SAI Global Corporate Law Bulletin No. 234>

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Bulletin No. 234

Legislation Hotline

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 The Purposeful Company Task Force publishes policy report on corporate governance

27 February 2017 - The Purposeful Company Task Force, in its latest report, has recommended that the UK's company law, accounting systems, investment industry, shareholder structure, and executive remuneration be significantly changed to promote purposeful companies.

In particular:

- companies should state precisely their purpose - their role from which profit results - in their articles of association and regularly report on the delivery of that purpose;
- directors should be required to report on how they fulfil their legal obligations to "have regard" to all stakeholders;
- government should formalise alternative models so that companies can choose a corporate form which best reflects their purpose, strategy and business model;
- company reporting should be overhauled to go behind financial assets and more effectively communicate companies' strategic intent and value to shareholders. Timely and disaggregated national statistics on intangibles should be reported;
- the asset management industry should be repurposed. Asset managers should state and have certified their purpose, in particular how they promote the long-term interest of the companies they invest in and the savers they invest for. They should also publish metrics on their stewardship activities;
- executive pay should be more simplified and aligned to the long-term. All companies should produce a Fair Pay Report, outlining their approach to pay fairness throughout the organisation;
- regulatory obstructions to the creation of and engagement by large independent shareholders - blockholders - should be removed. Voting with borrowed stock should be limited; and
- the default pension fund allocation could be set to apportion a given percentage towards purposeful companies, creating a pool of up to £100 billion for such investment.

Read The Purposeful Company Policy Report (2017).

1.2 SEC issues guidance update and investor bulletin on robo-advisers

23 February 2017 - The US Securities and Exchange Commission (SEC) has published information and guidance for investors and the financial services industry on the fast-growing use of robo-advisers, which are registered investment advisers that use computer algorithms to provide investment advisory services online with often limited human interaction.

Because of the unique issues raised by robo-advisers, the Commission's Division of Investment Management issued guidance for investment advisers with suggestions on meeting disclosure, suitability and compliance obligations under the *Investment Advisers Act of 1940*.

A second publication, an Investor Bulletin issued by the SEC's Office of Investor Education and Advocacy, provides individual investors with information they may need to make informed decisions if they consider using robo-advisers.

The Investor Bulletin describes a number of issues investors should consider, including:

- the level of human interaction important to the investor;
- the information the robo-adviser uses in formulating recommendations;
- the robo-adviser's approach to investing; and
- the fees and charges involved.

1.3 Draft legislation on industry funding model for ASIC

22 February 2017 - On 20 April 2016, the Government announced that it would introduce an industry funding model for the Australian Securities and Investments Commission (ASIC), commencing in the second half of 2017.

The Government is now seeking views on the draft legislation necessary to support the industry funding model (the model), which will recover ASIC's regulatory costs though annual levies and fees-for-service. There are three Bills for consideration, the:

- *ASIC Supervisory Cost Recovery Levy Bill 2017*;
- *ASIC Supervisory Cost Recovery Levy (Collection) Bill 2017*;
- *ASIC Supervisory Cost Recovery Levy (Consequential and Transitional) Bill 2017*; as well as
- accompanying explanatory materials.

The proposed Bills establish the overarching framework for the model. The Government is continuing to consult on the mechanisms that will be used to calculate the levies payable by each class of regulated entity, with this detail to be included in subsequent draft regulations.

The Exposure Drafts and accompanying materials are available on the Treasury Website.

1.4 Corporations Amendment (Professional Standards of Financial Advisers) Act
22 February 2017 - The Corporations Amendment (Professional Standards of Financial Advisers) Act 2017 No. 7 (Cth) was assented to on 22 February 2017. According to the explanatory memorandum, the purpose of the Act is to amend the Corporations Act 2001 No. 50 (Cth) to:

- raise the education, training and ethical standards of financial advisers by requiring relevant providers (that is, financial advisers providing personal advice to retail clients on more complex financial products) to hold a degree (or higher or equivalent) qualification, undertake a professional year, pass an exam, undertake continuous professional development and comply with a Code of Ethics;
- provide for transitional arrangements that would apply to "existing providers" (that is, those advisers who are relevant providers before the new requirements come into effect); and
- introduce a restriction on the use of the titles "financial adviser" and "financial planner" to ensure that they can only be used by a person who is authorised to provide personal advice to retail clients on relevant financial products.

1.5 FRC to review the UK Corporate Governance Code

16 February 2017 - The UK Financial Reporting Council (FRC) has announced plans for a fundamental review of the UK Corporate Governance Code. This will take account of work done by the FRC on corporate culture and succession planning, and the issues raised in the Government's Green Paper and the BEIS Select Committee inquiry.

In its response to the Government's Green Paper on Corporate Governance Reform, the FRC will highlight the importance of helping boards take better account of stakeholder views, linking executive remuneration with performance, and extending the FRC's enforcement powers to ensure that disciplinary action can be taken against all directors where there have been financial reporting breaches.

The FRC will commence a consultation on its proposals later in 2017, based on the outcome of the review and the Government's response to its Green Paper.

1.6 Audit quality and independence: FRC report

14 February 2017 - Six months after becoming the UK's Competent Authority for Audit, the UK FRC has published an update on Developments in Audit which highlights that while progress has been made, audit firms need to focus on the pace of improvement in audit quality and consistency.

Key findings in the FRC report are:

- whilst progress has been made in consultation with stakeholders on implementing the new standards for auditor independence, concerns have been raised that in dealing with perceived conflicts of interest, not all audit firms are demonstrably serving investors' interests;
- a faster pace of improvement in, and greater consistency of, audit quality requires strong leadership of, and the right culture in, the audit firms. The FRC proposes to review the effectiveness of governance and the culture of firms adopting its Audit Firm Governance Code,

which clarifies and emphasises the public interest role of independent non-executives of those firms;

- audit committee chairs surveyed by the FRC, at the same time, remain overwhelmingly positive as to tendering developments and audit quality. Of those entities responding to the survey that had carried out an audit tender, 70% changed auditors and of those 18% think there has been a significant change for the better in audit approach and quality. The FRC has issued updated notes on good audit tender practice to promote effective audit tenders;
- the FRC will increase the transparency of its audit quality reviews on individual audit engagements. It will now publish periodic lists of those entities whose audits it has reviewed. Accordingly, the FRC expects increased reporting by audit committees of its findings and increased investor scrutiny of audit quality; and
- an emerging theme from its ongoing 2016/17 audit quality monitoring cycle is insufficient auditor scepticism in identified areas of significant risk such as the assessment of potential impairments and judgments concerning material accounting treatments.

1.7 Consultation on increasing transparency of the beneficial ownership of companies

13 February 2017 - The Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, has released for public consultation a paper titled "Increasing Transparency of the Beneficial Ownership of Companies".

The consultation paper seeks views on increasing the transparency of the beneficial ownership of companies for relevant authorities, to better assist these authorities to combat illicit activities. The Government is seeking feedback on what information needs to be collected in order to achieve this objective and how it should be collected, stored and kept up to date. The Government also seeks feedback on the expected compliance costs for affected parties.

The consultation paper is available on the Treasury website.

1.8 UK: Work and Pensions Committee responds to government's consultation on corporate governance reform

12 February 2017 - The UK Work and Pensions Committee of the UK Parliament has issued a report in response to the government's consultation on corporate governance reform. The report calls for new duties on company directors to have regard to pension schemes and for Insolvency Service reports to be published in the public interest.

Read the report summary Read the report conclusions and recommendationsRead the full report: Response to the Government's consultation on corporate governance reform

The Work and Pensions Committee says the corporate governance and reporting requirements for public listed companies should be extended to private companies that have an important social impact: large private companies and those with over 5,000 defined benefit pension scheme members.

1.9 Consultation on packaged retail and insurance-based investment products with environmental or social objectives

10 February 2017 - The European Supervisory Authorities (ESAs) has launched a consultation on a proposal to set minimum requirements, which manufacturers of packaged retail and insurance-based investment products with environmental or social objectives (EOS PRIIPs) should comply with to ensure that credible products are offered to retail investors. This consultation is in response to a European Commission's call for advice.

The manufacturer of an EOS PRIIP is required to have specific governance measures in place to ensure that environmental or social objectives are met on an ongoing basis and must be able to demonstrate the relevance of these objectives to retail investors throughout the investment process.

The consultation paper provides an analysis of the current legal framework for product oversight and governance rules and considers whether there are possible gaps regarding EOS PRIIPs. Existing product oversight and governance provisions, laid down in the relevant legislation for PRIIPs, including MiFID II and the Insurance Distribution Directive, are in general found to be sufficient for PRIIPs in general. However, for EOS PRIIPs, the ESAs consider that it is important for the European Commission to provide additional guidance to the respective manufacturers when interpreting these existing rules.

View Consultation Paper

1.10 London Stock Exchange Group launches guidance for ESG reporting

9 February 2017 - London Stock Exchange Group has issued guidance, through its Global Sustainable Investment Centre, setting out recommendations for good practice in Environmental, Social and Governance (ESG) reporting. The global guide responds to demand from investors for a more consistent approach to ESG reporting, which is now a core part of the investment decision process. The report's intention is to help companies gain a clear understanding of what ESG information investors would like to see provided by companies.

The area of sustainable investment has changed dramatically, with consideration of ESG factors now seen as standard for most large institutional investors. According to the Global Sustainable Investment Alliance, over a third of professionally managed assets globally incorporate ESG approaches, which represents more than US$20 trillion of assets under management.

1.11 IOSCO analyses potential of tech-driven change in the securities market industry

8 February 2017 - A new report highlights the increasingly important intersection between financial technology (Fintech) and securities market regulation, and describes the impact it has on investors and financial services.

The IOSCO Research Report on Financial Technology, published by the International Organization of Securities Commissions (IOSCO), describes a variety of innovative business models and emerging technologies that are transforming the financial services industry, including:

- financing platforms: peer-to-peer lending and equity crowdfunding;
- retail trading and investment platforms, including robo-advisers and social trading;
- institutional trading platforms, with a specific focus on innovation in bond trading platforms; and
- distributed ledger technologies, including application of the blockchain technology and shared ledgers to the securities markets.

The report analyses both the opportunities and risks that each of these new technologies presents to investors, securities markets and their regulators.

The report also describes the key trends that are setting the stage for tech-driven change in the financial services industry, including:

- the greater availability of data;
- exponential growth in computing power that facilitates the analysis of ever larger data sets;
- broader access to and the decreasing cost of goods and services;
- increasing disintermediation and re-intermediation; and
- demographic and generational changes.

1.12 Distributed ledger technology potential: report

7 February 2017 - The European Securities and Markets Authority (ESMA) has issued a report on Distributed Ledger Technology (DLT). The report sets out ESMA's view on DLT, its possible applications, benefits, risks and how it maps to existing EU regulation. ESMA's position is that regulatory action is premature at this stage, considering that the technology is still at an early stage.

ESMA believes that DLT could bring a number of benefits to financial markets, including more efficient post-trade services, enhanced reporting capabilities and reduced costs. ESMA expects the early applications of DLT to focus on optimising processes using the current market structure. Likely first areas of use may be less automated processes in low volume market segments and processes with minimum dependency on the existing legal framework.

ESMA, as well as identifying the benefits, also points to some important challenges for DLT in terms of interoperability, governance and privacy issues and risk creation. These challenges would require further attention before any large-scale use of DLT across the financial services sector. An important point for the technology's advocates and developers to be aware of are the existing rules and their application to DLT. The development of a new technology, such as DLT, does not liberate users from complying with the existing regulatory framework, which provides important safeguards to ensure the stability and proper functioning of financial markets.

1.13 World Federation of Exchanges publishes white paper on CCP recovery and resolution

7 February 2017 - The World Federation of Exchanges (WFE), which represents more than 200 market infrastructure providers including exchanges and CCPs, has published a white paper entitled 'The interplay between Central Counterparty (CCP) recovery and resolution: a global perspective', setting out the views of the exchange and CCP community from a global practitioner perspective.

In particular, the paper outlines the position of the WFE and its global membership base on two key issues:

- the boundary between recovery and resolution, and the relative responsibilities of CCPs and market authorities: and
- third country arrangements when entering, and managing, the resolution of a CCP.

In summary, the WFE's position is that recovery should be given every opportunity to succeed, and resolution should only be invoked as a last resort once all appropriate recovery measures have been exhausted by the CCP.

Should resolution occur, however, the WFE advocates that there is not one single resolution strategy that will effectively manage all potential scenarios, therefore flexibility is key. In addition, cross-border cooperation is vital to ensure sound, smooth and orderly markets.

The white paper is accompanied by a one-page fact sheet on 'Desired outcomes relating to entering (and managing) resolution', which sets out the top ten outcomes the WFE and its membership seeks to achieve in this regard. These outcomes include that:

- regional and national authorities should implement international standards as closely as possible;
- continuity of payment, clearance and settlement services must be the primary objective, given the systemic importance of the functions they provide: and
- the resolution of a CCP should be led by the Resolution Authority of the jurisdiction in which the CCP is established, in close cooperation with other relevant authorities.

1.14 IOSCO report shows progress made in implementation of Benchmark Principles

7 February 2017 - The Board of the International Organization of Securities Commissions (IOSCO) has published the Second Review of the Implementation of IOSCO's Principles for Financial Benchmarks in respect of the WM/Reuters 4 p.m. Closing Spot Rate. The report found that the administrator had made very significant progress, with most of the recommendations from an earlier review having been implemented. However, some room exists to improve and refine recently implemented policies and practices.

1.15 Report into banking practices released

3 February 2017 - The Government has released the report of the Australian Small Business and Family Enterprise Ombudsman, Kate Carnell AO, into the small business lending practices of the major banks and other lenders.

The report makes 15 recommendations, four of which are for Government, and the remaining 11 directed to the banking industry itself.

The Inquiry was commissioned by the Government on 31 August 2016 to examine a selection of the most egregious cases that were presented to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the "Impairment of Customer Loans".

In total, the Inquiry considered the submissions of 23 affected customers, and conducted a detailed forensic analysis of six of those. The cases date from 2008 until more recently, and represent various industries.

Of the cases considered, the Inquiry found that a third were a result of poor business decisions; another third were a result of both poor business decisions and poor bank practices; and the final third were representative of poor bank practices and possible unconscionable conduct on the part of the banks involved.

A key focus of the recommendations for Government include access to an affordable, efficient and binding, out-of-court dispute resolution service for small business lending customers, with access to compensation in appropriate cases.

1.16 FSB consults on guidance for CCP resolution and resolution planning

1 February 2017 - The Financial Stability Board (FSB) has published for consultation draft Guidance on Central Counterparty Resolution and Resolution Planning. With central counterparties (CCPs) an increasingly important part of the financial system, particularly following post-crisis reforms to mandate central clearing of certain standardised over-the-counter derivatives, it is vital that CCPs do not themselves become a new source of "too-big-to-fail risk".

The draft Guidance builds on the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes) which sets out a framework for resolution of financial market infrastructures (FMI). This framework states the objectives of FMI resolution and a range of powers and tools that should be made available to resolution authorities to resolve a failing FMI. When finalised, the Guidance will assist authorities and jurisdictions with implementing effective resolution regimes and developing credible resolution strategies and plans for CCPs.

The Guidance covers a number of aspects which authorities should consider when developing frameworks for resolving failing CCPs, including:

- policy objectives for CCP resolution to maintain financial stability;
- the powers that resolution authorities should have to maintain the continuity of critical CCP functions, return the CCP to a matched book and address default and non-default losses, including potential indicators for considering when a CCP should enter resolution;
- use of loss allocation tools in resolution and provisions necessary to protect creditor rights so the triggering of resolution by authorities does not leave creditors worse off than if the authorities had not stepped in; and
- steps authorities should take to establish crisis management groups for CCPs that are systemically important in more than one jurisdiction, develop resolution plans and conduct resolvability assessments.

1.17 Framework of guiding principles for institutional investor stewardship and corporate governance

31 January 2017 - The Investor Stewardship Group, a collective of some of the largest US-based institutional investors and global asset managers, along with several of their international counterparts, have announced the launch of the framework for US Stewardship and Governance, an initiative to

establish a framework of basic standards of investment stewardship and corporate governance for US institutional investor and boardroom conduct.

Stewardship principles for institutional investors:

- institutional investors are accountable to those whose money they invest;
- institutional investors should demonstrate how they evaluate corporate governance factors with respect to the companies in which they invest;
- institutional investors should disclose, in general terms, how they manage potential conflicts of interest that may arise in their proxy voting and engagement activities;
- institutional investors are responsible for proxy voting decisions and should monitor the relevant activities and policies of third parties that advise them on those decisions;
- institutional investors should address and attempt to resolve differences with companies in a constructive and pragmatic manner; and
- institutional investors should work together, where appropriate, to encourage the adoption and implementation of the Corporate Governance and Stewardship principles.

Corporate governance principles for US listed companies:

- boards are accountable to shareholders;
- shareholders should be entitled to voting rights in proportion to their economic interest;
- boards should be responsive to shareholders and be proactive in order to understand their perspectives;
- boards should have a strong, independent leadership structure;
- boards should adopt structures and practices that enhance their effectiveness; and
- boards should develop management incentive structures that are aligned with the long-term strategy of the company.

For more on the Investor Stewardship Group and the framework for US Stewardship and Governance, see www.isgframework.org.

1.18 Social impact investing discussion paper released

28 January 2017 - The Government has released a discussion paper on social impact investing and the development of the social impact investment market in Australia.

The discussion paper sets out a proposed whole of government position on social impact investing for consultation, including the objectives the government has for its role in social impact investing, principles to guide Government involvement in the social impact investing market and determining possible regulatory barriers that can be addressed by the government to support the market.

The discussion paper is available on the Treasury website.

1.19 Corporate board refreshment: study

24 January 2017 - The intense focus that investors and others have placed on board refreshment has begun to pay off. But, structural trends and governance practices that encourage longer tenures could slow, or even reverse this progress over the next decade, according to a new study.

'Board Refreshment Trends at S&P 1500 Firms: 2008 To 2016', commissioned by the Investor Responsibility Research Center Institute (IRRCi) and conducted by Institutional Shareholder Services Inc. (ISS), shows that nearly one out of every ten directors was new to US boards in 2016. At a corporate level, more than one-half of S&P 1500 boards added one or more new directors to their rosters in 2016.

As a result, the average tenure of an S&P 1500 board member declined to 8.7 years in 2016 from nine years three years earlier, although median tenure held steady at seven years.

However, that recent surge in renewal obscures some longer-term trends towards longer-serving and older directors. Directors with at least ten years of board service now occupy 38% of board seats and about half of those are held by directors with 15 or more years of tenure. Also, directors in their seventies and eighties have increased their share of directorships to more than 20% of all directorships; the average director age rose two years for the study period, from 60.5 years in 2008 to 62.5 years 2016; and the proportion of directors aged less than 50 declined.

As of 2016, women held 17.8% of S&P 1500 board seats, and minority directors held slightly more than 10% of board seats.

1.20 OECD survey of corporate governance frameworks in Asia

January 2017 - The OECD has published a survey of corporate governance frameworks in Asia. The survey presents information for 14 jurisdictions and is based on questionnaire responses from organisations including securities regulators, institutes of directors, stock exchanges and governance centres. The jurisdictions included in the survey are Bangladesh, China, Chinese Taipei, Hong Kong, India, Indonesia, Korea, Malaysia, Mongolia, Pakistan, Philippines, Singapore, Thailand and Vietnam. The survey reports on a variety of matters including ownership structure, shareholder rights and board structure.

1.21 Latest Centre for Corporate Law and Securities Regulation research papers

Phoenix Activity: Recommendations on Detection, Disruption and Enforcement
Phoenix activity occurs where the business of a failed company is transferred to a second (typically newly incorporated) company and the second company's controllers are the same as the first company's controllers. Phoenix activity can be legal as well as illegal. Phoenix activity is illegal where the controllers' intention is to shift assets from the predecessor company to the successor company to avoid liabilities such as unsecured debts, employee entitlements, taxes, adverse court judgments and fines. Phoenix activity has become a significant concern for governments because of the number of individuals promoting illegal phoenix activity, the significant loss of tax revenue it causes, and the recognition of the potentially devastating impact it has on creditors and employees. This report is the third by the authors dealing with phoenix activity. The first report examines the various historical attempts to define phoenix activity and identifies five categories of phoenix activity ranging from legitimate business rescue to complex illegal phoenix activity and provides examples of each. The second report captures all available data relating to the incidence, cost and enforcement of laws dealing with illegal phoenix activity. In this

report, the authors propose reforms aimed at better detection, disruption, punishment and deterrence of illegal phoenix activity.

A Jurisdictional Comparison of the Twin Peaks Model of Financial Regulation The last two decades have seen an increasing number of jurisdictions adopting the "twin peaks" model of financial regulation. Since it was pioneered in Australia, the model has been adopted by the Netherlands, Belgium, New Zealand and the United Kingdom. South Africa is currently in the process of changing its model, and it has also been considered by the US. This paper evaluates the twin peaks model as it has been adopted in these jurisdictions and investigates the extent to which there is uniformity in its design and implementation from a regulatory perspective. The comparative analysis indicates that there are many variations in the design of a twin peaks model and that there is no archetypal twin peaks model. In particular, choices need to be made around key elements in areas such as structural design, operational independence and regulatory coordination.

Twin Peaks and Financial Regulation: The Challenges of Increasing Regulatory Overlap and Expanding Responsibilities
In recent years there has been a renewed emphasis on improving the regulatory frameworks of financial systems in part as a response to the global financial crisis. This has included a focus on how institutional design can promote financial stability. Support for the continued importance of institutional design in financial stability has often looked to the relatively positive performance during the financial crisis of some countries, including Australia, which have implemented the so-called "Twin Peaks" model of financial infrastructure. This has led several countries to consider adopting various forms of the Twin Peaks model. The authors examine how the Twin Peaks model in Australia has responded to financial collapses and challenges since its implementation. They argue that Australia's experience indicates continuing challenges for regulators in coordinating regulatory functions and resolving issues concerning the nature and scope of functions of regulators. The analysis may assist reformers in other countries looking to the Twin Peaks model to address regulatory problems.

Regulation of Mutual Funds in Australia
Over the last two decades, Australia has developed a unique legal and regulatory framework for collective investments, including mutual funds. This framework is built around a single "responsible entity" that combines the role of the fund sponsor and adviser with that of the trustee. This paper explains three key features of that framework - the fiduciary duties imposed on the responsible entity and its officers, the limited role of an independent party to monitor or oversee the responsible entity's conduct of the fund, and the availability of investor "self-help" mechanisms, including information rights, voting rights, enforcement rights and exit rights.

Super Behaviour: A Note on Young Australian Adults' Engagement with their Superannuation Accounts
The authors examine the behaviour and attitudes towards superannuation of 25-34 year old Australians. The results of the survey suggest they are generally uninterested in their superannuation accounts. They seldom read the information provided by their funds, rarely change their fund, and a majority of them do not make voluntary contributions. Overall the results suggest significant lack of interest in, and engagement and concern with issues related to their retirement planning.

An Empirical Study of Australian Judicial Decisions Relating to Insolvency Practitioner Remuneration
Insolvency practitioner remuneration is controversial as recent debates and reforms in Australia evidence. The role of courts in reviewing and setting remuneration has also been called into question. These debates have lacked, however, empirical evidence about remuneration and the role of courts. This article analyses 162 decisions from Australian courts to find out what roles courts are playing in reviewing and setting corporate insolvency practitioner remuneration. The findings suggest that there are still important roles for courts, particularly in the context of allegations of misconduct. The study also suggests, however, that there is merit in continuing to explore low cost, out-of-court mechanisms for reviewing and setting remuneration. The study found that many claims for approval of remuneration are coupled with requests from practitioners seeking other orders, are unopposed and typically approved as claimed. Over one third of the cases involved claims for amounts of less than $50,000. Out-of-court

mechanisms focused solely on remuneration may also provide more certainty and consistency across remuneration decisions which will benefit all stakeholders.

[At the Coalface of Corporate Insolvency and Phoenix Activity: A Survey of ARITA and AICM Members]
This research note presents the findings of surveys of members of the Australian Restructuring, Insolvency and Turnaround Association and the Australian Institute of Credit Management regarding illegal phoenix activity and related issues. Key findings of the surveys included that illegal phoenix activity is commonplace and where it occurs, significantly reduces returns to creditors. Respondents also expressed concerns regarding the adequacy of both laws and enforcement and offered views on several law reform proposals.

[The Role of Legal Hardship Protections in Coping with Debt Problems: Insights from a Survey of Consumers]
Special protections for Australians in financial hardship have recently been incorporated into the legal frameworks governing the consumer credit, energy, water and telecommunications sectors. These protections have the objective of enabling consumers to avoid the serious legal consequences of financial hardship, such as debt enforcement action in a court or tribunal, or disconnection from an essential service, by allowing them to seek alternative payment arrangements and other forms of assistance from their creditors. In this article, the authors draw upon the findings of their survey of consumers who have experienced financial hardship to show that these legal protections play a relatively modest role in the overall range of ways in which consumers cope with debt problems. Consumers face significant barriers to identifying themselves as being in need of assistance under these protections, and tend to favour individualistic strategies for reducing spending, even when this may jeopardise their ability to afford basic living essentials. For those who do access assistance from a creditor under the legal hardship protections, its effectiveness may be undermined by the prevalence of unaffordable payment arrangements across our target sectors.

[An Analysis of Shareholder Resolutions Involving Australian Listed Companies from 2004 to 2013]
The authors analyse resolutions proposed by shareholders of Australian companies listed on the Australian Securities Exchange for the ten year period from 2004 to 2013. They investigate the number of shareholder resolutions over time, the subject matter of the resolutions, whether the resolutions were supported by management, the number of resolutions at extraordinary and annual general meetings, and some of the characteristics of companies that were the subject of many of the resolutions.

Key findings include:

- an increase in resolutions during the global financial crisis;
- management recommended against 81% of the shareholder resolutions;
- 92% of the resolutions concerned the election or removal of directors;
- 71% of the resolutions were proposed for consideration at extraordinary general meetings and not annual general meetings; and
- a very small number of companies (23) were responsible for 37% of all shareholder resolutions and these companies tended to be small capitalisation companies and the majority of the resolutions involving these companies occurred in 2008-2009.

[Employment Restraints of Trade: An Empirical Study of Australian Court Judgments]
Employment restraints of trade can discourage employees from leaving their position by restricting their ability to work in their chosen field for a period of time after their employment has ended. This is a contentious issue in terms of fairness between employers and employees. This article presents the findings of an empirical study of employment restraint of trade judgments of courts in Australia from 1989 to 2012. The authors analyse the volume and outcome of employment restraint of trade cases, comparing trends over time, across different jurisdictions in Australia, and across industries. They also analyse the proportion of all restraint of trade cases that are employment restraint of trade cases. Key findings include that employment restraints of trade are increasing as a proportion of all restraint of trade cases and that employment restraints of trade are found most frequently in the financial services

and professional services industries. In addition, employers in the state of New South Wales have a significantly higher rate of success in enforcing employment restraints against their former employees than employers in other Australian jurisdictions.

2. Recent ASIC Developments

2.1 Reports on corporate finance regulation July to December 2016

24 February 2017 - ASIC has published its sixth report on the regulation of corporate finance issues in Australia. The report, which covers the period July to December 2016, provides companies and their advisers with insights into ASIC's regulatory approach in the corporate finance sector to assist them in carrying out their associated legal and compliance obligations.

Report 512 ASIC regulation of corporate finance: July to December 2016 (REP 512) 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.

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

This sixth report highlights a number of regulatory initiatives ASIC has undertaken regarding the disclosure of financial information and business models in prospectuses, the marketing and due diligence practices of issuers conducting initial public offerings, and the adequacy of independent expert reports.

2.2 Updated guidance on fee disclosure statements

22 February 2017 - ASIC has released an updated Regulatory Guide 245 Fee disclosure statements (RG 245) to reflect regulatory and legislative changes since the guide was first published, including revisions to the Future of Financial Advice (FOFA) reforms.

The fee disclosure statement (FDS) obligations require advice providers who have an ongoing fee arrangement with a retail client to provide the client with an annual FDS setting out information about:

- the fees paid by the client;
- the services provided to the client; and
- the services that the client was entitled to receive.

This obligation is designed to help clients determine whether the ongoing fees they are paying are proportionate to the services they have received, or were entitled to receive.

As well as some minor changes to remove outdated references, RG 245 has been updated to:

- reflect technical amendments to the FOFA legislation since the previous version of RG 245 was released; and
- clarify that the three limited no-action positions that were previously taken by ASIC in respect of the obligations to prepare and give an FDS, are no longer available. These no-action positions were taken to assist the industry to make a smooth transition to meeting the FDS obligations, which have now been in force for some time.

2.3 Consultation on "sunsetting" class order about reporting requirements for Australian financial services licensees who are natural persons

17 February 2017 - ASIC has released a consultation paper proposing to remake ASIC *Class Order [CO 03/748]* Reporting requirements under s. 989B. This is due to expire (sunset) on 1 October 2017.

This instrument grants relief to Australian financial services licensees who are natural persons from the requirement to include in a profit and loss statement any revenues and expenses that do not relate to financial services businesses carried on by the licensees.

ASIC has found this class order is operating effectively and efficiently, and continues to form a necessary and useful part of the legislative framework.

Consultation Paper 278 Remaking ASIC class order on reporting requirements for AFS licensees who are natural persons: [CO 03/748] (CP 278) outlines ASIC's rationale for proposing to remake *[CO 03/748]*. ASIC has published a draft ASIC instrument with CP 278.

2.4 ASIC 2015-16 self-assessment under regulator performance framework

27 January 2017 - ASIC has published its 2015-16 self-assessment under the Regulator Performance Framework. The self-assessment report is now available on the ASIC website.

The Regulator Performance Framework (Framework) provides a set of six common key performance indicators (KPIs) for Australian Government regulators. These KPIs cover reducing regulatory burden, communication, risk-based and proportionate approaches, transparency, and continuous improvement of regulatory frameworks.

3. Recent ASX Developments

3.1 ASX Trade24 Operating Rules and procedures - Rule amendment/changes

Amendments have been made to the ASX24 Operating Rules to introduce requirements that ensure that where the Participant is making Regulated Offers in New Zealand, it is appropriately licenced in New Zealand and has made certain disclosures to its clients. ASX24 Trading Participants will need to provide an annual attestation on 31 January each year, except where a transitional period applies.

The Notice is available on the ASX website.

3.2 Updated ASX Operating Rules Guidance Note 15 - mFund

The *ASX Operating Rules and ASX Settlement Operating Rules* have recently been amended to expand the range of Managed Fund Products that can be settled through the mFund Settlement Service (see Notice reference number 0029.17.01). As a consequence, ASX Operating Rules Guidance Note 15 ASX Managed Fund Settlement Service (mFund) has also been updated.

The Notice is available on the ASX website.

3.3 Changes to Clearing Participant Minimum Core Capital Requirements approach: Response to consultation

On 18 January 2017 - ASX released its response to consultation on ASX Clear's changes to the Participant Minimum Core Capital Requirements (MCCR) approach. ASX received responses (in the form of written submissions, emails and through bi-lateral meetings) from organisations and individuals in response to the consultation. All responses were provided on a confidential basis.

The response to the Consultation Paper is available on the ASX website.

3.4 Reports

On 3 February ASX released the ASX Monthly Activity Report for January 2017.

4. Recent Takeovers Panel Developments

4.1 Innate Immunotherapeutics Limited - Panel declines to conduct proceedings

20 February 2017 - The Panel has declined to conduct proceedings on an application dated 14 February 2017 from Mr James Wheeldon in relation to the affairs of Innate Immunotherapeutics Limited.

The applicant submitted (among other things) that there is an available inference that Mr Collins (a director and shareholder of Innate) may be associated with family members and other shareholders.

The Panel considered that the applicant did not provide sufficient material to justify the Panel making further enquiries and, in the circumstances of the matter, there was no reasonable prospect that it would make a declaration of unacceptable circumstances. Accordingly, the Panel declined to conduct proceedings.

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

4.2 Panel publishes revised Guidance Note 4 - Remedies General

30 January 2017 - The Takeovers Panel has published a revised *Guidance Note - 4 Remedies General*.

The Panel issued a consultation paper in relation to the proposed amendments of Guidance Note 4 on 2 September 2016. The Panel received one submission in response from ASIC, has taken ASIC's comments into account and made further changes to the Guidance Note.

The final revised Guidance Note, and the Public Consultation Response Statement detailing the material comments received and the Panel's response, are available on the Takeovers Panel website.

5. Recent Research Papers

5.1 Assessing managerial ability: Implications for corporate governance

A manager's current and potential future employers are continually assessing her or his ability. Such assessment is a crucial component of corporate governance and this paper provides an overview of the research on that aspect of governance. In particular, the authors review how assessment generates incentives (both good and bad), generates risks that must be faced by both managers and firms, and affects the contractual relationships between those parties in important ways. Assessment (or learning) proves a key perspective from which to study, evaluate, and possibly even regulate corporate governance. Moreover, because learning is a behaviour notoriously subject to systematic biases, this perspective is a natural avenue through which to introduce behavioural and psychological insights into the study of corporate governance.

Assessing Managerial Ability: Implications for Corporate Governance.

5.2 The role of the court in debt restructuring

This paper examines the intervention of the law, and the role of the court, in debt restructuring. The law has a role both in imposing constraints on creditors and in seeking to ameliorate the potential abuses that can arise from such constraints. Three potential forms of abuse are examined: the imposition of a restructuring on dissenting creditors, which introduces the potential for wealth transfers between creditors; the imposition of a moratorium while a restructuring is negotiated, which might lead to misuse of the process by managers wishing to prop up companies which are not viable, or may allow managers of viable businesses to "shake off" liabilities that the company is capable of servicing; and the imposition of debtor-in-possession arrangements, which raise the potential for new creditors to be preferred at the expense of existing creditors. It is argued that the court's role in protecting creditors from these three forms of potential abuse is vital, although the nature of that role differs according to the form of abuse. Detailed recommendations as to the court's role are put forward in the paper. Recent debt restructuring reform proposals in both the UK and the EU, which adopt very different approaches to the role of the court in this process, are examined in the light of this discussion.

The Role of the Court in Debt Restructuring.

5.3 Corporate officers as agents

Although officers are crucial to corporate operations, scholarly and theoretical accounts tend to slight officers and amalgamate them with directors into a single category, "managers." This paper anchors officers within the common law of agency-as does black-letter law-which crisply differentiates officers from directors. Understanding that agency is central to the legal account of officers' positions and responsibilities is crucial to seeing why, like directors, officers are fiduciaries, but distinctively so, not as instances of generic "corporate fiduciaries." Officers, like directors, owe duties of loyalty, but also particularised duties of care, competence, and diligence. Additionally, officers' duties of performance encompass two distinct to agency law: a duty to comply with reasonable instructions and a duty to share material information with the board of directors and others within the corporation. These furnish the legal underpinning for a corporation's ability to exercise control over its officers' actions.

Corporate Officers as Agents.

6. Recent Corporate Law Decisions

6.1 Buy-out order granted for family business in light of oppressive conduct

(By Andrew Robertson, Ashurst)

Peter Exton v Extons Pty Ltd [2017] VSC 14, Supreme Court of Victoria, Sifris J, 10 February 2017

Summary

Sifris J found that the defendants' conduct constituted oppressive conduct under s. 232 of the Corporations Act 2001 No. 50 (Cth), which provides that:

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

- the conduct of a company's affairs;
- an actual or proposed act or omission by or on behalf of a company; or
- a resolution, or a proposed resolution, of members or a class of members of a company;

is either:

- contrary to the interests of the members as a whole; or
- oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity.

In particular, three payments made from the company for the benefit of one of the shareholders were, together, oppressive and contrary to the interests of members as a whole and conduct that unfairly prejudiced and discriminated against another member, justifying a buy-out order. It was no defence that the offending conduct had terminated by the time of the trial.

Facts

The first plaintiff, Peter, commenced proceedings in 2016 against his brother, Ian, who is the sixth defendant in the present case. Peter and Ian each hold 50% of the shares in each of the five companies comprising the Extons Group, which are the first to fifth defendants. Peter and Ian are also both directors of those companies.

The brothers became 50% shareholders in 2010, and since then have shared responsibility for running each of the companies as joint owners and operators. Peter began to take issue with Ian's conduct from 2015, which he claimed was unfair towards both Peter and the Extons Group.

Peter claimed that Ian had forced the businesses to make payments to himself, his family and his friends and was also selling equipment inappropriately. He further claimed that Ian had humiliated and discriminated against him by excluding him from work and undermining his authority.

Peter applied for an order that Ian sell his shares back to the Extons Group. Ian denied Peter's claim and subsequently applied for a winding-up order on the just and equitable ground under s. 461(1)(k), which provides that the Court may order the winding up of a company if the Court is of opinion that it is just and equitable that the company be wound up.

His Honour noted that negotiations for the sale of Ian's shares had commenced but stalled, with Ian demanding $12 million while Peter offered $8.5 million.

Decision

Sifris J accepted three of Peter's eight grounds of oppressive conduct by Ian:

- causing the Extons Group to make payments to Ian;
- using the funds of the Extons Group for the benefit of Ian; and
- causing the Extons Group to make payments to a related company, TGH, for the benefit of Ian.

His Honour held that the three payments made out above constituted oppressive conduct. The first, a payment to TGH (owned by Ian and his wife) of $335,012, had no legitimate basis and amounted to a breach of Ian's fiduciary and statutory duties. When considering whether the payment was "commercially unfair, objectively judged" this payment was also found to be prejudicial and discriminatory against the other shareholders, as it resulted in some harm or prejudice that is "not reasonably or commercially justifiable". The second payment of $30,800 for Ian's benefit, and the third, $45,074.54 paid directly to Ian, also constituted oppressive conduct. His Honour rejected the argument that the nature and extent of the breach was less significant due to the context of a family business and the overlap between directors and shareholders, or that these circumstances attracted any notion of consent or ratification.

His Honour rejected the notion that the oppressive conduct must extend to the date of the hearing. Although whether the conduct had ceased at the time of trial may be relevant to determining which orders should be made, as well as the extent of such orders, the oppression provisions are nonetheless enlivened regardless of whether the conduct has ceased or not.

Ian's application for winding-up was rejected on two grounds. First, there was an alternative available, being a buy-out order. Such an order was deemed appropriate here, even for a solvent company, as there was conduct found to be contrary to the interests of members as a whole and conduct that unfairly prejudiced and discriminated against another member. Second, his Honour noted that a winding-up order would be unfair here as it had been applied for by Ian, the vendor, which would be to the detriment of Peter, the buyer.

6.2 Section 596A of the Corporations Act not contrary to Chapter III of the Commonwealth Constitution

(By Kelly Butler, King & Wood Mallesons)

Palmer v Ayres [2017] HCA 5, High Court of Australia, Kiefel, Gageler, Keane, Nettle and Gordon JJ, 8 February 2017

Summary

Clive Palmer and Ian Ferguson brought proceedings in the High Court of Australia challenging an order issued by the Federal Court of Australia pursuant to s. 596A of the Corporations Act. That order was for the issue of a summons requiring Mr Palmer and Mr Ferguson, two former directors of Queensland Nickel Pty Ltd (QN), to attend an examination of QN's affairs in connection with the company's liquidation. Mr Palmer and Mr Ferguson brought the proceedings in an attempt to avoid further public examination by liquidators over QN's $300 million collapse.

The plaintiffs submitted that the order issued by the Federal Court was invalid on the basis that s. 596A is contrary to Chapter III of the *Commonwealth Constitution* (Constitution).

The High Court heard oral submissions on 10 November 2016. After adjourning for five minutes, the Court handed down a unanimous decision rejecting the plaintiffs' submissions.

Facts

QN was placed under administration pursuant to s. 436A of the Corporations Act 2001 No. 50 (Cth). The creditors of QN subsequently decided that QN should be wound up in insolvency and QN's administrators be appointed as liquidators.

The liquidators applied to the Federal Court for an order for the issue of a summons under s. 596A. Relevantly, s. 596A provides:

"The Court is to summon a person for examination about a corporation's examinable affairs if:

- an eligible applicant applies for the summons; and
- the Court is satisfied that the person is an officer or provisional liquidator of the corporation or was such an officer or provisional liquidator during or after the 2 years ending [on the occurrence of a specified event]."

The liquidators obtained the summons, which required, among others, Mr Palmer and Mr Ferguson to attend for examination. Both former directors attended the Federal Court and were examined.

Subsequently, Mr Palmer and Mr Ferguson each filed a writ of summons in the High Court seeking, amongst other relief, a declaration that s. 596A was invalid as contrary to Chapter III of the Constitution.

Mr Palmer made six submissions in support of his claim:

- first, the power exercised under s. 596A does not satisfy the classical test of judicial power and therefore does not fall within the "core" or "practical conception" of judicial power under s. 71 of the Constitution;
- second, the power exercised under s. 596A is not incidental or ancillary to the exercise of judicial power;
- third, the power exercised under s. 596A is not sufficiently analogous to pre-Federation judicially exercised powers to qualify as judicial power;
- fourth, in the alternative, reasoning drawing upon historical analogues should no longer be followed;
- fifth, the power exercised under s. 596A is incompatible with, or falls outside, the judicial power of the Commonwealth; and
- sixth, proceedings under s. 596A raise no "matter" in the constitutional sense to engage the judicial power of the Commonwealth.

Mr Ferguson adopted Mr Palmer's submissions and contended in addition that the power exercised under s. 596A poses a real risk to the court's actual or perceived independence and impartiality, and offends the separation of powers.

Decision

The Court unanimously held that s. 596A is not repugnant to Chapter III. This was on the basis that s. 596A does not engage the exercise of a non-judicial power and proceedings made under s. 596A do raise a "matter" in the constitutional sense.

Kiefel (as her Honour was then), Keane, Nettle and Gordon JJ issued a joint judgment, while Gageler J published a separate judgment reaching the same conclusion.

Reasons of the plurality

First, their Honours examined whether s. 596A raised a "matter" within the meaning of the Constitution. A "matter" is a justiciable controversy. Their Honours re-iterated the well-accepted rule that for there to be a "matter", there must be an "immediate right, duty or liability to be established by the determination of the Court". Their Honours held that the order for the issue of a summons under s. 596A did constitute a "matter". This was on the basis that the examination process under s. 596A "looks forward" to a "matter". The reasons state "The s 596A power looks forward, using the concept of "examinable affairs" of the corporation, to the possibility that information gathered in the course of an examination under s 597 will support a claim for relief against the examinee or some other person."

Secondly, their Honours held the exercise of power under s. 596A is not incompatible with, and does not fall outside, the exercise of judicial power. The plurality characterised the power as "a procedure designed to lead to a controversy regarding potential rights and liabilities in possible further litigation."

Third, the Honours held that s. 596A is not a new power and cannot be accepted as insufficiently analogous to pre-Federation judicially exercised powers. In any case, their Honours held that "[h]istory alone does not provide a sufficient basis for defining the exercise of a power as judicial power."

Reasons of Gageler J

Gageler J also held that s. 596A is not contrary to Chapter III, placing great emphasis on the historical context of the Constitution. His Honour extensively examined the progression of jurisprudence interpreting the scope of judicial power.

His Honour ultimately held the duty that s. 596A imposes on a court to order an examination does not take the court beyond the role of supervising an administration.

His Honour further held the "matter" to which the exercise of the judicial power of supervision is directed is appropriately identified as external administration under the Corporations Act and is a "matter" within the meaning of Chapter III of the Constitution.

6.3 Successful shareholder claim for misrepresentation inducing investment

(By Lucy Gemmell, Herbert Smith Freehills)

In the matter of William Enterprise Holdings Pty Ltd [2017] NSWSC 38, Supreme Court of New South Wales, Black J, 7 February 2017

Summary

Mr Shi (the plaintiff) claimed that he was induced to pay $2,003,767.96 to acquire two million shares in William Enterprise Holdings Pty Ltd (WEH or the second defendant) through false and misleading or deceptive representations concerning WEH's financial status, the scope and nature of its business and the improved trading performance expected following the plaintiff's investment. Further, the plaintiff claimed that Mr Cai (the first defendant) falsely represented that the share issue would secure the plaintiff a 20% equity interest in the business that was conducted by WEH and the other companies within the William Enterprise group (the WE Group).

The misrepresentation claim was successful and the court cited the following position from, *Australian Competition and Consumer Commission v TPG Internet Pty Ltd [2013] HCA 54; (2013) 250 CLR 640*, to establish that "conduct is misleading or deceptive or likely to mislead or deceive if it tends to induce error." The court stated that the test is not whether the defendant intended to mislead or deceive but whether, viewed objectively, the relevant conduct was misleading or deceptive or likely to be misleading or deceptive.

Facts

Background

The plaintiff and the first defendant were parties to a meeting in October 2013 during which the plaintiff claims he was provided with a financial report detailing the financial position of the WE Group as at 30 June 2013 (Financial Report) and a brochure giving detailed information on the WE Group. The plaintiff acknowledges that the first defendant referred to a loss of the businesses of the WE Group, not exceeding $700,000, but that net assets were stated as $3,234,676 and that sales and profits were projected to increase following the plaintiff's investment.

The plaintiff and the first defendant, among others, entered into an investment agreement on 30 October 2013 (Investment Agreement) which provided that the plaintiff would invest $2,003,767.96 to acquire two million shares in WEH. The investment agreement also set out the projected plans and profits for the business and stated that the first defendant had previously directly invested $3.9 million into the business.

The plaintiff made his investment, pursuant to the Investment Agreement, in a number of separate transactions (the Investment). The first defendant submitted that he instructed his accountant to convert the Investment into shares, however, the accountant failed to do so, resulting in the plaintiff's two million shares in WEH being recorded as unpaid in the company's financial report for 2014.

On 29 December 2014, the plaintiff sought to withdraw his Investment in WEH on the basis of an "incorrect explanation" provided at the point of investment.

On 13 May 2016, after WEH was placed into voluntary administration, its administrators made a demand for $2 million on the plaintiff, described as unpaid share capital.

Grounds of alleged misrepresentation

The plaintiff claimed the following representations were falsely made and that they had induced him to make the Investment:

- that the first defendant was the sole owner of all corporations in the WE Group and that WEH was the 100% holding company for each of the other entities in the WE Group (Representation 1);
- that the plaintiff's investment would secure him a 20% total equity holding in the WE Group (Representation 2);
- that the equity in the WE Group was $3.23 million around the time of the Investment, as evidenced in the Financial Report (Representation 3);
- that the first defendant had personally invested $3.9 million into the WE Group (Representation 4); and
- that the WE Group was capable of becoming profitable and projected earnings were positive (Representation 5).

(together, the Representations).

Order sought

The plaintiff sought an order for rescission of his subscription for shares in WEH and compensation from both of the defendants. The plaintiff claimed loss and damage on the basis that the shares he had invested in were worthless.

Decision

Applicable legal principles

Black J applied s. 1041H of the Corporations Act 2001 No. 50 (Cth) as a starting point to determine breach, given the alleged representations were made in relation to financial products, being shares in WEH.

Black J noted that the court has power to issue an order revoking a contract where a party entered into a contract in reliance on another party's misrepresentation and in making such a decision the courts would have regard to whether the recession would be "just and fair".

Black J drew attention to the principle in *Houldsworth v City of Glasgow Bank (1880) 5 App Case 317*, which may previously have prevented the recovery of damages against a company where the plaintiff was a subscriber to shares in a company and remained a member of the company, in respect of misrepresentations alleged to have induced that subscription, and noted that this position had been overturned by s. 247E of the Corporations Act.

(ii) Interpretation of grounds of alleged misrepresentation

Black J determined that:

- representation 1 was misleading on the grounds that the materials provided to the plaintiff at the October 2013 meeting contained a diagram of shareholdings which did not disclose third parties' interests in several entities within the WE Group;
- representation 2 did not need to be determined given it would add nothing of substance to the finding on Representation 1;
- representation 3 was false and misleading as evidenced by the administrators report to the creditors showing consistent losses and negative assets;
- representation 4 amounted to an implied misleading representation by the first defendant (but not WEH) as it was clear on the evidence that the first defendant had not personally invested such amounts; and
- representation 5 was misleading on the grounds that the statements on planned profitability in the investment agreement implied that such plan existed and had a reasonable basis.

Order made

Black J determined that the evidence established reliance and causation in respect of the Representations inducing the payments made and the execution of the Investment Agreement by the plaintiff. The evidence was deemed consistent with the commercial probabilities, since the plaintiff's equity investment would have been structurally subordinate to other shareholders in the WE Group and he would have little security in his investment. Further, there was evidence that the plaintiff did not receive any financial return on the Investment.

Black J made an order under s. 1325 of the Corporations Act setting aside the plaintiff's obligation to subscribe for shares in WEH and ordering the plaintiff to be compensated by the first and second defendants for the value of the Investment.

6.4 Upholding of financial services licence suspension as a deterrent following breaches of and suspected future non-compliance with s. 912A of the Corporations Act

(By Alex Moores and Akshay Rao, DLA Piper)

MASU Financial Management Pty Ltd and Australian Securities and Investments Commission [2017] AATA 97, Administrative Appeals Tribunal, Taxation and Commercial Division, McCabe DP, 31 January 2017

Summary

MASU Financial Services Pty Ltd (MASU) operated a financial services licence that, following regulatory review and intervention by the ASIC, was suspended by an ASIC delegate for a period of eight weeks. The basis of the delegate's decision was that there had been historical and likely ongoing breaches of s. 912A of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), and that the same management was in charge despite several internal reviews.

The Administrative Appeals Tribunal (Tribunal) held that an eight week suspension was appropriate in cases where there is a culture of bad behaviour and non-compliance that is not addressed until an external trigger event, such as ASIC regulatory intervention, compels the company to take action. Further, the Tribunal held that suspension as a deterrent was valuable in encouraging early intervention to prevent non-compliance and to encourage companies not to tolerate breaches of their obligations under the Corporations Act. The Tribunal also commented that enforcement of regulatory action aimed at correcting bad corporate behaviour is encouraging for the investing public as it demonstrates that such behaviour will not be tolerated and will be addressed by the regulator.

Facts

MASU was granted a financial services license on 2 October 2003, permitting it to provide financial product advice to retail and wholesale clients. MASU operations consisted of a number of business units run by authorised representatives (both individuals and companies), each of whom were also under obligations pursuant to the license. It was the responsibility of MASU to ensure that representative operating under the licence were appropriately trained, qualified and in compliance with the conditions.

In 2012, ASIC raised concerns with one of MASU's representatives, and issued a notice to MASU under s. 33 of the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) (ASIC Act) to produce files relating to that representative. This notice then began a wider examination by ASIC of the adequacy of MASU's internal processes. Approximately two years later, MASU retained an independent consultant and commenced a review. Following the report of the first consultant, which made 52 recommendations to improve internal compliance, MASU engaged several other consultants to assist in addressing these recommendations. MASU claimed that through this process it had established appropriate compliance procedures, and an ongoing process of education, training and compliance monitoring.

Nevertheless, ASIC commenced regulatory action against MASU. A hearing was held before an ASIC-appointed delegate in March 2016. The delegate found that MASU had historically contravened its obligations under s. 912A of the ASIC Act. Notwithstanding the fact that MASU had "in the main" addressed those historical deficiencies, the delegate concluded that MASU's historical non-compliance showed that it was likely to contravene its obligations under s. 912A in the future. The delegate's reasoning was reached on the basis that the problems had continued over a long period of time, were only uncovered as a result of regulatory intervention, and that MASU's officers under which the non-compliance occurred were still in charge. Accordingly, the delegate exercised his discretion under s. 915C of the ASIC Act to suspend MASU's financial services license for an eight-week period.

Decision

It was necessary to establish that there had been the non-compliance necessary to enliven ASIC's ability to suspend the licence pursuant to the Act, and that the discretion to suspend had been exercised judiciously and proportionately. The Tribunal focused on three questions: first, whether MASU continues to be in contravention of s. 912A; second, whether MASU is likely to breach its obligations in the future; and third, whether the delegate's discretion was correctly exercised.

Continuing contravention of s. 912A

The Tribunal found that there was an emerging culture of compliance at MASU, including the implementation of training, procedures and personnel. However, more work needed to be done before the organisation could be said to be compliant. The Tribunal relied on evidence from MASU's compliance consultant, Ms Mei Ling Perry (Ms Perry), who was one of the subsequent consultants retained as part of MASU's review process. Ms Perry conceded that MASU's websites and promotional material were only "substantially" in compliance with its obligations, and acknowledged that there were deficiencies in certain training regimes, compliance documents and the risk register.

The delegate also brought the Tribunal's attention to comments by MASU's in-house lawyer stating that the company had never disputed the substance of ASIC's original concerns, and had also never disputed the recommendations proposed in the original consultant review. Accordingly, the Tribunal found that the delegate's discretion was enlivened under s. 915C(1)(a) because of MASU's past and continuing non-compliance with its obligations.

Likelihood of future breaches

Section 915C(1)(aa) provides that the discretion to suspend or cancel a license is also permitted where the licensee is likely to contravene its obligations in the future. Deputy President McCabe found that it was likely that further contraventions would occur for two primary reasons. First, the historical non-compliance had been presided over by certain individuals, such as the directors and in-house legal team, most of whom were still in the same positions of authority as at the time of the non-compliance and would continue to hold these positions into the future. Second, associated with the comments made in relation to the current state of compliance and the ongoing concerns being addressed by the review process, the Tribunal concluded that future breaches would be likely until such time as all historical compliance issues had been addressed. Since further improvements would need to be implemented before MASU could be said to be in compliance, there remained the likelihood of future breaches and the discretion to suspend or cancel the license was enlivened under s. 915C(1)(aa) of the ASIC Act.

Correct exercise of delegate's discretion

Once it was established that the justification for suspension or cancellation was appropriate, and the relevant sections of the Act had been enlivened on the facts, the Tribunal considered if and how the delegate's discretion should be exercised in those circumstances. In analysing this point, the Tribunal cited *Sovereign Capital and Australian Investments and Securities Commission [2008] AATA 901*, where ASIC had cancelled the license of a financial services firm. In that case, the Tribunal had determined that a suspension was more appropriate and referred to the objectives of the legislative scheme outlined in s. 760A of the Act.

After reviewing the statutory framework, the Tribunal held that a licence should only be suspended or cancelled if it is necessary to do so in order to accomplish the objects of the legislative scheme and the power to suspend or cancel should not be used merely to punish the licence-holder for transgressions. It is particularly appropriate to suspend rather than to cancel a licence where there is a reasonable prospect that the licence-holder can remedy defects which instigated the original concern. Cancellation is appropriate where there is no reasonable prospect of resolution of the issues.

The Tribunal in this case concurred with this analysis and held that the power must be seen as a regulatory tool, rather than an instrument of punishment. This is assisted by the fact that the delegate's decision making process is relatively flexible compared to ASIC's other powers, which allows for discretion in cases where there are less serious contraventions capable of remedy. The length of a suspension will involve a balance between sending the correct message to reflect the seriousness of the contraventions, but also not so long that the company is unfairly prejudiced and disproportionally disadvantaged so that compliance issues cannot be corrected.

Ultimately, the key point for the Tribunal was that, at the time of the hearing, MASU was non-compliant with its obligations so some action was required. Accordingly, it was appropriate that there had not been an exercise of the discretion to cancel the license and the Tribunal agreed that any remaining issues are capable of resolution even if such resolution requires a significant amount of work on behalf of MASU. A suspension of eight weeks is not a disproportionate penalty in the circumstances.

6.5 Application of the second limb of Barnes v Addy

(By Meagan Ryan, MinterEllison)

Australian Staging & Rigging - Events Pty Ltd (rec apptd) (in liq) v Elite Systems Australia Pty Ltd [2016] SASC 204, Supreme Court of South Australia (Civil), Kelly J, 23 December 2016

Summary

The sole director of the first plaintiff, Australian Staging and Rigging - Events Pty Ltd (rec apptd) (in liq) (ASR Events), provided the defendant, Elite Systems Australia Pty Ltd (Elite Systems), with security tokens to ASR Events' bank accounts. Elite Systems used these security tokens to transfer a total of $196,658.78 from these bank accounts to itself. The sole director was found to have dishonestly and fraudulently breached their fiduciary duties to ASR Events by providing Elite Systems with security tokens to ASR Events' bank accounts and failing to make further enquiries about the operation of the bank accounts. Elite Systems was accessorily liable for these breaches of fiduciary duties because it knew of the breaches of duty and had intentionally participated in the breaches. Elite Systems was ordered to pay equitable compensation of $196,658.78 to ASR Events.

Facts

ASR Events conducted a business of procuring and managing contracts as part of a group of companies (ASR Group). Peter Darren McColl (McColl) was the sole secretary and director of ASR Events and the other companies in the ASR Group. On 23 December 2013 receivers were appointed to ASR Events. The second and third plaintiffs, Alan Scott and Andrejs Strazdins (the Liquidators) were appointed as Joint and Several Liquidators of ASR Events on 18 March 2014.

Prior to the ASR Group's collapse in December 2013, ASR Events had begun discussion in about October or November 2013 to sell its assets to Elite Systems. McColl and the general manager of Elite Systems, Michael Clarke (Clarke), discussed that Elite Systems would not take an assignment of ASR Events' contracts and Elite Systems would instead negotiate new contracts. On 20 December 2013 Elite Systems and members of the ASR Group executed an asset sale agreement to sell certain assets to Elite Systems for $1,250,000.00. This agreement was conditional on the consent of the Commonwealth Bank of Australia (CBA) who held a charge over assets of the ASR Group. ASR Events was not a party to the asset sale agreement and the sale did not include goodwill or the book debts of the ASR Group.

On 29 November 2013, McColl was directed by Mr Lea Adams (Adams) (who was leading the acquisition process on behalf of Elite Systems, effectively as a shadow director) to go to a particular Westpac branch and open a new bank account in the name of ASR Events (Westpac Accounts). McColl was further instructed that Clarke was to be a signatory of the bank account. McColl complied with these instructions and both he and Clarke became signatories of the Westpac Accounts. Security tokens were sent to McColl and Clarke and when these were received, Clarke demanded that McColl provide him with his security token. McColl was then effectively told to "keep out of it". McColl never had access to the Westpac Accounts and did not receive his token back.

McColl's evidence was that Elite Systems had offered him employment and to support him through any imminent personal bankruptcy by purchasing his home and holding it for him to re-purchase post-bankruptcy. McColl therefore acted as instructed by Clarke and the directors of Elite Systems to ensure his future with Elite Systems. McColl suspected the Westpac Accounts were opened to stop CBA from freezing funds paid to ASR Group accounts.

Elite Systems in November 2013 instructed ASR Group customers that funds were to be paid to the Westpac Accounts. These funds were then disbursed from the Westpac Accounts.

The Liquidators reviewed the statements of the Westpac Accounts which recorded a number of disbursements totalling $196,658.78 over the period of 1 December 2013 to 22 December 2013 from the Westpac Accounts to Elite Systems. The Liquidators could not see any basis on which Elite Systems were entitled to the sum of $196,658.78 from ASR Group's books. Two letters of demand were sent to Elite Systems demanding they disgorge to ASR Events the sum of $196,658.78. Proceedings were then commenced to recover the sum of the disbursements.

Decision

The plaintiffs relied on a number of causes of action in seeking the recovery of the sum of $196,658.78, orders that McColl had breached his fiduciary duties and orders that Elite Systems were accessorily liable for those breaches. The primary cause of action the plaintiffs relied on was conversion. However, Kelly J's decision focussed on the successful cause of action of accessorial liability of Elite Systems for McColl's breaches of his fiduciary duties to ASR Events. Given this finding Kelly J did not consider it necessary to consider the plaintiff's other causes of action.

The second limb of the test in *Barnes v Addy (1874) LR 9 Ch App 244, 251* has three elements which must be satisfied for a third party to become liable for a directors' breach of fiduciary duties. These elements are:

- the director must dishonestly and fraudulently breach their fiduciary duties;
- the accessory had knowledge of the directors' breach of fiduciary duties; and
- the accessory assisted the directors' breach of fiduciary duties.

McColl owed fiduciary duties which were dishonestly and fraudulently breached

The relationship between a director and company is recognised as a fiduciary relationship with the director having fiduciary duties to the company (*Hospital Products Ltd v United States Surgical Corp [1984] HCA 64; (1984) 156 CLR 41, 96*). McColl, as director of ASR Events, had fiduciary duties to ASR Events as well as statutory duties arising from ss. 180, 181 and 182 of the Corporations Act 2001 No. 50 (Cth).

Kelly J considered that McColl had breached his fiduciary duties to ASR Events by improperly using his position to gain advantage for Elite Systems by providing Elite Systems with access to the Westpac Accounts and handing over his security token. This conduct was to the disadvantage of ASR Events. McColl also failed to make further enquiries into the Westpac Accounts. This conduct resulted in the breach of fiduciary duties.

Kelly J considered that McColl's breach was fraudulent and dishonest because at the time of McColl's conduct, McColl believed ASR Events to be in financial difficulty and he knew that ASR Groups was effectively controlled by Elite Systems. McColl gave Elite Systems, through an officer, unsupervised access to the Westpac Accounts in the name of ASR Events. Kelly J considered that McColl deliberately "closed his eyes' to these facts in favour of his personal interests and this amounted to dishonest and fraudulent breach of his fiduciary duties.

Elite Systems had knowledge of McColl's breach of fiduciary duties to ASR Events

Elite Systems, through its officers, had the requisite level of knowledge of McColl's breaches of fiduciary duties. The fourth category of knowledge, as classified in *Baden v Societe Generale pour Favoriser le Developpment du Commerce et de l'Industrie en France SA [1993] 1 WLR 509*, requires "knowledge of circumstances which would indicate the facts to an honest and reasonable man". Kelly J was satisfied that Elite Systems had the requisite level of knowledge of McColl's breaches of fiduciary duties. This was because Elite Systems' officers knew of McColl's breaches, as Adam had directed McColl to open the Westpac Accounts and to make Clarke a signatory, and Clarke had demanded McColl's security token.

Elite Systems knowingly assisted and intentionally participated in McColl's breach of duties

In the circumstances, Kelly J found that Elite Systems' conduct in participating in McColl's breach of duties was "plainly intentional'. It was more than just knowledge of the breaches. Elite Systems had procured the breaches through incentives and threats to McColl's personal circumstances.

In finding that Elite Systems was accessorily liable for McColl's breach of fiduciary duties, Kelly J granted the plaintiffs the remedies they sought. Namely:

- judgment was awarded in favour of ASR Events in the sum of $196,658.78;
- McColl was declared to have breached his fiduciary duties owed to ASR Events;
- Elite Systems was declared as an accessory to McColl's breaches of fiduciary duties owed to ASR Events; and
- Elite Systems was ordered to pay equitable compensation to ASR Events for all monies it withdrew from the Westpac Accounts.

6.6 Insolvent trading by absent director

(By Matt Edwards, Clayton Utz)

In the matter of KMS Imports (Aust) Pty Ltd (In Liq) [2016] FCA 1571, Federal Court of Australia, Gilmour J, 22 December 2016

Summary

The liquidators sought orders that a director, Mr Li, had breached s. 588G(2) of the Corporations Act 2001 No. 50 (Cth) by allowing KMS Imports (Aust) Pty Ltd (the Company) to trade while insolvent and as a result claimed the recovery of a specified debt (owed to the ATO) plus interest and costs. Mr Li argued that he was not a director of the Company at the date of liquidation and that he therefore did not know of the Company's insolvency.

Gilmour J found that Mr Li was a director at the relevant time and that, despite Mr Li's lack of knowledge of the dealings of the Company, a director acting reasonably would have known or suspected that the Company was insolvent. As a result, Mr Li's lack of knowledge did not excuse him from liability for insolvent trading.

Facts

The Company was in the business of importing kitchen parts from Germany and China and then on selling those parts to the public in flat packs or in an assembled format. The Company failed to file tax returns for the financial years ending 30 June 2007, 30 June 2010, 30 June 2011 and 30 June 2012 and otherwise did not meet its tax liabilities. At the petition of the ATO, orders were made on 7 December 2011 winding up the Company.

The existence of a debt to the ATO was not disputed. That debt had existed from 2 January 2009 and accumulated in accordance with a running balance account. At the time of liquidation the balance of the debt owed to the ATO was $74,159.37.

In accordance with usual practice, the liquidators immediately sought copies of the books and records of the Company from its directors and officers. Despite the liquidators best attempts, no books were delivered to the liquidators by the Company's directors, its former bookkeeper or any other person.

ASIC records indicated that Mr Li was appointed a director of the Company on 23 November 2006. On 15 December 2011 (8 days after the Court ordered that the Company be wound up and 7 days after the liquidator sent Mr Li a letter advising him of the winding up of the Company), a Form 484 "Change to Company Details" was lodged with ASIC stating that Mr Li had resigned as a director of the Company on 1 July 2011. No letter of resignation, minutes of meeting recording Mr Li's resignation or any other such document were produced to the Court.

The proceedings were commenced by the liquidators in order to recover the amount of the ATO debt. Section 588G of the Corporation Act relevantly provides:

This section applies if:

- a person is a director of a company at the time when the company incurs a debt;
- the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt;
- at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and
- that time is at or after the commencement this Act.

By failing to prevent the company from incurring the debt, the person contravenes this section if:

- the person is aware at that time that there are such grounds for so suspecting; or
- a reasonable person in a like position in a company in the company's circumstances would be so aware.

Section 588M allows the liquidator to recover from a director the amount of the loss or damage resulting from a contravention of s. 588G(2).

Decision

Mr Li's purported resignation

Gilmour J found that the ASIC Form 484 was not, in and of itself, evidence of when Mr Li validly resigned as a director of the Company. It is a company's constitution (and if no constitution, the replaceable rules) and the common law which determine the validity and effectuation of the resignation.

In circumstances where there was no evidence of Mr Li's resignation, including the absence of affidavit material by Mr Li deposing to the circumstances of his resignation, the Court inferred that, as a matter of fact, Mr Li was a director of the Company at all material times, including the date of winding up.

Insolvency of the Company

It was alleged that at the time that the Company incurred the ATO debt the Company was presumed to be insolvent or, alternatively, as a matter of fact, was insolvent.

No person was able to produce financial records of the Company. His Honour further found that, even if records did in fact exist, the Company's failure to lodge income tax returns meant that those books and records could not correctly record the Company's transactions. In the circumstances, it was found that the Company had not kept correct financial records as required by s. 286 of the Act and, in accordance with s. 588E(4) of the Act, a presumption of insolvency existed.

Reasonable grounds for suspecting insolvency

His Honour referred to the observations of Goldberg J in McLellan, in the matter of *The Stake Man Pty Ltd v Carrol* [2009] FCA 1415, in which it was stated that:

'The test prescribed by s 588G(1)(c) is an objective test. The concept of "suspecting" or "suspicion" involves having a state of mind which falls between having a firm belief or a significant degree of satisfaction that insolvency exists on the one hand and wondering whether it exists on the other. The concept of having a "suspicion" requires an affirmative feeling.' (citations omitted)

In the circumstances of the case, his Honour found that a person of ordinary competence would objectively have suspected that the Company was not able to pay its debts as and when they fell due.

Reasonable person would have suspected insolvency

His Honour confirmed, by reference to the finding of Einstein J in Green in his capacity as liquidator of *Arimco Mining Pty Ltd (in liq) v GCU Insurance Ltd (2008) 67 ACSR 398*, that:

"Subsection 588(2)(b) applies to cases where the directors did not know of the relevant facts and matters because they had failed to ascertain them, but a reasonable person in a like position would or ought to have ascertained those facts and matters."

It was conceded by the liquidators that Mr Li did not know what was happening in the Company after January 2010 and that they were unable to establish that Mr Li was aware that the Company was insolvent at the time that the debts were incurred. However, it was alleged that a reasonable director in Mr Li's circumstances would have monitored whether the Company was meeting its tax obligations and when they fell due. His Honour accepted that a reasonable director in Mr Li's position would have been aware that there were reasonable grounds for suspecting that the Company was insolvent.

Given the above, his Honour made orders requiring Mr Li to pay to the liquidators the amount of the debt owed to the ATO plus interest and costs.

6.7 Appeal against insider trading conspiracy conviction dismissed

(By Andrew Bell, Herbert Smith Freehills)

Curtis v R [2016] NSWCCA 299, New South Wales Court of Criminal Appeal, Payne JA, Price J and Davies J, 16 December 2016

Summary

The New South Wales Court of Criminal Appeal has unanimously dismissed Oliver Curtis' appeal against a conviction by jury of one count of conspiracy to commit insider trading. The Court found that the Crown was not required to prove that all information communicated pursuant to the defendants' agreement was "material" under s. 1042D of the Corporations Act 2001 No. 50 (Cth).

Facts

The Crown had successfully alleged that Curtis and John Hartman, an equities dealer at Orion Asset Management Limited, had an agreement where Hartman would pass proprietary information about certain prospective ASX trades by "pinning" instructions to a blackberry. This agreement was based on Hartman's experience that these trades would likely affect the ASX price of the securities.

Curtis would then "front run" the trades by purchasing in his own name Contracts for Difference (CFD) in the stock which Hartman would trade. He would then close the CFD position before Hartman completed his trade to reap the profit difference created by Hartman's trades. This occurred 45 times, generating a shared profit of over $1.4 million.

Decision

The appeal was brought under s. 5 of the [Criminal Appeal Act 1912 No. 16 (NSW)] on the ground that the verdict was unreasonable, since it was not open to the jury to find that the information about trading intentions was material. "Material" in this context means that "a reasonable person would expect it to have a material effect on the price or value of relevant contracts for difference."

Prosecution pleading and burden of proof

The appeal turned on the issue of whether the alleged agreement had been pleaded so generally that the Crown should have been required to prove that all information communicated pursuant to it would be "material".

"Material effect" is defined in s. 1042D of the Corporations Act: "For the purposes of this Division, a reasonable person would be taken to expect information to have a material effect on the price or value of particular Division 3 financial products if (and only if) the information would, or would be likely to, influence persons who commonly acquire Division 3 financial products in deciding whether or not to acquire or dispose of the first mentioned financial products."

The appellant unsuccessfully argued that the Crown needed to prove that all information communicated pursuant to the agreement "would", rather than "may" be "material", to make the pleadings capable of founding an offence. He argued that the Crown had to generically describe the information, since it did not exist at the time of the agreement. However, materiality could only be determined by the details of each isolated transaction.

Payne J wrote (with Price and Davies JJ agreeing), "The appellant and Mr Hartman entered into an agreement to commit the offence of insider procuring knowing or believing that information Mr Hartman would (in the future) possess would not be generally available and would be material."

It was sufficient that the pleading was particularised at this level of generality, supported by evidence of the 45 CFD trades.

There was a crucial distinction between the prosecution cases in *R v LK; R v RK (2010) 221 CLR 177* where the allegation centred on an agreement to use funds "whether or not" they were the proceeds of crime. Here, the entire purpose of the agreement was to exploit inside information where it would be material.

Therefore, an additional direction given by McCallum J that the Crown must also establish that the information the accused and Mr Hartman knew or believed Mr Hartman would possess would "in fact" be material according to s. 1042D was incorrect and superfluous in proof of the conspiracy. The single physical element of this offence, is that the appellant and Hartman entered into the agreement.

This statutory construction is supported by the fact that the conspiracy provisions allow a person to be convicted "even if ... committing the offence is impossible". If the information were leaked to the media before the trade could be completed (thus eliminating its materiality), the offence could still be proven.

In light of the evidence, it was open to the jury to find that the information conceived of by the agreement was material, in that it would be likely to influence people who commonly acquire Division 3 financial products.

Use of expert evidence to prove materiality

A further issue was whether information which may have a "material effect" should be the subject of expert evidence. It was argued that without expert evidence, "the jury might be tempted either to speculate or possibly to be influenced by the experience of one or more among their number" in determining this element. However, the court found that this case did not demand expert evidence to determine materiality.

6.8 Court grants leave to transfer shares under s. 444GA of the Corporations Act where shares had no value and company would otherwise be wound up

(By Alex Moores and Akshay Rao, DLA Piper)

In the matter of Kupang Resources Limited (subject to Deed of Company Arrangement) (receivers and managers appointed) [2016] NSWSC 1895, Supreme Court of New South Wales, Black J, 14 December 2016

Summary

The plaintiff, Mr Damien Hodgkinson (Mr Hodgkinson), sought leave to transfer all shares in Kupang Resources Limited (subject to Deed of Company Arrangement) (receivers and managers appointed) (Kupang) to International Litigation Partners Pte Limited ("ILP") under s. 444GA of the Corporations Act 2001 No. 50 (Cth). Section 444GA provides that the Court may only give leave "if it is satisfied that the transfer would not unfairly prejudice the interests of members of the company".

The Supreme Court of New South Wales (Court) found that the proposed transfer would not unfairly prejudice the interests of Kupang's members for two reasons: first, the shares to be transferred had no value; and, second, if the order for leave was not approved, Kupang would be wound up, resulting in no return to either unsecured creditors or shareholders. The Court granted leave pursuant to s. 444GA(1)(b) of the Act, permitting the administrator of the deed of company arrangement to transfer the shares.

Facts

Kupang, under another name, was initially funded by ILP to pursue complex litigation against various third parties. Subsequently, Kupang launched proceedings against ILP and ultimately failed to challenge the appointment of receivers and managers by ILP, so on 6 August 2014 ILP appointed receivers and managers to Kupang. Subsequently, on 2 September 2015, the creditors of Kupang voted in favour of the Deed of Company Arrangement (DOCA), and appointed Mr Hodgkinson as deed administrator. The three parties to the DOCA were Mr Hodgkinson on behalf of Kupang, Mr Hodgkinson in his capacity as deed administrator, and ILP.

Amongst other things, the DOCA provided for a transfer of all of the issued shares in Kupang to ILP by way of a partial debt for equity swap, subject to the court's approval of that transfer under s. 444GA of the Act, and ASIC granting relief from chapter 6 of the Act. In exchange for the transfer of shares, ILP would release and discharge Kupang from part of the debt owed to ILP. The DOCA indicated that should the transfer of shares not occur on or before 8 September 2016, the DOCA would terminate and Kupang would be voluntarily wound up. None of Kupang's shareholders objected to the proposed transfer of shares.

At the date of the judgment, Kupang was indebted to ILP for a sum in excess of $4.4 million. Kupang had also been delisted from the ASX. Notice of the application had been posted online, and letters sent through the share registry service provider. Despite 185 letters being returned without having been opened, it was determined that no further steps could practically have been taken to bring the application to the attention of the shareholders.

Decision

Legal principles

The Court considered the application of s. 444GA(1)(b) and 444GA(3) of the Act. Section 444GA(1)(b) provides that a company's deed administrator may transfer shares if the administrator has obtained the leave of the Court. As noted above, s. 444GA(3) provides that the Court may only give leave "if it is satisfied that the transfer would not unfairly prejudice the interests of members of the company".

In interpreting the meaning of "unfairly prejudice", the Court cited Lewis, Re; Diverse Barrel Solutions Pty Ltd (subject to deed of company arrangement) [2014] FCA 53. In that case, White J noted that relevant matters in determining "unfair prejudice" included the residual value of shares; the prospect of shares obtaining value within a reasonable time; the steps necessary before the prospect of shares attaining value may be realised; and the attitude of shareholders towards providing either means for the shares to obtain value or means for the company to continue in existence. In that case, White J found that there was no unfair prejudice to the shareholders because the shares to be transferred had no residual value, and the shareholders would not receive any return on a winding up of the company.

The Court also cited Weaver (in their capacity as joint and several deed administrators of *Midwest Vandium Pty Ltd) v Noble Resources Ltd [2010] WASC 182* as authority for the propositions that shareholders would not be prejudiced where there was no residual value or equity in the company, and that transferring shares without compensation was in itself insufficient to establish unfair prejudice.

Ultimately, the Court agreed with Mr Hodgkinson's submission that, in accordance with the relevant case law, "there would not ordinarily be any prejudice, or no prejudice that has the requisite quality of "unfairness", if the shares to be transferred have no value, and there would be no distribution in the event of a liquidation which is the only realistic alternative to the proposed transfer".

Value of Kupang's shares

The Court noted that the first step in determining the value of shareholders' equity in Kupang was to determine the value of Kupang's assets. In this case, the Court assessed Kupang's assets by reference to potential recoveries from litigation claims available to Kupang and the financial position of Kupang's mining operations. Mr Hodgkinson identified two viable litigation claims, of a potential five that were brought to the Court's attention, that Kupang could bring against its directors and officers. Kupang's ability to bring those claims, however, was subject to the availability of litigation funding.

The Court accepted that there was a likelihood that no litigation funder would be prepared to fund Kupang's claims. Nevertheless, the Court considered the potential recoveries if Kupang was able to secure litigation funding. The Court found that even assuming a "high range recovery" on an early settlement or successful hearing, and a minimum litigation funding fee of 25%, the recoveries would be insufficient to provide any return to shareholders in light of Kupang's outstanding debt to ILP. This point also demonstrated an inherent uncertainty arising from litigation risk and other variables that may affect the total quantum of recoverable funds, and the Court accepted Mr Hodgkinson's evidence that regardless of recovery prospects the potential amount achieved after deducting enforcement costs would be insufficient.

The Court similarly found that there were insufficient assets in Kupang's mining operations to provide any return to shareholders. Based on the market value of the assets and taking into account the costs of liquidation and other obligations to creditors, the return to shareholders from the mining operations would likely be nil. Therefore, the Court concluded that the residual value of Kupang's shares was nil.

Alternatives to proposed share transfer

The Court accepted the plaintiff's submission that the only alternative to the proposed share transfer was the liquidation of Kupang. That was because Kupang had been delisted from the ASX and, hence, had no realisable value in its corporate shell; held no other funds to pay outstanding claims; and no longer traded as a going concern. Further, ILP's approval was needed for any alternative proposals to be accepted.

Additional submissions that were made following the completion of the hearing, provided by Mr Hodgkinson, indicated that even in a scenario where the calculations assume the highest level of estimated recoveries and the lowest litigation funding fee there would be insufficient return to unsecured creditors and shareholders in a Kupang liquidation. This further evidence was accepted as supporting the position of Mr Hodgkinson at the hearing.

Overall assessment of prejudice

In its concluding remarks, the Court discussed the outcomes for shareholders and unsecured creditors under the DOCA and in Kupang's liquidation. While there was a modest financial advantage for unsecured creditors under the DOCA, the outcome was neutral for shareholders under both the DOCA and in Kupang's liquidation. The Court found that there was no "unfair prejudice" to shareholders as a result of the transfer. None of Kupang's shareholders had objected to the proposed transfer. Further, the shares had no value and no prospect of gaining value in a reasonable time, and the alternative to the DOCA (ie, Kupang's liquidation) would not provide any return to shareholders or unsecured creditors. On this basis, the Court was prepared to grant leave for a transfer of shares pursuant to s. 444GA(1)(b) of the Act by Mr Hodgkinson as deed administrator.

6.9 Making an example of wrongdoing: penalty orders against ASX listed company and its director

(By Annabelle Browne and Matthew Critchley, Corrs Chambers Westgarth)

In the matter of Sino Australia Oil and Gas Limited (in liq) [2016] FCA 1488, Federal Court of Australia, Davies J, 8 December 2016

Summary

The ASIC commenced proceedings against Sino Australia Oil and Gas Limited (in liq) (Sino) and its former executive director and chairman, Tianpeng Shao (Director) seeking, firstly, declarations of contraventions of the Corporations Act 2001 No. 50 (Cth) and, secondly, civil penalty orders against Sino and an order disqualifying the Director.

Separately, the liquidator of Sino sought compensation from the Director for loss and damage caused by the contraventions which, the Court held, had caused Sino to be placed into liquidation.

In the earlier decision in ASIC, in the matter of *Sino Australia Oil and Gas Limited (in liq) v Sino Australia Oil and Gas Limited (in liq) [2016] FCA 934*, the Court declared that Sino had contravened s. 728(1)(a), (b) and (c) of the Corporations Act, which provide that a person must not offer securities under a disclosure document if there is a misleading or deceptive statement in or omission from the disclosure document or certain accompanying documents.

Sino was also found to have contravened s. 1041H of the Corporations Act for conduct which is misleading or deceptive or likely to mislead or deceive in relation to a financial product or service and s. 674(2) of the Corporations Act for failure to notify the Australian Securities Exchange (ASX) of information which could reasonably be expected to have a material effect on the price or value of securities.

The Director was also found to have contravened s. 674(2A) of the Corporations Act for his involvement in the contraventions of Sino and s. 180(1) of the Corporations Act for breach of his director's duties. The Court held that the Director had failed to take reasonable steps to prevent the contraventions by Sino.

Significant penalties were awarded in respect of the contraventions. Sino was fined $800,000 (of a maximum $1m) and the Director was disqualified from managing corporations for a period of 20 years and required to pay compensation of $5,539,758 to Sino, in respect of the losses suffered by shareholders.

Facts

Sino is the Australian holding company of a Chinese operating company which claims to provide oil and gas recovery services in China.

In 2013, Sino issued a series of Prospectuses for an initial public offering on the ASX, all of which were signed by the Director. Sino was officially listed on the ASX in December 2013.

Immediately following the float, a non-executive director of Sino approached ASIC with concerns about corporate governance, following a request by the Director to approve a transfer of funds raised in the initial public offering to a Chinese bank account.

ASIC obtained an injunction freezing the assets of Sino and conducted examinations of each of the directors. Ultimately, the Court ordered that Sino be wound up on just and equitable grounds.

ASIC's allegations

The contravening conduct, as alleged by ASIC in the initial stage of the proceeding, included:

- making false statements in the Prospectuses in relation to patents claimed to be held by Sino;
- failing to make disclosure of material information concerning the profit downgrade for the 2013 year from the profit forecast in the Prospectuses;
- omissions from, and misleading and deceptive statements in, the Prospectuses in relation to a loan and certain service contracts said to be held by the Chinese subsidiary;
- making false statements in the Prospectuses, and the provision of false information to its auditors, in relation to certain financial information of Sino and the Chinese subsidiary;
- misleading and deceptive conduct in respect of the financial position of the Sino and the Chinese subsidiary; and
- that the Director was involved in Sino's contraventions for conduct including approving the Prospectuses without understanding English text and without obtaining a Chinese language translation and for failing to acquaint himself with the disclosure requirements for publically listed companies under Australian law.

ASIC then sought civil penalty orders against both Sino and the Director.

Decision

The Court observed that the principle purpose of imposing a pecuniary penalty is to act as a specific deterrent to the contravener and as a general deterrent to others. Therefore, it was appropriate in this case for a significant pecuniary penalty to be ordered against the company, despite it being in liquidation.

Where the relevant declarations have been made in relation to a contravention of a financial services penalty provision, the Court may impose a penalty on a company where the contravention is found to be serious (pursuant to s. 1317G of the Corporations Act). In imposing the pecuniary penalty on Sino, Davies J observed that:

- it was appropriate to impose a significant penalty, despite Sino being in liquidation and a penalty not being a provable debt, as a deterrent not only to the wrongdoer, but to the public at large;
- there was a material prejudice caused to shareholders by the contravention; and
- the responsibility for the contraventions lies with the failure of the Director to understand or attempt to understand Australia's legal requirements and the legal obligations in relation to continuous disclosure.

Pursuant to ss. 206C and 206E of the Corporations Act, on application by ASIC the Court may disqualify a person from managing a corporation where certain declarations have been made and the Court is satisfied that the disqualification is justified. Guidance is given in ss. 206C(2) and 206E(2) as to the factors a Court may take into account in determining whether the disqualification is justified.

Ultimately, the Director was disqualified from managing corporations for a period of 20 years, on the basis that:

- disqualification was justified in the circumstances;
- consideration be given to the importance of public and personal deterrence; and
- the nature and extent of the Director's contraventions in failing to understand the proper role of a director and the duty of due diligence that is owed; causing significant loss to shareholders; and failing to provide evidence of contrition for his failures, and the failure to understand the seriousness of the conduct or accept responsibility for it.

In handing down these penalties, Davies J observed that there is an increasing trend of entities from emerging markets seeking and obtaining listing on the ASX, particularly from the Asia Pacific region. This trend, and the serious nature of the contraventions here, were sufficient grounds for the Court to make an example of Sino and the Director in this case and impose significant penalties.

6.10 Court imposes pecuniary penalty of $400,000 for contravention of insider trading prohibitions

(By Imogen Nolan, Corrs Chambers Westgarth)

Australian Securities and Investments Commission v Hochtief Aktiengesellschaft [2016] FCA 1489, Federal Court of Australia, Wigney J, 8 December 2016

Summary

The Federal Court of Australia has declared that Hochtief Aktiengesellschaft (HAG) contravened s. 1043A(1)(d) of the Corporations Act 2001 No. 50 (Cth) by procuring its subsidiary, Hochtief Australia Holdings Limited (Hochtief Australia), to purchase shares in Leighton Holdings Limited (Leighton) in circumstances where HAG was in possession of "inside information" concerning Leighton. HAG possessed the relevant information through its Chief Financial Officer, Mr Sassenfeld. Mr Sassenfeld was also a director of Hochtief Australia.

On 14 January 2014, Mr Sassenfeld had attended a meeting of the Leighton audit committee during which Leighton's expected financial results for the year ended 31 December 2013 were discussed. Following that meeting, HAG sought to vary an instruction previously issued to Hochtief Australia regarding Hochtief Australia's acquisition of shares in Leighton, relevantly, by extending the completion date for the acquisition from 31 January 2014 to 14 February 2014.

The Court also ordered HAG to pay the Commonwealth a pecuniary penalty of $400,000, as well as ASIC's legal costs which were agreed in the amount of $50,000. HAG also separately agreed to pay ASIC's investigation costs of $50,000.

Importantly, HAG did not dispute the declaration or the payment of a pecuniary penalty, however it submitted that the appropriate penalty was $100,000. ASIC had sought a penalty in the order of $600,000. This was the first case where the Court had been asked to fix a pecuniary penalty for a corporation in respect of a civil contravention of s. 1043A of the Corporations Act.

Facts

HAG is the holding company of a worldwide group of construction companies based in Essen in the Federal Republic of Germany. One of its subsidiaries is Hochtief Australia, which is essentially operated by HAG as a vehicle to hold, acquire and dispose of securities, including shares in Leighton.

On 28 November 2013 on behalf of HAG, Mr Sassenfeld (the Chief Financial Officer of HAG) and Mr Hoestermann (Head of Corporate Finance of HAG) signed a written instruction to Mr Lancero (a director and secretary of Hochtief Australia) and Mr Somerville (an employee of Harveys Accounting Services Pty Ltd, a firm retained by Hochtief Australia to provide accounting services). The instruction directed Mr Lancero and Mr Somerville to acquire up to 4.8 million shares in Leighton on behalf of Hochtief Australia, to be completed by 31 January 2014.

On 14 January 2014, Mr Sassenfeld and Mr Robinson (a director and the Chairman of Hochtief Australia and the owner of Harveys Accounting Services Pty Ltd), attended a meeting of the Leighton audit committee. As a result of attending this meeting Mr Sassenfeld and Mr Robinson came into possession of information relating to Leighton's expected financial result for the year ended 31 December 2013. It was common ground between the parties that this information was "inside information" as defined in s.1042A of the Corporations Act.

On 27 January 2014 Mr Sassenfeld and Mr Hoestermann signed a "Variation of Instruction" which extended the time period for purchasing shares in Leighton to 14 February 2014. The variation was communicated to Mr Lancero and Mr Somerville on 29 January 2014. In the period from 29 January to 3 February 2014, Hochtief Australia purchased 1,275,616 Leighton shares for a total of $20,668,279 (excluding fees). On 3 February 2014, HAG determined to cease acquiring Leighton shares through Hochtief Australia.

ASIC contended that the trading on each of the four trading days from 29 January to 3 February 2014 was procured by the Variation of Instruction, whereas HAG contended that only the trading on 3 February 2014 was procured by the variation.

Legislation

Section 1043A(1) of the Corporations Act relevantly provides:

Subject to this Subdivision, if:

- a person (the insider) possesses inside information;
- the insider knows, or ought reasonably to know, that the matters specified in paragraphs (a) and (b) of the definition of inside information in s. 1042A are satisfied in relation to the information; the insider must not (whether as principal or agent);
- apply for, acquire, or dispose of, relevant Division 3 financial products, or enter into an agreement to apply for, acquire, or dispose of, relevant Division 3 financial products; or

- procure another person to apply for, acquire, or dispose of, relevant Division 3 financial products, or enter into an agreement to apply for, acquire, or dispose of, relevant Division 3 financial products.

Section 1042A defines "inside information" as follows:

inside information means information in relation to which the following two paragraphs are satisfied:

(a) the information is not generally available; and
(b) if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of particular Division 3 financial products.

The two elements of the "inside information" definition - not generally available and materiality - are the subject of further definitional provisions. The terms "possession" and "procure" in the context of the insider trading prohibition are also subject to further definition.

Decision

The Court found that the agreed facts provided a proper factual basis for the declaration sought by ASIC and agreed to by HAG. The sending of the Variation of Instruction on 29 January 2014 was sufficient to make out the conduct element of the contravention. Whilst not an issue in this case, the Court noted that where the conduct element involves procuring, it is not an element of a contravention of s. 1043A that the person procured actually purchases the relevant shares. However the result of procurement, namely, the number of Leighton shares that were in fact acquired was relevant to the question of penalty.

The Court rejected ASIC's submission that the effect of the issue of the Variation of Instruction was to replace or supersede the original instruction such that all trading that occurred after the issue of the Variation of Instruction was carried out pursuant to the variation. The Court found that the acquisition of Leighton shares that occurred on 29, 30 and 31 January 2014 were able to be made pursuant to the directions contained in the original instruction. Further, the variation did not state, in terms, that it operated to replace, supersede or otherwise terminate the original instruction; all that had been varied was the completion date. Accordingly, the appropriate pecuniary penalty payable by HAG was determined on the basis that the contravening conduct only caused the trading that occurred on 3 February 2014.

The Court found that the contravention was towards the middle or slightly lower side of the scale of seriousness for civil contraventions of the insider trading prohibition; it gave rise to a single day of trading and was not deliberate or intentional, but was the result of a serious failure by Mr Sassenfeld to exercise appropriate care and diligence in all the circumstances. Indeed HAG had been aware, through its senior officers, of the inside trading prohibition; both the original instruction and the variation had included a statement to the effect that HAG, Hochtief Australia and their respective officers did not possess any price sensitive information regarding Leighton. The original instruction had also referred to the establishment of a "Chinese Wall" to ensure Mr Lancero and Mr Somerville did not come into possession of price sensitive information.

In imposing a pecuniary penalty of $400,000 the Court took into account the fact that Hochtief AG had no prior contraventions, had admitted liability, had cooperated with ASIC and had conducted appropriate training to reduce the risk of further offending.

6.11 Leave by shareholder to proceed against company in voluntary administration refused

(By Molly Woods, Ashurst Australia)

In the Matter of Forge Group Ltd (In Liq) (Receivers and Managers Appointed) [2016] FCA 1471, Federal Court of Australia, Foster J, 7 December 2016

Summary

This case primarily dealt with the question of whether leave should be granted to Rushleigh Services Pty Ltd (Rushleigh) under s. 500(2) of the Corporations Act 2001 No. 50 (Cth) to proceed with its claim against Forge Group Ltd (In Liq) (Receivers and Managers Appointed) (Forge Group), notwithstanding that Forge Group was in the process of being voluntarily wound up at the time. In rejecting Rushleigh's claim, Foster J emphasised the importance of s. 500(2) in protecting the creditors of companies that are in voluntary liquidation from unnecessary claims being brought against the company, which would reduce the pool of funds available for those creditors. Foster J also rejected Rushleigh's request to have the matter transferred to the Supreme Court of New South Wales.

Facts

In 2014 the mining services company Forge Group collapsed after issues with two of its power station contracts overwhelmed Forge Group's ability to keep operating. This case was brought by Rushleigh as a representative proceeding under Pt IVA of the Federal Court of Australia Act 1976 No. 156 (Cth) with Rushleigh representing certain persons that purchased shares in Forge Group during the period from 7 March 2012 to 1 November 2013.

Rushleigh alleged the following:

- that Forge Group made false representations regarding the amount of revenue it would see in the 2012/2013 financial years from certain of its commercial projects (including the power station contracts);
- that Forge Group's Annual Report and Results Report for the 2012 and 2013 financial years did not give a true and fair view of Forge Group's financial position and performance and that Forge Group knew this was the case;
- that as at September 2013 and all material times after Forge Group was aware there was a real risk of significant margin erosion as a result of cost overruns and delays in the power station projects; and
- that Forge Group failed to comply with its continuous disclosure obligations.

Rushleigh originally commenced this proceeding in December of 2014 at which point Forge Group had already passed a resolution for its voluntary winding up. However, Rushleigh did not obtain leave of the Court to proceed against Forge Group prior to filing its originating application, and accordingly, was required to amend its statement of claim in order to do so. This is because s. 500(2) of the Corporations Act provides that after a resolution for voluntary winding up of a company has been passed, no action or other civil proceeding is to be proceeded with or commenced against that company except by leave of the Court. Accordingly, this case deals with the question of whether leave should be granted to Rushleigh pursuant to s. 500(2).

There was some delay in the hearing of this case to allow for the liquidators of Forge Group to attempt to obtain funding to bring an action against the ex-directors of Forge Group. Such funding was not obtained. In September 2015 Rushleigh obtained leave of the Court to join the ex-directors of Forge Group, Messrs Peter Hutchinson and David Simpson, as second and third defendants. Further, in December 2015 Rushleigh filed an interlocutory application seeking to transfer the proceedings to the Supreme Court of New South Wales. Accordingly, in this case Foster J also deals with Rushleigh's interlocutory application.

Decision

Leave to proceed refused

Foster J commenced his consideration of whether to grant Rushleigh leave to proceed against Forge Group by noting that the test for granting leave under s. 500(2) has been fairly well articulated in previous cases. Foster J emphasised that the prohibition against proceeding with an action in this context is a longstanding feature of companies law for good reason; otherwise companies in liquidation would be subject to numerous actions that would likely be time-consuming and expensive to creditors. Accordingly, a claimant must show that there is a good reason for departing from the ordinary proof of debt procedure before leave is granted.

Foster J then summarised and considered the parties' arguments. Critical to the final decision, Foster J determined that Forge Group's liability and the liability of the ex-directors likely goes hand-in-hand. His Honour commented that it is very likely each of the ex-directors would have been aware of the false representations (if indeed those representations are found to be made) and thus it would be unlikely for Forge Group to be found liable and for the ex-directors not to be. This (preliminary) finding of Foster J is important as Forge Group's directors and officers insurance policy (D&O Policy) would likely only cover the ex-directors' liability were both Forge Group and the ex-directors found liable.

In light of this, Foster J was critical of Rushleigh's motivation for continuing to proceed with the claim against Forge Group, as even if it was successful, Forge Group would likely be unable to pay. Foster J stated that he suspected Rushleigh's real motivation was to make discovery on Forge Group in the hopes that such discovery would assist Rushleigh in its claim against the ex-directors. Unsurprisingly, Foster J dis not consider this to be sufficient reason to grant leave to proceed against Forge Group. His Honour refused to grant leave under s. 500(2) and determined that Rushleigh must pay Forge Group's costs in defending the action. The second and third defendants did not bring arguments against Rushleigh's application for leave and thus no costs were awarded to them.

Application to transfer proceedings dismissed

In applying to transfer the entire proceedings to the Supreme Court of New South Wales, Rushleigh hoped to avoid being negatively affected by the application of s. 6 of the Law Reform (Miscellaneous Provisions) Act 1946 No. 33 (NSW). Section 6 relates to the payment of insurance monies to indemnify an insured person against liability they incur. Subsection 6(3) provides that where there are multiple claims on the same insurance policy, the claim that arises first in time must be paid out first.

At the same time as this case was being heard, another proceeding regarding the Forge Group insolvency was before the Supreme Court of New South Wales. That proceeding had the potential also to result in a charge on the D&O Policy. Rushleigh was concerned that if that case was decided before the substantive proceedings in the present case, Rushleigh would rank second in terms of claims on the D&O Policy and likely receive nothing. To avoid this Rushleigh requested that the proceedings be transferred to the Supreme Court of New South Wales such that the substantive case could be managed in conjunction with the other proceeding. Rushleigh argued that it was in the interests of justice for the cases to be heard together so that any successful claims on the D&O Policy would rank equally.

Foster J noted that the Court has the discretion to transfer proceedings to another jurisdiction where, in the interests of justice, it considers that it is appropriate to do so. However, Foster J did not agree with Rushleigh's view that transferring the entire proceedings was in the interests of justice. This was primarily because his Honour was not persuaded that there was any real likelihood the Supreme Court of New South Wales would case manage the two proceedings for Rushleigh's benefit. Further, Foster J noted that if such case management did occur, it would be unfair to Mr Hutchinson (one of the ex-directors of Forge Group) as he would have to endure the length and expense of the original Supreme Court proceeding to which he was not a defendant. Finally, his Honour noted that there was nothing preventing Rushleigh from commencing a separate proceeding against the ex-directors in New South Wales.

Foster J rejected Rushleigh's interlocutory application to transfer the proceedings and ordered Rushleigh to pay costs to Mr Hutchinson, who was the only defendant to defend the application.

6.12 Keeping it in the family: sharing confidential information among family members constitutes a breach of insider trading laws in the United States

(By Ellen Williams, King & Wood Mallesons)

Salman v United States [2016] 580 US, Supreme Court of the United States, Alito J delivering the opinion of the Court, 6 December 2016

Summary

For the first time in nearly 20 years, the Supreme Court of the United States (Court) has considered an insider trading case. Having granted a writ of certiorari, the Court confirmed that, when considering whether insider trading has occurred, a "gift" of inside information to a close friend or relative will be regarded as a personal benefit to the discloser of the information. In doing so, the Court unanimously upheld their previous decision in *Dirks v Securities and Exchange Commission 463 US 646 (1983)* (Dirks) and clarified the uncertainty created by the 2014 decision of the United States Court of Appeals for the Second Circuit (Second Circuit) in United States v Newman [2014] 773 F.3d 438 (Newman).

Facts

An investment banker employed by Citigroup gave inside information to his brother, who both traded on it, and also passed it on to his brother-in-law, Salman. Salman traded on the information whilst knowing that it was not publicly available, and that it had ultimately come from the investment banker. The investment banker and brother were both convicted of insider trading, however Salman argued that he was not guilty as his brother-in-law had not benefited from disclosing the inside information to him.

Decision

Insider trading in the United States under Dirks

Dirks is the seminal case regarding insider trading laws in the United States. It established the following key principles:

- a person with access to a company's inside information owes a fiduciary duty to the company and its shareholders to not exploit their knowledge of that information for a personal benefit;
- if the person with access to inside information (the "tipper") discloses that information to a third party (the "tippee"), the tippee will acquire a fiduciary duty to the company and its shareholders only if the tippee has knowledge that the tipper had improperly disclosed the information in breach their fiduciary duty to the company and its shareholders;
- the tipper will only breach their fiduciary duty to the company and its shareholders if they have personally benefitted from disclosing the information to the tippee. Such a personal benefit may be indirectly obtained, and may include a "pecuniary gain or a reputational benefit that will translate into future earnings"; and
- a "gift of confidential information to a trading relative or friend" is a sufficient personal benefit to constitute a breach of fiduciary duty by the tipper so as to invoke the fiduciary duty of non-disclosure in the tippee.

Uncertainty created by Newman

In Newman, the Second Circuit drew upon Dirks by stating that for a tippee to be aware that the tipper has breached its fiduciary duty of non-disclosure, the tippee must "[know] the information was confidential and divulged for personal benefit".

However, the Second Circuit then expanded on the principles established in Dirks. It added a new test which provided that a personal benefit must be "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similar valuable nature". Further, in contrast to the Dirks decision, the Second Circuit noted that a personal benefit cannot be inferred "by the mere act of friendship", and instead must be established through "proof of a meaningfully close relationship that generates an exchange that is objective, consequential, and that represents at least a potential gain of a pecuniary or similarly valuable nature". In adding this new pecuniary benefit test, the Second Circuit created some uncertainty surrounding situations where a tipper gives information to a trading friend or relative.

Restoring the authority of Dirks

Salman did not contest that he had traded on the inside information which he received from his brother-in-law, but instead argued in the United States Court of Appeals for the Ninth Circuit (Ninth Circuit) that his brother-in-law had not breached his fiduciary duty of non-disclosure as he had gratuitously disclosed the inside information, and therefore did not receive a personal benefit. He argued that this did not meet the pecuniary benefit test espoused by the Second Circuit in Newman.

The Court unanimously upheld the decision from the Ninth Circuit in finding that this case involved "precisely the 'gift of confidential information to a trading relative' that Dirks envisioned" and, as such, that Salman was guilty of insider trading. It noted that a gift of information to a trading relative or friend allows the jury to "infer that the tipper meant to provide the equivalent of a cash gift", and that a gift of information is equivalent to the tipper trading on the information themselves, then gifting the proceeds.

Unanswered questions

While Salman clarifies that the giving of information to a family member or friend will constitute sufficient personal benefit to be found guilty of insider trading, the Court left a number of questions outstanding, including whether a gift of information to anyone would be a benefit to the tippee, how close the friendship must be to justify prosecution, or whether the presumption to which the prosecution is entitled - that sufficient personal benefit is met where the information is gifted to a family member or friend - may be rebutted by evidence to show that no value was in fact received.

7. Contributions

If you would like to contribute an article or news item to the Bulletin, please email it to: law-cclsr@unimelb.edu.au.

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