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**Bulletin No. 229**

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## 1. Recent Corporate Law and Corporate Governance Developments

### 1.1 Supreme Court of Victoria Commercial Law Conference 2016

On 13 October 2016, the Supreme Court of Victoria will hold its annual Commercial Law Conference. The Conference is a joint initiative of the Court and Melbourne Law School. A program of eminent speakers will address topical and important commercial law issues. The Conference details are as follows:

**Date:** Thursday 13 October 2016

**Venue:** Banco Court, Supreme Court of Victoria, 210 William St, Melbourne

**Time:** 2:30pm - 5:00pm (Drinks 5 - 7 pm)

**Cost:** $220 (incl GST)

**Speakers:**

- **The Rt Hon Lady Justice Elizabeth Gloster DBE, Court of Appeal England & Wales -** "From oligarchs to insider traders - does commercial litigation tick the boxes?"
- **The Hon Justice Ruth McColl AO, Supreme Court of New South Wales Court of Appeal -** "Contractual ambiguity: an answer in search of a question?"
- **Professor Richard Garnett, Melbourne Law School -** "The resurgence of litigation in international commercial disputes"

For more information and to register, visit the Centre for Corporate Law website.

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### 1.2 APRA consults on proposed revisions to its counterparty credit risk framework for ADIs

15 September 2016 - The Australian Prudential Regulation Authority (APRA) has released a consultation package on proposed revisions to its counterparty credit risk framework for authorised deposit-taking institutions (ADIs).

The Basel Committee on Banking Supervision (Basel Committee) has made amendments to its framework for counterparty credit risk. These changes are set out in:

- *Standardised approach for measuring counterparty credit risk exposures (SA-CCR)*, released in March 2014; and
- *Capital requirements for bank exposures to central counterparties - final standard*, released in April 2014.

APRA proposes revisions to its counterparty credit risk framework to implement the Basel Committee changes. Specifically, APRA proposes to require all ADIs to use the SA-CCR methodology to measure counterparty credit risk exposures

arising from over-the-counter (OTC) derivatives, exchange traded derivatives and long settlement transactions. At this time, APRA does not propose introducing the Basel Committee's internal model method for counterparty credit risk into its framework. APRA also proposes that all ADIs will be required to hold capital for exposures to central counterparties in a manner consistent with the Basel Committee's final standard.

APRA proposes to establish a dedicated ADI prudential standard for counterparty credit risk, *Prudential Standard APS 180 Capital Adequacy: Counterparty Credit Risk (APS 180)*. The draft APS 180 contains APRA's proposed new requirements for the SA-CCR and exposures to central counterparties. The draft APS 180 also includes APRA's existing requirements for counterparty credit risk, which have been relocated from Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk (APS 112). Together with draft APS 180, APRA has also released a revised draft of APS 112.

APRA proposes that the new requirements will take effect from 1 January 2018. APRA also proposes that an ADI that meets certain criteria may apply for approval to further extend its implementation date for SA-CCR until 1 January 2019.

The consultation packages can be found on the APRA website.

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**1.3 External dispute resolution in the financial system issues paper released**

9 September 2016 - The independent expert panel that is conducting the review into the financial system's external dispute resolution and complaints framework has released an Issues Paper calling for submissions.

The independent expert panel is comprised of Professor Ian Ramsay, Ms Julie Abramson and Mr Alan Kirkland.

The terms of reference for the review were published on 8 August 2016. The terms of reference require the panel to examine the Financial Ombudsman Service, the Credit & Investments Ombudsman, and the Superannuation Complaints Tribunal "to consider whether changes to current dispute resolution and complaints bodies in the financial sector are necessary to deliver effective outcomes for users in a rapidly changing and dynamic financial system." In undertaking this examination, the panel is required to have regard to the principles of efficiency, equity, complexity, transparency, accountability, comparability of outcomes, and regulatory costs. The terms of reference require consideration of the role, powers, governance and funding arrangements of the three schemes as well as the extent of gaps and overlaps between the schemes, and the schemes' role in working with government, regulators, consumers, industry and other stakeholders to improve the framework to deliver better user outcomes. They also require the panel to consider

the relative merits and any issues associated with different models in resolving disputes.

The submissions received by the expert panel will inform the recommendations made by the panel in its interim report, which will be released later this year. The panel's final report will be delivered to Government in March 2017.

The Issues Paper and information on how to make a submission is available on the Treasury website.

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### 1.4 Main risks for the EU financial system

7 September 2016 - The Joint Committee of the European Supervisory Authorities (ESAs) has published its September 2016 Report on Risks and Vulnerabilities in the EU Financial System.

This Report focuses on recent developments concerning the low growth and low yield environment and its potential effects on financial institutions' profitability and asset quality, and highlights concerns related to the interconnectedness in the EU financial system. These risks have persisted for some time and can be related to lasting effects of the 2007 financial crisis. However, the EU financial system is also vulnerable to more immediate risks such as the result of the UK referendum on EU membership which has added political and legal uncertainties to those already affecting the financial system.

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### 1.5 FSB publishes second progress report on measures to reduce misconduct risk

2 September 2016 - The Financial Stability Board (FSB) has published its second report on progress in its workplan of Measures to reduce misconduct risk that it agreed on in May 2015.

Ethical conduct, and compliance with both the letter and spirit of applicable laws and regulations, is critical to public trust and confidence in the financial system. Misconduct is also relevant to prudential oversight as it can potentially affect the safety and soundness of a particular financial institution.

The FSB's workplan covers: (1) examining whether reforms to incentives, for instance to governance and compensation structures, are having sufficient effect on reducing misconduct; (2) improving global standards of conduct in the fixed

income, commodities and currency (FICC) markets; and (3) reforming major benchmarks.

The report provides an update on progress made and future actions to take forward the FSB's misconduct workplan:

- The role of incentives in reducing misconduct**.** By end-2017, the FSB will develop and consult on (i) supplementary misconduct-related guidance for existing compensation standards and (ii) recommendations for consistent national reporting and collection of data on the use of compensation tools to address misconduct.

- Improving standards of market practice. The International Organization for Securities Commissions (IOSCO) continues to explore ways to further strengthen the current global framework to address misconduct by firms and individuals in professional markets. It has completed a mapping exercise of past IOSCO work on conduct issues in wholesale markets and a survey of IOSCO members on their tools and approaches used to regulate this sector. IOSCO will publish a final report of its Market Conduct Task Force in January 2017, including a detailed regulatory toolkit for wholesale market conduct regulation.

To promote the integrity and effective functioning of foreign exchange markets, in May 2016 the Foreign Exchange Working Group of the Bank for International Settlements (BIS) issued its first phase of the Global Code of Conduct for the Foreign Exchange Market and principles for adhering to the new standard. The complete Global Code and the adherence mechanisms will be released in May 2017, which will include principles related to electronic trading (including algorithmic operators and users), trading venues, brokers and prime brokerage.

- Reforming financial benchmarks. The FSB is monitoring progress in implementing the FSB's recommendations set out in its July 2014 report Reforming Major Interest Rate Benchmarks, which includes proposals, plans and timelines for reform and strengthening of existing major interest rate benchmarks and for additional work on the development and introduction of alternative benchmarks. The FSB will issue a final progress report by end-2017.

IOSCO has undertaken a number of projects with respect to benchmarks reform which are aimed primarily at assessing the degree of implementation of the Principles for Financial Benchmarks by benchmark administrators operating in IOSCO jurisdictions. By end-2016, IOSCO will finalise guidance for benchmark administrators on the content of the statements of compliance that administrators are expected to publish, and will also publish its follow-up review of the WM/Reuters 4pm London Closing Spot Rate, a key FX benchmark.

The FSB will publish a third progress report on its misconduct workplan in advance of the next G20 Leaders' meeting in July 2017.

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### 1.6 Survey of foreign exchange and over-the-counter interest rate derivatives markets

1 September 2016 - The Bank of England has published the results of their latest survey of turnover in the markets for foreign exchange and over-the-counter interest rate derivatives, which takes place every three years.

The survey is coordinated globally by the Bank for International Settlements (BIS), and was carried out in April by central banks and monetary authorities in 52 countries. The Bank of England conducts the UK survey, which covers the business of leading UK financial institutions in the markets for foreign exchange (spot, forwards, foreign exchange swaps, currency swaps and options) and over-the-counter (OTC) interest rate derivatives. The survey is aimed at obtaining comprehensive and internationally consistent information on the size and structure of the global markets.

Headline results from the survey:

- Average daily turnover in foreign exchange was US$2,426 billion during April 2016, 11% lower than the US$2,726 billion recorded for April 2013. The United Kingdom remains the single largest centre of foreign exchange activity with 37% of global turnover in April 2016, decreasing from 41% in 2013.
- The decrease was driven by a fall in foreign exchange spot transactions, which decreased by 24%. Average daily turnover in options and forward transactions also decreased, down 37% and 14% respectively.
- In contrast, turnover in foreign exchange swaps increased by 3% and remain the largest traded foreign exchange item in the UK, accounting for 48% of all trades. Turnover in currency swaps also increased, up 125%, although account for just 3% of total turnover.
- Average daily turnover in OTC interest rate derivatives was US$1,181 billion during April 2016, a 12% decrease on the US$1,348 billion recorded for April 2013. The UK is no longer the largest centre for OTC interest rate derivatives activity, with 39% of OTC interest rate derivatives activity taking place in the United Kingdom, compared with 41% in the US.
- Turnover in interest rate forward rate agreements decreased 21%, whilst turnover in interest rate swaps and interest options decreased 5% and 39% respectively. Interest rate swaps remained the most traded interest rate derivative, accounting for 64% of total OTC interest rate derivatives turnover in April 2016.

Summary of UK Survey results
Summary of global results from BIS

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**1.7 Australian CEO pay packets fall but bonuses rise, new study finds**

31 August 2016 - Average fixed pay for chief executives in Australia's 100 largest listed companies has fallen to its lowest in almost a decade, down 3.3% to $1.86m, as boards hire new CEOs on lower pay packets.

Across the entire ASX200, the fall was an even larger 4.6%, with CEOs taking home an average $1.51m - before bonuses and shares - according to the Australian Council of Superannuation Investors' 15th annual study of CEO Pay in ASX200 Companies, carried out by Ownership Matters for ACSI.

This 15th ACSI CEO Pay study has, for the first time, included data on the proportion of maximum bonus awarded across the 156 CEOs in the sample. It found the median bonus for an ASX100 CEO was 76% of maximum (where data was available). Only 7% of the 86 CEOs in the sample missed out on a bonus.

Bonuses were much more variable across the ASX 101-200, where the median bonus was 56% of maximum. A third of the 70 CEOs in the ASX 101-200 sample did not receive a bonus.

For the second year, ACSI has looked at realised pay, which adds the actual value of shares received by CEOs on vesting during the financial year rather than the theoretical accounting value included in remuneration reports. Median realised pay across the ASX100 was down 2%, at $3.88m. Average and median CEO fixed pay fell across the ASX200, with the median Top 100 CEO's fixed pay down 5.2% to $1.72m and the median ASX 101-200 CEO's fixed pay down 5.1% to $883,000.

Top 100 CEOs' median and average fixed pay were at their lowest levels since 2007, and well down from the peak median fixed pay of $1.95m recorded in 2012 (and the record average of $2.02m in FY09).

ACSI Annual Survey of S&P/ASX200 Chief Executive Remuneration (August 2016)

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**1.8 NZX review of corporate governance best practice code**

31 August 2016 - NZX released a consultation paper seeking feedback from interested parties on proposed updates to NZX's corporate governance best practice code. This consultation paper follows an initial discussion paper released

by NZX on 15 November 2015 which commenced a review of the current code, which had not been updated since 2003.

The consultation paper, draft code, initial consultation paper and the (non confidential) submissions received in response to the initial consultation can be viewed here:

Consultation Paper on NZX Corporate Governance Code - 31 August 2016
Proposed Updated NZX Code - for feedback -31 August 2016
Discussion Document - 2 November 2015
Link to submissions in response to Discussion Document dated 2 November 2015

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**1.9 BIS, FSB and IMF publish elements of effective macroprudential policies**

31 August 2016 - The International Monetary Fund (IMF), Financial Stability Board (FSB) and Bank for International Settlements (BIS) have released a new publication on Elements of effective macroprudential policies. The document, which responds to a G20 request, takes stock of the international experience since the financial crisis in developing and implementing macroprudential policies.

The paper documents a number of elements that have been found useful for macroprudential policy making, these include:

- a clear mandate that forms the basis for assigning responsibility for taking macroprudential policy decisions;
- adequate institutional foundations for macroprudential policy frameworks. Many of the observed designs give the main mandate to an influential body with a broad view of the entire financial system;
- well-defined objectives and powers that can foster the ability and willingness to act;
- transparency and accountability mechanisms to establish legitimacy and create commitment to take action;
- measures to promote cooperation and information-sharing between domestic authorities;
- a comprehensive framework for analysing and monitoring systemic risk as well as efforts to close information gaps;
- a broad range of policy tools to address systemic risk over time and from across the financial system; and
- the ability to calibrate policy responses to risks, including by considering the costs and benefits, addressing any leakages, and evaluating responses. In financially integrated economies, this includes assessing potential cross-border effects.

The document includes some data on the use of macroprudential tools; illustrative examples of institutional models for macroprudential policymaking; and a brief

summary of some of the empirical literature on the effectiveness of macroprudential tools.

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### 1.10 FSB reports to G20 leaders on financial regulatory reforms

31 August 2016 - The Financial Stability Board (FSB) has published a letter from its Chair to G20 Leaders and the second annual report on the Implementation and Effects of the G20 Financial Regulatory Reforms.

The letter sets out four main points:

- the G20 financial reforms are working - in the face of recent shocks the financial system has continued to function effectively, dampening aftershocks rather than amplifying them;
- the financial system is changing to rely more on markets and less on banks - this is a major positive development, but one that also raises new vulnerabilities which the FSB will address with its continued work to promote resilient market-based finance;
- ongoing support of the G20 Leaders is required to implement the reforms fully, consistently and promptly - in particular support is required from G20 Leaders to implement the critical measures to end too-big-to-fail; and
- developments in recent years raise the importance of new measures to support a more resilient, inclusive globalisation built on sustainable cross-border investment.

The FSB's second annual report concludes that implementation progress remains steady but uneven, and that the strengthened resilience due to the reforms has stood the global financial system in good stead.

The largest internationally active banks are considerably more resilient than before the crisis, and remain on track to meet the Basel III capital and liquidity standards. Importantly, this improvement has been achieved while maintaining the overall provision of credit to the real economy.

Implementation of policies to end too-big-to-fail has advanced the most for global systemically important banks, but substantial work remains to build effective resolution regimes and to operationalise resolution plans for cross-border firms.

Progress has also been made in strengthening the resilience of financial markets, although additional efforts are needed to implement reforms to over-the-counter (OTC) derivatives markets and to transform shadow banking into resilient market-based finance. In this respect, work is ongoing to strengthen market infrastructure and address vulnerabilities in market-based finance and asset management activities.

The report includes further analysis on three areas identified in last year's report as meriting close attention: market liquidity; effects of reforms on emerging market and developing economies; and maintaining an open and integrated global financial system. On market liquidity, the report concludes that there is limited evidence of a broad deterioration in market liquidity, although there is some evidence of less depth in certain sovereign and corporate bond markets.

The report highlights key challenges that G20 Leaders need to address to ensure the full, timely and consistent implementation of the reforms. These include: (i) putting in place legal powers to share information across borders and to give prompt effect to foreign resolution actions; (ii) removing legal barriers to reporting OTC derivatives to trade repositories and to authorities' access to such data; and (iii) removing other legal, data and capacity constraints that could hamper implementation efforts.

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**1.11 SEC whistleblower program surpasses $100 million in awards**

30 August 2016 - The US Securities and Exchange Commission's awards to whistleblowers have surpassed the US$100 million mark, with announcement of the program's second-largest award of more than $22 million.

The whistleblower program was established by Congress to incentivise whistleblowers with specific, timely and credible information about federal securities law violations to report to the SEC. To date, enforcement actions resulting from whistleblower tips have resulted in orders for more than US$500 million in financial remedies, much of which has been returned to harmed investors.

Whistleblowers may be eligible for an award when they voluntarily provide the SEC with unique and useful information that leads to a successful enforcement action. Whistleblower awards can range from 10% to 30% of the money collected when the monetary sanctions ordered exceed US$1 million. The SEC paid its first award in 2012, just over a year after its Office of the Whistleblower opened for business.

Since the program's inception, the Whistleblower Office has received more than 14,000 whistleblower tips from individuals in all 50 states and the District of Columbia and 95 foreign countries. Tips from whistleblowers have increased from 3,001 in fiscal year 2012 - the first full fiscal year that the Whistleblower Office was in operation - to nearly 4,000 last year, an approximately 30 percent increase.

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**1.12 APRA releases prudential practice guide on capital buffers**

30 August 2016 - The Australian Prudential Regulation Authority (APRA) has released a new prudential practice guide on the operation of capital buffers for authorised deposit-taking institutions (ADIs).

*Prudential Practice Guide APG 110 Capital Buffers* (APG 110) provides clarification and guidance for ADIs on the operation of the capital conservation buffer and the countercyclical capital buffer - collectively referred to as the capital buffers.

APRA released draft APG 110 for consultation in December 2015. In response to feedback received during the consultation period, APRA made amendments to APG 110 to provide some additional clarification on the operation of the capital buffers. Details on these changes can be found in APRA's response to submissions letter.

The prudential practice guide APG 110 and the response to submissions letter can be found at: www.apra.gov.au/adi/Pages/August-2016-Response-APG-110.aspx

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**1.13 SEC adopts amendments providing authorities access to data obtained by security-based swap data repositories**

29 August 2016 - The US Securities and Exchange Commission has adopted amendments to a rule that would require security-based swap data repositories to make data available to regulators and other authorities, allowing them to share information and more effectively oversee the security-based swap market.

The Dodd-Frank Act established provisions for regulators to access security-based swap data from data repositories. Building on a proposal from September 2015, the final rule amendments implement these provisions and, among other things:

- require either a memorandum of understanding or other arrangement between the Commission and the recipient of the data to address the confidentiality of the security-based swap data provided to the recipient;
- identify the five prudential regulators named in the statute, as well as the Federal Reserve banks and the Office of Financial Research, as being eligible to access data; and
- address factors that the Commission may consider in determining whether to permit other entities to access data.

Final Rule Release No. 34-78716

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### 1.14 FSB publishes progress reports on implementation of reforms to the OTC derivatives market and on removal of barriers to trade reporting

26 August 2016 - The Financial Stability Board (FSB) has published two reports on the implementation of key aspects of reforms to the over-the-counter (OTC) derivatives market. They show that although progress continues to be made, further action is required, particularly on implementing margin requirements and platform trading commitments, and on removing legal barriers to trade reporting and authorities' access to data held by trade repositories.

The OTC Derivatives Market Reforms: Eleventh Progress Report on Implementation sets out progress on implementation of the reforms to the OTC derivatives market agreed by the G20. Trade reporting requirements for OTC derivatives and higher capital requirements for non-centrally cleared derivatives (NCCDs) are mostly in force and central clearing frameworks are being implemented. By contrast, current indications are that a substantial number of jurisdictions will not have margin requirements for NCCDs in force in accordance with the internationally agreed implementation schedule for these reforms, while platform trading frameworks are relatively undeveloped in most jurisdictions. Authorities continue to note a range of implementation challenges, many of which FSB members are seeking to address through international workstreams.

The FSB has also published a Report on FSB Members' Plans to Address Legal Barriers to Reporting and Accessing OTC Derivatives Transaction Data. This provides a summary of FSB member jurisdictions' planned actions to remove legal barriers to reporting complete transaction information to trade repositories and to authorities' access to data held in trade repositories.

The FSB had published a thematic peer review of OTC derivative trade reporting in November 2015, which identified a number of remaining legal barriers in FSB member jurisdictions in this regard. FSB members had therefore agreed as a follow up that, by June 2018, all jurisdictions should remove barriers to full reporting of trade information and have a legal framework in place to permit authorities' access to data in accordance with their mandates. This report sets out jurisdictions' plans to achieve this.

The individual reports by FSB jurisdictions of their planned actions to remove these barriers have also been published by the FSB.

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### 1.15 IOSCO good practice for CIS fees and expenses

25 August 2016 - The Board of the International Organization of Securities Commission has published the final report on Good Practice for Fees and Expenses of Collective Investment Schemes (CIS), which aims to identify common international examples of good practice that can be applied to CIS fees and expenses.

Regulators have long been concerned about the impact of CIS fees and expenses on the investment decisions taken by investors. Fee arrangements, even when fully disclosed, can give rise to conflicts of interest that are best addressed by rules of conduct. High standards of transparency and conduct in this area should help encourage competition among CIS operators and lead to a more efficient market, thereby eventually benefitting investors.

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### 1.16 SEC adopts rules to enhance information reported by investment advisers

25 August 2016 - The US Securities and Exchange Commission has adopted amendments to several *Investment Advisers Act* rules and the investment adviser registration and reporting form to enhance the reporting and disclosure of information by investment advisers. The amendments will improve the quality of information that investment advisers provide to investors and the Commission.

The amendments will require investment advisers to provide additional information regarding their separately managed account business, including aggregate data related to the use of borrowings and derivatives, and information about other aspects of their advisory business, including branch office operations and the use of social media. In addition, the amendments will facilitate streamlined registration and reporting for groups of private fund adviser entities operating a single advisory business.

Final Rules Release No. IA-4509

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### 1.17 FSB publishes further guidance on resolution planning and fifth report to the G20 on progress in resolution

18 August 2016 - The Financial Stability Board (FSB) has published two final guidance papers to assist the resolution planning work of authorities and firms, as part of the policy agenda to end "too-big-to-fail":

- Guiding Principles on the Temporary Funding Needed to Support the Orderly Resolution of a Global Systemically Important Bank (G-SIB) -

The guiding principles seek to address the risk of banks having insufficient liquidity to maintain critical operations during a resolution. They are intended to ensure that temporary funding is available to enable the effective resolution of G-SIBs without bail-out by the public sector. The guidance was issued for public consultation in November 2015 and has been revised in light of the comments received during that consultation.

- Guidance on Arrangements to Support Operational Continuity in Resolution - The guidance sets out arrangements to support the continuity of critical shared services, such as information technology infrastructure and software-related services, that are necessary to maintain a firm's critical functions in resolution. The guidance was issued for public consultation in November 2015 and has been revised in light of the comments received during that consultation.

The guidance papers contribute to the removal of impediments to the orderly and effective resolution of firms. They complement the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes), which provide a policy framework for resolution of systemically important financial institutions.

The FSB also published its fifth report to the G20 on progress in resolution Resilience through resolvability - moving from policy design to implementation. The report reviews what has been achieved so far and sets out further actions to fully implement the Key Attributes and ensure that all global systemically important financial institutions (G-SIFIs) are resolvable. It also reports the findings from the second round of the Resolvability Assessment Process (RAP) for global systemically important banks (G-SIBs) and the initial results from the first RAP for global systemically important insurers (G-SIIs).

## 2. Recent ASIC Developments

### 2.1 Report on review of marketing practices in IPOs

19 September 2016 - ASIC has warned firms and issuers involved in initial public offerings (IPOs) in Australia to ensure their marketing campaigns comply with the letter and spirit of the law, particularly when using emerging social-media strategies.

An ASIC review of marketing practices in IPOs has found that so-called "traditional" means of communication - telephone calls, emails and websites - remain more important for the marketing of an offer to retail investors. The review found that the use of social media is not yet pervasive; it is only used occasionally by small to medium-sized firms to market IPOs.

REP 494 Marketing practices in initial public offerings of securities details the review's findings, highlights areas of concern and provides for consideration ASIC's recommendations to improve marketing practices for IPOs in the future.

Between October 2015 and March 2016 ASIC reviewed the online and social media marketing of 23 IPOs where a prospectus was lodged. ASIC then conducted a more extensive review of the marketing practices and materials of 17 firms that were involved in seven of the original IPOs. ASIC also monitored the marketing of other IPOs as part of its usual prospectus review work.

Key findings of the report included:

- there were some oversight weaknesses in relation to marketing done via telephone calls and social media, and in ensuring that marketing material is kept up to date;
- the use of forecasts in communications or the targeting of investors from a particular background means special care may need to be taken to avoid misleading investors;
- firms and issuers did not always properly control access to information about the offer to ensure retail investors base their decision on the prospectus; and
- some good practices were adopted by firms to ensure that communication was consistent with the prospectus information.

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**2.2 Guidance on review and remediation**

15 September 2016 - ASIC has released guidance on review and remediation conducted by Australian financial services (AFS) licensees providing personal advice to retail clients.

View Regulatory Guide 256 Client review and remediation conducted by advice licensees (RG 256).

This follows *Consultation Paper 247 Client review and remediation programs and update to record-keeping requirements* (CP 247), issued in December 2015 (refer: 15-388MR).

The guidance reflects work done with industry over the past several years where ASIC has worked with advice licensees with large remediation programs to shape the scope and nature of remediation arising from systemic advice issues.

The key principles set out in the guidance are:

- review and remediation is likely to be appropriate where a systemic issue has occurred that may have caused loss or detriment to clients;

- the scope of review and remediation should ensure it covers the right advisers, the right clients and the right timeframe;
- the process of review and remediation should be comprehensive, timely, fair, and transparent. There should be clearly defined principles to guide the process and an appropriate governance structure;
- effective, timely and targeted communication is key to ensuring that clients understand the review and remediation and how it will affect them; and
- clients should have access to an EDR scheme if they are not satisfied with the remediation decision made.

In the 2015-16 financial year, ASIC secured over $200 million in compensation and remediation for financial consumers and investors across the areas it regulates.

While the guidance is directed at licensees who provide personal advice to retail clients, review and remediation takes place in many other sectors of the financial services industry. The principles set out in the guidance should be applied to other review and remediation where relevant.

ASIC will shortly release an amendment to *Class Order [CO 14/923] Record-keeping obligations for Australian financial services licensees when giving personal advice* together with a report summarising the key feedback ASIC received in response to CP 247, and ASIC's response to that feedback.

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**2.3 Report on mortgage brokers' responsible lending practices in relation to interest only home loans**

14 September 2016 - Australia's home loans industry has improved its performance over the past year, adopting better "responsible lending" practices, an ASIC review has found, though there is still room for improvement.

ASIC has released its report (REP 493) 'Review of interest-only home loans: Mortgage brokers' inquiries into consumers' requirements and objectives' on the responsible lending practices of 11 large mortgage brokers with a particular focus on how they inquire into and record consumers' requirements and objectives.

It also examined how the changes implemented by lenders in response to the findings from ASIC's report into interest-only home loans from 12 months ago last year (refer: Report 445) have flowed through to mortgage brokers.

Since the release of Report 445 in August 2015,

- the percentage of new home loans approved by lenders which are interest-only has decreased by 12%; and
- the amount that can be borrowed by an individual consumer through an interest-only home loan has decreased, as lenders have adjusted their

assessment of consumers' ability to repay, in line with ASIC's recommendation in Report 445.

Almost 80% of applications reviewed included a statement summarising how the interest-only feature specifically met the consumer's requirements and objectives. This compared favourably with Report 445's finding that more than 30% of applications reviewed showed no evidence the lender had considered whether the interest-only loan met the consumer's requirements.

The report details steps that mortgage brokers should take to improve their current practices.

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**2.4 Serious failures in the sale of add-on insurance through car dealers**

12 September 2016 - ASIC has reviewed the sale of add-on general insurance policies through car dealers and found that the market is failing consumers.

The report (REP 492) finds that consumers are being sold expensive, poor value products; products that provide consumers very little to no benefit; and a sales environment with pressure selling, very high commissions and conflicts of interest.

These products are sold to consumers when they purchase a new or used car, and cover risks relating to the car itself or relating to the loan that the consumer takes out to purchase the car. Examples include consumer credit insurance and tyre and rim insurance.

For the three year period that ASIC reviewed, it found that:

- consumers obtained little financial benefit from buying add-on insurance, with consumers paying $1.6 billion in premiums and receiving only $144 million in successful insurance claims - representing a very low claims payout of 9%. For some major add-on products, the benefit to consumers was even lower, with consumer credit insurance claims payouts representing just five cents for each dollar of premium;
- car dealers earned $602 million in commissions - over four times more than consumers received in claims, with commissions paid to car dealers as high as 79%;
- payment for these insurance products is commonly packaged into the consumer's car loan as a single upfront premium. This can substantially increase the cost of the product by increasing the loan amount and interest paid. Research shows that consumers are often unaware that they even have the policy when it is paid upfront as a single premium, and they may not get a premium refund if they repay their car loan early. Policies have

been sold where it is impossible for the consumer to receive a claim payout that is greater than the cost of the insurance; adn
- the car sales environment inhibits good decision making about these products because of the conflicts of interest and pressure sales built into the distribution model. The consumer is focussed on purchasing a car and financing that purchase - not on the details of the complex insurance policy.

This report follows ASIC's release of two reports in February this year about the sale of add-on life insurance by car dealers. ASIC stressed the need for insurers to address the high costs, poor value and poor claim outcomes of life insurance products sold this way.

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### 2.5 ASIC's Corporate Plan 2016-17 to 2019-20 and Focus for 2016-17

31 August 2016 - ASIC has published its *Corporate Plan* for 2016-17. The *Corporate Plan* explains how ASIC will achieve its vision, by outlining:

- long-term challenges
- strategy for responding to long-term challenges and key risks, including:
    - ASIC's "detect, understand and respond" approach;
    - strengthening capabilities;
    - specific actions for addressing long-term challenges and key risks, including the key areas to which ASIC will pay particular attention over the four years to 2019-20 and the key areas ASIC will focus on in 2016-17;
    - how ASIC will measure and evaluate performance.

The long-term challenges are:

- aligning conduct in a market-based system with investor and consumer trust and confidence;
- digital disruption and cyber resilience in financial services and markets;
- structural change in the financial system through market-based financing, which is led by the growth in superannuation;
- complexity in financial markets and products, driven by innovation; and
- globalisation of financial markets, products and services.

View:
ASIC's Corporate Plan 2016-2017 to 2019-2020

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### 2.6 Guidance on regulating digital advice

30 August 2016 - ASIC has released its guidance on providing digital financial product advice for retail investors, Regulatory Guide 255: Providing digital financial product advice to retail clients (RG 255).

The guide brings together some of the issues that digital advice providers need to consider when operating in Australia - from the licensing stage through to the actual provision of advice.

RG 255 also includes guidance on some issues that are unique to digital advice, such as how the organisational competence obligation applies to digital advice licensees and the ways in which digital advice licensees should monitor and test their algorithms.

In March 2016, ASIC released Consultation Paper 254 Regulating digital financial product advice (CP 254) which attached a draft Regulatory Guide on regulating digital advice and sought feedback on a number of proposals in relation to ASIC's draft guidance.

The consultation period for CP 254 closed in May 2016. See responses to CP 254 in Feedback Report 490 Response to submissions on CP 254 Regulating digital financial product advice.

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### 2.7 Fifth report on corporate finance regulation

26 August 2016 - ASIC has published its fifth report on the regulation of corporate finance issues in Australia.

The report, which covers the period January to June 2016, provides companies and their advisers with insights into ASIC's regulatory approach in the corporate finance sector and aims to assist them with their associated legal and compliance obligations.

Report 489 ASIC regulation of corporate finance: January to June 2016 (REP 489) provides statistical data, highlights key focus areas, and includes relevant guidance about ASIC's regulation of:

- fundraising transactions;
- mergers and acquisitions;
- corporate governance issues;
- related party transactions; and
- financial reporting.

REP 489 details the approach ASIC takes in these areas, including the types of issues that have caused ASIC to intervene, and ASIC's approach to novel issues seen in transactions during the period. The report also provides an overview of ASIC's current policy initiatives in this space.

This fifth report discusses a number of regulatory initiatives ASIC has undertaken in relation to due diligence practices, disclosure of financial information in prospectuses and applications to the Takeovers Panel.

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**2.8 "Sunsetting" class orders on dollar disclosure**

26 August 2016 - ASIC has made a new legislative instrument to replace three class orders on dollar disclosure that were due to expire (sunset) on 1 October 2016 and 1 April 2017 respectively.

The new legislative instrument is *ASIC Corporations (Disclosure in Dollars) Instrument 2016/767*. The instrument has the same effect as relief that ASIC had granted by Class Orders [CO 04/1431], [CO 04/1433] and [CO 04/1435]. It provides exemptions from the requirements to display in dollar amounts various costs, fees, charges, expenses, benefits and interests in Statements of Advice, Product Disclosure Statements and periodic statements, subject to the conditions in the instrument.

ASIC consulted on its proposal to make the new legislative instrument through *Consultation Paper 253 Remaking and repealing ASIC class order on dollar disclosure* (CP 253), released on 29 February 2016.

CP 253 sought feedback on ASIC's proposals to continue the relief in [CO 04/1431], [CO 04/1433] and [CO 04/1435] without substantive changes and to repeal [CO 04/1430] and [CO 04/1432]. Comments closed on 30 March 2016 (refer: 16-048MR).

View:

- ASIC Corporations (Disclosure in Dollars) Instrument 2016/767
- Non-confidential submissions to CP 253

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**2.9 Instruments that affect financial reporting**

26 August 2016 - Following public consultation, ASIC has remade five legislative instruments that affect financial reporting by disclosing entities and entities generally. The relief is set out in the following new legislative instruments:

- ASIC Corporations (Uncontactable Members) Instrument 2016/187 (replaces Class Order 98/101);
- ASIC Corporations (Directors' Report Relief) Instrument 2016/188 (replaces Class Order 98/2395);
- ASIC Corporations (Synchronisation of Financial Years) Instrument 2016/189 (replaces Class Order 98/96);
- ASIC Corporations (Disclosing Entities) Instrument 2016/190 (replaces Class Orders 98/2016 and 08/15); and
- ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191 (replaces Class Order 98/100).

ASIC remade these instruments without significant changes before they were due to sunset over the next few years under the *Legislation Act 2003*.

The instruments:

- relieve entities of the obligation to send a hard copy of the directors' report, financial report and auditor's report to members who are uncontactable;
- allow entities to transfer some information from the directors' report to the financial report or to a separate document accompanying both the directors' report and financial report;
- allow entities to synchronise their financial year with that of a foreign parent where that foreign parent has an obligation under a foreign law to synchronise the financial years of controlled entities with its own;
- relieve entities from reporting as disclosing entities if they cease to be disclosing entities before the reporting deadline for a financial year;
- relieve disclosing entities which have a first financial year of 8 months or less from preparing a half-year financial report and directors' report during that financial year; and
- allow entities to round amounts disclosed in the directors' report and financial report.

## 3. Recent ASX Developments

### 3.1 Rule amendments / changes - ASX Clear (Futures) has changed clearing system designation in MarkitWire to "Agency Model"

ASX Clear (Futures) has changed its clearing system designation in MarkitWire to "Agency Model" to support clearing by OTC Participants on behalf of their

Affiliates and Clients. To align with this change, ASX Clear (Futures) has amended its operating rules for clearing on behalf of Affiliates.

The Notice is available here.

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### 3.2 New ASX Clear Guidance Note 13: Managing liquidity requirements

ASX has released the *ASX Clear Operating Rules Guidance Note 13 Managing Liquidity Requirements* on the minimum liquidity management arrangements a participant should have to meet its obligations under the *ASX Clear Operating Rules*.

The Notice is available here.

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### 3.3 ASX Equity FlexClearT Rules Procedures amendments

Participants are advised of amendments to the *ASX Clear Operating Rules Procedures*, specifically Procedure 12.1.1A and Procedure 12.22.2, which became effective on 8 September 2016. The amendments relate to allowable times for registration of OTC Options Market Transactions and the allowable times and procedures for cancellation of Derivatives Market Contracts in relation to OTC Options Market Transactions.

The Notice is available here.

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### 3.4 Amendments to Appendix 4C and Appendix 5B- Quarterly Cash Flow Reports are effective now

ASX has received regulatory approval to amend Appendices 4C (Quarterly report for entities admitted on the basis of commitments) and 5B (Mining exploration entity and oil and gas exploration entity quarterly report) of the Listing Rules.

The new Appendices 4C and 5B came into effect on 1 September 2016 and are effective for quarters ending on or after 30 September 2016. Accordingly, listed entities filing Appendices 4C or 5B will need to use the new form for their September 2016 quarter filings and all subsequent filings.

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### 3.5 Submission - Data availability and use

On 5 August 2016, ASX made a submission to the Productivity Commission's Inquiry into Data Availability and Use. The submission highlighted the well-developed arrangements for access to exchange-traded data tailored to different customer needs at reasonable commercial terms to fund investment in data production and distribution. It also noted the growing importance of managing cybersecurity risks in protecting data.

The Submission is available here.

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### 3.6 Submission - ASIC CP 262: Remaking and repealing ASIC class orders on markets and securities

On 12 August 2016, ASX made a submission to ASIC regarding CP262: Remaking and repealing ASIC class orders on markets and securities. The submission supported ASIC's proposals to remake a number of class orders that reduce compliance costs for participants in public markets.

The Submission is available here.

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### 3.7 Consultation paper - ASX OTC Interest Rate Derivatives Clearing

On 22 August 2016, ASX released a consultation paper, *ASX OTC Interest Rate Derivatives Clearing*. This paper seeks feedback from OTC Participants on: (i) ASX's proposal to expand the product coverage of the OTC Clearing Service to include Asset Swaps and BBSW vs AONIA Basis Swaps; and (ii) whether ASX should amend its OTC Rules to confirm that OTC Open Contracts are "settled to market" rather than "collateralised to market" by variation margin payments.

The Consultation Paper is available here.

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### 3.8 Reports

On 5 September ASX released the ASX Monthly Activity Report for August 2016.

## 4. Recent Takeovers Panel Developments

### 4.1 Consultation paper: Revised guidance note 12 on frustrating action

14 September 2016 - The Takeovers Panel has released a Consultation Paper seeking public comment in relation to a draft rewrite of Guidance Note 12 on Frustrating Action.

The draft rewrite seeks to provide clearer guidance about the Panel's approach to frustrating action, including the circumstances in which a frustrating action is unlikely to be unacceptable.

The Consultation Paper and draft Guidance Note are available on the Panel's website on the consultation page.

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### 4.2 Consultation paper: Revised guidance note 4 on remedies general

2 September 2016 - The Takeovers Panel has released a Consultation Paper seeking public comment in relation to a draft revised *Guidance Note 4* on Remedies General.

The draft revises *Guidance Note 4* to clarify that, while a party may offer an undertaking to resolve a matter at any point in the Panel's process, the timing of the offer is a relevant factor when the Panel is exercising its discretion whether to accept an undertaking in lieu of a declaration or orders.

The Consultation Paper is available on the Panel's website on the consultation page.

## 5. Recent Research Papers

### 5.1 Contracting out of the fiduciary duty of loyalty: An empirical analysis of corporate opportunity waivers

For centuries, the duty of loyalty has been the hallowed centerpiece of fiduciary obligation, widely considered one of the few "mandatory" rules of corporate law. That view, however, is no longer true. Beginning in 2000, Delaware dramatically departed from tradition by granting incorporated entities a statutory right to waive a crucial part of the duty of loyalty: the corporate opportunities doctrine. Other states have since followed Delaware's lead, similarly permitting firms to execute "corporate opportunity waivers." Surprisingly, more than fifteen years into this reform experiment, no empirical study has attempted to measure either the corporate response to these reforms, or to evaluate the implications of that response.

This article presents the first broad empirical investigation of the area. Contrary to conventional wisdom, the authors find that hundreds of public corporations have adopted waivers - often with capacious scope and reach. They thus establish a central empirical fact that is an important baseline for further discussion: public corporations have an enormous appetite for contracting out of the duty of loyalty when freed to do so. Their analysis further sheds light on the high-stakes normative debate around the relationship between fiduciary principles and freedom of contract. What types of corporations choose to contract around default rules? When they do so, do such measures tend to bolster or thwart shareholder welfare? The authors develop an efficient contracting approach to explain why corporations - and their shareholders - might favour tailoring the duty of loyalty, and provide empirical evidence that Delaware's experiment has generally been a success.

Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers

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### 5.2 Shareholder primacy, labour and the historic ambivalence of UK company law

Most directors and senior managers of UK companies would likely regard it as trite law that, in undertaking their managerial and/or control functions, they are accountable first and foremost to their employer firm's general body of shareholders. It follows that the interests of other corporate constituencies - and, in particular, those of employees - must ultimately cede to those of shareholders in the event of conflict. Although frequently taken for granted today, the lexical priority that the British company law framework affords to the interests of shareholders over those of other corporate constituencies is remarkable, not least when viewed alongside the correspondingly disempowered corporate governance status of labour in the UK. However, whilst the centrality of shareholders' interests to the doctrinal and normative fabric of contemporary UK company law is both

manifest and incontrovertible, this has curiously not always been the case. In this paper the author argues that, whilst UK company law might look substantively stable and well-settled on its surface today, on closer inspection this façade of apparent calm can be seen to mask a fairly recent history of doctrinal and ideological turbulence with regard to fundamental underlying concerns. There is thus cause to question whether the basic normative impetus of the UK's company law framework is as complementary to its surrounding economic and socio-political context as might first appear.

Shareholder Primacy, Labour and the Historic Ambivalence of UK Company Law

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### 5.3 Board independence and corporate innovation

Corporate innovation is constrained by excessive managerial conservatism, and the authors hypothesise that an independent board could incentivise managerial risk-taking and hence boost innovation. Using a sample of US public firms, the authors confirm the positive effect of board independence on corporate innovation. This effect is concentrated in firms that are larger in size, in the non-technical industries, facing less product market competition, and using more debt, where managers are more likely to be excessively risk averse. In addition, this effect is mostly driven by firms with outsider-dominated boards. The authors examine incentive compensation and tolerance for failure as possible mechanisms. They show that firms with outsider-dominated boards use more equity-based compensation as a way to promote corporate risk-taking; these firms also exhibit more tolerance for failure as CEO compensation is less responsive to short-term performance.

Board Independence and Corporate Innovation

## 6. Recent Corporate Law Decisions

### 6.1 Liquidators' right to seek advice in distributing funds

(By Samuel Moran, Herbert Smith Freehills)

*Erskine and Gooding v Elan Media Partners Pty Ltd* [2016] VSC 493, Supreme Court of Victoria, Sifris J, 1 September 2016

**(a) Summary**

Liquidators of a company in voluntary administration are titled under s. 511 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) to seek the Court's

direction, as long as the factual situation creates a sufficient question of legal substance or procedure to justify the exercise of judicial guidance.

Specifically, in distributing a company's funds, money held on trust, by virtue of contractual agreements clearly importing the language of trusts, grants the beneficiary an equitable proprietary interest which prevails over all creditors. Alternatively, in determining if a party is a secured creditor, defects in the Personal Property Securities Register (the PPSR) only invalidate a claim if they fall within s. 164 or 165 of the Corporations Act, and are not remedied by s. 166.

**(b) Facts**

Erskine and Gooding were liquidators (the Liquidators) appointed to the voluntary administration of Stomp Entertainment (Stomp). Stomp was an international wholesale and online business selling entertainment media and related products, which went into voluntary administration on 26 August 2010.

17 days earlier, on 9 August 2010, Stomp had entered a Business Sale Agreement (the BSA) with the first defendant, Elan Media Partners Pty Ltd (Elan), to sell its business. Under the BSA, Stomp agreed (clause 8.2) that any payments made to Stomp during Completion, but from invoices dated immediately after the signing of the BSA were owed to Elan. Similarly, Elan agreed Stomp retained the right to all Trade Debts, from work completed prior to the BSA (cl. 9.1).

The proceedings arose in determining competing claims for distribution of Stomp's remaining funds. Elan asserted it had an equitable proprietary interest in the funds held by the Liquidators, valued at $446,387.22, which prevailed over any creditors' claims. A competing claim emerged from the Second Defendant, Mrs Barry, who contended she was a secured creditor, disputing Elan's alleged proprietary interest and asserting her interest as a secured creditor.

The Liquidator's determination of the quantity of funds actually possessed by Stomp and the proportions in which it should be distributed was hindered by a number of factors; including the confusion regarding what debts fell within the circumstances conceived of in cll. 8.2 and 9.1; doubts regarding the legitimacy and quantity of Mrs Barry's secured interests; and a number of incidental issues that made reviewing Stomp's financial statements a difficult and laborious process.

As a result, the Liquidators applied to the Court for assistance, under s. 511 of the Corporations Act, in determining two related questions:

1. who should receive the funds held; and
2. in what amounts the money should be distributed.

**(c) Decision**

Sifris J ultimately ordered that, in order:

- The Liquidators should first retain sufficient funds to cover their "reasonable remuneration, costs and expenses";
- Elan had an equitable proprietary interest, entitling it to $446,387.33; and
- Mrs Barry was a secured creditor of the company, entitling her to a value of a minimum no less than $1,411,985.18.

His Honour noted that although the Liquidators should first apply any funds in excess of the sum held on trust in satisfying their remuneration costs and expenses, if necessary some portion could be drawn from the trust.

**(i) Section 511 of the Corporations Act**

Under s. 511 liquidators can seek guidance from the Court on any question relating to winding up a company. However, the Court is only bound to provide such direction if it is satisfied that to do so would be "just and beneficial". The breadth of this phrasing creates some uncertainty as to how courts might exercise this discretion.

Section 511 broadly operates to provide guidance to liquidators, but also operates as a safeguard against claims they acted in breach of their duty of care. Accordingly, his Honour reinforced that s. 511 should be viewed not as determining rights and/or liabilities, but as sanctioning a proposed course of conduct. In doing so, the directions would have the corollary effect of protecting liquidators from liability.

However, given directions serve this protective function, there is the possibility of abuse by liquidators desperate to consult the courts on every minor decision, which would impose an undue and unnecessary burden on courts.

His Honour considered authorities which supported a broad interpretation of s. 511, given the assistive function performed by the s. was designed to enable liquidators to perform their roles properly. However, quoting Justice Pritchard, Sifris J warned (paragraph [33]): "there must be some issue which calls for the exercise of legal judgment so as to warrant its direction - whether that be a legal issue of substance or procedure, or an issue of power, propriety or reasonableness." (*Re Great Southern Managers Australia Ltd (In Liq); Ex Parte Martin Bruce Jones, Darren Gordon Weaver and James Henry Stewart* [2014] WASC 312 at 56-65 (Pritchard J)).

In this case, Sifris J comfortably determined the Liquidators were faced with a serious legal issue, which satisfied his Honour that it was "just and beneficial" to make the above directions.

**(ii) Determining priority**

Once satisfied the Liquidators were entitled to seek the Court's direction in this matter, his Honour proceeded to consider what interests there were in Stomp's property and in what order it should be distributed.

Elan's submissions were that, besides disputing the Liquidator's calculations of the money owed to Elan, any debts paid into Stomp's account, which under the BSA were owed to Elan should be held on trust. While the Second Defendant, Mrs Barry, disputed whether contractual obligations were sufficient evidence of the asserted trust, both his Honour and the Liquidators accepted this claim. The trust was established since the language of the clauses, with phrases such as "sole and absolute property", evidenced a clear intention to create a trust from funds received from relevant invoices. His Honour also noted that the failure to create a separate account was not fatal and given there was a fund containing the amount claimed it was "probably not necessary to deal with the various rules relating to tracing" (paragraph [41]).

On 18 May 2011, Mrs Barry paid $1,411,985.18 to Bankwest for an assignment of its fixed and floating security in Stomp. Her claim, accepted by his Honour, was that after this assignment she became the valid, secured creditor. Problematically, this assignment was not initially transferred to the PPSR due to some error and she was notified of this on 30 March 2012. On 25 May 2013, her husband applied to register her interest but erred. The error was identified on 24 November 2014 and rectified on 27 November 2014.

The Liquidators sought the Court's assistance in determining whether the initial failure to register and/or subsequent error on record invalidated Mrs Barry's claim to be a secured creditor of Stomp. The relevant provisions are ss. 164 to 166 of the Corporations Act. Sifris J held Mrs Barry was a valid secured creditor, noting s. 164 presumed validity but for a "seriously misleading defect" or where one of the circumstances contemplated in s. 165 applied. Not only did his Honour not find a seriously misleading defect, but he also considered s. 166 (2)(c), which provides five working days to rectify a defect on the registry after the party acquires actual or constructive knowledge. His Honour held Mrs Barry had only become aware of the defect on 24 November 2014 and since it was rectified three days after there was no defect.

Counsel for Mrs Barry had provided additional explanations for why Mrs Barry was a secured creditor but his Honour, after making the above determination, did not consider it necessary to evaluate them or their applicability to the case at hand.

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**6.2 Directors' state of mind as to company's solvency holds the key in invalidating the appointment of a voluntary administrator**

(By Jack Hill and Antony Freeman, King & Wood Mallesons)

*In the matter of Condor Blanco Mines Ltd* [2016] NSWSC 1196, Supreme Court of New South Wales (Equity), Barrett AJA, 30 August 2016

**(a) Summary**

The appointment of a voluntary administrator to ASX-listed Condor Blanco Mines Ltd (Condor) was deemed to be invalid, void and of no effect by the Supreme Court of New South Wales on the basis that the statutory precondition to the appointment prescribed by s. 436A(1)(a) of the Corporations Act 2001 No. 50 (Cth) (the Act) was not satisfied. Under that section of the Act, a company may appoint an administrator if the directors are of the opinion that "the company is insolvent, or is likely to become insolvent at some future time".

Barrett AJA found that while one of Condor's two directors held the rationally based opinion that Condor was (or was likely to become) insolvent at the time of the administrator's appointment; there was "not the slightest indication.that [the other director] Mr Stops ever formed any opinion about the capacity of Condor to pay its debts as and when they fall due".

His Honour held (at [82]) that Mr Stops failed to fulfil his "responsibility to think and assess for himself, and, for the purposes of doing so, to familiarize himself with relevant financial facts" relating to Condor. Mr Stops deposed that he had never been given a copy of Condor's financial statements and that his knowledge of the company's financial position was based on information provided by the other director. Due to his unquestioning acceptance of what he was told by his fellow director, his Honour held that Mr Stops did not form a genuine opinion on his own in relation to Condor's solvency at the time the administrator was appointed and as such, the appointment was invalid, void and of no effect. This effectively meant that three new directors subsequently elected at a general meeting were no longer precluded by s. 437C of the Act from acting as directors.

**(b) Facts**

Barrett AJA described (at [25]) the period leading up to the appointment of the administrator as one of "particular turbulence" for Condor. The company had attempted to raise capital twice, once in September 2014 and again in March 2015, and was subsequently investigated in May 2016 by the Takeovers Panel after a shareholder made an application under s. 657C(2) of the Act for a declaration of unacceptable circumstances in respect of the failed capital raising in March 2015. Following that investigation the Takeovers Panel ordered that the shares issued under the March 2015 capital raising and any unplaced shares from the September 2014 capital raising be cancelled and that Condor make a corrective announcement to the ASX.

Around the same time in May 2016, three shareholders (including the shareholder who applied to the Takeovers Panel) requisitioned a general meeting to consider resolutions for the removal of the directors and for the appointment of replacement directors, with Condor issuing the notice of meeting on 27 May 2016 for a general meeting on 5 July 2016. Following the issue of the notice of meeting, the composition of Condor's board changed significantly, with two of the three sitting directors resigning before the date of the general meeting and Mr Stops being appointed as a replacement director during that period. For the five days leading

up to the general meeting on 5 July 2016, Condor only had two directors left in office, being Mr Darby and Mr Stops.

On 29 June 2016 (before the general meeting), the Takeovers Panel issued a media release detailing that ASIC was concerned that another company, Minesweeper Pty Ltd (and its associates), had come to control more than 20 per cent of Condor's shares. ASIC sought interim orders that included the postponement of the general meeting. However, after receiving the near final proxy count which indicated almost two-thirds of the votes were in favour of the removal of the directors and the election of their replacements, ASIC did not press their application for the order postponing the meeting.

It was in this context that the two remaining Condor directors, Mr Darby and Mr Stops, met with an administrator named Mr Calabretta on 4 July 2016 and signed two documents headed "Resolution of Board of Directors" and "Instrument of Appointment of Administrators" respectively. The resolutions noted that in the directors' opinion, the company was insolvent (or likely to become so) and also noted the appointment of Mr Calabretta as administrator. There was some conjecture as to whether Mr Stops did in fact sign the documents, as Mr Stops admitted in cross-examination that he could not remember whether he was at the venue where the signing was purported to have taken place, due to his possible intoxication at that time.

At the general meeting on 5 July 2016, a resolution removing Mr Darby from office was passed. A resolution was not required to remove Mr Stops from office, as he was appointed to fill a casual vacancy only and ceased to hold office as a director at the commencement of the general meeting by operation of Condor's constitution. Three new directors were elected at the meeting and instigated the proceedings to invalidate the appointment of Mr Calabretta as administrator.

**(c) Decision**

The key question to be determined was whether the directors held the opinion that the company was, or was likely to become, insolvent at the time of the appointment of Mr Calabretta. Key to his Honour's analysis of this issue was an evaluation of both directors' state of mind at that time.

**(i) State of mind of Mr Darby**

His Honour held (at [72]) that the state of mind of Mr Darby as to the solvency of Condor was firstly to be measured at the time of the appointment being made (i.e. late on 4 July 2016 at the time of the signing of the documents appointing Mr Calabretta). By way of background, it was noted that Mr Darby had a good working knowledge of the company, having been director of Condor for more than six years continuously and also having previously held the position of managing director. Relevantly, minutes from two Condor board meetings in late June 2016 recorded that the directors were of the opinion that Condor remained solvent. At those meetings, capital raisings or funding from directors were mooted as possible sources of funds to improve the company's financial position, and it was also

mentioned that the directors would hold off demanding payments owed to them by Condor.

Barrett AJA found (at [74]) that "there was a rational basis for an opinion on Mr Darby's part that a state of solvency - albeit parlous - existed on both 21 June 2016 and 30 June 2016". However, his Honour found (at [74]) that "[t]here is also a rational basis for concluding that Mr Darby's opinion changed when it became obvious to him in the course of 4 July 2016 that he would be voted off the board and new directors would be installed. That circumstance would have led to a conclusion that he and associated directors would no longer make loan funds available or exercise forbearance in requiring payment by the company". Moreover, without his efforts being put towards securing a capital injection and with no guarantee of financial assistance from incoming board members, Barrett AJA found (at [74]) that "[i]t was understandable that [Mr Darby] should think that the parlous position that already existed would degenerate into insolvency at some point after the new and unknown group of directors took over".

As such, Barrett AJA found no sufficient basis to support the finding that Mr Darby did not hold a rationally based opinion that Condor was or would likely become insolvent at the time of Mr Calabretta was appointed.

### (ii) State of mind of Mr Stops

In contrast to the decision in relation to Mr Darby, his Honour found that Mr Stops did not hold a genuine opinion that Condor was, or was likely to become, insolvent. Based on Mr Stops statements (at [77]) that he "took no proactive steps to ask anyone to inform me of the financial position of the company", his Honour held (at [82]) that "[t]he evidence makes it clear that Mr Stops never inquired about Condor's financial state or addressed his mind independently to the question whether Condor was insolvent or likely to become insolvent".

His Honour further noted (at [82]) that there was no indication "that Mr Stops ever formed any opinion about the capacity of Condor to pay its debts as and when they fell due". Mr Stops had asked Mr Darby whether appointing an administrator was "the right thing to do", to which Mr Darby had replied "[w]e have no choice" (at [79]-[81]). Barrett AJA noted (at [82]) that it "was not open to Mr Stops simply to take at face value and unquestioningly the terse opinion communicated by Mr Darby" and further that "[h]e had a responsibility to think and assess for himself and, for the purpose of doing so, to familiarize himself with relevant financial facts."

As such, Barrett AJA held that Mr Stops had not held a genuine opinion in good faith as to the insolvency of Condor as to warrant the appointment of Mr Calabretta as voluntary administrator.

### (iii) Other matters - only two directors at the time of appointment

Though not strictly necessary to decide, Barrett AJA in obiter dictum continued on to address whether the appointment of the administrator was invalid on the ground

that only two directors were in place at the time of the appointment, in contravention of s. 201A(2) of the Act. Paraphrasing Mason J in *Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd* (1978) 139 CLR 410 (at 423), Barrett AJA framed the relevant question as: "having imposed the requirement and provided for a penalty.does the statute intend merely to penalize non-compliance or is there an intention to go further and deny efficacy to acts of a non-compliant organ?" Another way of looking at this was drawn from the judgment of McHugh and Gummow JJ in *Fitzgerald v FJ Leonhart Pty Ltd* (1997) 189 CLR 215 (at 227), being that the predominant consideration in answering the question is whether the legislative purpose will be fulfilled without regarding the contract as void or unenforceable.

His Honour found (at [91]) that both Condor's Constitution, which aligned with the replaceable rules in the Act, and the Act itself contemplated "valid and effective action by a public company board having fewer than three members".

His Honour therefore noted that he would have held that the lack of a third director did not affect the validity of an otherwise valid board resolution.

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### 6.3 Call for law reform via amendment of s. 601AH of the Corporations Act 2001 (Cth)

(By Meagan Ryan, MinterEllison)

*Re Rocha Pty Ltd (No 2)* [2016] NSWSC 1172, Supreme Court of New South Wales, Brereton J, 29 August 2016

#### (a) Summary

An application for an order to set aside the dissolution of a company as void was dismissed. The dissolved company was registered under the Companies Act 1961 (NSW) (the Companies Act) which was repealed in 2008. The Court had found in an earlier judgment that the Court did not have jurisdiction to make an order that the dissolution was void. The plaintiff then made a further application that s. 307 of the Companies Act gave the plaintiff an accrued right to apply for an order to set aside the dissolution of the company relying on s. 30(c) of the Interpretation Act 1987 No. 15 (NSW) (the Interpretation Act). The Court declined to set aside its earlier order dismissing the plaintiff's application on the basis that a procedural right to make an application is not an accrued right and was not preserved by the operation of s. 30(c) of the Interpretation Act. The Court expressed regret at this decision and suggested that the operation of s. 601AH of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act 2001) be extended to include companies dissolved under earlier companies legislation.

**(b) Facts**

The plaintiff was the majority shareholder and director of Rocha Pty Ltd and used the company as a vehicle to conduct his psychiatry practice. Rocha Pty Ltd was registered under the Companies Act and owned a property in Hamilton. Rocha Pty Ltd was deregistered in 1980 and the property vested in the NSW Corporate Affairs Commission and subsequently ASIC.

The plaintiff appears to have continued to practice at the property from 1980 to 1993. The property was generally vacant from 1993, when the plaintiff ceased conducting his psychiatric practice there, until 2008. From 2008 to 2015 the plaintiff leased the property to a third party on an informal basis. In October 2015 the plaintiff received correspondence from a potential purchaser and correspondence from ASIC.

**(i) Initial application considering s. 601AH**

The initial application brought by the plaintiff was for a declaration extending the time for bringing an application that the dissolution of Rocha Pty Ltd was void pursuant to s. 307 of the Companies Act and that the property be re-vested from ASIC to Rocha Pty Ltd. Brereton J in *Re Rocha Pty Ltd (Deregistered)* [2016] NSWSC 899 (22 June 2016), reaching his conclusion "with regret", found that it was not possible to reinstate Rocha Pty Ltd. This conclusion was reached because s. 601AH of the Corporations Act 2001 (Cth) did not provide jurisdiction to reinstate a company incorporated under the repealed Companies Act 1961 (NSW). This was due to the narrow meaning of "company" and the transitional provisions in the Corporations Act 2001 applying to companies registered under the Corporations Act 1989 No. 109 (Cth) but not earlier companies legislation. In obiter dicta the Court stated that but for the lack of jurisdiction, on the merits of the application it would be appropriate to declare the dissolution of Rocha Pty Ltd void so that the property could be dealt with. Accordingly, the Court ordered the plaintiff have liberty to apply to set aside the Court's order within one month of the date of the order as the application was unopposed and not unmeritorious.

Brereton J also called for an amendment to s. 601AH of the Corporations Act 2001 to extend its operation to a company which had been dissolved or deregistered under earlier companies legislation.

**(ii) Further application**

This judgment concerns a further application brought by the plaintiff on 26 July 2016 that the dissolution of the company was void on the alternative basis that the plaintiff had an "accrued right" within the meaning of s. 30(1)(c) of the Interpretation Act to make an application under s. 307.

Summarised, s. 30(1)(c) of the Interpretation Act provides that the repeal of an Act does not affect any right accrued under the Act and any such legal proceeding may be instituted, continued or enforced as if the Act had not been repealed. The plaintiff submitted that the accrued right to make an application under s. 307

meant that the Court retains jurisdiction to make an order under s. 307 of the Companies Act notwithstanding its repeal.

Section 307 of the Companies Act provided "[w]here a company has been dissolved the Court may at any time within the two years after the date of dissolution, on application of the liquidator of the company or any other person who appears to the Court to be interested, make an order upon such terms as the Court thinks fit declaring the dissolution to have been void, and thereupon such proceedings may be taken as might have been taken if the company had not been dissolved".

The Court investigated the nature of the plaintiff's rights under s. 307 of the Companies Act 1961 (NSW) to determine whether the plaintiff had an accrued right permitting the order dissolving Rocha Pty Ltd to be set aside.

**(c) Decision**

The Court stated that s. 307 of the Companies Act provided a discretion to declare a dissolution void and that this right was a merely a right to apply for an order under s. 307. As the relief sought was dependent on an exercise of discretion, the right to apply was not considered an "accrued right" and so did not preserve the plaintiff's right to make the application.

The case of *Continental Liqueurs Pty Ltd v G F Heublein and Bro Incorporated* [1960] HCA 37; (1960) 103 CLR 422 was considered analogous. In that case Kitto J found that where an applicant had standing to seek discretionary relief, this right was not an accrued right. Similarly, the Court considered s. 307 of the Companies Act only gave an interested person standing to apply to have a dissolution declared void and not a right to have the dissolution declared void. The vital distinction being that substantive rights are preserved whilst procedural rights to make an application are not preserved.

Accordingly, as the plaintiff had a procedural right to make an application under s. 307 of the Companies Act 1961 (NSW) which was a mere locus standi and was not an accrued right, the Court declined to set aside the order of 29 June 2016 dismissing the plaintiff's application.

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**6.4 Federal Court rejects constitutional challenge to its examination power**

(By Tim Ancev, Ashurst)

*In the matter of Queensland Nickel Pty Ltd (in liq)* [2016] FCA 1048, Federal Court of Australia, Greenwood J, 29 August 2016

**(a) Summary**

This decision of the Federal Court of Australia concerned three separate applications by Mr Ferguson, Mr Wolfe and Mr Palmer, each seeking to set aside summonses for their examination, issued on the application of the Special Purpose Liquidators of Queensland Nickel Pty Ltd (Queensland Nickel). There were three grounds for each of the challenges.

Those parts of each application relating to the first two grounds were stood over by the Court in light of ongoing discussions as between the examinees and the Special Purpose Liquidators. The substantive issue remaining to be considered by the Court was a constitutional challenge to the Court's powers to summon a person for examination about a corporation's examinable affairs under ss. 596A and 596B of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). The applicants failed to establish that there was an arguable constitutional question, and the corresponding parts of their applications were dismissed.

**(b) Facts**

Queensland Nickel had been the manager of a joint venture that operated the Yabulu Refinery near Townsville. In January 2016, administrators were appointed to Queensland Nickel and in April 2016, the company's creditors resolved that it be wound up. In May 2016, the Commonwealth of Australia and the Commissioner of Taxation for the Commonwealth successfully applied, as creditors of the company, for the appointment of Special Purpose Liquidators to conduct investigations into and report to creditors on a variety of matters, including by conducting examinations pursuant to ss. 596A and 596B of the Corporations Act.

These provisions give the Court both a mandatory and discretionary power to summon a person for examination about a corporation's examinable affairs, where an eligible applicant has applied and particular statutory matters have been satisfied. Summonses for public examination were issued against Messrs Ferguson, Wolfe and Palmer on the application of the Special Purpose Liquidators in August 2016.

The applicants argued that the power conferred on the Court under ss. 596A and 596B was neither judicial in character nor incidental to judicial power, and thus was not a valid conferral of judicial power under Chapter III of the Constitution.

**(c) Decision**

**(i) Scope and operation of examination power**

Greenwood J emphasised that the examination power conferred by ss. 596A and 596B "is undertaken in the exercise of the Court's supervision", whereby the Court fulfils its functions with a view to ensuring that the examination process is "not abused or conducted oppressively". The exercise of the power was said to involve the Court in a facilitative, rather than inquisitorial role, it being noted by his

Honour that the examination of individuals is conducted before the Court rather than by it.

**(ii) The decision in Saraceni v Jones**

In order to succeed, the applicants needed to establish that the decision of the Court of Appeal of the Supreme Court of Western Australia in *Saraceni v Jones* (2012) 42 WAR 518 had no application to the determination of the judicial character of the power in relation to a voluntary liquidation.

In *Saraceni v Jones*, the Court of Appeal was required to determine whether the exercise of the examination power on the application of a privately appointed receiver and manager was unconstitutional. In that case, the Court concluded that the examination powers in relation to companies in receivership and companies in voluntary liquidation were very closely analogous, and found that the latter power had long been recognised as being appropriate for judicial performance. Greenwood J could find no error in the Court's approach.

**(ii) Voluntary winding up**

Mr Ferguson and Mr Wolfe argued that while the power conferred by ss. 596A and 596B might be incidental to the Court's exercise of its power to order the winding up of a company, it is not judicial in character in so far as it is exercised in the context of a voluntary winding up.

Greenwood J found that in its terms, the examination power conferred by ss. 596A and 596B clearly extends to corporations in voluntary liquidation. Following *Saraceni v Jones*, his Honour noted that in the context of a voluntary liquidation, ss. 596A and 596B reflect the historical evolution of a power which has over time come to be well recognised as a proper exercise of judicial power.

His Honour reasoned that because powers of examination require an application for an appropriate order upon the satisfaction of the Court and the continuing supervision of the examination process by the Court, they have historically and correctly been understood as powers properly conferred on a Court. This was so despite the examination power not directly engaging commonly recognised features of judicial power such as "the quelling of controversies".

Based on these considerations, Greenwood J rejected the argument that the circumstances of voluntary winding up conditioned the character of the power conferred by ss. 596A and 596B in such a way as to render the provisions an unconstitutional conferral of non-judicial power on the Court.

His Honour accordingly held that ss. 596A and 596B "reflect valid laws of the Commonwealth".

### 6.5 ASIC v Cassimatis: What is a director's liability for a breach of law by the company?

(By Andrew Eastwood and Tania Gray, Herbert Smith Freehills)

*Australian Securities and Investments Commission v Cassimatis (No 8)* [2016] FCA 1023, Federal Court of Australia, Edelman J, 26 August 2016

#### (a) Summary

The Federal Court has found that the directors of Storm Financial - one of the high profile collapses of the global financial crisis - breached their directors' duties.

Edelman J concluded that the directors breached their duty of care and diligence, under s. 180 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) , by permitting (or failing to prevent) the Storm Financial model being applied indiscriminately to clients who were retired or near retired with limited income and few assets. This model involved investors borrowing against their homes and obtaining margin loans to invest in index funds. The Court found that a reasonable director would have realised that there was a strong likelihood that retired or near-retired investors would be inappropriately advised to use their homes as security for their investment.

In reaching that conclusion, the Court explored various important concepts arising in respect of the directors' duty of care and diligence. In particular, the decision confirms that in exercising care and diligence, directors must think beyond the financial consequences of a particular action or approach and consider all of the possible harm that may arise - including reputational harm and potentially, the loss of a licence arising from a failure by the company to comply with the law.

#### (c) Decision

#### (i) Is company misconduct a necessary stepping stone to a directors breach?

ASIC's case relied upon an actual breach by the company as a "stepping stone" for a finding that the directors breached their duty under s. 180 of the Corporations Act. Although actual breach was in fact made out, Edelman J queried whether ASIC had set itself an unnecessarily high bar, expressing some doubt as to whether a contravention by the company was a necessary requirement for a breach by a director. If it were a requirement, this would lead to the unusual result that a director might escape liability for an act which was extremely likely to involve a serious breach of the law, simply because by some good fortune no actual breach occurred.

#### (ii) Can s. 180 be used as to create "back door" accessory liability?

Relatedly, Edelman J rejected the notion that s. 180 can be used to create liability in directors merely because their companies have contravened another provision of

the Corporations Act - "back door" accessory liability. He rejected a submission made by ASIC that there was some general duty imposed on directors to ensure that the corporation meets its statutory obligations - there is no strict liability duty to ensure compliance. Edelman J confirmed the conclusion from *ASIC v Mariner Corporation* that it is wrong to assert that if a director causes a company to contravene a provision of the Corporations Act, then necessarily the director has contravened s. 180.

Edelman J did, however, confirm that contraventions or the risk of contraventions by the corporation are circumstances to be taken into account in assessing whether a director or officer exercised care and diligence - they are not the only circumstances, and they are not conditions of liability.

The Court also considered the concept that any breach of s. 180 must be "founded on jeopardy to the interests of the corporation" (an expression arising from the decision of the Court in *ASIC v Maxwell* and discussed in later decisions). Edelman J described this expression as "short-hand" for the idea that if the interests of the corporation are not threatened (or foreseeably harmed), there cannot be any breach. In the context of a breach of the law, the relevant jeopardy is the threat of damage to the interests of the corporation which include exposure to sanctions. The risk of exposure to liability or sanctions must be clear to the directors and the countervailing potential benefits insignificant.

**(iii) Is financial harm the only concern in thinking about the directors' duty of care and diligence?**

Under s. 180, whether a director has exercised care and diligence can only be answered by balancing the foreseeable risk of harm against the potential benefits that could reasonably be expected to accrue. The mere fact that there is a foreseeable risk of harm to the interests of the company will not necessarily mean a director has failed to exercise care and diligence.

In exploring the content of the duty under s. 180, Edelman J noted that harm is not confined to financial harm. It extents to harm to any of the interests of the corporation, including its reputation and interests which relate to compliance with the law (e.g. the potential loss of a licence).

[482] .it would be hard to imagine examples where it could be in a corporation's interests for the corporation to engage in serious unlawful conduct even if that serious unlawful conduct was highly profitable and was reasonably considered by the director to be virtually undetectable during a limitation period for liability.

Edelman J also concluded that the balancing exercise to be undertaken in determining whether the duty has been breached is not a literal weighing of costs against profits. A director will not necessarily avoid liability merely by showing that the likely financial cost of a penalty for breaching the law was exceeded by the likely profit from the contravention.

**(iv) Are directors who are the sole shareholders of a solvent company effectively excused from s. 180?**

The directors in this case asserted that there could be no breach of s. 180 where a director of a solvent company has the consent of the shareholders in embarking on a course which is highly likely to contravene provisions of the Corporations Act. They argued that where the directors and shareholders are the same, as was the case here, such a ratification by the shareholders is implicit.

Edelman J rejected the directors' submission on this point, finding that the right to exercise business judgment does not give a director/ shareholder carte blanche to engage in any venture, even if the venture is highly likely to (and does) contravene the law. He found that while the acquiescence of shareholders (including where there is an identity of interests between directors and shareholders) can affect the duty of care and diligence, it does not relieve the directors of their duties where there are other relevant interests of the corporation, apart from the interests of shareholders. These interests do not always coincide.

**(v) Is a breach of the statutory directors' duty of care and diligence a public wrong?**

Edelman J explored a question raised by the parties as to whether a breach of the obligation in s. 180 of the Corporations Act to exercise care and diligence is both a private and a public wrong.

The directors argued that the duty is essentially a private duty owed only to the company, with a public component reflected in ASIC's ability to pursue enforcement and impose public sanctions. They also argued that in a solvent company, the only interest of the company is the interest of its shareholders.

In contrast, ASIC argued that s. 180 creates an independent public duty requiring consideration of a "general norm of conduct" which is not limited to the interests of the corporation - it is a duty which requires consideration of the public interest.

While Edelman J did not consider it necessary, in the relevant context, to resolve this question, he did explore the possibility that the relevant text in the Corporations Act and contextual considerations might indicate that a public duty is owed.

In the current climate, where ASIC is repeatedly emphasising that "culture is the new black", this possibility of a broader public duty raises questions about the extent to which directors might be at risk, regardless of harm to shareholders, for failures of the company and its employees.

### 6.6 Application for extension of time to register interest on Personal Property Securities Register - Applicable principles

(By Stephanie Glover, DLA Piper)

*Caason Investments Pty Ltd v Ausroc Metals Ltd* [2016] WASC 267, Supreme Court of Western Australia, Master Sanderson, 23 August 2016

#### (a) Summary

The court was asked to make an order under s. 588FM of the Corporations Act 2001 No. 50 (Cth) (the Act) to extend time to register a General Security Deed (GSD) on the Personal Property Securities Register (the PPSR). The court considered that the plaintiff's inadvertence and ignorance of the law were sufficient grounds for granting the order and that "inadvertence" had been established in the circumstances even though the plaintiff's actions were deliberate and intentional, as opposed to accidental.

#### (b) Facts

The plaintiff provided financial accommodation to the defendant on 28 November 2014, while the defendant undertook a capital raising. The plaintiff was not ordinarily engaged in the business of lending and its primary operations included investment in mining and resources companies and research and development in clean energy. The parties executed a loan agreement and the defendant granted the plaintiff a GSD over all its present and after acquired property. The plaintiff failed to register the GSD on the PPSR until some 18 months later, on 31 May 2016.

The plaintiff sought an order that 31 May 2016 be fixed as the later time for the plaintiff to register its security interest on the PPSR for the purposes of subparagraph 588FL(2)(b)(iv) of the Act.

To grant the order sought, pursuant to s. 588FM(2), the court must be satisfied that:

- the failure to register the collateral earlier was accidental, or due to inadvertence or some other sufficient cause;
- the failure to register the collateral earlier is not of such a nature as to prejudice the position to creditors or shareholders; or
- on other grounds, it is just and equitable to grant relief.

The plaintiff cited inadvertence and ignorance of the law as the reason for failing to register earlier. In affidavit evidence, it was stated that a Mr Flory of the plaintiff had never previously dealt with registration on the PPSR and, while he was aware that the GSD should have been registered, he did not appreciate the detrimental effect that the failure to register within a particular period of time would have on the enforceability of the GSD.

The court reviewed the authorities relevant to the exercise of its discretion and was  satisfied its discretion to make the order sought was enlivened.

The court considered that the evidence of Mr Flory demonstrated a lack of understanding as to the legal implications of late registration and that there was clearly a level of inadvertence in this instance on the part of the plaintiff. The fact that the plaintiff's inadvertence was not produced by accident was of no consequence - although the plaintiff had deliberately and intentionally elected not to immediately register the GSD rather than accidentally, it was done without the plaintiff having a proper appreciation of the consequences of that decision.

Master Sanderson opined at paragraph 19: "It is clear. that the actions of the plaintiff in electing not to immediately register were not made with any fraudulent intent or improper intention and, as such, were not beyond the scope of those acts or omissions for which the curative power of the court is intended. The failings of the plaintiff can be attributed to oversight or inadvertence. It is precisely these circumstances for which the provision in s. 588FM of the Act is designed to remedy."

It was noted that one other creditor had registered a security interest against the defendant following the execution of the GSD but before the plaintiff registered on 31 May 2016. That creditor did not appear at the hearing but, in pre-trial correspondence with the plaintiff, suggested that any order granted in the plaintiff's favour should be such as to have no effect on the priority to be afforded to the creditor's security interest.

**(c) Decision**

The court granted the extension of time sought by the plaintiff.

Master Sanderson declined to make the specific order sought by the creditor on grounds that it was not necessary, but gave liberty to apply generally so as to allow the court to remedy any prejudice which might be suffered as a creditor as a result of the orders made.

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### 6.7 The enforcement of director guarantees following the appointment of administrators - Section 440J of the Corporations Act 2001

(By Matt Edwards and Jess Tinsley, Clayton Utz)

*Mizuho Bank Ltd v Mark Anthony Ackroyd* [2016] NSWSC 1148, Supreme Court of New South Wales, Hammerschlag J, 19 August 2016

**(a) Summary**

The Supreme Court of New South Wales has supported the previously unopposed decision reached in *Bank of Western Australia Limited v Clift* (2010) 80 ACSR 163 finding that s. 440J(1) of the *Corporations Act 2009 (Cth)* (the Act) does not protect a director from a party enforcing a guarantee when that enforcement action was commenced prior to the company entering into administration.

**(b) Facts**

The plaintiff in these proceedings, Mizuho Bank Ltd (the Bank), lent National Plant & Equipment (the Company), a significant sum of money. The defendant was a director of the Company and guaranteed the company's obligations to the bank (the Director).

In June 2016 the Bank commenced proceedings against the Director, relying on the guarantee, and sought repayment of the guaranteed debt in the amount of $20,281,169.31.

In July 2016 the Company appointed administrators under s. 436A of the Act. The Bank continued to prosecute the proceedings and the Director subsequently sought a stay of the proceedings. It was argued that s. 440J(1) prevented a party from enforcing a guarantee against a director of a company in administration.

Section 440J(1) (a) provides that "during the administration of a company. a guarantee of a liability of the company cannot be enforced, as against. a director of the company. except with the leave of the Court.".

The Bank argued that s. 440J(1) has no application to a proceeding that has already commenced prior to administration. Alternatively, it sought the Court's leave to continue to prosecute the action under subsection (b).

The Director, instead, claimed that the ordinary meaning of "enforce" in the context of a liability under guarantee includes both the bringing and furthering of legal proceedings and therefore the proceedings should be stayed. In doing so the Director contended that the conclusion reached in *Bank of Western Australia v Clift* was wrong.

**(c) Decision**

In supporting the ultimate conclusion reached in *Bank of Western Australia v Clift*, Hammerschlag J noted generally that:

- by commencing these proceedings the plaintiff invoked the jurisdiction of the Court which should not be interpreted as limited unless a statute clearly and unmistakably does so; and
- in the absence of a clear intention to do so, a statute will not be construed so to deprive a party of its common law rights.

His Honour held that if the Director was correct, the Bank would be deprived of its right to sue and vindicate its chose in action.

With these general considerations in mind, his Honour looked at contextual and textual considerations to support his decision.

**(i) Contextual consideration**

The explicit object of Part 5.3A of the Act is to maximise the chances of the beleaguered company staying alive and to maximise return. It is to this end that Part 5.3A contains provisions which restrict the exercise of rights and the bringing of proceedings against the company.

The Explanatory Memorandum accompanying the Bill sets out that s. 440J(1) was introduced to encourage directors who have guaranteed loans for their company to ensure that this guarantee does not impede the timely appointment of administrators if administration is necessary. There were concerns that if an enforceable guarantee became trigged by the commencement of administration, the directors may delay the appointment to avoid personal liability to the detriment of the company.

However in this same part, it was noted that s. 440J(1) should not be used by directors as a way of appointing an administrator to avoid action already on foot. His Honour pointed to the wording of s. 440J(1)(b), being "a proceeding in relation to such a guarantee cannot be begun against such a director.".

The words "cannot be begun" support the legislative intent that proceedings already on foot (as opposed to action taken after the appointment of administrators) are still allowed to proceed.

**(ii) Textual considerations**

Leading from the contextual considerations and looking specifically at the wording of s. 440J(1), his Honour held that:

- there is a clear temporal sequence in which (a) and (b) appear which is likely to indicate that the legislature did not intend that the continuation of proceedings already on foot would be stopped by s. 400J(1); and
- s. 440J(1) differs from other provisions in the Act (such as ss 440D, 440F and 471B) where proceedings may be "begun or proceeded with". The deliberate exclusion of the words "proceeded with" support the view that the legislature has deliberately excluded proceedings already on foot from the protection offered by s. 440J(1).

### 6.8 Court considers nature and extent of liquidator's lien, rejects claims of creditors that liquidators remuneration be fixed at 2% of assets realised

(By Ned Sutton, King & Wood Mallesons)

*Clout in his capacity as liquidator of Mainz Developments Pty Ltd (in liquidation)* [2016] NSWSC 1146, Supreme Court of New South Wales, Robb J, 19 August 2016

**(a) Summary**

In this case Robb J considered the nature and extent of a liquidator's lien over amounts realised in a liquidation to pay the liquidator's remuneration and expenses and whether the amount of such remuneration and expenses should be determined by reference to a percentage of the assets realised. His Honour found that the liquidator, by accruing considerable costs in extensively investigating the validity and priority of and negotiating for the removal of caveats, went beyond steps reasonably related to the care, preservation and realisation of the property. As such the liquidator's claim for the entire amount of the proceeds to cover his remuneration and expenses was rejected. In considering the extent to which liquidator's remuneration can be fixed by reference to a percentage of the assets realised, his Honour found that the process in which the court engages does not involve the direct adoption of any particular proportion or percentage. Rather in a process that involves an evaluative assessment of a number of discretionary factors the Court may, where appropriate, adopt an appropriate percentage using other cases as a guide.

**(b) Facts**

**(i) The liquidation**

David Clout was appointed liquidator of Mainz Developments Pty Ltd (in liquidation) (Mainz). At the time of this appointment Mainz was the registered owner of a property in North Sydney (the Property). In realising the assets of Mainz, Mr Clout accepted an offer made by a purchaser to purchase the Property for $240,000. After settlement but before the date for completion of the contract of sale, a number of caveats were lodged against the title to the Property by certain creditor companies (the Creditors). Each of the caveats was lodged to protect a charge over the Property said to have been granted by Mainz in favour of the Creditors under agreements to provide credit to Mainz and had the effect of preventing Mr Clout from completing the contract of sale.

After considerable correspondence, for which Mr Clout accrued liquidators fees on a time basis and incurred significant legal costs, the Creditors agreed that the caveats would be withdrawn at settlement upon the basis that Mr Clout would retain the balance of the sale proceeds (after payment of the mortgage and costs),

being an amount of $47,000, as a fund pending the determination of the competing claims to the fund (the Proceeds).

### (ii) The proceedings

Mr Clout initiated proceedings and claimed that he was entitled to a lien over the Proceeds in respect of his remuneration and expenses (approximately $60,000) for effecting the sale of the Property, and sought orders that the entire amount of the Proceeds be paid out to him on account of his remuneration and expenses, including those incurred in determining the validity of the caveats and the charges, the amounts secured by them, and the relative priorities of the charges. Mr Clout's claim was based on the well-established principle laid down in *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171 and further explained by the High Court in *Stewart v Atco Controls Pty Ltd (in liq)* [2014] HCA 15, that a liquidator's lien should take priority over creditor's charges to the extent that the liquidator's remuneration and expenses reasonably relate to the care, preservation and realisation of the assets.

The Creditors, while accepting the existence of Mr Clout's lien, disputed that he was entitled to the full amount of the Proceeds. The Creditors argued that much of the remuneration and expenses claimed by Mr Clout fell outside the protection of the lien, because it related to work done that was not necessary for the realisation of the property. Rather, the Creditors argued, the work concerned communications and investigations about the validity and priority of the charges, and the amounts secured, which was not necessary to enable the contract for sale to be completed. The Creditors, citing a recent decision handed down by Brereton J of the New South Wales Supreme Court in *Re Independent Contractor Services (Aust) Pty Ltd ACN 119 186 971 (in liq)* (No 2) [2016] NSWSC 106, went on to claim that the reasonable amount allowed should be limited to 2% of the realised value of the Property, or $4,800.

### (c) Decision

Ultimately his Honour found that Mr Clout and his solicitors went beyond the steps necessary to effect an early settlement of the contract for sale, by extensively negotiating and obtaining the agreement of all of the Creditors to provide withdrawals of the caveats at settlement. While his Honour considered that it may have been reasonable for Mr Clout and his solicitors to explore the issue of the validity of the charges claimed by the Creditors and that some of his fees and expenses of doing so may have been reasonably necessary for the purposes of realising the Property, his Honour found that in making final adjudications of the Creditor's claims, he was acting on behalf of the unsecured creditors in a way that would cause part of his fees and expenses to fall outside the lien.

The quality of evidence presented meant his Honour was not able to quantify the proper amount of remuneration and instead ordered the parties to confer and bring in short minutes of order to provide for the further conduct of the dispute.

In coming to this decision Robb J considered a number of issues including:

**(i) Costs of scrutinising validity and priority of charges**

His Honour found that while a liquidator may have a duty to "carefully scrutinise" charges existing over company property, it does not follow that the cost of doing so will necessarily fall within the cost of realising the property and so be covered by the liquidator's lien in priority to the claims of chargees. In this respect his Honour distinguished the facts from those in *Stewart v Atco Controls Pty Ltd (in liq)* [2014] HCA 15 as in that case the fees incurred in scrutinising the charges led to a settlement which created the fund in dispute whereas in the present case, "Mr Clout's costs of scrutinising and possibly challenging the validity of existing charges over the property owned by Mainz did not create any fund, but may in part have been justified by the need to realise the Property".

**(ii) Liquidator's remuneration as a percentage of assets realised**

His Honour rejected the Creditor's argument that Mr Clout's remuneration should be fixed at 2%. His Honour found that the Creditors did not adequately explain why 2% was an appropriate percentage of assets realised upon which to base Mr Clout's remuneration. His Honour, after reviewing the recent cases on this issue, found that the process in which the court engages does not involve the direct adoption of any particular percentage, but rather is a process that involves an evaluative assessment of a number of discretionary factors which may involve adopting an appropriate percentage, having regard to previous cases, as a guide. His Honour stated that "it is not correct to say that the process by which the court determines the amount of remuneration to be allowed to liquidators has evolved to the point where the determination involves the selection of a percentage, divorced from all of the other relevant circumstances of the winding up."

**(iii) Quantification of the liquidator's remuneration**

His Honour found that ultimately, a liquidator in Mr Clout's position must approach the task of formulating and justifying his claim for remuneration on the basis that he has the burden of proving that the claim is reasonable. His Honour considered that Mr Clout's remuneration report, whereby he sought to quantify and substantiate his remuneration for realising the property, was expressed in overly general terms and lacking in detail. As such it followed that it was likely Mr Clout had claimed remuneration for work that was not reasonably done for the purposes of the care, preservation and realisation of the property.

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### 6.9 Determining the appropriateness of proposed penalties for contraventions of the Corporations Act 2001 in a proposed minute of consent orders

(By Katrina Sleiman and Lara Nurick, Corrs Chambers Westgarth)

*In the matter of Padbury Mining Limited* [2016] FCA 990, Federal Court of Australia, Siopis J, 19 August 2016

**(a) Summary**

The Australian Securities and Investments Commission (ASIC) sought declarations and orders against Padbury Mining Limited (Padbury), its managing director, Gary Stokes, and its executive director and chairman, Terence Quinn, in relation to an announcement by Padbury to the Australian Stock Exchange (ASX) on 11 April 2014.

ASIC alleged that the announcement was misleading or deceptive or likely to mislead or deceive in contravention of s. 1041H(1) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). ASIC also alleged that Padbury's announcement also contravened s. 674(2) of the Corporations Act.

ASIC sought declarations to that effect against Padbury as well as declarations against Stokes and Quinn, alleging that by authorising the announcement, they were involved in Padbury's contraventions, thereby contravening ss. 674(2A) and 180(1) of the Corporations Act. ASIC also sought orders under s. 206C of the Corporations Act to prohibit Stokes and Quinn from managing a corporation for three years as well as orders for pecuniary penalties.

The defendants admitted all of the contraventions such that the only question to be decided was whether the penalties ASIC proposed were appropriate. Siopis J examined the approach of courts to proposed consent orders and the factors considered in making disqualification orders and imposing pecuniary penalties. His Honour found the proposed orders were appropriate and made all declarations and orders sought by ASIC.

**(b) Facts**

Padbury, a mining exploration company, is a public company whose shares are listed on the ASX. Its objective was to develop and construct a deep water port and associated railway network at Oakjee. To secure funding for this project Padbury entered into a shareholders agreement on 8 April 2014 under which funding would be provided by Superkite Pty Ltd (Superkite) in three tranches, each subject to Padbury procuring a bank to provide a demand guarantee. If these preconditions were not satisfied, either party could terminate.

Following a board meeting on 3 April 2014 at which the shareholders agreement and funding for the Oakjee project were discussed, Stokes and Quinn drafted and exchanged several draft funding announcements. Notwithstanding their knowledge of the preconditions in the shareholders agreement and the ASX disclosure obligations (in respect of which they sought legal advice), they authorised the release of an announcement to the ASX that represented that Padbury secured

funding of approximately $6 billion, but did not disclose the contractual preconditions to the funding or identify Superkite as the funder.

Importantly, at the time of making the representation:

- Superkite was not required to provide the funding unless Padbury had procured the issue of each of the demand guarantees;
- Padbury did not have sufficient available funds to procure the issue by a bank or any other financial institution to Superkite of any of the demand guarantees; and
- Padbury had not secured any commitment from any entity to provide funding that would enable Padbury to procure the issue by a bank or any other financial institution of any of the demand guarantees in the near future or at all.

Trading of Padbury's shares was halted prior to the announcement being made. Before the trading halt, Padbury's shares traded at about $0.02 per share. Following the announcement on 11 April 2014, shares traded as high as $0.052. Padbury's shares were halted a second time that day at 2.15pm. During that period, in excess of 200 million shares traded.

Padbury failed to procure the demand guarantees within the requisite time due to lack of funds, thereby failing to satisfy the pre-conditions for funding. Accordingly, on 29 April 2014 the shareholders agreement was terminated.

**(c) Decision**

Since the parties executed an agreed statement of facts in which the defendants admitted to all contraventions alleged, the Court only had to decide on the question of penalties. After having regard to these facts, Siopis J decided that ASIC's proposed consent orders were appropriate given the seriousness of the conduct and made all of the declarations and orders sought by ASIC.

**(i) How should courts approach proposed consent orders?**

Siopis J applied the High Court case of *Commonwealth of Australia v Director, Fair Work Building Industry Inspectorate* [2015] HCA 46 which found that in civil penalty proceedings a court may make orders based on a proposed minute of consent orders. In making its decision whether to do so, a court must consider the appropriateness of the penalties - in particular whether they are within an appropriate range, and whether the proposed orders are in the public interest. Interestingly, a proposed penalty may be considered appropriate even if the court would not itself impose the same penalty.

**(ii) Determining the appropriateness of ASIC's proposed declarations and orders**

Siopis J found the declarations sought by ASIC to be appropriate and in the public interest. This was primarily because in recording the Court's disapproval of the unlawful conduct, the declarations resolve a legal controversy, assist ASIC's role as regulator, vindicate ASIC's claims, inform investors and the public of the contraventions and act as a deterrent for other corporations and directors.

In relation to the orders prohibiting Stokes and Quinn from managing corporations, Siopis J firstly considered whether such an order would be appropriate in the circumstances, and if so, what would be the appropriate duration of such an order. In relation to the first question, his Honour was guided by ss. 206C(1) and (2) of the Corporations Act, which permit a Court to disqualify a person where a declaration has been made that the person contravened a civil penalty provision and the Court thinks the disqualification is justified having regard to: (a) the person's conduct in relation to the management or business of the corporation; and (b) any other matter the Court considers appropriate.

Given a declaration had been made and Stokes and Quinn conceded the seriousness of their conduct, which involved a serious departure from the standard expected of directors, Siopis J considered the disqualification was justified. In considering the duration of the order, his Honour noted that a disqualification order must have a deterrent effect as its purpose is to protect the public and demonstrate disapproval of contravening conduct. Applying the findings of Sackville AJA in *Gillfillan v Australian Securities and Investments Commission* [2012] NSWCA 370 ("Gillfillan") wherein the directors similarly approved a draft ASX announcement which they ought to have known was misleading, Siopis J found the conduct of Stokes and Quinn to be very serious, requiring a five year disqualification before taking into account mitigating factors.

After having regard to mitigating factors such as the absence of any dishonesty, their cooperation with ASIC, their admission and recognition of the seriousness of the conduct and their display of contrition, Siopis J reduced this time period and found that ASIC's proposal of a three year disqualification was appropriate and in the public interest.

In relation to imposing a pecuniary penalty in addition to the disqualification order, Siopis J again referred to Gillfillan. In Gillfillan it was noted that pecuniary penalties are generally imposed where a disqualification order is inadequate or inappropriate. However, a pecuniary penalty, even for a modest amount, may be awarded in addition to a disqualification order where the contravention is serious. Given the seriousness of the conduct, his Honour considered that it was both appropriate in the circumstances and in the public interest to impose a pecuniary penalty of $25,000 on each of Stokes and Quinn in addition to the disqualification order. Stokes and Quinn were also ordered to pay ASIC's costs.

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## 6.10 No leniency for foreign directors in relation to directors' duties and Australian disclosure obligations

(By Katrina Sleiman and Louise Hang, Corrs Chambers Westgarth)

*In the matter of Sino Australia Oil and Gas Limited (in liq)* [2016] FCA 934, Federal Court of Australia, Davies J, 11 August 2016

### (a) Summary

ASIC obtained declarations of contravention of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) against Sino Australia Oil and Gas Limited (Sino) and its former executive director and chairman, Mr Tianpeng Shao, in relation to the prospectuses issued by Sino in 2013.

The Court declared that Sino contravened ss. 728(1)(a), 728(1)(b), 728(1)(c), 1041H and 674(2) of the Corporations Act on the basis that it had:

- made false representations in its prospectus documents in respect to patents that it claimed it and its Chinese operating subsidiary held;
- made omissions from, and misleading and deceptive statements in, the prospectus documents in relation to a loan, certain convertible notes and certain service contracts;
- failed to disclose that its profit for the 2013 calendar year would be significantly less than the forecast of $13.66 million in the replacement prospectus;
- breached its continuous obligations by failing to notify the ASX of circumstances that had arisen affecting its profit forecast; and
- engaged in misleading and deceptive conduct in respect of the financial position of Sino and its Chinese operating subsidiary and false representations made to its auditors.

In addition, the Court declared that Mr Shao contravened ss. 180(1) and 674(2A) of the Corporations Act, finding that he:

- failed to understand the content of Sino's prospectus documents and inform himself about Sino's disclosure requirements;
- failed to disclose to the ASX and Sino's Board information regarding the profit downgrade;
- had attempted to transfer approximately $7.5 million of the proceeds of the capital raising to a bank account in China without proper explanation and documentation; and
- caused or permitted Sino's contraventions of the Corporations Act.

### (b) Facts

Sino is the Australian holding company of a Chinese operating company, Zhaodong Huaying Oil Drilling Services Company Limited (Huaying). Mr Shao

was, at all material times, the managing director, chairman and chief executive officer of Sino, as well as the managing director and chairman of Huaying.

In 2013, Sino issued a prospectus for an initial public offering (IPO) on the ASX, followed by a replacement prospectus and three supplementary prospectuses which were signed by Mr Shao. On 11 December 2013, Sino was admitted to the official list of the ASX and announced that it had raised $12,829,318 from the IPO.

Mr Shao subsequently sought authorisation from Sino's two resident Australian non-executive directors, Mr Johnson and Mr Faulkner, to transfer approximately $7.5 million of the proceeds of the capital raising out of Australia to a bank account of Sino in China, of which neither Mr Johnson nor Mr Faulkner had any knowledge. The two non-executive directors refused to cooperate and reported their concerns regarding the governance of Sino to ASIC. Following an investigation by ASIC, the Federal Court ordered that the company be wound up and a liquidator was appointed in March 2016.

**(c) Decision**

The Court found that Sino contravened ss. 728(1)(a), 728(1)(b), 728(c), 1041H and 674(2) of the Corporations Act in relation to the prospectus documents, its continuous disclosure obligations, and misleading or deceptive conduct in relation to a financial product. The Court also found that Mr Shao was involved in Sino's contravention of its continuous obligations under s. 674(2) and thereby contravened s. 674(2A), and breached his duties as a director under s. 180(1). Accordingly, the Court made the declarations of contraventions sought by ASIC in respect of Sino's and Mr Shao's conduct.

**(i) Contraventions by Sino**

Section 728(1) of the Corporations Act prohibits a person from offering securities under a disclosure document if there is:

- a misleading or deceptive statement (s. 728(1)(a));
- an omission from the disclosure document of material required to be disclosed (s. 728(1)(b)); or
- a new circumstance that has arisen since the disclosure document was lodged and would have been required to be disclosed (s. 728(c)).

The Court found that Sino contravened s. 728(1)(a) because the prospectus documents contained misleading or deceptive statements in relation to patents that it claimed it and Huaying held, the existence of service contracts it claimed to hold, and the sum of $3,114,000 it claimed to have received from the proceeds of convertible notes. Furthermore, Sino's failure to disclose the loan agreement with the sole director of a subsidiary of Sino in the prospectus documents was found to be a contravention of s. 728(1)(b).

The Court also found that Sino contravened ss. 728(1)(b) and 728(1)(c) because it failed to disclose certain circumstances affecting its forecasted net profits and that its profits would be significantly less than the forecast in its replacement prospectus. By failing to notify the ASX about these circumstances, Sino was also found to have breached its continuous disclosure obligations by operation of ASX Listing Rule 3.1 and s. 674 of the Corporations Act.

Finally, the Court found that Sino contravened s. 1041H of the Corporations Act. Justice Davies found that the false information about Huaying's financial position provided by Sino to its auditors was misleading or deceptive conduct in relation to a financial product because the false representation was likely to affect the value of its shares.

**(ii) Contraventions by Mr Shao**

The Court held that Mr Shao was involved in Sino's contravention of its continuous disclosure obligations under s. 674(2) and thereby contravened s. 647(2A) of the Corporations Act because Mr Shao knew that the actual profit would be impacted by the circumstances alleged by ASIC even before the listing.

The Court also found that Mr Shao breached his duty of care and diligence to Sino under s. 180(1) of the Corporations Act on a number of bases.

First, by approving the prospectus documents without understanding the English text and without obtaining Chinese language translations of them. Davies J referred to *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291 where Middleton J noted that the reading of financial statements by directors is "to ensure, as far as possible and reasonable, that the information included therein is accurate" and "involves understanding their content". Davies J said that these comments are "equally apposite to prospectus documents" and that Mr Shao was required to inform himself fully and comprehensively about the content of the prospectus documents to ensure that the information contained in them was accurate. Accordingly, Mr Shao's failure to understand the content of the prospectus documents that he signed, even in the most basic sense, was a breach of his director's duties.

Second, by failing to have sufficient knowledge of the disclosure requirements for publicly listed companies under Australian law. In his defence, Mr Shao argued that he received and relied on the advice given to him by the two Australian directors and professional advisers in respect of the disclosure requirements. Davies J rejected this defence and found that the fact that Mr Shao was not an English speaker or writer and did not understand Australian legal requirements did not excuse him from performing his own duties with reasonable care and diligence.

Third, by failing to disclose in the prospectus documents, to the Board of Sino and to the ASX, the change in circumstances and the deterioration in the forecasted net profits of the company. Mr Shao's failure to make these disclosures, in spite of his

knowledge of the circumstances affecting the financial position of Sino, was a breach of his duties.

Fourth, by attempting to transfer the proceeds from the IPO to bank accounts in China for the purpose of advancing a loan to Huaying without proper explanation or disclosure to the Board, and in circumstances where the loan would not have been recoverable (due to its lack of documentation and non-compliance with Chinese law).

Fifth, by causing or permitting the contraventions of ss. 728, 674 and 1041H of the Corporations Act by Sino. Davies J found Mr Shao's conduct plainly jeopardised the company's interests because it exposed Sino to the risk of civil pecuniary penalties for its contraventions of the Corporations Act, the cost and trouble of the legal proceedings and ASIC's investigation leading to its placement into liquidation. Davies J found that having not taken steps to avoid this detriment to Sino, Mr Shao had breached his duties.

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**6.11 Termination of winding up orders: Considering the solvency of a company and the risk to future creditors**

(By Dea Fairbairn, MinterEllison)

*In the matter of Tien Investments Pty Ltd (in liq)* [2016] FCA 861, Federal Court of Australia, Reeves J, 2 August 2016

**(a) Summary**

This case concerned an application to set aside a winding up order. In issue was whether the company's solvency could be clearly established and whether there was a risk to future creditors based on the company's sole director failing to comply with past taxation obligations.

**(b) Facts**

On 16 September 2015, Tien Investments was placed in liquidation after it failed to respond to a statutory demand based on unpaid strata levy debts owed to the Owners - Units Plan No 1753 and then subsequently failed to attend the hearing of the winding up application.

In 1996, while living in Adelaide, Mr Tuong Le (the sole director and shareholder of Tien Investments) instructed his accountant, Mr Richard Chong, to incorporate Tien Investments as a holding company for three investment properties he planned to purchase. The registered office of Tien Investments was listed as the address of Mr Chong's office in Adelaide.

In 2000, Mr Le relocated from Adelaide to Queanbeyan in New South Wales. Around that time, Mr Chong notified the Australian Securities and Investments Commission (ASIC) that the address of the registered office of Tien Investments had changed to Mr Le's residential address in Queanbeyan. Mr Le was not aware that Mr Chong had alerted ASIC to this change.

In 2010 or 2011, Mr Le relocated from Queanbeyan to Narrabundah in the Australian Capital Territory (ACT). Shortly after, Me Le notified ACT Strata Management Services (the licensed strata managers of the Owners - Units Plan No 1753) of his change of address. Being unaware of the previous change to his company's address of the registered office, he did not notify ASIC.

The statutory demand and documentation relating to the winding up were sent to Mr Le's previous address in Queanbeyan and consequently Mr Le did not become aware of the statutory demand and the date for the hearing of the winding up application. Mr Le was notified of the winding up order by his bank on 22 September 2015. After being notified of the winding up of his company, Mr Le paid the two unpaid strata levy debts to the Owners - Units Plan no 1753 and made an application to terminate the winding up order.

**(i) Law**

The Corporations Act 2001 No. 50 (Cth), s. 482(1A)(a) allows Mr Le to make an application to the court to set aside the winding up order.

Reeves J acknowledged that, in determining whether or not to exercise its discretion to terminate a winding up, the Court will typically have regard to the following:

- whether the termination is justified in the circumstances;
- the solvency of the company; and
- the interests of creditors of the company (including future creditors), the liquidator (particularly their costs), contributories, and the public interest (weighing up matters of commercial morality against the public interest that insolvent companies be wound up).

With regard to the above considerations, the official liquidator of Tien Investments, Mr Paul Cook, opposed Mr Le's application on the basis that firstly, the company's solvency had not been clearly established and secondly, there was a risk to future creditors posed by Mr Le's past inability to ensure that Tien Investments complied with its taxation obligations.

**(ii) The solvency of Tien Investments**

The issue of Tien Investments' solvency mainly concerned its current unpaid liabilities to the Australian Taxation Office (ATO) for unpaid goods and services tax instalments and to Mr Cook for his fees and disbursements as liquidator.

Tien Investment's current liabilities totalled approximately $351,000 (including $262,900 to the ATO). To meet those liabilities, Counsel for Mr Le submitted that Mr Le was willing to sell his former home in Adelaide and with the proceeds of that sale he intended to contribute $352,000 in equity into the company. He stated that Mr Le would be willing to give an undertaking to the Court to the effect that he would inject that amount of capital into the company within a period of four months (allowing time to sell the home).

Mr Cook had reservations with the proposal by Mr Le. The primary reservation concerned the possibility that the ATO may file an amended proof of debt, which could result in a material change to the estimate of funds required to meet the liability. Mr Cook referred to a letter from the ATO which attached the proof of debt. Reeves J noted that apart from a reference in the letter to s. 260-45 of Schedule 1 of the Taxation Administration Act 1953 No. 1 (Cth) (the Taxation Administration Act), which relates to obligations of a liquidator, there was no qualification expressed by the ATO in either the letter or the attached proof of debt which raised the possibility of interest or penalties being added to the debt.

The letter from the ATO stated that the proof of debt it lodged with Mr Cook was not to be treated as notification pursuant to s. 260-45. Relevantly, it was not a notification by the Commissioner of the amount that the Commissioner considers is enough to discharge any outstanding tax-related liabilities (s. 260-45(3)). Until such time as that notice is given, Mr Cook has an obligation to comply with s. 260-45(4) which sets out that the liquidator must not part with any of the company's assets without the Commissioner's permission (subject to the exceptions at s. 260-45(5)). Once he receives the notice, Mr Cook will have an obligation to comply with the requirements to set aside a certain amount of the assets available for paying the company's debts in order to discharge the outstanding tax-related liabilities (ss. 260-45(6) and (7)).

Reeves J noted that the above provisions affect the termination of the company's winding up. Specifically, the winding up cannot be terminated until such time as Mr Cook receives the notice from the Commissioner and complies with his obligations pursuant to it. Despite this, Reeves J considered it to be in everyone's interest that Mr Le be allowed to make the proposed equity contribution to Tien Investments. This would ensure the ATO would be paid the amount of $262,900, as claimed in the proof of debt, and Mr Cook would be paid for his fees and disbursements. In addition, Tien Investments solvency would be enhanced such that it would be in a position where the winding up process could be terminated.

**(iii) The risk to future creditors**

In considering the second area of contention raised by Mr Cook, the risk posed to future creditors of the company, Reeves J considered that the appointment of a liquidator to Tien Investments had uncovered significant deficiencies in the company's accounting records and its compliance with its taxation obligations. Reeves J considered that Mr Cook's concern that there would be no guarantee of the ability of the company to trade in future without imperilling future creditors was well held. However, Reeves J considered that Mr Le had

learnt a lesson from the winding up process and as a result, was unlikely to conduct the affairs of Tien Investments in the same way in the future.

**(c) Decision**

The Court considered it reasonable to exercise its discretion to terminate the winding up of Tien Investments. This was subject to Mr Le honouring his commitment to contribute $352,000 in equity into the company and Mr Cook being granted sufficient time to comply with his obligations under the Taxation Administration Act. This includes paying the debts due to the ATO. Once those obligations are met and Mr Cook's fees and disbursements are paid, the Court considered that Tien Investments will be in a satisfactory position in which the winding up can be terminated. The parties were asked to provide the Court with orders consistent with the above series of steps required. The Court also requested that the orders include an order that Tien Investments pay Mr Cook's costs of the application.

## 7. Contributions

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