal resolution to this effect; rather, there was an informal agreement via email between all the parties. Contrary to this 'informal' resolution, Mr Hunt, in his capacity as sole director of FITN, later agreed to sell the entire business undertaking of FITN and CWS to a third party, Sun Rising Fisheries Pty Ltd (Sun Rising) for approximately $2.15 million. This sale proceeded with a condition that $150,000 of that sale amount was to be withheld by Sun Rising for a period of 12 months and that Mr Hunt would be employed by Sun Rising for a minimum of 6 months. The sale of the business was completed in April 2013.

DGP contended that:

- Mr Hunt accepted an offer on terms inferior to an existing alternative offer (being its own offer to purchase the business), conduct which meant that Mr Hunt allegedly breached his fiduciary duties to FITN and CWS; and
- Mr Hunt entered into a transaction that had a collateral personal benefit (being his employment with FITN).

In contrast, Mr Hunt alleged that DGP withdrew its proposed offer (the circumstances of which were not disclosed to the court) soon after it had been agreed between the parties, after which negotiations began with Sun Rising. During the negotiation and sale process, DGP objected to the sale, but in those objections neither referred to its offer nor asserted that offer was still open or still capable of acceptance.

(ii) Directors' Fees

DGP alleged that, in breach of his duty to the companies, Mr Hunt had received directors' fees and consulting fees from FITN and CWS. While Mr Hunt did not contest this allocation of the sale proceeds, he claimed that he received them on the basis of a conversation in 2005 in which it was agreed that he would be paid annual fees out of sufficient profits as a condition of his becoming a director of the companies.

DGP sought to bring a derivative action in the name of FITN and CWS against Mr Hunt in respect of all the above claims under s.s 236 and 237 of the Corporations Act 2001 (Cth) and also sought a declaration holding Mr Hunt liable for any benefit he received as a result of a breach of fiduciary duty.

(iii) Need for indemnity

The court stressed the significance of indemnities in the context of a statutory derivative action. Given the potential costs that could be incurred by FITN and CWS if the proposed proceedings were unsuccessful, DGP would need to provide an indemnity in favour of FITN and CWS. DGP indicated that such an undertaking could be provided or, alternatively, could be a condition to granting the leave.

The court held that in the absence of any evidence to show DGP's ability to meet such an indemnity, a further hearing date would be required which would add further costs to the matter. While DGP would be required to reimburse Mr Hunt for his additional costs, there was no guarantee that DGP had the assets to meet such an order.

(c) Decision

In order to grant leave under s. 237(2) of the Corporations Act, the court must be satisfied of the following five matters:

> (a) it is probable that the company will not itself bring the proceedings, or properly take responsibility for them, or for the steps in them; and
> (b) the applicant is acting in good faith; and
> (c) it is in the best interests of the company that the applicant be granted leave; and
> (d) if the applicant is applying for leave to bring proceedings - there is a serious question to be tried; and
> (e) either:
> (i) at least 14 days before making the application, the applicant gave written notice to the company of the intention to apply for leave and of the reasons for applying; or
> (ii) it is appropriate to grant leave even though subsection (i) is not satisfied.

The court considered the first of these conditions to be satisfied, noting that it was probable that FITN and CWS would not otherwise bring the proceedings as there was no contention from Mr Hunt that this requirement was not satisfied.

The court also concluded that DPG was acting in good faith. The relevant factors to consider in determining whether an applicant is acting in good faith are:

- the applicant's honest belief that a good cause of action exists and has reasonable prospects of success; and
- whether the applicant is seeking to bring the proceedings for a collateral purpose.

The court noted that this requirement is easily satisfied where the application is made by a current shareholder and the proceedings seek recovery of property so that the value of the applicant's shares will increase. As DGP was essentially in this position, the court was willing to infer that the proceedings were brought in good faith and DGP

was not acting for a collateral purpose.

The court considered together the requirements under ss. 237(2)(c) and (d), being whether the grant of leave was in the companies' best interests and whether there was a serious question to be tried. Relevant considerations in determining whether the proposed action was, on the balance of probabilities, in the best interests of the companies were their prospects of success, their likely costs, the likelihood of recovery if the proceedings were successful, and the likely consequences if they were not.

The court considered whether there was a serious question to be tried in relation to DGP's proposed pleadings regarding the sale of business, the directors' fees and the need for indemnity. It found, in relation to each of these, insufficient grounds upon which to grant leave.

In respect of the notice requirement for the grant of leave in s. 237(2)(e), the court noted that no such notice had been given as DGP considered that fulfilling this requirement would be "futile" given Mr Hunt was the sole director of the FITN and CWS and Mr Hunt did not contend that leave should not be granted by reason of the absence of such a notice.

A stay of 28 days was granted to allow DGP to lead any further evidence of its ability to give an indemnity to FITN and CWS and to meet Mr Hunt's costs for an additional hearing.

6.7 Threshold for obtaining security for costs: Reason to believe that the plaintiff will be unable to meet an adverse order for costs

(By Julie Chan, Ashurst Australia)

Cornelius v Global Medical Solutions Australia Pty Ltd; Farag v Global Medical Solutions Australia Pty Ltd [2014] NSWCA 65, New South Wales Court of Appeal, Macfarlan JA, Ward JA and Tobias AJA, 17 March 2014

The full text of this judgment is available online.

(a) Summary

In this case, the New South Wales Court of Appeal held that the threshold test on an application for security for costs under rl. 42.21(1)(d) of the Uniform Civil Procedure Rules 2005 (NSW) (the Uniform Civil Procedure Rules) and s. 1335(1) of the Corporations Act 2001 (Cth) (the Corporations Act) is whether there is "reason to

believe" that the plaintiff "will be" unable to meet an adverse costs order. The words of the statute and rule do not require consideration of whether there is "a risk" that the plaintiff will not have sufficient funds.

(b) Facts

This case is ancillary to the substantive proceeding involving the nuclear pharmacy company, Global Medical Solutions Australia Pty Ltd (GMSA), and a number of its former senior employees, including Cornelius and Falag (the Defendants). In the substantive proceeding, GMSA alleged that the Defendants conspired to divert GMSA's business and use its property, including confidential information, in competition with GMSA.

The Defendants sought security for costs against GMSA pursuant to rl. 42.21(1)(d) of the Uniform Civil Procedure Rules and s. 1335(1) of the Corporations Act 2001. The power to grant security for costs arises under s. 1335(1) of the Corporations Act if "it appears by credible testimony that there is reason to believe that the corporation will be unable to pay the costs of the defendant if successful in his, her, or its defence".

At first instance, Stevenson J refused to grant security for costs on the basis that there was no reason to believe there was a risk that GMSA would be unable to meet an adverse costs order (*Global Medical Solutions Australia Pty Ltd v Axiom Molecular Pty Ltd* [2013] NSWSC 1433). Since the decision to deny security for costs is interlocutory in nature, an appeal does not lie as of right and the Defendants applied to the Court of Appeal seeking leave to appeal. In particular, the Defendants submitted that Stevenson J erred in assessing GMSA's financial position.

(c) Decision

The Court of Appeal refused to grant leave to appeal on the basis that the Defendants were unable to establish material error in the reasons of Stevenson J.

It was accepted by all parties that there is no material difference between rl. 42.21(1)(d) of the Uniform Civil Procedure Rules and s. 1335(1) of the Corporations Act.

The Court of Appeal adopted a narrower formulation than Stevenson J's enunciation of the threshold test for security for costs applications. While Stevenson J considered that the power to grant security for costs arose where there is reason to believe there is a real or sensible, and not merely fanciful or theoretically possible, risk that the party will be unable to meet an adverse costs order, Macfarlane JA considered that this formulation of the test was too generous. The Court of Appeal confirmed that the statutory language does not refer to a requirement of there being a "risk", and that the existence of a risk is insufficient (at [16]). The conclusion then followed that the Defendants submissions would fall short of Macfarlane JA's narrower formulation of the threshold test. Ward JA additionally commented that the threshold test requires

there be a rational basis for the requisite belief to be held that the party will be unable to satisfy an adverse costs order.

In relation to the onus of proof, Macfarlane JA confirmed that "the legal onus of proving entitlement to an order for security of costs ... rest[s] throughout on an applicant for such an order" (at [20]).

On the factual question, the Defendants submitted that Stevenson J erred in his Honour's consideration of the material facts concerning GMSA's financial position, including:

- erroneously classifying GMSA's inter-company loans as long-term liabilities rather than as current liabilities;
- failing to take into account that most of GMSA's assets as recorded in management accounts were constituted by goodwill;
- failing to consider that GMSA's legal costs incurred in the substantive proceedings would prejudice its ability to meet an adverse costs order;
- erroneous consideration of GMSA's prospects of borrowing against its assets;
- erroneous consideration of whether GMSA's parent company would "cut [GMSA] adrift" if the parent company was ordered to meet an adverse costs order made against GMSA; and
- erroneous calculation of GMSA's assets and the ability of GMSA to realise its assets in sufficient time to meet an adverse costs order.

In spite of the Defendants' submissions, the Court of Appeal was unable to find any material error in Stevenson J's reasons. As the Defendants were unable to establish that the power to grant security for costs had arisen, the Court of Appeal did not further consider the factors relevant to the discretion to grant security for costs.

6.8 Litigation funding approval and admittance of fresh evidence on appeal

(By James Marburg and David Bryant, King & Wood Mallesons)

Re Ascot Vale Self-Storage Centre Pty Ltd (in liquidation) [2014] VSC 75, Supreme Court of Victoria, Robson J, 11 March 2014

The full text of this judgment is available online.

(a) Summary

The case was an appeal from a decision in the Commercial and Equity Division of the Supreme Court of Victoria by an Associate Judge giving approval for a liquidator to

enter into a litigation funding deed.

Robson J found that the Associate Judge erred in failing to take into account all relevant matters when he exercised his discretion to approve the funding deed. His Honour subsequently allowed the appeal and set aside the decision of the Associate Judge. His Honour also found that the Associate Judge erred in not admitting some evidence from an ongoing case involving the same parties (the Fingal proceeding).

(b) Facts

The case was an appeal from a decision by Randall AsJ giving approval for a liquidator to enter into a litigation funding deed under s. 477(2B) of the Corporations Act 2001 (Cth) (the Corporations Act).

A unit trust (Ascot Vale Self Storage Centre Unit Trust) was established with a number of unit holders contributing funds for the purpose of undertaking a joint venture to acquire and develop a property. The Unit Trust subsequently went into liquidation and the creditors were in dispute as to whether the funds provided to the unit trust by the unit holders were provided on a secured or unsecured basis, and in relation to the validity of certain charges over the trust assets.

In the course of the liquidation, the liquidator, Wallace-Smith, was approached by one of the creditors of the Unit Trust, Melville, in relation to funding an action against another of the creditors, Leggo, for breach of contract or insolvent trading in relation to Leggo's role as trustee of the unit trust (the Fingal proceeding). The liquidator agreed to enter into a funding deed with Melville in relation to the funding of these proceedings. The deed included a clause (clause 12) prohibiting the liquidator from challenging a charge that Melville's company held over the trust assets.

Relevant legal provisions

Court approval for litigation funding arrangements is required under s. 477(2B) of the Corporations Act where it is likely that the litigation being funded will continue for more than three months after the deed has been entered into.

The Federal Court noted in the matter of *Newtronics Pty Ltd* [2007] FCA 1375 that, in exercising the Court's power under s. 477(2B), the Court does not simply "rubber stamp" what is put forward by a liquidator, and that the Court grants approval under s. 477(2B) of the Act only where the transaction is the proper realisation of the assets of the company or otherwise assists in the winding up of the company.

In addition, the judgment of Austin J in *Re ACN 076 673 875 Ltd* [2002] NSWSC 578 also summarises relevant factors that the Court will take into account in determining these matters.

These include:

- the liquidator's prospects of success in the proceedings;
- the interests of creditors other than the proposed defendants;
- the nature and complexity of the cause of action; and
- the risks involved in the claim (including the amount of costs likely to be incurred in the proposed litigation).

At first instance, having considered the above factors, the Associate Judge was satisfied that the funding deed should be approved.

(c) Decision

This decision dealt with a preliminary issue as to the nature of the appeal and three further grounds of appeal brought by the appellants in relation to the approval of the funding deed by the Associate Judge.

(i) Preliminary issue - nature of appeal

The appellants wished to rely upon an affidavit to lead certain evidence in the appeal proceeding. So that they might do so, the appellants argued that the appeal (from Associate Judge to Trial Division Judge) fell between a strict appeal to the Court of Appeal or the High Court and a rehearing *de novo*. In their application, the appellants acknowledged that an appeal to the Court of Appeal from a Judge of the Trial Division is a strict appeal, and that in the case of a strict appeal the power to admit fresh evidence is strictly limited. The appellants contended that in order for fresh evidence to be admitted, it is necessary to demonstrate that the evidence is truly fresh evidence and that it could not with reasonable diligence have been discovered in the gist of the trial. This is the test set out in *McDonald v McDonald* (1965) 113 CLR 529.

Practice Note No 4 of 2012 (current) states that under the Supreme Court (Associate Judges Appeals Amendment) Rules 2012, appeals from Associate Judges to a Judge of the Trial Division are to be by way of re-hearing rather than by re-hearing *de novo*.

Ultimately, Robson J held that the nature of an appeal to a Judge of the Trial Division from a decision of an Associate Judge is not of a nature that falls between an appeal to the Court of Appeal and a rehearing *de novo*. In his opinion, on an appeal from an Associate Judge to a Judge of the Trial Division, fresh evidence may be admitted in the limited circumstances as described in *McDonald v McDonald*, as it would be on an appeal to the Court of Appeal.

Robson J subsequently found that, as the relevant evidence was known and available at the time of the hearing before the Associate Judge it was not fresh evidence and was therefore not admissible in the appeal proceeding.

(ii) Grounds

The body of the appeal was based on three grounds for striking out the approval of the funding deed. Firstly, it was argued that the deed was not in the interests of creditors, secondly that the funding deed contained inconsistent clauses and therefore failed for uncertainty and thirdly that the Associate Judge erred in declining to read certain witness statements associated with the Fingal proceedings.

Approval not in the interests of creditors

Robson J found that the Associate Judge had failed to take into account all relevant matters in exercising his discretion to approve the funding arrangement and had thereby erred. Specifically, his Honour found that clause 12 of the agreement (described above) surrendered the opportunity for the liquidator to challenge a particular charge that had been made over the assets of the company. This prevented the current liquidator or any future liquidator from acting in the interests of all creditors without fear or favour. Accordingly, Robson J did not consider that it was in the interests of the liquidation to approve the funding deed.

Funding deed void for uncertainty

This ground of appeal alleged that the Associate Judge erred in failing to find that the funding deed was uncertain in view of alleged inconsistency in the construction of two clauses in the funding deed, which related to the funding fee. Robson J found no inconsistency between the clauses identified by the appellants.

Associate Judge erred in declining to read witness statements

The Associate Judge declined to read certain witness statements filed in the Fingal proceeding or have regard to the extracts of those witness statements referred to in the affidavits in opposition to the liquidator's application for approval under s. 477(2B).

In so declining the Associate Judge said that the filing of such witness statements, pursuant to the orders of the Court in the Fingal proceeding, were captured by Commercial Court Practice Note No 10, which provides a party receiving a witness statement is taken to have done so subject to an implied undertaking to the Court that the witness statement will not be used for any purpose other than the proceeding it was intended for.

In special circumstances, as set out in *Springfield Nominees Pty Ltd v Bridgelands Securities Ltd* (110 ALR 685), the Court may modify or vary the implied undertaking referred to above. The Springfield case sets out certain factors that a Court can consider in exercising its discretion to modify or vary the implied undertaking to allow a witness statement to be used in a second proceeding.

These include:

- the nature of the document;
- the circumstances under which it came into existence;
- the attitude of the author and the prejudice the author may sustain;
- whether the document pre-existed litigation or was created for that purpose; and
- most importantly the likely contribution of the document to achieving justice in the second proceeding.

Having considered these factors, Robson J found that "special circumstances" did exist in the liquidator's application which afforded a reason for modifying or releasing the undertaking. In his view, the Fingal proceedings and the liquidator's action against Leggo were both manifestations of the dispute that had arisen between the joint venture parties. Accordingly, Robson J held that the statements should have been admitted into evidence in the hearing before the Associate Judge.

6.9 The reinstatement of a deregistered company and whether its former liquidator automatically resumes office upon reinstatement

(By Peter Motti, Minter Ellison)

In the matter of ERB International Pty Limited (deregistered) [2014] NSWSC 200, Supreme Court of New South Wales, Brereton J, 7 March 2014

The full text of this judgment is available online.

(a) Summary

The Court considered whether it was just to order the reinstatement of a deregistered company, pursuant to an application by its former liquidator, where the purpose for reinstatement was for the liquidator to bring claims against the former directors. The Court also considered whether, upon reinstatement, a former liquidator automatically resumes office.

(b) Facts

ERB International Pty Ltd (the Company) went into liquidation pursuant to a creditors' voluntary winding up on 2 April 2008. Its liquidators were the applicant Mr Fiorentino together with William James Hamilton. At the request of the liquidators, the company was deregistered on 24 January 2010. On 16 September 2011, the first respondent, ASIC, commenced investigating the liquidators' administration of the Company, and on 12 June 2013 filed applications against each liquidator in the Companies Auditors and Liquidators Disciplinary Board (CALDB), alleging that they were not fit and

proper to remain a liquidator.

One of the allegations against Mr Fiorentino was that he failed to properly investigate potential voidable transactions or misappropriation of funds by the directors. On 4 November 2013, Mr Fiorentino, having previously notified ASIC of his intention, instituted the proceedings for the reinstatement of the Company (Mr Hamilton did not wish to be reappointed as liquidator). ASIC, subject to a number of provisos, did not oppose the application, but did oppose the reappointment of Mr Fiorentino as liquidator. The former directors of the Company also opposed the application, essentially on the ground that it was not demonstrated to be "just" that the company be reinstated.

(c) Decision

Section 601AH(2) of the Corporations Act 2001 (Cth) (the Corporations Act), provides that the Court may make an order that ASIC reinstate the registration of a company upon the application of "a person aggrieved" by the deregistration, or a former liquidator of the company, if the Court is satisfied that it is just that the company's registration be reinstated.

(i) Would it be just to order reinstatement?

Brereton J observed that the provision that the Court "may" order reinstatement if satisfied that it is "just" to do so had been said to confer a broad discretionary judgment on the Court. His Honour stated that relevant considerations included "the circumstances in which the Company was de-registered, the purpose in seeking its re-instatement, whether any person is likely to be prejudiced by reinstatement, and the public interest generally."

His Honour noted that the Company was deregistered at the request of the liquidators, who had entered into a deed of release (the Deed) with the directors under which they gave a general release of all claims they or the Company had or might of had against the directors arising out of or in any way related to the affairs of the Company. The Deed recited that the liquidators had formed the view that it was appropriate to publically examine the directors and that there were undisclosed causes of action which could be investigated.

His Honour also noted that the purpose of seeking reinstatement in this case was "said to be to enable the liquidator to pursue claims against the former directors, for moneys allegedly taken by them from the company" and that "[a]t first sight, the deed of release stands in the way of any such proceedings". His Honour accepted that the applicant bore the burden of adducing evidence that persuades the Court that reinstatement is "just", but in doing so, His Honour pointed out that in the application for reinstatement, "the Court is concerned with the justice of reinstating the Company - not the justice of any proceedings which it proposed that the reinstated Company might institute or resume." His Honour referred to the decision of the Victorian Court

of Appeal in *AMP General Insurance Ltd v Victorian Workcover Authority* [2006] VSCA 236, quoting (at [35]), without disapproval, the primary judge's statement:

> The application for reinstatement is not the appropriate venue to deal with such matters, other than in the clearest of clear cases. If it were clear that the prospective action would be stayed as an abuse of process, then the reinstatement would be futile and the Court would not order it, either because it was not just to do so or in the exercise of the Court's residual discretion. That is not the position I am in. It is not clear to me that the prospective proceeding will be stayed as an abuse of process.

His Honour took the view that it would be "a very rare case" that simply reinstating a company would be prejudicial to a potential defendant, noting that all that the defendant would be deprived of is "the opportunity to prevent the proceedings even being instituted - an issue on which a defendant usually has no say". His Honour thought that the Court should not, on a reinstatement application, conclude that reinstatement would be unjust on account of considerations equivalent to abuse of process or want of prosecution unless "affirmatively satisfied that a fair trial could not be had, or that the proposed proceedings were doomed to fail".

His Honour judged that public policy favoured reinstatement of the Company, in order to enable the matters regarding the former directors to be investigated, and for any potential causes of action to recover funds for the benefit of the creditors to be explored. His Honour, therefore, was satisfied that it was just that the Company's registration be reinstated.

(ii) Does the former liquidator automatically resume office?

In considering this question, his Honour noted that there was some controversy in the authorities as to the effect of a reinstatement order in the context of a company in liquidation, as regards the status of the liquidator (although it was accepted that a company in liquidation, upon a reinstatement order being made, continued in liquidation). The disagreement in the authorities was as to whether the former liquidator automatically resumes the office of liquidator (as is the case with directors).

The relevant section of the Corporations Act, s. 601AH(5), provides that:

> If a company is reinstated, the company is taken to have continued in existence as if it had not been deregistered. A person who was a director of the company immediately before deregistration becomes a director again as from the time when ASIC or the Court reinstate the company...

His Honour thought that it was significant (as did the cited authorities), that while the subsection makes provision for a former director to resume office, it did not make

provision for a former liquidator to do so - notwithstanding that subsection (2)(b) expressly confers standing to make an application on a "former liquidator".

Later cases had cast doubt on the proposition that the effect of reinstatement is to return the company to the precise position in which it was before deregistration. His Honour specifically cited that decision of Barrett J, in *Ramantanis v G&M Excavations Pty Ltd* [2003] NSWSC 1250, where Barrett J took the view that the liquidator did not automatically resume office on reinstatement. His Honour agreed with Barrett J as to the implication to be drawn from the fact that s. 601AH(5) specifically provides for the continuity of directors of a re-registered company, that is that on re-registration of a company, the liquidator who was in office at the time of deregistration is not automatically reinstated and therefore, it is necessary for the Court to make a new appointment to take effect on re-registration.

His Honour, therefore, held that the effect of reinstatement was that a company is taken to have continued in existence as if it had not been deregistered, not that it comes back into existence in the same form (but, upon the reinstatement of a company that was at the time of deregistration in liquidation, it remains in liquidation unless the court otherwise orders).

His Honour went on to state that "while all other things being equal, reappointment of the former liquidator is preferable, it will not be the appropriate course where there are considerations militating against that course." In this case, his Honour had regard to the serious possibility that the liquidator may have to be replaced and concluded that "it would not be appropriate to reappoint Mr Fiorentino and that new liquidators should be appointed".

His Honour ordered, *inter alia*, that:

- pursuant to s. 601AH(2) of the Corporations Act, ASIC reinstate the registration of the Company; and
- pursuant to s. 601AH(3)(b) and (d) of the Corporations Act, new liquidators be appointed to the Company.

6.10 Suppliers beware: Care must be taken to ensure security interests arising under a retention of title clause are perfected under the Personal Property Securities Act 2009 (Cth)

(By Tracey Kile and Clementyne Rawlyk, Corrs Chambers Westgarth)

Central Cleaning Supplies (Aust) Pty Ltd v Elkerton [2014] VSC 61, Supreme Court of Victoria, Ferguson J, 7 March 2014

The full text of this judgment is available online.

(a) Summary

This case considered the requirements for perfecting a transitional security interest under the Personal Property Securities Act 2009 (Cth) (the PPS Act). Specifically, the Court looked at whether a supplier's approved credit application that was signed by the customer before the commencement of the PPS Act (the Credit Agreement) validly incorporated a retention of title condition printed on the supplier's invoices and issued after the commencement of the PPS Act, such that the Credit Agreement was a "transitional security agreement" for the purposes of the PPS Act provisions.

Pursuant to the transitional provisions of the PPS Act, a security interest granted under a transitional security agreement was automatically perfected without the need for registration for an initial two-year transitional period (which, incidentally has now expired). The supplier relied on these transitional provisions as grounds for arguing that it had a perfected security interest in the goods it supplied to the customer and that it was entitled to seek the return of those goods when the customer entered liquidation and defaulted on some invoices.

In her decision, Ferguson J held that the supplier was not entitled to the protection of the transitional PPS Act provisions as the retention of title clause which created the security interest was neither contained within, nor incorporated into, the Credit Agreement. This was because the retention of title condition printed on the invoice stated that it applied in relation to the goods the subject of that particular invoice. This, the Court held, created an individual sale agreement in respect of each separate supply. As the transactions in question had occurred between November 2012 and May 2013 - that is, after the 30 January 2012 commencement date for the Personal Property Securities Register (the PPS Register) - in the absence of both a perfected transitional security interest and registration on the PPS Register, the supplier had no claim over the unpaid goods.

(b) Facts

Central Cleaning Supplies (Aust) Pty Ltd (Central Cleaning) supplied cleaning equipment and products to Swan Services Pty Ltd (Swan Services). In September 2009, Swan Services signed the Credit Agreement which stated, among other things, that the supply of goods to Swan Services was governed by Central Cleaning's "Standard Terms and Conditions" and that Swan Services would have 30 days to pay for any goods supplied by Central Cleaning. The "Standard Terms and Conditions" referred to in the Credit Agreement were not attached to the document and they were not otherwise provided to Swan Services.

The arrangement between the companies from that point was that, upon receiving a purchase order from Swan Services, Central Cleaning would deliver the requested

goods within approximately four weeks. Following delivery of the goods, Central Cleaning would then render an invoice to Swan Services. Printed at the bottom of each invoice was a retention of title "Condition of Sale". This condition stated that the goods the subject of that particular invoice remained the property of Central Cleaning until the whole of the purchase price for those goods had been paid in full by Swan Services (the ROT Clause).

The PPS Register commenced operation on 30 January 2012. At no time following the commencement of the PPS Register did Central Cleaning register any security interest it had over the goods delivered to Swan Services by virtue of the ROT Clause. Between November 2012 and May 2013, Central Cleaning supplied various equipment and products in the manner described above, but Swan Services did not pay for them. When Swan Services was placed into administration (and then liquidation) in May 2013, Central Cleaning claimed the return of the unpaid goods. The Liquidators rejected Central Cleaning's claim on the basis that Central Cleaning had not perfected its security interest in the unpaid goods and as such the goods had vested in Swan Services when it went into administration. Central Cleaning appealed to the court to reverse the Liquidators' decision.

Personal Property Securities legislation

Under the PPS Act, a supplier of goods is only entitled to reclaim the goods if the supplier has a 'security interest' in those goods and if that security interest has been "perfected".

(i) "Security interest"

By virtue of s. 12 of the PPS Act, a supplier will have a "security interest" in the goods if it sells those goods subject to a retention of title clause which, in substance, secures payment or performance of an obligation. The ROT Clause printed on Central Cleaning's invoices thus created a security interest in the goods in favour of Central Cleaning for the purposes of the PPS Act.

(ii) "Perfected security interests

The most common method of perfecting a security interest is to register the interest on the PPS Register. However, as stated above, Central Cleaning did not do this. Accordingly, Central Cleaning sought to rely on the transitional provisions of the PPS Act which provide for automatic perfection of transitional security interests immediately before the commencement of the PPS Register, where such interests are contained in a "transitional security agreement". Section 307 of the PPS Act defines a transitional security agreement as "a security agreement that is in force immediately before the registration commencement time, and that continues in force at and after that time."

Central Cleaning claimed that the ROT Clause formed part of the Credit Agreement

with Swan Services and therefore, that the Credit Agreement constituted a transitional security agreement for the purposes of the PPS Act. In this regard, Central Cleaning sought to persuade the Court that, among other things, the references in the Credit Agreement to its "Standard Terms and Conditions" was a reference to, and therefore incorporated, the ROT Clause which appeared on the invoices.

On the basis that the Credit Agreement was a transitional security agreement under the PPS Act, Central Cleaning argued that from 30 January 2012, it had a perfected transitional security interest over the equipment it provided to Swan Services and was therefore entitled to reclaim the unpaid goods from the Liquidators.

(c) Decision

The Court dismissed Central Cleaning's application, finding in favour of Swan Services. Ferguson J held that the ROT Clause did not form part of Central Cleaning's "Standard Terms and Conditions" and therefore was not incorporated into the Credit Agreement. In reaching this decision, Ferguson J was persuaded by the fact that the ROT Clause printed on each invoice stated that Central Cleaning retained title to the goods the subject of that specific invoice. Ferguson J held that a separate sale contract was constituted each and every time goods were sold to Swan Services.

As the Credit Agreement did not grant a security interest in favour of the supplier, it was not a transitional security agreement. Consequently, Central Cleaning could not rely on the benefit of the transitional provisions of the PPS Act to create a perfected security interest. Further, as it had not registered any interest on the PPS Register after 30 January 2012, it had no basis on which to seek the return of the unpaid equipment. The Court therefore held that the Liquidators were correct to reject Central Cleaning's claim.

6.11 Claim of estoppel leading to a successful application to set aside a creditor's statutory demand

(By Louis Italiano, DLA Piper)

In the matter of International Materials & Technologies Pty Ltd [2014] NSWSC 168, Supreme Court of New South Wales, Black J, 4 March 2014.

The full text of this judgment is available online.

(a) Summary

This case concerned an Originating Process seeking an order to set aside a creditor's

statutory demand pursuant to ss. 459G - 459H of the Corporations Act 2001 (Cth) (the Corporations Act).

In considering whether to set aside the creditor's statutory demand, Black J examined whether a genuine dispute had arisen for the purposes of s. 459H(1)(a) by reason of:

- the fact that the agreement in relation to which the relevant debt had accrued contained a clause requiring that it be enforced and construed pursuant to the laws of the State of Michigan;
- the plaintiff's assertions that the defendant had never been validly assigned the relevant debt; and
- the plaintiff's claims of estoppel against the defendant.

Black J further considered whether an offsetting claim could be established under s. 459H(1)(b) of the Corporations Act. His Honour held that the evidence led by the plaintiff was not capable of establishing or quantifying such a claim except in relation to a previous, undisputed costs order made by the Court.

(b) Facts

Hougen Manufacturing Inc (Hougen Manufacturing) was a manufacturer of magnetic drilling machines, other machinery and lubricants and accessories. International Materials & Technologies (IMT) was a distributor of chemicals, machinery and other products to the mining, manufacturing and process industries. On 1 August 2005, IMT entered into an exclusive distributorship agreement (the Distributorship Agreement) with Hougen Manufacturing.

In October 2012, Hougen Manufacturing validly terminated the Distributorship Agreement and subsequently assigned its right, title and interest in respect of debt owed to it by IMT to its wholly owned Australian subsidiary, Hougen Australia.

On 26 July 2013 Hougen Australia served a creditor's statutory demand on IMT, claiming US$164,532.73 for monies due and payable for goods sold and supplied by Hougen Manufacturing and interest which had accrued on the debt.

By Originating Process filed on 15 August 2013, IMT sought orders under ss. 459G - 459H of the Corporations Act setting aside Hougen Australia's creditor's statutory demand.

(c) Decision

(i) Whether a genuine dispute had been established

IMT sought to set aside Hougen Australia's creditor's statutory demand pursuant to s. 459H(1)(a) of the Corporations Act, which provides a ground for setting aside such a demand where a court is satisfied there is a genuine dispute about the existence or

amount to which the demand relates. After reviewing the authorities, his Honour concluded that IMT needed only to establish it had a "plausible contention" as to its claims to give rise to a genuine dispute for the purposes of s. 459H(1)(a).

IMT contended that genuine disputes existed in respect of the debt it allegedly owed Hougen Australia by reason of the operation of clause 14 of the Distributorship Agreement, which provided:

> This Agreement shall be enforced and construed pursuant to the laws of the State of Michigan. The distributor [IMT] hereby submits to the jurisdiction and agrees that any action with respect to this Agreement shall be brought in the Michigan Courts.

IMT argued that because the Distributorship Agreement required that it be enforced and construed pursuant to the laws of the US State of Michigan, the statutory demand under New South Wales law was of no effect. Black J rejected this argument, noting that there was no reason why foreign law could not be proved in the proceedings. Further, his Honour held that clause 14 referred only to jurisdictional submission by IMT and did not operate to restrict Hougen Manufacturing or Hougen Australia from bringing an action in Australia.

IMT also argued that the assignment of its debt from Hougen Manufacturing to Hougen Australia was invalid as it was undertaken under New South Wales law rather than Michigan law pursuant to clause 14 of the Distributorship Agreement. Black J rejected this contention, noting that the usual position is that a simple contract debt is treated as situated in the place of residence of the debtor unless there exists an agreement to the contrary. His Honour noted that even if such a plausible legal argument had been mounted by IMT, it had not sought to establish the necessary next step of demonstrating that the assignment was not effective under Michigan law.

IMT further argued that as the agreement that assigned its debt to Hougen Australia appointed Hougen Australia as Hougen Manufacturing's 'attorney', its legal effect was to establish a relationship of agency rather than to assign Hougen Australia with the relevant debt. Black J rejected this argument, noting that the agreement made it clear there was an assignment and that the agreement that Hougen Australia would be Hougen Manufacturing's 'attorney' merely authorised Hougen Australia to act in Hougen Manufacturing's name for its own benefit.

IMT contended that a genuine dispute about the existence of the relevant debt had arisen from claims of estoppel it purported to have against Hougen Manufacturing. IMT produced evidence that Hougen Manufacturing had represented it would accept return of all Hougen Manufacturing stock held by IMT in a series of emails dated between 15 October 2012 and 22 December 2012. IMT never returned Hougen Manufacturing's stock because the parties never reached an agreement in respect of the manner in which the return would take place and as to the liability of each party for GST on return of the goods. IMT claimed that as a result of the representations it did

not contact its customer base and offer sale of its stock and had suffered a loss as a result.

After reviewing the authorities in relation to equitable promissory and common law conventional estoppel, Black J noted that whether Hougen Manufacturing's conduct allowed relief in unconscionability could depend on whether IMT had unreasonably delayed in returning the goods or was unreasonable in its approach to the conditions of return including in relation to the dispute as to liability for GST. His Honour held that the question as to whether Hougen Manufacturing's requirement for repayment of debt was unconscionable in the circumstances was a serious question warranting further investigation that should properly be determined in proceedings for recovery of the relevant debt. His Honour therefore ordered that the creditor's statutory demand should be set aside pursuant to s. 459H(1)(a) of the Corporations Act.

(ii) Whether an offsetting claim had been established

Despite having determined that the demand should be set aside under s. 459H(1)(a) of the Corporations Act, Black J considered whether IMT had an "offsetting claim" under s. 459H(1)(b) in case an appellate court took a different view as to whether a genuine dispute had been established and hence the issue would arise. An "offsetting claim" under s. 459H(1)(b) was the amount of a claim or claims that a plaintiff has against the defendant by way of counterclaim, set-off or cross-demand, whether or not the amount arose from the same transaction or circumstances as the debt to which the demand relates.

Whilst Black J considered that the evidence led by IMT may have established a serious claim that Hougen Manufacturing had elected to purchase stock from IMT, his Honour held that a mere election to purchase stock was not capable of establishing an offsetting claim where no stock had actually been returned to Hougen Manufacturing.

Black J noted that even if IMT were able to establish such an offsetting claim, only the difference between the amount payable by Hougen Manufacturing and the amount the goods would realise by ordinary sale on market could be used to quantify the offsetting claim. As IMT had not led any evidence of the market value of the Hougen Manufacturing products in its possession, his Honour held that the quantum of any such offsetting claim could not be established.

Finally, Black J held that an offsetting claim in relation to an undisputed costs order made by the Court in a previous application by IMT to set aside a previous statutory demand served upon it by Hougen Australia would need to be deducted from the amount of the demand, had it not been set aside.

6.12 Good reasons and bad debts - When will courts order that a company already in voluntary liquidation be wound up in insolvency?

(By James Siemon, Minter Ellison Lawyers)

In the matter of Evcorp Grains Pty Ltd (No 2) [2014] NSWSC 155, Supreme Court of New South Wales, Brereton J, 3 March 2014

The full text of this judgment is available online.

(a) Summary

This case examines when the courts will grant an application for winding up of a company where the company is already in voluntary liquidation. Brereton J considered and applied the proposition that there must be 'good reasons' for the court to intervene by making a winding-up order in such circumstances.

(b) Facts

On 29 October 2013, the plaintiff filed an originating process under s. 459A of the Corporations Act 2001 (Cth) (the Corporations Act) seeking orders that the defendant company be wound up in insolvency and a liquidator appointed. On 2 December 2013, before the first return date of those proceedings, the defendant company went into voluntary administration and an administrator was appointed. On 10 December, the proceedings were adjourned by consent to 18 December and again by consent to 11 February 2014.

On 15 January 2014, a second creditors' meeting was held and a resolution was passed that the company be wound up under s. 439C of the Corporations Act. The administration therefore transitioned to a creditors' voluntary winding up under s. 446A of the Corporations Act and the administrator was appointed as liquidator. Concerns which had been raised about the validity of the second meeting and of the resolution to wind up the company were dismissed by Brereton J in an earlier judgment (*Re Evcorp Grains Pty Ltd* [2014] NSWSC 72).

When the matter returned to court on 24 February 2014, the plaintiff sought to have the company wound up in insolvency. The defendant opposed this and submitted that the existing voluntary winding up of the defendant company should continue.

(c) Decision

After setting out the facts discussed above, Brereton J noted that the orders the subject of the proceeding were able to be granted by the court notwithstanding that the defendant company was already in voluntary liquidation and the effect of such an

order is that the court-appointed liquidator supplants the voluntary liquidator. Section 467B of the Corporations Act provides that:

> The Court may make an order under ss. 246AA, 459A, 459B or 461 even if the company is already being wound up voluntarily.

Brereton J therefore proceeded to examine the test to be applied in deciding whether the orders sought by the plaintiff should be made by the court. In particular, his Honour examined prior decisions applying the proposition expressed by Austin J in Carter v New Tel Ltd (in liq) [2003] NSWSC 128 that "there must be good reasons for the Court to intervene by making a winding up order in the case where the company is already in liquidation."

These included:

- *Citrix Systems Inc v Telesystems Learning Pty Ltd (in liq)* (1998) 28 ACSR 529, in which Moore J held that a creditor's reasonably-based belief that a liquidator had not given the appearance of being independent was sufficient grounds for the court to order that the company be wound up and a different liquidator be appointed;
- *Neha Impex International Pty Ltd v Mintz & Co Pty Ltd* [2003] WASC 196, in which Newnes M also examined concerns raised by the plaintiff about the liquidator's independence and noted counsel's acceptance that, where the sole purpose of an application is to replace a voluntary liquidator with a liquidator appointed by the court, the approach to be taken by the court is the same as on an application under s. 503 of the Corporations Act;
- *Carter v New Tel Ltd (in liq)* [2003] NSWSC 128, in which Austin J held that good reasons for the court to order that a company be wound up in insolvency included that the validity of a charge or certain dispositions of property could only be challenged by the liquidator if the court had made such orders;
- *Re Green (as liq of Australian Resources Ltd (in liq))* [2004] NSWSC 1095, in which Barrett J considered it unlikely that "a desire merely to replace the liquidator represents a sufficient reason to make a winding up order in respect of a company already in voluntary winding up" in the absence of an objectively demonstrated need for replacement and held that the enhancement of the prospect that an insurance policy would be responsive to claims against directors for insolvent trading where the liquidator was court-appointed rather than appointed under a creditors' voluntary winding up (with concomitant benefits to the general body of creditors) was a sufficient reason to make the order that was sought; and
- *Deputy Commissioner of Taxation v Tull Reinforcing Pty Ltd* [2006] FCA 810; (2006) 153 FCR 394, in which Besanko J held that the absence of objection to the orders sought and the desire of the applicant to recover costs were not good reasons to order that the company be wound up in insolvency in circumstances where it is already in voluntary liquidation.

Brereton J noted the concerns raised by Foster, Barker and Griffiths JJ in *CBA Corporate Services (NSW) Pty Ltd v Walker; Re ZYX Learning Centres Ltd (recs and mgrs apptd) (in liq)* [2013] FCAFC 74 that the phrase "for good reason" (in relation to the test expressed above) might "displace or distort the otherwise broad discretion conferred by s. 459A". Their Honours expressed their view that:

> [w]hether or not the discretion under s 459A should be exercised in any particular case necessarily turns on an assessment [of] all the relevant circumstances. In our opinion, the broad discretion under that provision should not be inhibited by artificially introducing a requirement of "for good reason" as though that is part of the provision itself.

Citing their Honours reasons for judgment, including the above passage, Brereton J considered that their Honours:

> nonetheless accepted that such an order should only be made in an appropriate case, and that it was relevant that the company was already the subject of a voluntary winding up.

Brereton J set out the position in four considerations:

- firstly, that while "an unpaid creditor who establishes insolvency is usually regarded as entitled to a winding up order almost as of course", the existence of a voluntary liquidation is a relevant consideration and some justification is required to replace it with a compulsory liquidation;
- secondly, that such a justification will ordinarily be found, if at all, in the interests of the administration and the general body of creditors. Brereton J determined that typically the possibility that a court-appointed liquidator will be able to realise additional benefits for the creditors not available to a voluntary liquidator will provide such justification;
- thirdly, that the mere preferences of the plaintiff, such as to replace the liquidator, are insufficient; and
- finally, that the views of the general body of creditors are also a relevant consideration.

Brereton J determined that the grounds advanced by the plaintiff did not impugn the independence of the voluntary liquidator or assert that he had acted in any such way as would justify his removal. Further, Brereton J held that the plaintiff did not suggest that the replacement with a court-appointed liquidator would result in any additional powers or remedies.

Brereton J noted that the Court should not accede to a party's preference for a particular liquidator on account of its threat or promise to fund that liquidator but no other as "to do so would encourage parties to be selective of their funding of liquidators for an irrelevant reason and effectively abdicate the Court's responsibility to select an appropriate, rather than a party's preferred liquidator."

It was determined that when the plaintiff consented to an adjournment of the winding up proceedings pending the administration, it took chances as to the outcome of the administration, of which voluntary liquidation was an obvious outcome. Brereton J held that in reality the plaintiff wished to retrospectively undo the consequences of its consent to the adjournment proceedings to restore a position which would have prevailed but for the intervention of the administration. Brereton J concluded that the desire to rewrite history does not provide sufficient justification to replace the voluntary liquidator with a court-appointed liquidator.

Given these considerations and the facts before him, his Honour found that insufficient cause was shown for replacing the voluntary liquidator with another appointed by the court and therefore dismissed the plaintiff's proceedings.

6.13 Consistency between a shareholders' agreement and constitution

(By Geoff Hoffman and Preeti Chugh, Clayton Utz)

Cody v Live Board Holdings Ltd [2014] NSWSC 78, Supreme Court of New South Wales, Brereton J, 17 February 2014

The full text of this judgment is available online.

(a) Summary

The directors of Live Board Holding resolved to issue and issued a number of preference shares to Bligh Capital and ordinary shares to existing shareholders. The existing shareholders alleged that this issue of shares was not valid under the constitution and the shareholders' agreement. Consequently, the directors sought a declaration from the court that the company had the power and authority to issue those shares. While the shareholders' agreement gave Live Board Holdings the power to issue shares in the company with a simple majority, the constitution stated that any issue of shares which affected the rights of existing shareholders would require a special resolution of holders of shares in that class. There was also a provision for the shareholders' agreement to prevail where there was an inconsistency with the constitution. The court was of the opinion that, while only a simple majority was required for the issue of shares under the shareholders' agreement, it nonetheless varied the rights of the existing shareholders. It did not consider the provisions in the two governing documents as inconsistent; rather, Live Board Holdings was required to comply with both provisions. Accordingly, the application for a declaration that the company had power and authority to make the share issue was refused.

(b) Facts

In August 2013, the board of Live Board Holdings resolved to issue 5,226,550 preference shares to Bligh Capital (a new shareholder) and 3,323,324 ordinary shares to existing shareholders pursuant to anti-dilution provisions. A dispute arose between an existing shareholder and the board as to whether the share issue was valid and in line with the constitution and shareholders' agreement of Live Board Holdings. The board consequently sought a declaration from the New South Wales Supreme Court that it had the power and authority to issue those shares and had the power and authority to issue further shares to raise capital in Live Board Holdings (the latter declaration was ultimately not sought by Live Board Holdings at the hearing).

(i) The constitution

Live Board Holding's constitution provided that the directors could cause the company to issue and allot securities with such preferred, deferred or other special rights to any person, whether member or not, in such proportions or numbers and for such consideration as the directors determined. However, if that share issue directly or indirectly varied the rights of a class of shares, the variation would require the approval of at least 75% of holders of shares of that class.

(ii) The shareholders' agreement

The shareholders' agreement provided that the management of the company was under the direction and control of the board. However certain powers of the company were reserved for decision by shareholders. Of these reserved matters, the issue of shares or other securities of Live Board Holdings or the grant of rights over any shares or other securities in Live Board Holdings was to be approved by a simple majority of shareholders.

The shareholders' agreement also included an inconsistency provision at clause 18.1 which stated that, in the case of any conflict between the provisions of that agreement and the constitution, the shareholders' agreement would prevail. Further, upon written request, all parties were required to cause the constitution to be amended to remove the conflict.

The shareholders' agreement also contemplated a binding commitment with Bligh Capital to raise at least $1 million by April 2013 and a further $5 million (in equity or a combination of debt and equity) in 2013, in capital for Live Board Holdings and that such funding might dilute the existing shareholding.

(iii) The issue

In January 2013, prior to the issue of shares in August 2013, the board of Live Board Holdings resolved to exercise the right to raise capital for Live Board Holdings. Although a defendant shareholder initially agreed, they subsequently purported to

withdraw that consent to such funding.

The existing shareholders argued that the directors could not issue the preference shares to Bligh Capital without the approval of 75% of ordinary shareholders, as it would vary the existing rights of ordinary shareholders within the meaning of the constitution.

On the other hand, the directors contended that the 75% majority was not required, as the issue of preferences shares was an "issue of shares" within the meaning of the shareholders' agreement, and therefore only required simple majority approval. Further, by virtue of the inconsistency provision at clause 18.1 of the shareholders' agreement, the provisions in the shareholders' agreement would prevail over the constitution. Further, the directors contended that the resolution to proceed with the funding manifested the unanimous agreement and approval of the shareholders of Live Board Holdings to make the issue of shares.

(c) Decision

The parties agreed that, if there was an inconsistency between the constitution and the shareholders' agreement, the shareholders' agreement would prevail. The Court was not convinced that this was correct. However, it did not have to decide the point, because it held that there was no inconsistency.

Essentially, even though the relevant provisions in both documents dealt with the same subject matter (being the issue of shares), the court said that the purpose behind the requirements were different. Specifically, the clause in the constitution was aimed at protecting the interests of the holders of shares, and the rights attached to the ordinary shares "would be varied, at least indirectly, by the issue of preference shares which would . rank ahead of them".

In contrast, the purpose of the provision in the shareholders' agreement was to reserve the power to issue shares to the shareholders and its effect did not remove the prohibition on varying class rights without written approval or a resolution of holders of 75% of the shares of the affected class. As these two provisions were not inconsistent with each other, the court did not find a conflict between them and accordingly both the constitution and shareholders' agreement needed to be complied with.

Further, the court was of the opinion that the provision contemplating a raising of capital by Live Board Holdings did not amount to an agreement to proceed with the share issue, particularly since the relevant provision was silent on the form of the capital raising. Accordingly, the court did not make the declaration as sought by the directors of Live Board Holdings.

6.14 Court grants leave for administrator to transfer shares without consent

(By Ned Sutton and Will Heath, King & Wood Mallesons)

Lewis, in the matter of Diverse Barrel Solutions Pty Ltd (Subject to a Deed of Company Arrangement) [2014] FCA 53, Federal Court of Australia, White J, 7 February 2014

The full text of this judgment is available online.

(a) Summary

The Federal Court granted leave under s. 444GA of the Corporations Act 2001 (Cth) (the Corporations Act) for the administrators of a deed of company arrangement (DOCA) to transfer all the shares in a company to a shareholder creditor without the consent of the other shareholders.

Section 444GA(1) provides that the administrator of a DOCA may transfer shares in the company if the administrator has obtained (a) the written consent of shareholders or (b) the leave of the Court. Section 444GA(3) further provides that the Court may only grant leave under s. 444GA(1) if it is satisfied that the transfer would not unfairly prejudice the interests of the company's members. The Federal Court was satisfied the transfer would not unfairly prejudice members in this case.

(b) Facts

Diverse Barrel Solutions Pty Ltd (DBS) was a company involved in the manufacture and rejuvenation of wine barrels for a number of customers in South Australia and interstate. Although it had invested heavily in research and the development of technology and processes to extend the useful life of wine barrels, it had made significant loses over several recent years amounting to $6.893 million.

DBS had been financed primarily by its 51% shareholder and secured creditor, Pinara Group Pty Ltd (Pinara). Pinara was the largest creditor of DBS, being owed $5.209 million. By letter dated 9 October 2013, Pinara informed DBS that it was no longer prepared to continue financing the whole of DBS's operations. The letter indicated that it was prepared to finance those operations only in proportion to its approximate 51% shareholding. Subsequently DBS needed an alternative source of finance for the remaining 49%. The directors of DBS then resolved, in the light of the uncertainty occasioned by Pinara's decision, to place DBS in the control of voluntary administrators.

The administrators concluded, among other things, that the debt owing to Pinara exceeded the value of the assets of DBS, no shareholder, other than Pinara, had

expressed a willingness to provide funding to enable DBS to continue to trade, and DBS was insolvent on both a cash flow test and a balance sheet test.

On 18 November 2013, DBS' creditors executed a DOCA. The DOCA provided, relevantly, that all shares in DBS not presently held by Pinara were to be transferred to Pinara.

Although the administrators sought the consent of the remaining shareholders to the DOCA, only five shareholders representing 19% of the share capital consented to the transfer. The applicants then sought leave of the Court to transfer the remaining 30% of the shares in DBS to Pinara under s. 444GA.

(c) Decision

White J granted leave for DBS's administrator to transfer all outstanding shares to Pinara on the basis that such transfer would not unfairly prejudice the interests of the company's members under s. 444GA(3).

His Honour considered that the adverb "unfairly" indicates that the Court must be satisfied that such prejudice as may result should not be "unfair".

The Court will consider relevant factors including:

- whether the shares have any residual value which may be lost to the existing shareholders if leave is granted under s. 444GA;
- whether there is a prospect of the shares obtaining some value within a reasonable time;
- the steps or measures necessary before the prospect of the shares attaining some value may be realised; and
- the attitude of the existing shareholders to providing the means by which the shares may obtain some value or by which the company may continue in existence.

White J also cited, with approval, the decision of Martin CJ in *Weaver v Noble Resources Ltd* [2010] WASC 182 which found, in relation to s. 444AG, "that a mere transfer of shares without compensation cannot of itself constitute unfair prejudice, otherwise [section 444GA's] operation will be significantly constrained."

In the circumstances of the case, White J granted leave to the administrator to transfer all the shares in DBS to Pinara under s. 444GA because:

- the shares in DBS had no residual value and it was likely to be considerable time, if ever, before they did gain some value;
- on a winding-up, the unsecured creditors of DBS would not receive any return at all. It followed that the shareholders would not receive any return either;
- several of the affected shareholders consented to the transfer;

- the remaining shareholders who did not consent to the transfer had not appeared before the Court to object to the transfer. One of them had expressed a neutral attitude to the transfer and the remaining shareholders could not be contacted by the administrators. While it was possible that the remaining shareholders whom the administrators could not contact may object to the transfer, it seemed improbable that any objection could lead to a conclusion that the shares in DBS had any residual value given its financial condition; and
- no shareholder of DBS other than Pinara was willing to contribute to the financing of its continued operations.