Ian Ramsay

From: SAI Global Information Services <corporatelawbulletin@saiglobal.com>
Sent: Monday, June 24, 2019 5:46 PM
To: Ian Ramsay
Subject: SAI Global Corporate Law Bulletin No. 262

SAI GLOBAL

24 June 2019 > Regulatory Newsfeed

SAI Global Corporate Law Bulletin No. 262>

Index

info.regulatory@saiglobal.com

Bulletin No. 262

Editor: Professor Ian Ramsay, Director, Centre for Corporate Law

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

1. Recent Corporate Law and Corporate Governance Developments
2. Recent ASIC Developments
3. Recent ASX Developments
4. Recent Takeovers Panel Developments
5. Recent Research Papers
6. Recent Corporate Law Decisions
7. Previous editions of the Corporate Law Bulletin

Legislation Hotline

> WHAT'S NEW
> MODIFY MY NEWSFEEDS
> SEARCH NEWSFEED ARCHIVE
> RELEVANT STANDARDS
> SEARCH LEGISLATION
> ABOUT LEGISLATIVE ALERT
> MORE SERVICES
> ABOUT SAI GLOBAL

Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

- 1.1 APRA responds to first phase of consultation on revisions to ADI capital framework
- 1.2 OECD publishes Corporate Governance Factbook 2019
- 1.3 FSB report considers implications of decentralised financial technologies
- 1.4 SEC adopts rules and interpretations to enhance protections for retail investors in their relationships with financial professionals
- 1.5 Taskforce on climate-related financial disclosures: 2019 status report
- 1.6 Emerging market regulators issue recommendations related to sustainable finance
- 1.7 CPMI and IOSCO publish for public comment a paper on CCP auctions
- 1.8 CDP report: World's biggest companies face US$1 trillion in climate change risks
- 1.9 Governance Institute remuneration survey
- 1.10 IOSCO and FSB examine regulatory-driven market fragmentation
- 1.11 Risk management survey
- 1.12 FSB reports on work underway to address crypto-asset risks
- 1.13 Consultation into the effectiveness of board evaluations for listed companies
- 1.14 PwC releases Australia's first balanced scorecard on audit quality
- 1.15 FSB publishes peer review of implementation of the Legal Entity Identifier
- 1.16 IOSCO requests feedback on key considerations for regulating crypto-asset trading platforms
- 1.17 FSB launches evaluation of too-big-to-fail reforms
- 1.18 FESE Blueprint: 'Capital markets union by 2024 - A vision for Europe'

2. Recent ASIC Developments

- 2.1 Approval of AFCA Rules change for legacy complaints
- 2.2 Major financial reporting changes and other focuses
- 2.3 Guidance to licensees to protect against share sale fraud
- 2.4 Amendment of relief conditions for superannuation and retirement calculators
- 2.5 Consultation on proposals to maintain investor protections by restricting retail offers of 'stub-equity' in control transactions
- 2.6 Market integrity report
- 2.7 Updated information for businesses on ICOs and crypto-assets

3. Recent ASX Developments

- 3.1 Amendments to the ASX 24 Operating Rules
- 3.2 Monthly Activity Report

4. Recent Takeovers Panel Developments

- 4.1 Aguia Resources Limited - Declaration of unacceptable circumstances, orders and undertaking

5. Recent Research Papers

- 5.1 Global cryptoasset regulatory landscape study
- 5.2 Bankruptcy as bailout: Coal company insolvency and the erosion of federal law

5.3 Network-sensitive financial regulation
5.4 Regulating substance through form: Lessons from the SEC's plain English initiative
5.5 The business case for ESG
5.6 Exercising the 'Governance Option': Labour's new push to reshape financial capitalism

6. Recent Corporate Law Decisions

6.1 Liability for involvement in company's disclosure breaches
6.2 Unfair to chair: Management of director interests in schemes of arrangement
6.3 Inter-party correspondence and agreements to arbitrate
6.4 Court orders compensation to be paid by directors for insolvent trading pursuant to s. 588M of the Corporations Act 2001
6.5 Court provides guidance on factors to be considered in 'beauty parades' in competing class actions
6.6 Good faith and collateral purposes in the context of a derivative action
6.7 Principal or interest? The nature of funds recovered via litigation during liquidation
6.8 Spent convictions and banning orders
6.9 Court upholds litigation funding agreement based on statutory assumptions in the Corporations Act 2001
6.10 Application for leave to bring shareholder derivative action

1. Recent Corporate Law and Corporate Governance Developments

1.1 APRA responds to first phase of consultation on revisions to ADI capital framework

12 June 2019 - The Australian Prudential Regulation Authority (APRA) has released its response to the first round of consultation on proposed changes to the capital framework for authorised deposit-taking institutions (ADIs).

The package of proposed changes, first released in February 2018, flows from the finalised Basel III reforms, as well as the Financial System Inquiry recommendation for the capital ratios of Australian ADIs to be 'unquestionably strong'.

ADIs that already meet the 'unquestionably strong' capital targets that APRA announced in July 2017 should not need to raise additional capital to meet these new measures. Rather, the measures aim to reinforce the safety and stability of the ADI sector by better aligning capital requirements with underlying risk, especially with regards to residential mortgage lending.

APRA received 18 industry submissions to the proposed revisions, and released a Response Paper, as well as drafts of three updated prudential standards:

- *APS 112 Capital Adequacy: Standardised Approach to Credit Risk*;
- the residential mortgages extract of *APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk*; and
- *APS 115 Capital Adequacy: Standardised Measurement Approach to Operational Risk*.

The Response Paper details revised capital requirements for residential mortgages, credit risk and operational risk requirements under the standardised approaches, as well as a simplified capital framework for small, less complex ADIs. Other measures proposed in the February 2018

Discussion Paper, as well as improvements to the transparency, comparability and flexibility of the ADI capital framework, will be consulted on in a subsequent response paper due to be released in the second half of 2019.

After taking into account both industry feedback and the findings of a quantitative impact study, APRA is proposing to revise some of its initial proposals, including:

- for residential mortgages, some narrowing in the capital difference that applies to lower risk owner-occupied, principal-and-interest mortgages and all other mortgages;
- more granular risk weight buckets and the recognition of additional types of collateral for SME lending, as recommended by the Productivity Commission in its report on Competition in the Financial System; and
- lower risk weights for credit cards and personal loans secured by vehicles.

The latest proposals do not, at this stage, make any change to the Level 1 risk weight for ADIs' equity investments in subsidiary ADIs. This issue has been raised by stakeholders in response to proposed changes to the capital adequacy framework in New Zealand. APRA has been actively engaging with the Reserve Bank of New Zealand on this issue, and any change to the current approach will be consulted on as part of APRA's review of *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* later this year.

APRA's consultation on the revisions to the ADI capital framework is a multi-year project. APRA expects to conduct one further round of consultation on the draft prudential standards for credit risk prior to their finalisation. It is intended that they will come into effect from 1 January 2022, in line with the Basel Committee on Banking Supervision's internationally agreed implementation date. An exception is the operational risk capital proposals for ADIs that currently use advanced models: APRA is proposing these new requirements be implemented from the earlier date of 1 January 2021.

Copies of the Response Paper and draft prudential standards are available on APRA's website.

1.2 OECD publishes Corporate Governance Factbook 2019

11 June 2019 - The Organisation for Economic Co-operation and Development (OECD) has published its 2019 Corporate Governance Factbook (the Factbook). The Factbook was accompanied by a special report to the G20 on implementation of the G20/OECD Principles of Corporate Governance.

The OECD Factbook provides up-to-date information about the institutional, legal and regulatory frameworks for corporate governance across 49 jurisdictions worldwide.

The Factbook complements the G20/OECD *Principles of Corporate Governance* and can be used by governments, regulators and the private sector to compare their own frameworks with those of other countries and also to obtain information on practices in specific jurisdictions.

The Factbook is divided into five main areas:

- the corporate and market landscape;
- the corporate governance and institutional framework;
- the rights and equitable treatment of shareholders and key ownership functions;

- the corporate board of directors; and
- mechanisms for flexibility and proportionality in corporate governance.

The Factbook covers 49 jurisdictions, including all 36 OECD countries as well as Argentina, Brazil, China, Colombia, Costa Rica, Hong Kong (China), India, Indonesia, Malaysia, Russian Federation, Saudi Arabia, Singapore and South Africa.

1.3 FSB report considers implications of decentralised financial technologies

6 June 2019 - The Financial Stability Board (FSB) has published a report on Decentralised financial technologies. This report considers the financial stability, regulatory and governance implications of the use of decentralised financial technologies such as those involving distributed ledgers and online peer-to-peer, or user-matching, platforms.

The report has been delivered to G20 Finance Ministers and Central Bank Governors for their meeting in Fukuoka on 8-9 June 2019, which includes a High-Level Seminar on Financial Innovation.

The report focuses on technologies that may reduce or eliminate the need for intermediaries or centralised processes that have traditionally been involved in the provision of financial services. Such decentralisation generally takes one of three broad forms: the decentralisation of decision-making, risk-taking or record-keeping. There are already examples emerging of decentralisation in payments and settlement, capital markets, trade finance and lending.

The report notes that the application of decentralised financial technologies - and the more decentralised financial system to which they may give rise - could benefit financial stability in some ways. It may also lead to greater competition and diversity in the financial system and reduce the systemic importance of some existing entities. At the same time, the use of decentralised technologies may entail risks to financial stability. These include the emergence of concentrations in the ownership and operation of key infrastructure and technology, as well as a possible greater degree of procyclicality in decentralised risk-taking. New uncertainties concerning the determination of legal liability and consumer protection may also affect public trust in the financial system. Recovery and resolution of decentralised structures may be more difficult.

These issues may pose challenges for financial regulatory and supervisory frameworks, particularly those that currently focus on centralised financial institutions. A more decentralised financial system may reinforce the importance of an activity-based approach to regulation, particularly where it delivers financial services that are difficult to link to specific entities and/or jurisdictions. Certain technologies may also challenge the technology-neutral approach to regulation taken by some authorities.

1.4 SEC adopts rules and interpretations to enhance protections for retail investors in their relationships with financial professionals

5 June 2019 - The US Securities and Exchange Commission (SEC) has voted to adopt a package of rulemakings and interpretations designed to enhance the quality and transparency of retail investors' relationships with investment advisers and broker-dealers, bringing the legal requirements and mandated disclosures in line with reasonable investor expectations, while preserving access (in terms of choice and cost) to a variety of investment services and products. Specifically, these actions include new *Regulation Best Interest*, the new *Form CRS Relationship Summary*, and two separate interpretations under the *Investment Advisers Act of 1940* (the Advisers Act).

Individually and collectively, these actions are designed to enhance and clarify the standards of conduct applicable to broker-dealers and investment advisers, help retail investors better understand and compare the services offered and make an informed choice of the relationship best suited to their needs and circumstances, and foster greater consistency in the level of protections provided by each regime, particularly at the point in time that a recommendation is made.

Under *Regulation Best Interest*, broker-dealers will be required to act in the best interest of a retail customer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. Regulation Best Interest will enhance the broker-dealer standard of conduct beyond existing suitability obligations and make it clear that a broker-dealer may not put its financial interests ahead of the interests of a retail customer when making recommendations.

The *Form CRS Relationship Summary* will require registered investment advisers and broker-dealers to provide retail investors with simple, easy-to-understand information about the nature of their relationship with their financial professional. While facilitating layered disclosure, the format of the relationship summary allows for comparability among the two different types of firms in a way that is distinct from other required disclosures. Form CRS will also include a link to a dedicated page on the Commission's investor education website, Investor.gov, which offers educational information about broker-dealers and investment advisers, and other materials.

The Commission also issued an interpretation to reaffirm and, in some cases, clarify the Commission's views of the fiduciary duty that investment advisers owe to their clients under the Advisers Act. The interpretation reflects how the Commission and its staff have applied and enforced the law in this area, and inspected for compliance, for decades. By highlighting principles relevant to the fiduciary duty, investment advisers and their clients will have greater clarity about advisers' legal obligations.

Finally, the Commission issued an interpretation of the "solely incidental" prong of the broker-dealer exclusion under the Advisers Act, which is intended to more clearly delineate when a broker-dealer's performance of advisory activities causes it to become an investment adviser within the meaning of the Advisers Act. This interpretation confirms and clarifies the Commission's position, and illustrates the application in practice in connection with exercising investment discretion over customer accounts and account monitoring.

Regulation Best Interest and *Form CRS Relationship Summary* will become effective 60 days after they are published in the Federal Register, and will include a transition period until 30 June 2020 to give firms sufficient time to come into compliance. SEC interpretations under the Advisers Act will become effective upon publication in the Federal Register.

View:

- Final Rule - Regulation Best Interest
- Final Rule - Form CRS Relationship Summary and Form ADV Amendments

- Commission Interpretation - Standard of Conduct for Investment Advisers
- Commission Interpretation - Broker-Dealer Exclusion

1.5 Taskforce on climate-related financial disclosures: 2019 status report

5 June 2019 - The Task Force for Climate-related Financial Disclosures (TCFD) has published its second status report. The Status Report provides an overview of the extent to which companies in their 2018 reports included information aligned with the core TCFD recommendations published in June 2017.

To better understand current climate-related financial disclosure practices and how they have evolved, the Task Force reviewed reports for over 1,100 companies from 142 countries in eight industries over a three-year period. In addition, the Task Force conducted a survey on companies' efforts to implement the TCFD recommendations as well as users' views on the usefulness of climate-related financial disclosures for decision-making. While the Task Force found some of the results of its disclosure review and survey encouraging, it has concerns that not enough companies are disclosing decision-useful climate-related financial information.

The Task Force reviewed financial filings, annual reports, integrated reports, and sustainability reports.

It found that:

- disclosure of climate-related financial information has increased since 2016, but is still insufficient for investors;
- more clarity is needed on the potential financial impact of climate-related issues on companies;
- of companies using scenarios, the majority do not disclose information on the resilience of their strategies;
- mainstreaming climate-related issues requires the involvement of multiple functions.

The FSB has asked the TCFD to deliver another status report to the FSB in September 2020. The TCFD will undertake further work during the course of the next year to promote and monitor adoption of the TCFD recommendations.

The Task Force is considering additional work to:

- clarify elements of the TCFD's supplemental guidance;
- develop process guidance around how to introduce and conduct climate-related scenario analysis; and
- identify business-relevant and accessible climate-related scenarios.

1.6 Emerging market regulators issue recommendations related to sustainable finance

5 June 2019 - Securities regulators from growth and emerging markets have published a report that sets forth recommendations related to the development of sustainable finance in emerging markets and the role of securities regulators in this area.

The International Organization of Securities Commissions (IOSCO) Growth and Emerging Market Committee (GEMC) has published the report Sustainable finance in emerging markets and the role of securities regulators, which provides 10 recommendations for emerging market member jurisdictions to consider when issuing regulations or guidance regarding sustainable financial instruments. Among other things, the recommendations include requirements for reporting and disclosure of material Environmental, Social and Governance (ESG) specific risks, aimed at enhancing transparency.

The report explores the trends and challenges that influence the development of sustainable finance in emerging capital markets. It also provides an overview of the initiatives that regulators, stock exchanges, policy makers and others key stakeholders in emerging markets have undertaken in this area. The report identifies the pre-requisites for creating an ecosystem that facilitates sustainable finance, such as an appropriate regulatory framework and fit-for-purpose market infrastructure, reporting and disclosure requirements, governance and investor protection guidelines and mechanisms to address needs and requirements of institutional investors.

The recommendations fall into the following categories:

- integration by issuers and regulated entities of ESG-specific issues in their overall risk assessment and governance (Recommendation 1);
- integration by institutional investors of ESG-specific issues into their investment analysis, strategies and overall governance (Recommendation 2);
- ESG-specific disclosures, reporting and data quality (Recommendation 3);
- definition and taxonomy of sustainable instruments (Recommendation 4);
- specific requirements regarding sustainable instruments (Recommendations 5 to 9); and
- building capacity and expertise for ESG issues (Recommendation 10).

1.7 CPMI and IOSCO publish for public comment a paper on CCP auctions

5 June 2019 - The Committee on Payments and Market Infrastructures (CPMI) and IOSCO have published for public comment A discussion paper on central counterparty default management auctions (the Discussion Paper).

Central counterparties (CCPs) have become increasingly critical components of the financial system in recent years, due in part to the introduction of mandatory clearing for standardised over-the-counter (OTC) derivatives in some jurisdictions. Consistent with the key responsibility of guaranteeing the fulfilment of transactions to their clearing participants, CCPs play an important role in mitigating contagion in the event of a participant default. A CCP's ability to effectively manage a default is essential to its resilience and can help reduce systemic risk.

A default management auction is one of the tools that a CCP may use to transfer a defaulting participant's positions to a non-defaulting participant, thereby restoring the CCP to a matched book. In response to the public consultation that resulted in the revised report on Recovery of financial market infrastructures (2017), CPMIIOSCO agreed that follow-up work should be conducted in the area of CCPs' default management auctions.

The Discussion Paper focuses on five key aspects of a CCP's default management auctions:

- governance;
- considerations for a successful default management auction;
- operational considerations;
- client participation; and
- default of a common participant across multiple CCPs.

1.8 CDP report: World's biggest companies face US$1 trillion in climate change risks

4 June 2019 - A group of the world's biggest companies representing nearly US$17 trillion in market capitalization have valued the climate risks to their businesses at almost US$1 trillion. This is revealed in a new report published by CDP, which runs the global disclosure system for environmental information.

Over 80% see major climate impacts, including extreme weather patterns, rising global temperatures and increased pricing of greenhouse gas emissions. Around US$500 billion of costs are rated as likely to be virtually certain, with higher operating costs linked to legal and policy changes making up a significant risk.

Companies report potential US$250 billion in losses due to stranded assets - these include fossil fuel assets that may no longer offer economic returns as a result of market shifts associated with the transition to a low-carbon economy, or companies that are significantly exposed to the physical impacts of climate change.

The group also reported cumulative gains from realising business opportunities related to climate change at US$2.1 trillion, with the majority on track as almost certain. These opportunities include increased revenue through demand for low emissions products and services (such as electric vehicles), shifting consumer preferences and increased capital availability as financial institutions increasingly favour low-emissions producers.

On average, the potential value of climate-related opportunities is almost 7 times the cost of achieving them (US$ 311 billion in costs, US$ 2.1 trillion in opportunities). Given this, investors and stakeholders could expect to see a significant shift in climate-friendly products and services from the world's largest companies.

Companies in the financial sector see the most potential revenue (US$ 1.2 trillion) from potential new sustainable products and services, followed by manufacturing (US$ 338 billion), services (US$ 149 billion), fossil fuels (US$ 141 billion) and the food, beverage and agriculture industries (US$ 106 billion).The vast majority of risks are also concentrated in the financial services industry - the sector reported almost 80% of all financial risk value.

Other key findings from the report include that:

- only half of the fossil fuel companies in the Global 500 provided any financial figures for the substantive risks and opportunities identified; and
- power companies represent one of the few industries where the costs to manage risks, or realize opportunities, outweigh their impact on the business. Disclosures centred around the substantial costs associated with updating existing power plant infrastructure.

The full report covers 6,937 companies who reported data to CDP in 2018, including a sample based on the 500 biggest global companies by market cap, 366 of which reported to CDP. It analyzes the risks and opportunities related to climate change reported by companies in 2018 in line with the recommendations from the Task Force on Climate-related Financial Disclosures (TCFD).

CDP has committed to align its information requests with the TCFD, which will help drive the adoption of TCFD recommendations by reporting companies.

1.9 Governance Institute remuneration survey

4 June 2019 - The Governance Institute of Australia (GIA), in partnership with McGuirk Management Consultants (MMC), have released the results of its seventh annual Australian Board Remuneration Survey report. While remuneration is up for board chairs and directors across the board, it is down for Financial and Insurance sector organisations.

Overall, across all industries and organisation types, chairs and directors saw average remuneration grow by 3% and 4% respectively. However, ASX200 respondents saw a 7% and 1% decline on average remuneration for chairs and directors.

When analysing by industry, Financial and Insurance respondents stood out, with 11% drops for both their chairs and their directors (after 11% increases the year prior). The drop was similar for Financial and Insurance Industry executives, as Managing Directors and CEOs saw their pay packets drop by 10% and 21% respectively. This is after all these roles, except CEO, saw large increases in 2017-2018.

One third of all the Boards across the survey increased their board remuneration last year. 32% of ASX boards saw an increase (up from 30% in 2018), 40% of unlisted businesses, 28% of not-for-profit boards and 28% of private company boards.

The average annual package for company secretaries at Financial and Insurance companies was $205,393 (a 24% increase), but it dropped amongst organisations overall (down 7% to $165,263).

The 2019 Australian Board Remunerations Survey is based on remuneration data covering 1,545 boards, and is current to the year ending 30 June 2019. GIA and MMC collected data from 779 online contributors, 377 boards who are ongoing contributors to the survey, and a further 390 client boards of MMC.

1.10 IOSCO and FSB examine regulatory-driven market fragmentation

4 June 2019 - The IOSCO Board has published a report that examines instances of regulatory-driven fragmentation in wholesale securities and derivatives markets and considers what actions regulators can take to minimize its adverse effects.

The report, titled Market Fragmentation and Cross-border Regulation, focuses on market fragmentation that arises as an unintended consequence of financial regulation. It provides examples of market fragmentation that IOSCO members consider to be significant and potentially harmful to the oversight and supervision of financial markets.

The report also examines the progress made by IOSCO members in using deference, and the regulatory mechanisms and tools associated with this concept (e.g., passporting, substituted compliance, recognition/equivalence). In doing so, the report follows up on a 2015 IOSCO report on cross-border regulation and seeks to identify remaining challenges that can restrict cross-border activities.

Regulators have become increasingly aware of the risks associated with unintended market fragmentation and are cooperating more among themselves to mitigate its effects through deference and its associated tools. Bilateral arrangements in the form of MoUs continue to be a common tool used by regulators, particularly with respect to information exchanges. Regulators also have developed novel processes to work multilaterally to the benefit of the markets they oversee. Nevertheless, several challenges remain and strengthening cooperation between authorities could further assist in addressing adverse effects on the financial system stemming from market fragmentation.

The report proposes potential measures that IOSCO and relevant national authorities could explore to mitigate the risk, and potential adverse effects, of fragmentation on global securities markets. These measures include ways to foster further mutual understanding of one another's legislative frameworks, deepen existing regulatory and supervisory cooperation and consider whether there are any good or sound practices that can be identified regarding deference tools. The IOSCO Board will decide on its approach to these next steps in the second half of this year.

The Financial Stability Board (FSB) also published a report on market fragmentation and identified several areas for further work to address it. The report looks at some examples of financial activities where supervisory practices and regulatory policies may give rise to market fragmentation. It discusses potential trade-offs that authorities have considered between the benefits of increased cross-border activity and a need to tailor domestic regulatory frameworks to local conditions and mandates.

The areas the report examines are:

- the trading and clearing of OTC derivatives across borders;
- banks' cross-border management of capital and liquidity; and
- the sharing of data and other information internationally.

The report lays out approaches and mechanisms that may enhance the effectiveness and efficiency of international cooperation, and help to mitigate any negative effects of market fragmentation on financial stability.

1.11 Risk management survey

31 May 2019 - The GIA has released its 2019 Risk Management Survey, which saw nearly 500 Australian risk managers and governance leaders provide their insights into the challenges facing their organisations, both now and into the future.

Almost unanimously across all respondents, regardless of industry, organisation size and job title, 'Regulatory Reform/Legislative Change' was chosen as the top risk both across the next 12 months, and the next three to five years.

Damage to Brand or Reputation (#2), Increased Competition (#3), Talent Attraction/Retention (#4) and Cyber-crime (#5) followed to round out the top five risks facing Australian organisations over the next 12 months.

In the context of the recent Federal and State Elections, respondents ranked risks such as Political Instability (#8), Environmental Risk/Sustainability (#11), and Economic Shock (#7) further down in their priorities over the next 12 months, and in 3-5 years.

When asked to score their organisation's current preparedness, again Regulatory/Legislative change topped the list, followed by Professional Liability, Staff Conduct, Damage to Brand and Reputation and Business Continuity.

Talent Retention/Attraction ranked last in terms of current preparedness (average of 5.8/10) and was followed closely by 'Disruption/Failure to Innovate' (6/10) highlighting the competitive pressures local companies are feeling from multi-national giants, such as Amazon, Apple, Google and Facebook. Disruption jumps to #2 in the 3-5 year risk rankings.

While respondents felt that Risk Management was highly valued by their organisations (70% agreed/strongly agreed), the need for 'better tools and resources' (29%) to manage risk and 'clarity of purpose and strategy' (23%) from senior leadership were key areas of concern.

Additional survey information:

- 499 respondents, surveyed from 3 April to 3 May 2019;
- Seniority: 38% Senior Governance/Risk Managers, 21% C-Suite. 27% lead the risk management team in their organisation;
- Organisation revenue: 39% of organisations surveyed had revenue over $100 million, 45.4% $1 - $100 million;
- Top five industries: Financial Services (20%), Healthcare (17%), Education (15%), Professional and Technical Services (11%), Public Sector (11%); and
- 31% operate in other countries, as well as Australia.

1.12 FSB reports on work underway to address crypto-asset risks

31 May 2019 - The FSB has published a report on crypto-assets, which considers work underway, regulatory approaches and potential gaps.

International organisations are working on a number of fronts, directly addressing issues arising from crypto-assets. As described in the report, they are mainly focused on investor protection, market integrity, anti-money laundering, bank exposures and financial stability monitoring. They are monitoring and analysing developments in these markets, setting supervisory expectations for firms and clarifying how international standards apply to crypto-assets.

The report notes that gaps may arise in cases where such assets are outside the perimeter of market regulators and payment system oversight. To some extent, this may reflect the nature of crypto-assets, which may have been designed to function outside established regulatory frameworks. Gaps may also arise from the absence of international standards or recommendations.

1.13 Consultation into the effectiveness of board evaluations for listed companies

29 May 2019 - The UK Governance Institute has opened a consultation into the effectiveness of independent board evaluation in the UK listed sector. The review, which is being carried out at the request of the Department of Business, Energy and Industrial Strategy, will assess the quality of evaluations and identify ways in which board evaluation might be improved.

The consultation is seeking views on whether there is a need for:

- a code of practice for the providers of board evaluation services, and formal arrangements for implementing and monitoring such a code;
- voluntary principles to be applied by listed companies when engaging external reviewers to undertake board evaluations; and
- guidance for listed companies on disclosure of the conduct and outcomes of their board evaluation, in accordance with the *2018 UK Corporate Governance Code*.

The consultation document can be viewed here.

1.14 PwC releases Australia's first balanced scorecard on audit quality

29 May 2019 - PwC Australia has released a balanced scorecard on audit quality, the first for an Australian firm, including the firm's individual Australian Securities and Investments Commission (ASIC) audit inspection results along with other key measures of audit quality such as internal inspection findings, restatement rates and adjustments to financial statements.

PwC's audit quality balanced scorecard includes the following:

ASIC audit inspection findings: Based on ASIC's most recent report (for the 18 months ended 30 June 2018) in 12% of the key audit areas that ASIC reviewed across PwC files, ASIC considered PwC did not obtain reasonable assurance that the financial report was free from material misstatement. This compares to 24% across the whole industry and 20% at the six largest firms in Australia.

PwC's global audit inspections: In the period between 2016-2018, no PwC Australia audits of publicly listed companies were rated as non-compliant with PwC's guidelines and auditing standards. In 2018, PwC global inspections identified that five sample files of smaller, private companies were not compliant with PwC standards. In no instance did this involve an inappropriate opinion being issued, but instead a need for improvement in how the audit work was performed and documented.

Restatements: In cases where audit findings were identified by ASIC or PwC internal inspections for public companies, between 2016 and 2018, there were no instances where the relevant financial statements needed to be restated to the market. This compares to an industry average of 4% based on ASIC's financial reporting surveillance program of public companies.

Adjustments: Before a company publishes its financial statements, it may make adjustments, or clarify or enhance it disclosures, as a result of an audit. This is a critical and important part of a quality audit process. In 2018 PwC identified on average six adjustments to the financial statements of listed companies - and ensured their appropriate treatment - before they were finalised and published.

Non-audit services and independence: The Corporations Act 2001 No. 50 (Cth) prohibits several types of services from being performed for a client by its external auditor and PwC has comprehensive internal policies in place to ensure PwC's independence is not impaired. The level of non-audit work at PwC audit clients in the ASX200 represents, on average, approximately 26% of audit fees over the past three years. This equates to less than 3% of total PwC Australia revenue in 2018.

1.15 FSB publishes peer review of implementation of the Legal Entity Identifier

28 May 2019 - The Financial Stability Board (FSB) has published a Thematic Review on Implementation of the Legal Entity Identifier (LEI).

The LEI is a 20-character, alpha-numeric code that was introduced following the financial crisis to be adopted globally, to uniquely identify legally distinct entities that engage in financial transactions.

Since its endorsement by the G20 in 2012, the Global LEI System has been successfully brought into operation, with over 1.4 million entities uniquely identified by an LEI in more than 200 countries. Most FSB jurisdictions have implemented rules mandating LEI use in at least one area. Adoption has been most successful when the LEI has been mandated by regulators as part of an international standard-setting effort or across multiple market segments. Widespread coverage has already been achieved in over-the-counter (OTC) derivatives and securities markets. In these areas, the LEI has come the closest to meeting the G20's objective to "encourage global adoption of the LEI to support authorities and market participants in identifying and managing financial risks".

The regulatory uses of the LEI are multiple and the benefits can be substantial. The LEI standardises identification of legal entities at the global level, to support the management and analysis of large datasets. Implementation of the LEI enhances regulators' surveillance by tracking market abuse across institutions, products and jurisdictions. The LEI can also assist regulators' and market participants' aggregation and more flexible retrieval of granular data on entities from multiple sources, as well as the analysis of counterparty risks, interconnectedness and complex group structures.

Notwithstanding this progress, the LEI has far to go to meet the G20's objective. Coverage is too low outside securities and derivatives markets to effectively support new industry or regulatory uses, or to reach a tipping point where voluntary take-up by market participants would suffice to propel further adoption. LEI adoption also remains uneven across jurisdictions, with coverage concentrated in Canada, the European Union (EU) and the United States. More efforts should be made both at national and international levels to promote LEI adoption and enhance the benefits to authorities and market participants from its use by addressing identified obstacles.

These obstacles include:

- the current business model, which does not clearly align the current benefits and costs of LEI use for participants;
- a lack of LEI coverage for so-called "Level 2" (relationship) data; and
- insufficient links with other (in particular, business registry) identifiers.

The report sets out four sets of recommendations to address the issues identified in the peer review and promote broader LEI adoption.

1.16 IOSCO requests feedback on key considerations for regulating crypto-asset trading platforms

28 May 2019 - The IOSCO Board is seeking comments on a consultation paper that describes the issues associated with crypto-asset trading platforms (CTPs) and sets forth key considerations to assist regulatory authorities in addressing these issues.

The development of crypto-assets is an important area of interest for regulatory authorities around the world. Accordingly, IOSCO has published the consultation report titled Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms, which describes the risks and issues that IOSCO has identified regarding CTPs. The report sets out key considerations that are intended to assist regulatory authorities in evaluating CTPs within the context of their regulatory frameworks.

The primary topics covered include:

- access to CTPs;
- safeguarding participant assets;
- conflicts of interest;
- operations of CTPs;
- market integrity;
- price discovery; and
- technology.

Many of the issues related to the regulation of CTPs are common to traditional securities trading venues, but may be heightened by how CTPs are operated. Where a regulatory authority has determined that a crypto-asset is a security and falls within its remit, the basic principles or objectives of securities regulation should apply. The report, therefore, sets out that the *IOSCO Principles and Methodology* provide useful guidance for regulatory authorities considering the identified issues and risks.

1.17 FSB launches evaluation of too-big-to-fail reforms

23 May 2019 - The FSB is seeking feedback from stakeholders as part of its evaluation of the effects of the too-big-to-fail (TBTF) reforms for banks that were agreed by the G20 in the aftermath of the global financial crisis. The evaluation will assess whether the implemented reforms are reducing the systemic and moral hazard risks associated with systemically important banks (SIBs). It will also examine the broader effects of the reforms to address TBTF for SIBs on the overall functioning of the financial system. More details on the evaluation can be found in the summary terms of reference.

The FSB invites feedback on the following issues:

- to what extent are TBTF reforms achieving their objectives as described in the terms of reference? Are they reducing the systemic and moral hazard risks associated with SIBs? Are they enhancing the ability of authorities to resolve systemic banks in an orderly manner and without exposing taxpayers to loss, while maintaining continuity of their economic functions?;
- which types of TBTF policies (e.g. higher loss absorbency, more intensive supervision, resolution and resolvability, other) have had an impact on SIBs and how?;
- is there any evidence that the effects of these reforms differ by type of bank (e.g. global vs domestic SIBs)? If so, what might explain these differences?;
- what have been the broader effects of these reforms on financial system resilience and structure, the functioning of financial markets, global financial integration, or the cost and availability of financing?;
- have there been any material unintended consequences from the implementation of these reforms to date?; and
- are there other issues relating to the effects of TBTF reforms that are not covered in the questions above and on which you would like to provide your views?

1.18 FESE Blueprint: 'Capital markets union by 2024 - A vision for Europe'

May 2019 - The Federation of European Securities Exchanges (FESE) has launched its FESE Blueprint: 'Capital Markets Union by 2024 - A vision for Europe' which sets out 20 Principles and Policy Recommendations on how to take the Capital Markets Union (CMU) forward.

In the context of the global challenges that the EU is facing, it is stated in the Blueprint that the EU must consider how to foster a deeper and more integrated European financial system while continuing to be open to global capital markets. The EU should aim at significantly increasing the size of equity financing in relative terms to GDP.

The recommendations are grouped under seven different themes, which are:

- regulatory initiatives;
- funding the economy and exploring how the EU can improve conditions for investors and companies;
- how to ensure fair and orderly equity market structure;
- assessing efficient risk management, specifically exchange traded derivatives (ETDs);
- new technologies;
- sustainable finance; and
- the pursuit of global competitiveness and access.

2. Recent ASIC Developments

2.1 Approval of AFCA Rules change for legacy complaints

18 June 2019 - ASIC has approved changes to the *Australian Financial Complaints Authority (AFCA) Rules* (the Rules) which give effect to the Australian Financial Complaints Authority (AFCA) authorisation condition introduced on 19 February 2019.

Under the additional condition, AFCA is required to give expanded access to the AFCA scheme for consumers and small businesses that were harmed by financial misconduct, dating back to 1 January 2008. AFCA will be able to deal with certain complaints about conduct by current member financial firms, which AFCA, its predecessor schemes, courts, or tribunals have not previously dealt with.

Consistent with the condition, AFCA's new Rules require that an eligible legacy complaint:

- relates to a compulsory member of the AFCA scheme who is a member of the AFCA scheme at the time the complaint is made;
- is not an excluded complaint; and
- is made during the lodgement period,1 July 2019 to 30 June 2020.

ASIC approved these Rules in accordance with legislative requirements in s. 1052D of the Corporations Act 2001 No. 50 (Cth), which require AFCA to seek ASIC approval of material changes to the AFCA scheme.

AFCA has also released updated *Operational Guidelines*, which give further guidance on how AFCA will deal with legacy complaints. The new jurisdiction, which covers complaints about conduct going back to 2008, may raise novel issues about how AFCA deals with complaints. If these issues require or necessitate material changes to the scheme, then ASIC will review these as part of its ongoing oversight role.

2.2 Major financial reporting changes and other focuses

17 June 2019 - Announcing its focus areas for 30 June 2019 financial reports of listed entities and other entities of public interest with many stakeholders, ASIC has called on companies to focus on new requirements that can materially affect reported assets, liabilities and profits.

Major new accounting standards will have the greatest impact on financial reporting for many companies since the adoption of International Financial Reporting Standards (IFRS) in 2005. Full-year reports at 30 June 2019 must comply with new accounting standards on revenue recognition and financial instrument values (including hedge accounting and loan loss provisioning). The reports must also disclose the future impact of new lease accounting requirements.

There are also new standards covering accounting by insurers and the definition and recognition criteria for assets, liabilities, income and expenses.

Directors and management must ensure that companies inform investors and other financial report users of the impact on reported results. Required disclosure on the effect of the new standards is more extensive than that made by many companies for the 31 December 2018 half year.

ASIC will be reviewing more than 200 full year financial reports at 30 June 2019 to promote quality financial reporting, and useful and meaningful information for investors.

More detailed information on focus areas for 30 June 2019 is provided on the ASIC website.

2.3 Guidance to licensees to protect against share sale fraud

17 June 2019 - ASIC has provided guidance for Australian financial services (AFS) licensees about how they can mitigate the risks to their clients and business of share sale fraud. Share sale fraud refers to the fraudulent activity of a person who is not who they claim to be, selling shares that do not belong to them.

ASIC has identified a rise in the instance of share sale fraud, primarily in connection with issuer-sponsored holdings and is providing guidance in Information Sheet 237 Protecting against share sale fraud (INFO 237) to AFS licensees who may be vulnerable to share sale fraud.

Specifically, INFO 237 provides guidance in relation to ASIC's expectations around licensees' management of:

- one-off share sales;
- customer due diligence;
- ongoing customer due diligence;
- intermediary clients;
- anti-money laundering and counter-terrorism financing (AML/CTF) training; and
- reporting of suspicious matters.

ASIC considers that robust account opening and customer due diligence practices can be effective in preventing fraudulent activity such as share sale fraud.

2.4 Amendment of relief conditions for superannuation and retirement calculators

5 June 2019 - ASIC has amended *ASIC Corporations (Generic Calculators) Instrument 2016/207* to ensure that estimates produced by superannuation and retirement calculators are adjusted for inflation.

The new requirements will commence on 5 December 2019 to provide calculator providers with a transition period of six months.

The amendments require superannuation and retirement calculator providers to adjust for inflation in estimates by using either:

- the default inflation rate set out in the instrument for superannuation and retirement calculators; or
- an alternative inflation rate, as long as certain disclosure requirements are met.

The default inflation rate set out in the instrument is the rate used by ASIC's MoneySmart superannuation and retirement calculators. It includes a component that reflects changes in the cost of meeting increases in community living standards. Adjusting for the cost of meeting increases in community living standards may assist users to better decide if future retirement assets or income will be adequate compared to their standard of living. ASIC will amend the instrument in June each year to reflect any changes in the default inflation rate used by ASIC's MoneySmart superannuation and retirement calculators. This rate is reviewed and updated annually.

The option of using an alternative inflation rate recognises that there may be instances where it is appropriate for a superannuation and retirement calculator to use a different inflation assumption - for example, to take into account:

- the wage profile of the likely users of the calculator; or
- the provider's wage growth outlook.

If the alternative inflation rate used does not include a component that reflects the cost of meeting increases in community living standards, the superannuation or retirement calculator must explain the implications of not taking into account the cost of meeting those increases.

Until commencement of the changes on 5 December 2019, superannuation and retirement calculators must disclose whether or not estimates take into account changes in the cost of living.

ASIC has also updated its existing guidance in *Regulatory Guide 167 Licensing: Discretionary Powers* (RG 167) to reflect the amendments to the legislative instrument.

View:

- RG 167
- ASIC Corporations (Generic Calculators) Instrument 2016/207
- ASIC Corporations (Amendment) Instrument 2019/514

2.5 Consultation on proposals to maintain investor protections by restricting retail offers of 'stub-equity' in control transactions

4 June 2019 - ASIC has issued a consultation paper seeking feedback on proposals to address concerns with offers of 'stub-equity' to retail investors in control transactions.

The proposals seek to restrict certain structures that would result in retail investors not being covered by the normal protections available under Australian law when participating in a broad offer of securities. This can occur when shares in a proprietary, rather than public, company are offered as consideration under a takeover bid or scheme of arrangement. It can also arise when scrip consideration is required to be held by a custodian. ASIC is concerned offers of consideration of this kind, often known as 'stub-equity', deny retail investors important rights.

As foreshadowed in 18-376MR, ASIC is proposing to execute a legislative instrument which will modify the law to address its concerns with offers of proprietary company scrip under a takeover bid or scheme of arrangement.

Since publication of 18-376MR, ASIC has also observed stub-equity offers of public company scrip on terms that mandate the use of nominee or custody arrangements or entry into securityholder agreements. Consequently, ASIC is also consulting on a proposal that the legislative instrument additionally seek to restrict such arrangements being used in a way that deprives investors of the protections they would otherwise have under the takeover and disclosing entity provisions.

2.6 Market integrity report

31 May 2019 - ASIC has released its latest report on market integrity for the period 1 July to 31 December 2018.

Key outcomes during the six-month period include:

- Criminal actions:
  - two individuals charged in criminal proceedings;
  - four criminal charges laid against two individuals; and
  - 1 individual found guilty of two charges;
- Civil outcomes:
  - $3.65 million in civil penalties;
  - three court enforceable undertakings; and
  - $15.5 million in community benefit payments; and
- Bannings and infringement notices:
  - two infringement notice issued;
  - $153,000 in infringement notices paid;
  - three individuals banned from providing financial services; and
  - two AFS licences cancelled.

The report looks at ASIC's recent focus on high-frequency trading, changes to reporting requirements, and enhanced supervision and onsite reviews. It also looks at some of ASIC's key activities over the last six months in areas such as bank bill swap rate (BBSW) surveillance, foreign exchange (FX) margin practices, and misleading initial coin offerings (ICOs) and crypto-asset funds.

ASIC's markets team will continue to focus on the following existing and emerging risks:

- conduct governance;
- technology risk and resilience; and
- effective capital markets.

2.7 Updated information for businesses on ICOs and crypto-assets

30 May 2019 - ASIC has released new information to help businesses involved with ICOs and crypto-assets consider their legal obligations and satisfy themselves they are operating lawfully.

ASIC has updated Information Sheet 225 Initial coin offerings and crypto-assets (INFO 225) based on ASIC's recent experiences with ICOs and crypto-assets, which indicate that ICOs and crypto-assets will often be financial products or involve financial products that are regulated under the Corporations Act.

INFO 225 provides information on how the Corporations Act 2001 No. 50 (Cth) may apply to businesses that are considering raising funds through an ICO and to businesses involved with crypto-assets.

---

3. Recent ASX Developments

3.1 Amendments to the ASX 24 Operating Rules

The Australian Securities Exchange (ASX) has made amendments to the *ASX 24 Operating Rules* to accommodate the new S&P/ASX 200 Gross Total Return futures contract.

The amendments, which are effective as of 3 June 2019, make changes to:

- Schedule 2.41;
- Procedures 2500.1, 3200.9-10, 4060, 4800 & 4820; and
- Appendix 2.41.

A notice is available on the ASX website.

Changes to the *ASX 24 Operating Rules* are available in mark-up on the ASX website.

3.2 Monthly Activity Report

On 5 June 2019, ASX released the ASX Monthly Activity Report for May 2019.

---

4. Recent Takeovers Panel Developments

4.1 Aguia Resources Limited - Declaration of unacceptable circumstances, orders and undertaking

31 May 2019 - The Takeovers Panel has made a declaration of unacceptable circumstances, final orders and accepted an undertaking in relation to an application dated 1 May 2019 by Aguia Resources Limited (Aguia) in relation to its affairs.

On or about 11 April 2019, Kemosabe Capital Pty Ltd, Henderson International Pty Limited and David Shearwood and Harry Shearwood as trustees for the David K. Shearwood DIY Superannuation Fund (Shearwood Trust) (together, the Requisitioning Shareholders) gave a notice under s. 249D of the Corporations Act 2001 (Cth) to requisition a meeting of Aguia shareholders to consider resolutions to remove and replace directors of Aguia. Two of the new directors nominated by the Requisitioning Shareholders were Ms Christine McGrath and Mr David Shearwood.

By reason of structural links and the exchange of correspondence, the Panel found the following persons were associated for the purpose of controlling or influencing the composition of the Aguia board:

- Richard McGrath, David Shearwood and Peter Curtis;
- the Requisitioning Shareholders;
- the Requisitioning Shareholders and Messrs McGrath, Shearwood and Curtis;
- David Buckland and Messrs McGrath, Shearwood and Curtis; and
- Christine McGrath and Messrs McGrath, Shearwood and Curtis.

The associates have not disclosed their respective voting power in Aguia shares, in contravention of s. 671B of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act.

The Panel considered that the circumstances were unacceptable:

- having regard to the purposes of Chapter 6 set out in s. 602 of the Corporations Act; or
- in the alternative, because they gave rise to a contravention of s. 671B of the Corporations Act.

The Panel has made orders requiring disclosure by way of a substantial holder notice. The Panel accepted an undertaking offered by Kemosabe that it will write to all of its clients that hold Aguia shares in relation to the requisition meetings.

The Panel will publish its reasons for the decision in due course on its website.

---

5. Recent Research Papers

5.1 Global cryptoasset regulatory landscape study

The first global comparative study of cryptoasset regulation by the Cambridge Centre for Alternative Finance provides a comprehensive, systematic, and comparative analysis of the current regulatory landscape of cryptoassets and related activities. The study covers 23 jurisdictions and is based on both desktop research and in-person interviews with regulators and policymakers.

The report aims to compare and contrast various regulatory approaches and practices with regards to cryptoassets in a number of jurisdictions and shed light on current regulatory challenges and opportunities. The study serves as a practical and analytical tool for regulators, market participants, and other stakeholders in the cryptoasset ecosystem.

Section 1 sets out a theoretical framework to conceptualise cryptoassets and related activities. It looks at three key aspects in a regulatory context: (1) the nature and form of cryptoassets, (2) the issuance of cryptoassets, and (3) intermediated activities in the life cycle of cryptoassets. A number of regulatory recommendations are proposed.

Section 2 provides a global comparative analysis of cryptoasset regulation in 23 jurisdictions. It examines regulatory authorities regulating cryptoassets, their current definition and classification of cryptoassets and related activities, as well as regulatory processes and responses (e.g. existing regulation, retrofitted regulation, bespoke regulation and bespoke regulatory regime).

Section 3 highlights some of the most salient challenges and potential gaps that stem from the development and implementation of cryptoasset regulation.

Section 4 consists of an in-depth analysis of cryptoasset regulations in 23 jurisdictions that constitute the backbone of the comparative analysis.

Global Cryptoasset Regulatory Landscape Study

5.2 Bankruptcy as bailout: Coal company insolvency and the erosion of federal law

Almost half of all the coal produced in the United States is mined by companies that have recently gone bankrupt. This Article explains how those bankruptcy proceedings have undermined federal environmental and labour laws. In particular, coal companies have used the Bankruptcy Code to evade congressionally imposed liabilities requiring that they pay lifetime health benefits to coal miners and restore land degraded by surface mining. Using financial information reported in filings to the Securities and Exchange Commission and in the companies' reorganization agreements, the authors show that between 2012 and 2017, four of the largest coal companies in the United States succeeded in shedding almost US$5.2 billion of environmental and retiree liabilities. Most of these liabilities were backed by federal mandates. Coal companies disposed of these regulatory obligations by placing them in underfunded subsidiaries that they later spun off. When the underfunded successor companies liquidated, the coal companies managed to get rid of their regulatory obligations without defaulting on the pecuniary debts they owed to their creditors. The authors conclude by arguing that many of the strategies coal companies have used to discharge these federal regulatory obligations are illegal.

Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law

---

5.3 Network-sensitive financial regulation

Shocks that hit part of the financial system, such as the subprime mortgage market in 2007, can propagate through a complex network of interconnections among financial and non-financial institutions. As the financial crisis of 2007-2009 has showed, the consequences for the entire economy of such systemic risk materializing can be catastrophic. Following the crisis, economists and policymakers have become increasingly aware that the structure of the financial system is a key determinant of systemic risk. A wide consensus now exists among them that network theory is the natural framework for studying systemic risk. Yet, most of the existing rules in financial regulation are still "atomistic," in that they fail to incorporate the fact that each individual institution is part of a wider network.

This article shows that policies building upon insights from network theory (network-sensitive policies) can address systemic risk more effectively than traditional atomistic policies also in areas where an atomistic approach would seem natural, such as the corporate governance of systemically important financial institutions. In particular, the authors consider four prescriptions for the governance of systemically important institutions (one on directors' liability, two on executive compensation and one on failing financial institutions' shareholders appraisal rights in mergers) and show how making them network-sensitive would both increase their effectiveness in taming systemic risk and better calibrate their impact on individual institutions.

Network-Sensitive Financial Regulation

5.4 Regulating substance through form: Lessons from the SEC's plain English initiative

Mandatory disclosure is an important piece of government regulation in many spheres, including securities offerings. Regulators recognize that the form of disclosure matters significantly for how well the substance is conveyed. Thus, regulators like the Securities Exchange Commission (SEC) that focus on disclosure spend time and energy thinking about form as well as substance. As the author explains and supports empirically in this Article, at least some of these "stylistic regulations" - regulations that govern the form of disclosure - can provide useful tools for improving how well substance is communicated, but at the same time, long-term compliance with these rules can be difficult to ensure. Using natural language processing methods, the author assesses compliance with the SEC's "plain English" regulations for new issuances, and investigate how well these regulations have worked over time. The author does so by creating a measure of plain English based on the SEC's rules. This measure of plain English goes beyond prior research, providing a more robust analysis of compliance with these rules and their potential effects Using a dataset of 2,255 initial public offering prospectuses and related documents, the author finds that the SEC's regulations increased the degree to which disclosure was written in "plain English," although the impact of the regulations has faded over time.

Regulating Substance Through Form: Lessons from the SEC's Plain English Initiative

---

5.5 The business case for ESG

Recently, there has been debate among corporate managers, board of directors, and institutional investors around how best to incorporate ESG (environmental, social, and governance) factors into strategic and investment decision-making processes. In this article, the authors ask:

- What is the investment horizon prevalent among most companies today?
- Do companies miss long-term opportunities because of a focus on short-term costs?
- How many companies have an opportunity to profitably invest in ESG solutions?
- What factors determine whether a company can profitably invest in ESG solutions?
- Can investors earn competitive risk-adjusted returns through ESG investments?
- If so, how widespread is this opportunity?

The Business Case for ESG

5.6 Exercising the 'Governance Option': Labour's new push to reshape financial capitalism

New forms of stockholder activism call into question longstanding assumptions underpinning our system of corporate governance. Scholarship has largely failed to explain the basis for these new forms and, in particular, the differences among activists. Activists are not one undifferentiated mass. Small activist hedge funds, as well as large union sponsored or influenced pension funds, both use governance mechanisms to influence corporate behaviour. Pension funds, however, have a different set of incentives than hedge funds. The beneficiaries of these funds cannot easily switch between consumption and investment by buying or selling their holdings in firms. Thus, instead, institutional investors exercise an embedded "governance option" found within shares of common stock to engage with firms. Organized labour, in particular, now uses its influence in pension funds to motivate progressive change by corporations. This form of activism has the potential to alter the balance of power between workers and capitalists in the era of financial capitalism.

Exercising the 'Governance Option': Labour's New Push to Reshape Financial Capitalism

---

6. Recent Corporate Law Decisions

6.1 Liability for involvement in company's disclosure breaches
(By Andrew Lumsden and Katrina Sleiman, Corrs Chambers Westgarth)

Australian Securities and Investments Commission v Vocation Limited (In Liquidation) [2019] FCA 807 (31 May 2019), Federal Court of Australia, Nicholas J

(a) Summary

The Federal Court of Australia has delivered judgment in civil penalty proceedings commenced by the Australian Securities and Investments Commission (ASIC) against Vocation Ltd (In Liquidation) (Vocation) and its officers, Mark Hutchinson (CEO), John Dawkins (Chairman), and Manvinder Gréwal (CFO). The proceedings related to various statements made to the Australian

Securities Exchange (ASX) and in documents relating to a fully underwritten placement to institutional and sophisticated investors in September 2014 and a review undertaken by the Victorian Department of Education and Early Childhood Development (DEECD) into Vocation's registered training organisations (RTOs).

In finding that the officers breached their statutory duty of care and diligence by causing or permitting Vocation to breach its obligations, the Court reiterated the limitations of an officer's reliance on others in the discharge of their statutory duty of care and diligence. The Court also provided further guidance on the test for knowing involvement in a breach of a company's continuous disclosure obligations.

(b) Facts

Vocation provided vocational education, training and assessment activities leading to accredited outcomes offered by RTOs. These activities were conducted by wholly owned subsidiaries, including BAWM Pty Ltd (BAWM) and Aspin Pty Limited. Vocation listed on the ASX in late 2013, giving it a market capitalisation of $378 million at first listing.

In 2013-2014, the vocational education and training sector was comprised of both government-run and privately-operated RTOs, funded primarily by the various governments through funding contracts. On 3 July 2014, DEECD wrote to BAWM regarding suspected breaches of BAWM's funding contract and advised it was withholding payment of all continuing funding until issues were resolved. On 24 July 2014, DEECD wrote to BAWM directing it to suspend new enrolments and commencement of delivery of training. On 5 August 2014, DEECD wrote to Aspin providing the same advice and direction. The total amount withheld from BAWM and Aspin was approximately $21 million. DEECD commenced a forensic audit of BAWM and Aspin, and specifically the delivery of three major courses for which they were claiming government funding.

On 21 August 2014, the day of Vocation's full-year results announcement, the company released a slide presentation to the ASX which maintained that its "current government support" in Victoria was "$1.2 billion of funding over the next three years", the lion's share of which was receivable by BAWM. On an investor call later that day, Gréwal was asked whether there had been any change to the BAWM funding arrangements with the government since 30 June 2014. Gréwal stated there had not. Later that evening, DEECD wrote to the ASX complaining about what was alleged to be a failure on the part of Vocation to comply with its continuous disclosure obligations.

On 25 August 2014, Vocation released an announcement to ASX responding to press speculation and stated that:

- Vocation's funding contracts with DEECD had not been suspended and were continuing;
- DEECD was undertaking a review of three of the courses conducted by Vocation for which Vocation received funding and as part of the review process, the DEECD had withheld recent payments under the funding contracts; and
- Vocation considered that neither the review nor its anticipated outcomes were material to Vocation.

On 25 August 2014, after the ASX announcement had been released, the Vocation Board was provided with external legal advice that BAWM was party to a contract weighted heavily against it, that there was a possibility that DEECD may terminate the contract at any time, that BAWM should adopt a conciliatory approach rather than commence legal proceedings, and that it was quite possible that DEECD would not release funds for some time, if at all.

On 26 August 2014, DEECD wrote to Vocation advising it was conducting a review of all Vocation RTOs and reiterating that the suspensions extended to all BAWM and Aspin courses.

On 28 August 2014, representatives of DEECD and Vocation (including Dawson) attended a meeting. Nicholas J found that it would have been apparent to those from Vocation who attended the meeting that there was a significant risk that DEECD may seek to permanently withhold payment in respect of two courses and, quite possibly, other qualifications as a result of DEECD's perception that the training provided was poorly designed and executed.

On 10 September 2014, Vocation issued an ASX announcement of "a fully underwritten placement to institutional and sophisticated investors to raise approximately $74 million". Vocation referred to its 25 August announcement and reiterated that neither DEECD's review nor its anticipated outcomes were material to Vocation. The announcement did not disclose that following the 25 August announcement, the review had expanded to cover all of Vocation's RTOs that were party to relevant funding contracts with DEECD. There was, again, also no mention of suspension of enrolments or commencement dates. The steps taken by Vocation in connection with the placement included the provision by Vocation to UBS of a due diligence questionnaire dated 10 September 2014 ("DDQ") completed and signed by Hutchinson and Gréwal.

On 18 September 2014, Vocation issued an ASX announcement in which it reiterated its 25 August and 10 September disclosures. It included statements not supported by DEECD and did not disclose that approximately 90% of Vocation's payments in the 2014 calendar year related to the RTOs whose payments had been withheld.

On 27 October 2014, Vocation announced the completion of DEECD's review into BAWM and Aspin. Under the terms of the settlement reached between Vocation and DEECD, Vocation lost almost $20 million in government funding and BAWM and Aspin relinquished their funding contracts. The adverse review findings triggered a significant fall in Vocation's share price, its earnings and market value. Liquidators were appointed to Vocation in late 2015.

(c) Decision

(i) The Withholding and Suspension Information

ASIC's case, based on the continuous disclosure provisions in s. 674 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), related to the nature and extent of the impact of DEECD's contractual measures on Vocation, including the withholding of payments and suspension of enrolments and commencement dates (Withholding and Suspension Information").

The evidence established that the contractual measures imposed by DEECD had the potential to negatively impact Vocation's earnings in the financial year ending 30 June 2015 by upwards of $5.8 million (about 9% of EBIT) and quite possibly upwards of $10.0 million (about 16% of EBIT). Nicholas J was satisfied that the cash flow impact of the contractual measures left Vocation with no alternative other than to undertake a capital raising to protect itself against the very real possibility that DEECD would not make a partial payment of the withheld funds before completion of the proposed review.

When the additional risk of impairment of revenue growth in the future due to reputational damage was weighed alongside the the potential earnings and cash flow impact of the contractual measures, his Honour considered it fanciful to think that investors would not be influenced by the Withholding and Suspension Information.

In those circumstances, Nicholas J was satisfied that the Withholding and Suspension Information was material in that it would likely have influenced persons who commonly invest in securities in deciding whether to acquire or dispose of Vocation shares. Accordingly, his Honour held that Vocation contravened s. 674(2) of the Corporations Act by failing to comply with *Listing Rule 3.1* by not notifying the ASX of the Withholding and Suspension Information.

ASIC contended that Hutchinson and Dawkins abetted, or by their acts and omissions were directly or indirectly knowingly concerned in, Vocation's failure to disclose the Withholding and Suspension Information in the period between 28 August 2014 and 18 September 2014, and thereby contravened s. 674(2A) of the Corporations Act. ASIC contended that it was not necessary for either Hutchinson or Dawkins to have known that the Withholding and Suspension Information was material in the relevant sense. Rather, it was sufficient that each of them knew the underlying facts from which the Court could infer that a reasonable person would have expected such information to be likely to influence an investor in making a decision whether to acquire or dispose of shares in Vocation. Nicholas J rejected ASIC's contention and found that the case against Hutchinson and Dawkins based on s. 674(2A) of the Act must fail.

However, Nicholas J did find that Hutchinson failed, in contravention of s. 180(1) of the Corporations Act, to exercise the degree of care and diligence that a reasonable person would have exercised in his position during the relevant period in his consideration of the Withholding and Suspension Information and the question whether Vocation was required to disclose such information pursuant to *Listing Rule 3.1*.

His Honour was also satisfied that Dawkins breached his duty under s. 180(1) of the Corporations Act on the basis that a person in his position exercising reasonable care and diligence would have appreciated that the Withholding and Suspension Information would be likely to affect Vocation's share price not merely due to the potential earnings impact of DEECD's contractual measures, but also due to their cash flow impact, which had resulted in a situation which, if it were not for the capital raising that was undertaken on 10 September 2014, was likely to have resulted in Vocation running out of cash before any substantial payment had been received from DEECD.

In so finding, Nicholas J did not accept submissions by Hutchinson and Dawson as to their reliance on external lawyers and management.

(ii) The 25 August announcement

Nicholas J determined that the 25 August announcement was likely to convey the impression that while a review of three courses was taking place and recent payments in respect of those courses had been withheld as part of that review, Vocation's funding contracts were operating normally and that Vocation's entitlements under the funding contracts were not otherwise affected by the review. This impression was misleading because, while the funding contracts may not have been suspended, the RTO's entitlements under those funding contracts to receive payment for past training and to enrol new students for future training had been suspended. Nicholas J also held that Vocation did not have reasonable grounds for making the implied representation in the announcement that the withholding by DEECD of recent payments was not material to Vocation.

His Honour held that the 25 August announcement was misleading or deceptive in contravention of s. 1041H of the Corporations Act and found that Hutchinson breached his duty in s. 180(1) of the Corporations Act by approving the announcement.

(iii) The DDQ

The DDQ signed by Hutchinson and Gréwal was given to UBS in circumstances where UBS was considering underwriting the proposed offer of shares under a Placement. Nicholas J held that the

DDQ contained misleading or deceptive statements in contravention of s. 1041H of the Corporations Act in respect of the focus of DEECD's review, the extent of the loss of revenue and the prospects of DEECD paying the withheld funds. His Honour found that both Hutchinson and Gréwal breached their duty in s. 180(1) of the Corporations Act by providing the DDQ to UBS in circumstances where a person in their position exercising reasonable care and diligence would have understood that it conveyed the misleading or deceptive representations.

6.2 Unfair to chair: Management of director interests in schemes of arrangement
(By Andrew Hay and Samuel Higgs, Clayton Utz)

Re Nzuri Copper Ltd [2019] WASC 189 (30 May 2019), Supreme Court of Western Australia, Vaughan J

(a) Summary

In its consideration of a proposed scheme of arrangement under s. 411 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), the Supreme Court of Western Australia has declined to make orders providing for the relevant company's executive directors to be appointed as chairperson and alternate chairperson of the scheme meeting, on the basis that the executive directors stand to receive a bonus if the scheme is approved.

Despite making orders that the scheme meeting be convened and that the scheme booklet be distributed to shareholders of the company, the Court found that the collateral benefit to be received by the company's Chief Executive Officer and Chief Operating Officer should the scheme be approved precluded those executives from being appointed as the chairperson and alternate chairperson for the scheme meeting. Although the potential conflict of interest had been adequately disclosed by the company and the executives, the question before the Court was whether shareholders might have a reasonable apprehension, based on the disclosed conflict, that the executives might not act impartially and independently as a chairperson of the scheme meeting.

(b) Facts

On 27 February 2019, Nzuri Copper Ltd (Nzuri) made an ASX announcement that it had entered into a scheme implementation deed (the SID) with Xuchen International Ltd (Xuchen). Under the SID it was proposed that Xuchen would acquire 100% of the share capital of Nzuri by way of a scheme of arrangement under s. 411 of the Corporations Act.

Key details of the proposed scheme are as follows:

- ordinary shareholders of Nzuri to receive 37 cents per Nzuri share (making a total transaction value of approximately $109 million);
- the offer price represents a 42% premium to the closing price on 26 February 2019 and a 93% premium on the 30-day volume weighted average price to 26 February 2019;
- the proposal received unanimous recommendation from the Nzuri directors, subject to no superior proposal arising; and
- the scheme is subject to certain conditions, including the completed transfer of certain exploration permits, and regulatory approvals in relation to such transfers in Australia,

China and the Democratic Republic of Congo (the site of Nzuri's current major operations).

Having confirmed that the proposed scheme was in compliance with the legal framework set out in s. 411 of the Corporations Act, Vaughan J considered the matter of directors benefits. Nzuri's chief executive officer (CEO) and chief operating officer (COO) each stand to receive a bonus of $240,000 from the Company under their respective Executive Service Agreements on a change of control, upon shareholder approval of the scheme. These director benefits were disclosed in the scheme booklet and to the court. It was also proposed that the CEO and COO be appointed as chairperson and alternate chairperson of the scheme meeting.

The issue for Vaughan J was whether the shareholders of Nzuri might have a reasonable apprehension, based on the disclosed conflict of interest, that the executives might not act impartially and independently as a chairperson and alternate chairperson of the scheme meeting.

(c) Decision

Despite ordering the convening of the scheme meeting and the distribution of the scheme booklet, Vaughan J declined to make an order providing for the appointment of the CEO and COO as chairperson and alternate chairperson of the scheme meeting.

The following factors weighed in favour of the proposed appointments:

- the executives' interest was disclosed in the initial draft scheme booklet;
- such disclosure was made in a more prominent way following discussions between Vaughan J's chambers and Nzuri's legal representatives;
- the appointments had been proposed because the independent chair of the Nzuri Board would be out of Western Australia on the day of the proposed scheme meeting; and
- there is no evidence to suggest that the executives have been, or will be, influenced by the collateral benefit in performing the role as chairperson of the scheme meeting.

However, Vaughan J noted that the issue is not one of actual apprehension that the executives may be influenced by their additional interest so as to bring about the passing of a shareholders' resolution approving the proposed scheme. Rather, the issue is one of perception - and Vaughan J decided that the more prudent course was to insist that the chairperson and alternate chairperson be appointees rather than the executives.

Vaughan J highlighted the following matters affecting his decision:

- the test for apprehended bias is an objective test of possibility as distinct from probability;
- the chairperson maintains oversight of the conduct of the scheme meeting and the vote on the scheme resolution, meaning the chairperson may have to rule on particular matters or deal with undirected proxies;
- the chairperson is usually granted an absolute discretion to adjourn the scheme meeting; and
- the services of a skilled and experienced professional could be obtained to serve as independent chair at a relatively minor cost.

Although it was ordered that the scheme meeting be convened, Vaughan J also turned to the broader question of whether it is appropriate for directors with an interest in the outcome of a scheme to make a recommendation on whether shareholders should vote in favour of the scheme. Citing the recent decision of Farrell J in *Re Gazal Corporation Ltd* [2019] FCA 701, Vaughan J noted that the common practice is for an interested director to decline to make a recommendation.

In certain instances, the making of such a recommendation by an interested director may result in the relevant court declining to order the convening of the scheme meeting.

In this instance, Vaughan J was satisfied that the orders convening the scheme meeting should be made despite the executives joining in the Nzuri Board's recommendation to the shareholders as:

- the interests held by the executives was not out of the ordinary and within the scope of what might be considered commercially reasonable (i.e. one year's salary);
- the interests held by the executives arose under pre-existing contracts executed well before the SID;
- the interests were linked to the possibility that the executives' employment might be terminated immediately after the scheme becomes effective, and the executives are not entitled to notice of termination or payment in lieu of notice if terminated within six months of the change in control; and
- most importantly, the scheme booklet made fulsome and prominent disclosure of the executives' interests.

6.3 Inter-party correspondence and agreements to arbitrate
(By Jordan Osrin, King & Wood Mallesons)

RW Health Partnership Pty Ltd v Lendlease Building Contractors Pty Ltd [2019] VSC 353 (29 May 2019), Supreme Court of Victoria, Riordan J

(a) Summary

This case considered the circumstances in which correspondence between parties may result in the creation of an ad hoc agreement to arbitrate a dispute, an election to choose one form of dispute resolution over another, or the unequivocal abandonment of the right to have a dispute resolved in accordance with the contract.

In dismissing the plaintiff's application to refer the dispute to arbitration, Riordan J held that:

- the dispute was not the subject of an arbitration agreement, within the meaning of s. 8 of the Commercial Arbitration Act 2011 No. 50 (Vic) (the Commercial Arbitration Act), and was therefore not required to be referred to arbitration;
- the correspondence between the parties in preparation for arbitration did not constitute an ad hoc agreement to vary the original agreement and to instead arbitrate the dispute;
- Lendlease Building Contractors Pty Ltd (Lendlease), through its correspondence in preparation for arbitration rather than expert determination, had not elected between inconsistent rights; and
- Lendlease had not, through its correspondence with the RW Health Partnership Pty Ltd (the Plaintiff), unequivocally abandoned its right to expert determination of the dispute.

(b) Facts

On or about 5 June 2005, the Plaintiff entered into an agreement with Lendlease for Lendlease to carry out the demolition, design, construction and commission works for the Royal Women's Hospital (the Agreement). The terms of the Agreement provided for disputes to be resolved through a particular dispute resolution process. This process required any dispute to be referred by notice to a panel for resolution.

If this panel did not meet and resolve the dispute within the resolution period, the dispute would be:

- referred to expert determination if the Agreement expressly provided for that dispute to be resolved by expert determination (cl 74.1(g)(i));
- referred to expert determination in the case of "disputes in relation to compensation" (cl 74.1(g)(ii)); or
- referred to arbitration in the case of all other disputes (cl 74.1(g)(iii)).

On 6 March 2018 the Plaintiff gave Lendlease a referral notice under cl 74.1(a) of the Agreement alleging that Lendlease's design and construction of the domestic water system was defective and therefore Lendlease had breached its duty of care.

On 14 March 2018, after the dispute was not resolved during the resolution period, the Plaintiff then issued a notice to Lendlease referring the dispute to arbitration pursuant to cl 74.1(g)(iii), or alternatively to expert determination. The Plaintiff then filed proceedings in the Supreme Court of Victoria seeking an order to have the dispute referred to arbitration.

Over the next 3 weeks, the Plaintiff and Lendlease engaged in correspondence regarding referring this matter to arbitration. The parties, via email and letters, agreed to an extension of time for the panel to select an arbitrator for the dispute. By email on 29 March, Lendlease suggested three possible arbitrators, included Professor John Sharkey AM. The Plaintiff replied with an email to Lendlease containing a draft letter to Professor Sharkey seeking his consent to his appointment as arbitrator. Eventually, without reaching an agreement, Lendlease filed an appearance in this matter.

(c) Decision

(i) Issue 1: Was the dispute the 'subject of an arbitration agreement' within the meaning of s. 8 of the Commercial Arbitration Act?

Section 8(1) of the Commercial Arbitration Act provides that where an action is brought before the court and the matter is the subject of an arbitration agreement, the court must refer the dispute to arbitration. As the Agreement did not expressly provide for the dispute to be resolved in accordance with expert determination, issue 1 turned on whether the dispute was "in relation to compensation" in accordance with cl 74(g)(ii) of the Agreement. If this issue was to be answered in the affirmative, the dispute should be referred to expert determination, and is therefore not 'the subject of an arbitration agreement, within the meaning of s. 8 of the Commercial Arbitration Act.

Riordan J considered that dispute resolution clauses are construed using the same principles that apply to other commercial contracts.

Accordingly, his Honour applied the following principles:

- the terms of the agreement are to be construed objectively and the subjective intentions of the parties are irrelevant; and
- the Court will consider not only the text and its ordinary meaning but also the context of the agreement and the commercial purpose and object of the agreement.

Riordan J determined that the expression "disputes in relation to compensation" in cl 74.1(g) should be read as including disputes with respect to liability for compensation and should not be limited to disputes with respect to the assessment of compensation.

His Honour considered that the phrase "in relation to" is wide in its connotation, and does not warrant reading words of limitation into the expression. His Honour was also satisfied that the broader construction of this provision produces a commercially sensible result, while not resulting in the provision referring disputes to arbitration in cl 74.1(g)(iii) being so narrow as to be inoperative.

Accordingly, his Honour found that the dispute was 'in relation to compensation' within the meaning of the Agreement, and therefore not 'the subject of an arbitration agreement' and not required to be referred to arbitration under s. 8 of the Commercial Arbitration Act.

(ii) Issue 2: Did the parties' correspondence constitute an agreement that the dispute be arbitrated?

As Riordan J held that the dispute was to be automatically referred to expert determination under cl 74.1(g), issue 2 turned on whether the parties contracted to terminate the expert determination mechanism under the Agreement and to instead submit the dispute to arbitration.

Therefore, it was necessary to prove the requisite elements for the formation of a contract, being:

- offer and acceptance;
- consideration;
- intention to create legal relations; and
- certainty of terms.

Riordan J determined that a contract to terminate the expert determination mechanism and submit the dispute to arbitration could not be inferred from the correspondence between the Plaintiff and Lendlease. His Honour considered that there was nothing that could be inferred from the correspondence between the parties, except evidence of a mistaken apprehension that arbitration was the appropriate mechanism for the dispute. Further, there was no precedent whereby correspondence was inferred to terminate the contract's existing dispute resolution mechanism and submit the dispute to arbitration prior to the appointment of an arbitrator. Therefore, as the correspondence did not demonstrate any intention to vary the contract, the correspondence did not constitute an agreement that the dispute be arbitrated.

(iii) Issue 3: Had Lendlease waived its right under the contract for the dispute to be referred to expert determination, with the result that the dispute be referred to arbitration?

In determining that Lendlease has not waived its right for the dispute to be referred to expert determination, Riordan J endorsed the summary of the three forms of waiver in *Tridon* [2002] NSWSC 896 by Austin J, being waivers by election, abandonment, or non-insistence.

Riordan J did not consider that choosing to select another procedure for the adjudication of the dispute constituted an election between inconsistent substantive rights, and therefore a waiver by election. Further, his Honour did not consider that the correspondence between the parties constituted an unequivocal election to arbitrate and to not enforce the rights under the Agreement to refer the dispute to expert determination.

Finally, Riordan J held that the correspondence did not constitute a deliberate, intentional and unequivocal representation that Lendlease will forego certain rights, and therefore waive the right to expert determination by abandonment.

6.4 Court orders compensation to be paid by directors for insolvent trading pursuant to s. 588M of the Corporations Act 2001

(By Eloise Culic, DLA Piper)

In the matter of Substance Technologies Pty Ltd [2019] NSWSC 612 (24 May 2019), Supreme Court of New South Wales, Rees J

(a) Summary

This was an application by the liquidator of Substance Technologies Limited (the company) against the company's directors, Andrew Thaler and his father Christopher Thaler. The liquidator sought an order the directors pay $170,000 for debts incurred to the Australian Taxation Office (ATO) and Ausgrid whilst the company was insolvent. The issues for judicial consideration included whether the company was insolvent when the debts were incurred, either by reason of the presumption of insolvency which arises where a company fails to comply with its obligations to keep financial records, or by reasons of other evidence pointing to insolvency. Rees J found in favour of the liquidator, that the presumption of insolvency arose and that it was apparent from the evidence the company became insolvent by November 2009.

(b) Facts

The company operated a scrap metal yard at Cooma NSW. Its primary business was recycling, logistics and consulting. Christopher was a director of the company from 8 September 2004 to 3 January 2015. Andrew was operations manager and a truck driver for the Company, and took over the business from his father when he became a director on 2 January 2015.

The company had ceased trading in late 2013 and the final tax return was filed for the year ending 30 June 2013. However, in early 2014, the company bought scrap metal from Ausgrid a state owned corporation. At this time the following evidence suggested the company was insolvent: the cash at the bank was insufficient to pay invoices, the company had ceased trading due to problems being paid by substantial customers, the company had not made a profit for some years and had a deficiency of assets over liabilities for several years, and the company's running account balance with the ATO indicated that the company was not able to pay its tax debts as and when they fell due.

In April 2015, Ausgrid commenced legal proceedings against the company in the Local Court of New South Wales for the unpaid invoices. On 2 April 2015, the ATO also wrote to the company advising that it intended to take debt collection action in respect of $23,869.96 then owing. On 11 November 2015, Ausgrid's proceedings against the company were heard in the Magistrate's Court. Magistrate Milledge entered judgment in favour of Ausgrid for $78,463 plus interests and costs. On 27 November 2015, Ausgrid served a statutory demand on the company in respect of the Local Court judgment. The company did not comply with the statutory demand and consequently Ausgrid filed an Originating Process to wind up the Company. On 27 June 2016, Black J ordered the Company be wound up.

On 28 June 2016, the liquidator wrote to Andrew requiring him to deliver up all books, documents, papers and writings in his custody or his control belonging to the company in accordance with s. 530A of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). On 1 September 2016 the liquidator wrote to Andrew noting he had failed to provide any books and records apart from the tax returns, financial statements and five bank statements from the company's former accountant. The liquidator said he considered the company had not complied with its obligations under s. 286, which therefore gave rise to a presumption of insolvency under s. 588E (4) of the Corporations Act.

The liquidator advised that he had received creditor claims of $112,634.96 and that he demanded payment of this sum from Andrew. On 10 October 2018, the liquidator filed an Interlocutory Process Seeking orders for compensation in respect of insolvent trading.

(c) Decision

(i) Insolvency

Although directors at different times, both Christopher and Andrew were directors of the company when it incurred a debt thus satisfying s. 588G(1)(a) of the Corporations Act.

The liquidator relied on the presumption of insolvency in s. 588E(4) of the Corporations Act and the company's obligation to keep financial records in s. 286.

The obligation to keep financial records under s. 286 of the Corporations Act is twofold - first, to keep records which record the company's transactions and financial performance sufficient to enable statements to be prepared and, second, to retain those records for seven years. On the evidence before Rees J, it was found the company complied with its obligations to keep financial records under s. 286(1) until the financial year ended 30 June 2013 but did not comply with this obligation thereafter.

The company therefore failed to comply with its obligation under s. 286(2) of the Corporations Act for the entire period in question. Section 588E(4) makes clear that the presumption of insolvency arises when the company has failed in its obligations to keep records under s. 286(1) or s. 286(2).

The liquidator also argued that the company was insolvent by November 2009 as it was unable to pay its debts as and when they fell due. The liquidator pointed to the company's inability to pay its tax debts when due over a prolonged period, and the company's communications with the ATO advising the company had not been able to afford to pay a tax agent. It was apparent the company became insolvent by November 2009. Having sustained losses in the year ending 30 June 2009 and with a deficiency of assets over liabilities, the company fell behind in its payment obligations to the ATO and never managed to 'catch up'.

(ii) Directors' knowledge

Having regard to the financial information from July 2009 on, there were reasonable grounds for a director of ordinary competence to suspect the company was insolvent.

The information available to Christopher from 2009 to 2013 pointed strongly to insolvency. By the time the company decided to purchase scrap metal from Ausgrid, the company had been insolvent for a considerable amount of time. Christopher could not reasonably have thought that the company would have been able to pay Ausgrid's invoices given such a prolonged period of insolvency. According to Rees J, a reasonable person in the director's position would have kept appraised of the company's bank account balances, its payment of its tax obligations and its financial position as recorded in its financial statements. Reviewing this basic information, a director would have been left in no doubt that the company was insolvent from November 2009 on.

(iii) Defence

The court held that the defence put forward by Christopher, that he reasonably believed the company would make a profit from the scrap metal materials purchased from Ausgrid, did not apply. Given the prolonged period of insolvency leading up to the Ausgrid invoices, Rees J was not prepared to find that the company was solvent when it bought the scrap metal from Ausgrid. In addition, Ausgrid required payment within three weeks of issue of the invoice. There was no evidence that the company expected to earn profits before the invoices were due for payment.

(iv) Compensation

The Court ordered the directors of the company to compensate the company for loss resulting from insolvent trading. The court considered how it should determine the amount of compensation to be paid by directors where the directors succeed each other.

Pursuant to s. 588M(2) of the Corporations Act the court ordered that:

- Andrew Thaler pay to the company $13,242, together with interest from 27 June 2016 to date in the amount of $2,135; and
- Christopher Thaler pay the company $103,709 together with interest from 3 January 2015 to date in the amount of $25,192.

The directors were also ordered to pay the applicant's costs.

6.5 Court provides guidance on factors to be considered in 'beauty parades' in competing class actions
(By Chris Pagent, Catherine Oldenburg and Camryn Cooper, Corrs Chambers Westgarth)

Wigmans v AMP Ltd [2019] NSWSC 603 (23 May 2019) Supreme Court of New South Wales, Ward CJ

(a) Summary

The 'race to the registry' in competing class actions has become a common phenomenon. The response of the Courts has been to hold what has become known as a 'beauty parade' - the 'most attractive' proceeding winning the right to continue against the defendant(s).

Most recently, the Supreme Court of New South Wales was required to decide which plaintiff would have the right to prosecute a significant class action against AMP. The Court's judgment in *Wigmans v AMP* provides useful guidance as to the factors to be considered.

The decision reflects the proposition that in the event of competing class actions, each aspect of the competing proceedings will need to be considered on its merits. The nature of the funding models and returns to group members are likely to be key considerations for the Court when confronting competing class actions. The Court was more interested in these matters than arguments regarding the respective experience and abilities of the lawyers. The latter is likely to be a factor only where one party can point to a significant disparity in relevant skills and experience.

(b) Facts

Following evidence given by AMP's executives to the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* in April 2018, five competing class actions were commenced against the company in the period 9 May 2018 to 7 June 2018.

The class actions variously alleged that AMP had breached its continuous disclosure obligations and engaged in misleading and deceptive conduct. Those allegations focussed on AMP's failure to disclose to the market that it had charged its customers fees for financial advice and related services where no services were provided.

The five class actions were brought by:

- Ms Wigmans;
- Fernbrook (Aust) Investments Pty Limited;
- Komlotex Pty Limited; Wileypark Pty Limited; and
- Mr Georgiou.

The Wigmans proceeding was the first to be commenced (albeit by a matter of hours) in the Supreme Court of New South Wales. The remaining matters were commenced in the Federal Court and transferred to the Supreme Court. The proceedings were at various stages of preparation (the Wigmans proceeding being the most advanced).

Given the multiplicity of proceedings arising from the same subject matter, applications were filed seeking (in effect) a determination by the Court as to which one (or more) of the class actions should continue and on what terms. The plaintiffs in the Fernbrook and Komlotex proceedings also filed an application (which was not opposed by AMP) seeking the consolidation of their proceedings.

In her judgment, Ward CJ (in Eq) noted that although the beauty parade process had 'unedifying aspects' (for example, insofar as she was asked to make assessments of the comparative skills and experience of the legal teams), she was nevertheless bound to determine the applications before her. In doing so, she was required to consider a variety of factors.

Each of the plaintiffs relied on different factors to distinguish their claim, summarised as follows:

Ms Wigmans emphasised:

- the 'first mover advantage';
- an additional (unconscionable conduct) cause of action in her proceeding;
- the extended definition of group members in her proceeding;
- the advanced progress of her proceeding; and
- the staged funding model provided by Burford (this was said to provide an incentive to the funder to achieve the highest recovery for group members).

Komlotex emphasised:

- its 'no win, no fee' funding model (that is, the proceeding would be conducted without a litigation funder but with after-the-event insurance);

- the experience of its solicitors; and
- its funding structure.

Upon consolidation of the Fernbrook proceedings, payments would be made to Slater & Gordon (Fernbrook's solicitors) and Therium (Fernbrook's funder).

- Wileypark emphasised: the size of its group (including the 'informed choice' that its institutional group members were said to have made); and
- the experience of its funder (IMF) in the analysis of financial data and provision of project management services (said to be "at no cost" to group members).

Mr Georgiou emphasised:

- that his estimate as to legal costs had been appraised by a costs consultant and involved the lowest solicitors' rates (which would likely result in the highest recovery for group members); and
- that those responsible for the matter at his funder (Augusta) were qualified solicitors and this presented an advantage over funder decision-makers (who do not owe paramount obligations to the Court).

(c) Decision

(i) Multifactorial analysis

Ward CJ (in Eq), having regard to the approach undertaken by the Court in *Perera v GetSwift Ltd*, undertook a multifactorial analysis to determine which of the proceedings should be allowed to continue and which should be stayed.

A number of factors were considered by her Honour.

First, her Honour considered the competing funding proposals, costs estimates and net hypothetical return to members. Ward CJ (in Eq) saw pros and cons with each funding model. However, her Honour ultimately saw the 'no win, no fee' model of the Komlotex proceeding as most favourable because it "balances the potential incentives and disincentives by putting the risk of the litigation squarely with the solicitors but incentivising additional work (which might be likely to produce a higher settlement sum) by reference to an uplift on fees to be achieved only when the stipulated threshold for a resolution sum is achieved".

Her Honour next considered the parties' proposals as to security for AMP's costs, finding that the Wigmans and Komlotex proceedings offered the most favourable proposals for security.

Insofar as the nature and scope of the causes of action advanced by the plaintiffs and the size of the respective classes to the representative proceedings were concerned, these factors understandably did not weigh heavily in the equation.

In relation to the extent of book building, her Honour considered that the weight sought to be placed by Wileypark on this factor was contrary to observations made by the Court in the *Perera v GetSwift Ltd* regarding book building. Her Honour gave this factor no weight.

As to submissions made by the parties regarding the respective experience and/or abilities of the solicitors or funders, her Honour considered there was no sensible basis upon which to differentiate between the parties. Further, no weight was attached to the various complaints made by the parties as to the conduct of the other competing proceedings.

Her Honour also did not regard the fact that the Wigmans proceeding was the most advanced to be significant (as the remaining proceedings would be able to catch up).

(ii) Findings

Ultimately, Ward CJ found that the Komlotex and Fernbrook proceedings should be consolidated and proceed in favour of the other proceedings. Ultimately, the factor which her Honour found the most persuasive was the funding model - namely, a 'no win, no fee' model that involved no funding commission. This meant, based on the modelling undertaken, that the net return for group members in those proceedings would probably be the highest.

Against that background, her Honour made orders that the proceedings other than the consolidated Komlotex/Fernbrook proceeding be stayed, on the condition that the plaintiffs pay $5 million as security for AMP's costs.

6.6 Good faith and collateral purposes in the context of a derivative action
(By Andrea Farrell, MinterEllison)

Li v Wu [2019] ACTCA 14 (16 May 2019), Supreme Court of the Australian Capital Territory, Court of Appeal, Elkaim, Loukas-Karlsson and Rangiah JJ

(a) Summary

Mr Li and Ms Chen sought leave to appeal against a decision to grant leave to Mr Wu to bring a derivative application on behalf of Golden Constructions Pty Ltd (Golden Constructions) to recover amounts owing under:

- a building contract to which Mr Li and Ms Chen were a party (building contract); and
- a loan agreement between Golden Constructions and Mr Li (loan contract).

It was alleged that Mr Wu sought to litigate the claims, which were allegedly statute barred, to avoid a sequestration order Mr Li obtained against him.

Leave to appeal was granted and the appeal was partially successful. While the grant of the derivative action application was upheld with respect to the building contract, it was overturned with respect to the loan contract.

(b) Facts

Mr Li and Ms Chen formed a business relationship with Mr Wu and several companies he owned, and each held shares in Golden Constructions.

During the course of the business relationship:

- Mr Li, in his personal capacity, loaned money to a company Mr Wu owned;
- Golden Constructions contracted with Mr Li and Ms Chen to build their residential property; and

- Golden Constructions loaned Mr Li $572,998.02.

Mr Wu's corporate group subsequently collapsed and the loan was not repaid. Mr Li commenced proceedings in the Federal Court of Australia to enforce repayment. He was successful and Mr Wu was ordered to repay $976,866.60 plus interest. On appeal, Mr Wu was ordered to repay $1,076,767.00 plus interest.

Mr Li issued a bankruptcy notice to Mr Wu, who unsuccessfully applied to the Federal Circuit Court to have the bankruptcy notice set aside. Mr Li presented a creditor's petition to the Federal Circuit Court. Though opposed, a sequestration order was made.

Mr Wu purported to take an assignment of the building contract and loan contract from the liquidator. He paid an initial $16,000.00 and subsequently agreed that he would pay the liquidator 5% of the proceeds recovered in the event the matters were litigated successfully.

The building contract contained a clause requiring Mr Li and Ms Chen to consent to any assignment, though no consent was obtained prior to the assignment. Consent was not required to assign the loan contract.

To overcome the defective assignment, Mr Wu, relying on the court's inherent jurisdiction, made an application to the Supreme Court of the Australian Capital Territory to bring a derivative action on behalf of Golden Constructions.

He sought:

- contractual damages following Mr Li and Ms Chen's failure to meet their payment obligations under the building contract; or
- in the alternative, payment for the value of the work performed on a quantum meruit basis; and
- contractual damages following Mr Li's failure to comply with his repayment obligations under the loan contract.

Mr Li and Ms Chen defended the matter on the basis that:

- Mr Wu's pursuit of the claims was a contrivance to avoid the bankruptcy proceedings and therefore lacked good faith and constituted an abuse of process; and
- in any event, pursuant to s. 11 of the Limitation Act 1985 No. 66 (ACT), the claims were statute barred.

Mr Wu's application to bring a derivative action was granted.

Mr Li and Ms Chen appealed, arguing that the primary judge erred in finding that:

- the claims were brought in good faith and did not constitute an abuse of process; and
- the claims had a proper legal basis and were not statute-barred.

(c) Decision

Elkaim, Loukas-Karlsson and Rangiah JJ unanimously granted leave to appeal.

In relation to the first ground of appeal, their Honours upheld the decision of the primary judge in finding that:

- Mr Wu exhibited good faith in making the derivative application; and
- the proceeding did not constitute an abuse of process.

Mr Wu articulated his reasons for bringing the proceedings as to "preserve [his] rights in the event that Court ultimately finds that the Assignment was ineffective" (see paragraph [76]).

Considering the surrounding evidence, their Honours considered Mr Wu acted in good faith because:

- he initially commenced proceedings in his personal capacity;
- the primary purpose of the proceeding was to recover debts owing under the building contract and the loan agreement, not to avoid bankruptcy proceedings;
- both Mr Wu and Golden Constructions would benefit if the claims were successful; and
- simply because Mr Wu would receive the majority of the proceeds if successful did not automatically constitute a lack of good faith.

In relation to the second ground of appeal, Mr Li and Ms Chen succeeded in arguing that the primary judge should not have granted leave for Mr Wu to bring a derivative action on behalf of Golden Constructions with respect to the loan contract. In that regard, their Honours held that assignment of the loan contract did not require the consent of Mr Li and Ms Chen to be effective and, as a result, Mr Wu could recover any amounts owing under the loan agreement in his personal capacity without corresponding derivative proceedings.

Mr Li and Ms Chen were ordered to pay Mr Wu's costs.

6.7 Principal or interest? The nature of funds recovered via litigation during liquidation

(By Katherine O'Brien, Herbert Smith Freehills)

Australian Securities and Investments Commission v Piggott Wood & Baker (A Firm) (No 6) [2019] FCA 672 (16 May 2019), Federal Court of Australia, Kerr J

(a) Summary

The Court found distributions initially proposed by the liquidator of an unregistered managed investment scheme contained an error of law. This provided a proper basis for the Court not to apply the general rule of non-interference with the liquidator's judgment. The liquidator had proposed to treat the proceeds of litigation recovered during the wind up wholly as interest, earmarking these funds for investors in the scheme. The Court found this proposal failed take into account the interests of the Solicitors' Trust, which had previously made payments to investors who had lost capital in the scheme.

(b) Facts

(i) Background

Tasmanian law firm Piggott Wood & Baker operated a contributory mortgage fund known as the "Run-Out Mortgage Business". Substantial problems with the fund emerged in the late 1990s which resulted in significant losses. In 2001 an order was made that the fund be wound up as an unregistered managed investment scheme and a liquidator appointed. In 2002 the Law Society of Tasmania obtained an order from the Supreme Court of Tasmania that Piggott Wood & Baker was in default. This triggered payments from the Court Fund established under s. 111(2) of the Legal Profession Act 1993 No. 90 (Tas) (the Legal Profession Act) to the Solicitors' Trust, which in turn made payments to investors who lost principal due to the collapse of Piggott Wood & Baker's scheme.

The rights and interests of investors who received payments from the Solicitors Trust (Trust) were assigned to the Trust by virtue of the operation of s. 113 of the Legal Profession Act. To the extent the Trust made payments to investors, it imposed a condition that where investors later received payment from the liquidator, the Trust would be entitled to treat that money as payment of capital unless investors could satisfy the Trust that payments should be treated as income. The Trust made total payments of $7,405,443.32 to investors in respect of lost principal. No payments were made by the Trust in respect of lost interest.

(ii) Initial proposed distribution

In May 2019 the liquidator applied to the Federal Court for directions that they were justified in distributing funds realised in the liquidation. The scheme was run as a contributory, rather than pooled, mortgage scheme. Specific investments were allocated to specific mortgages, so investors in the scheme had varying underlying legal rights that the liquidator took account of when determining entitlements.

The liquidator had recovered certain funds via litigation against a property valuer. The valuer, it was alleged, has negligently provided overvaluations of properties which the scheme relied on when lending money secured by mortgages over the properties. In the particulars of damage claims were made for lost capital and interest, as well as Hungerfords damages (a claim for use of money foregone which would otherwise have been available to the plaintiff, per *Hungerfords v Walker* [1998] 171 CLR 152). The litigation was settled. The deed of release did not, however, apportion any part of the settlement between interest and capital.

As the amount recovered in the litigation could not be disaggregated between capital and interest, the liquidator proposed that the whole of the funds be applied in reduction of interest, citing the rule in *Falk v Hugh* (1935) 53 CLR 163. This meant the Solicitors' Trust would not be entitled to any funds recovered from the litigation unless and until investors in the loans concerned had their claims for interest fully satisfied.

The Trust posited instead that the whole of the funds should be characterised as a return of capital. Citing *McLaurin v FCT* (1960-61) 104 CLR 381, *Allsop v FCT* (1964-5) 113 CLR 341, and *Commissioner of Taxation v CSR Ltd* (2000) ATC 4710, the Trust argued the established position for tax purposes was that the undissected lump sum was wholly capital. Alternately, the Trust argued that if equity were to intervene, the *pari passu* rule would apply.

(iii) Amended proposed distribution

In response to the Trust's arguments the Liquidator obtained leave to amend its application. Accounts had been kept detailing the distinct liabilities of capital and interest in respect to each investor and investment. The amended application provided for proceedings from the litigation to be apportioned between the Trust and investors in shares that reflected the proportions of unrecovered funds paid from the Trust on account of principal to the investors claims for unpaid interest.

(c) Decision

The Court found the distribution originally proposed involved an error of law or principle of the kind identified in *Re Spedley Securities Ltd (in liq)* (1992) 9 ACSR 83 that provided a proper basis for the Court not to apply the general rule of non-interference with a liquidator's judgment. Although the settlement made no distinction between principal, interest, and Hungerfords damages, the nature of the pleadings allowed the Court to infer that an entitlement to interest or Hungerford damages only arose if there was also an entitlement to recover principal.

Kerr J rejected the Trust's argument that the undissected damages should be treated wholly as capital, finding the question of how the liquidator should distribute funds could not be answered by analogy to how the funds may have been taxed. Per *Australian Securities and Investments Commission v Letten (No 7)* [2010] FCA 1231 the Court's powers do not generally permit the making of an order that departs from the proprietary rights of scheme participants. As the scheme in question was contributory in nature, it was inevitable that different classes of investors would be entitled to receive different dividends.

The Court held that the Solicitors' Trust had a proprietary right in the funds recovered through the litigation by virtue of s. 113 of the Legal Profession Act at the time payments were made to investors. The section then in force provided that: "If a default order has been made in respect of a firm or legal practitioner corporation, the rights and interests of any person arising from any loss incurred in respect of which the default order was made are assigned to the Trust when an amount is paid out of a Court fund to that person and only to the extent of that amount".

Kerr J held that s. 113 of the Legal Profession Act must be construed so as to create a distinct legal entitlement in order to enforce the statutory assignment it provided for. The Solicitors' Trust derived its relevant proprietary rights in the proceeds of the litigation from this section of the Act, rather than any legal or equitable interest derived from the investors. The Court was satisfied it would be justifiable to distribute the funds in the manner specified in the liquidator's amended application, noting that funds distributed to investors pursuant to this direction would be clearly on account of interest.

6.8 Spent convictions and banning orders
(*By Katrina Sleiman, Corrs Chambers Westgarth)*

Frugtniet v Australian Securities and Investments Commission [2019] HCA 16 (15 May 2019), High Court of Australia, Kiefel CJ, Bell, Gageler, Keane, Nettle, Gordon and Edelman JJ

(a) Summary

The High Court of Australia considered an appeal in respect of a review by the Administrative Appeals Tribunal (the AAT) of a decision by a delegate of the Australian Securities and Investments Commission (ASIC). The issue was whether a "spent conviction" within the meaning of Pt VIIC of the Crimes Act 1914 No. 12 (Cth) (the Crimes Act) which cannot be taken into consideration by ASIC in deciding to make a banning order against a person on the basis that the person is not a fit and proper person to engage in credit activities under the National Consumer Credit Protection Act 2009 No. 134 (Cth) (the NCCP Act), can be taken into consideration by the AAT on a review of ASIC's decision under the Administrative Appeals Tribunal Act 1975 No. 91 (Cth) (the AAT Act).

The High Court unanimously held that it cannot. Except where altered by statute, the jurisdiction conferred on the AAT is to stand in the shoes of the original decision-maker so as to determine for itself, on the material before it, the decision which can and should be made in the exercise of the power conferred on the original decision-maker. The AAT exercises the same power as the original decision-maker, subject to the same constraints, and a consideration which the original decision-maker must not take into account must not be taken into account by the AAT.

(b) Facts

The appellant lodged an application for an Australian credit licence with ASIC. In the application the appellant declared that the information was complete and accurate, including questions about his status as a "fit and proper person". The appellant did not disclose that he had a conviction in 1978 for dishonesty for which he had served two years in prison, and neither did he disclose that he had been found guilty in 1997 of obtaining property by deception. Those offences constituted "spent convictions" within the meaning of Pt VIIC of the Crimes Act. The credit licence was granted.

In 2014, a delegate of ASIC made a banning order against the appellant under s. 80(1) of the NCCP Act on the basis that ASIC had reason to believe that the appellant was not a fit and proper person to engage in credit activities. In making that determination, ASIC was required to have regard to the range of considerations specified in s. 80(2) of the NCCP Act, which, perforce of s. 85ZW of the Crimes Act, excluded spent convictions.

On a review of the delegate's decision, the AAT took into consideration the appellant's spent convictions. The appellant's appeal to the Federal Court on grounds including that the AAT had erred in law in taking the spent convictions into consideration, was dismissed. The appellant's appeal to the Full Court of the Federal Court was also dismissed. The Full Court held that s. 85ZZH(c) of the Crimes Act entitled the AAT to take into consideration material which ASIC was prevented from taking into consideration by Div 3 of Pt VIIC of the Crimes Act. By grant of special leave, the appellant appealed to the High Court.

(c) Decision

(i) Relevant legislative provisions

In considering whether to make a banning order under s. 80(1) of the NCCP Act on the basis that ASIC has reason to believe that a person is not a fit and proper person to engage in credit activities, ASIC is required to have regard to the range of considerations specified in s. 80(2) of the NCCP Act, subject to the application of Div 3 of Pt VIIC of the Crimes Act.

Division 3 of Pt VIIC of the Crimes Act (which includes s. 85ZW) has the relevant effect that, subject to Div 6 of Pt VIIC (which includes s. 85ZZH(c)), a person whose conviction is spent is not required to disclose to any Commonwealth authority the fact that the person was charged with or convicted of the offence, and that a Commonwealth authority is prohibited from taking account of the fact that the person was charged with or convicted of the offence. A Commonwealth authority includes both the AAT and ASIC. However, s. 85ZZH(c) of the Crimes Act provides that Div 3 does not apply in relation to the disclosure of information to, or the taking into account of information by, a tribunal established under a Commonwealth law. The AAT is a tribunal established under Commonwealth law.

(ii) The nature of administrative review

By force of s. 25(4) of the AAT Act, the AAT has power to review any decision in respect of which an application is made to it under any Commonwealth Act. Section 43(1) of the AAT Act provides that for the purpose of reviewing a decision, the AAT may exercise all the powers and discretions that are conferred by any relevant enactment on the person who made the decision and shall make a decision in writing.

Keifel CJ, Keane and Nettle JJ noted that the enactment of the AAT Act established a new and substantially unprecedented regime of administrative merits review, distinguished principally by the AAT's jurisdiction to re-exercise the functions of original administrative decision-makers. The question for determination on a review under s. 25 of the AAT Act is whether the decision is the correct or preferable decision. The AAT is subject to the same general constraints as the original decision-maker and should ordinarily approach its task as though it were performing the relevant function of the original decision-maker in accordance with the law as it applied to the decision-maker at the time of the original decision.

Their Honours noted that depending on the nature of the decision the subject of review, the AAT may sometimes take into account evidence that was not before the original decision-maker. But subject to any clearly expressed contrary statutory indication, the AAT may do so only if and to the extent that the evidence is relevant to the question which the original decision-maker was bound to decide. The AAT cannot take into account matters which were not before the original decision-maker where to do so would change the nature of the decision or, put another way, the question before the original decision-maker.

Similarly, Bell, Gageler, Gordon and Edelman JJ noted that except where altered by some other statute, the jurisdiction conferred on the AAT by ss. 25 and 43 of the AAT Act, where application is made to it under an enactment, is to stand in the shoes of the decision-maker whose decision is under review so as to determine for itself on the material before it the decision which can, and which it considers should, be made in the exercise of the power(s) conferred on the original decision-maker for the purpose of making the decision under review. A consideration which the original decision-maker must not take into account must not be taken into account by the AAT.

(iii) Is there a clearly expressed legislative intent?

Having regard to their Honours' comments regarding the jurisdiction of the AAT, the relevant question for determination was whether there existed a clearly expressed legislative intent that the AAT may take into account matters (the spent convictions) that ASIC, as the original decision maker, could not.

Keifel CJ, Keane and Nettle JJ held that s. 80(2) of the NCCP Act does not express a clear contrary legislative intent, noting that it is implicit in the stipulation in s. 80(2) of the NCCP Act that the criteria to which ASIC must have regard is subject to Pt VIIC of the Crimes Act only insofar as that Part is capable of application to ASIC. Section 85ZW of the Crimes Act is capable of application to ASIC because it specifies that spent convictions are not to be taken into account by a Commonwealth authority, and ASIC is such an authority. But s. 85ZZH(c), which qualifies the operation of s. 85ZW in relation to courts and tribunals, is incapable of application to ASIC because ASIC is not a court or tribunal.

Their Honours held that upon its proper construction, s. 80(2) of the NCCP Act does not make s. 85ZZH(c) of the Crimes Act applicable to the AAT in the review of a decision of ASIC under s. 80(1) of the NCCP Act. To adopt and adapt Basten JA's comments in *Kocic v Commissioner of Police, NSW Police Force* (2014) 88 NSWLR 159, it is not to be supposed that Parliament intended to make such a profound change to the nature of merits review by a legislative side-wind.

Bell, Gageler, Gordon and Edelman JJ noted that s. 85ZZH(c) of the Crimes Act says nothing more of present relevance than that Div 3 of Pt VIIC of the Crimes Act has no application to a tribunal established by statute taking information into account for the purpose of making a decision. Section 85ZZH(c) does nothing to alter the statutory jurisdiction of the tribunal. In particular, it does not make a spent conviction relevant to be taken into account in the exercise of that jurisdiction.

Understood in this sense, their Honours noted that the apparent conflict between s. 85ZZH(c) and the AAT's review jurisdiction falls away. Accordingly, the jurisdiction of the AAT, on a review under s. 327 of the NCCP Act of a decision made by ASIC under s. 80 of the NCCP Act, is unaffected by s. 85ZZH(c) of the Crimes Act, and is subject to the same constraint as ASIC under Part VIIC of the Crimes Act.

6.9 Court upholds litigation funding agreement based on statutory assumptions in the Corporations Act 2001
(By Tom Monotti, King & Wood Mallesons)

Gallop Reserve Pty Ltd v Matton Developments Pty Ltd [2019] QSC 113 (13 May 2019), Supreme Court of Queensland, Holmes CJ

(a) Summary

This decision primarily concerned the ability of a litigation funder to rely on the statutory assumptions under s. 129 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) to enforce a litigation funding agreement with a company. It also provides a useful reminder of the issues that can arise where directors of a company seek to enter into agreements on behalf of the company without involving the other directors.

(b) Facts

Gallop Reserve Pty Ltd (GRPL) entered into a litigation funding agreement with Matton Developments Pty Ltd (MDPL) to support proceedings MDPL had commenced against CGU (the CGU litigation). The agreement provided for GRPL to receive a 3:1 return on the funding provided to MDPL, were MDPL successful in the CGU litigation. The litigation funding agreement was entered into after one of MDPL's directors, Mr Clark, failed to contribute funds to support the CGU litigation. At this time, Mr Clark's relationship had deteriorated significantly with MDPL's other director (Mr Kenward) and GRPL's sole director (Mr Foggo).

The litigation funding agreement was signed on 12 March 2012, but had not been properly executed by MDPL in accordance with s. 127(1) of the Corporations Act. Mr Kenward sought to ratify the agreement by holding a director's meeting without Mr Clark, appointing his wife as director and resolving to execute a Deed of Variation which ratified the litigation funding agreement. The Deed of Variation was executed in late May 2012, with Mr and Mrs Kenward signing on behalf of MDPL. Further, at that same meeting, Mr and Mrs Kenward resolved to appoint Mr Kenward under power of attorney to do all things necessary in relation to the CGU litigation and the Westpac debt disclosed below. This power of attorney was also signed that same day by Mr and Mrs Kenward.

Around September 2012, GRPL commenced negotiations with Westpac to assign all legal and beneficial interests under a loan agreement Westpac had entered into with MDPL ("Westpac loan agreement") and associated security provided by MDPL and its directors. A Deed of Assignment was executed on 10 April and co-signed by MDPL under Mr Kenward's power of attorney. Mr Foggo had no concerns about Mr Kenward's ability to bind MDPL under this power of attorney.

In addition, on 1 April 2013, Mr Kenward prematurely signed a side letter sent from Mr Foggo ("priority letter") purporting to prioritise repayments owed under the litigation funding agreement over repayment of assigned Westpac debt.

Around April 2013, the litigation funding agreement was extended by a Continuation Deed, also executed by Mr Kenward under the power of attorney.

MDPL was successful in the CGU litigation. Up to that point, GRPL had contributed $1,237,056.33 to the CGU litigation, which meant it was entitled to an overall return of $3,711.168.99 under the litigation funding agreement. GRPL had already received $1,560,000 from MDPL and a further $1,288,721 from amounts paid into court.

As a result, GRPL sought to claim the balance of the funds paid into court in respect of the CGU litigation, first in satisfaction of the remaining amounts owed under the litigation funding agreement ($862,447.99), and secondly in satisfaction of the Westpac debt ($1,560,000, inclusive of interest). Mr Clark resisted, concerned that GRPL would enforce the personal guarantee he had provided in respect of the Westpac loan agreement, given the CGU litigation settlement amount was not sufficient to cover both outstanding amounts. Mr Clark sought to dispute the relief by claiming the litigation funding agreement was not valid, or alternatively, that GRPL was not entitled to apply monies it received towards amounts owed under the litigation funding agreement without first discharging the Westpac debt.

(c) Issues

The Court was required to address the following issues:

- whether the litigation funding agreement gave GRPL the right to recover three times the amount advanced. This raised two relevant questions, notably:
    - whether the litigation funding agreement was ratified, and relevantly, whether the resolutions appointing Mrs Kenward as director were valid by reference to s. 1322 of the Corporations Act for being merely a procedural irregularity; and
    - if no to the above, whether GRPL, acting through Mr Foggo, could rely on ss. 128 and 129 of the Corporations Act and assume that Mr and Mrs Kenward had acted with authority thereafter to ratify the litigation funding agreement and/or the power of attorney and deeds in relation to the litigation funding had been duly executed; and
- whether GRPL was entitled to amend the order of priority of the debts it was owed by MDPL.

The Court dismissed a counterclaim brought by Mr Clark, alleging:

- GRPL knowingly assisted Mr Kenward to act in breach of his duties under ss. 180 and 182-184 of the Corporations Act, having regard to the second limb of *Barnes v Addy*;
- GRPL engaged in unconscionable conduct under s. 20 of the *Australian Consumer Law* by entering into the Deed of Assignment and concealing this from Mr Clark; and
- Mr Clark was entitled to damages against GRPL for a breach of s. 111 of the Personal Property Securities Act 2009 No. 130 (Cth).

(d) Decision

(i) Procedural irregularities and court orders under s. 1322

Holmes CJ considered Mrs Kenward's appointment did not constitute a procedural irregularity and refused to order that the appointment was valid pursuant to s. 1322(4)(a) of the Corporations Act. That is because the appointment had been made to fill a quorum deficiency at the directors' meeting that only arose because Mr Clark was invalidly excluded from the meeting.

(ii) Assumptions under s. 129 of the Corporations Act

Holmes CJ relevantly held that GRPL could not rely on s. 129(2) of the Corporations Act to assume that Mrs Kenward had been validly appointed as a director of MDPL. That is because the appointment had been made solely by Mr Kenward and was not valid. Therefore, the information provided to ASIC outlining the appointment was not information provided by MDPL and could not be relied on by GRPL to support the assumption (citing *Wood v Inglis* (2008) 68 ACSR 420.

However, her Honour was satisfied that it was open to GRPL to assume that the Deed of Variation and power of attorney (used to execute the Continuation Deed) had been duly executed by MDPL (s. 129(5)) as they both appeared to be signed by two of its directors (at [81]). She did not consider that Mr Foggo knew or suspected that these assumptions were incorrect (citing s. 128(4)) because he was not involved in Mrs Kenward's appointment, nor did he have the requisite legal knowledge to assess whether the appointment was valid. This finding was made despite Mr Foggo's knowledge of, and involvement in, efforts to restrict Mr Clark's involvement in the CGU litigation. Based on these assumptions, her Honour concluded that the Deed of Variation was effective and ratified the litigation funding agreement as extended by the Continuation Deed.

(iii) Could GRPL reorder the priority of payments?

Holmes CJ held the priority letter was not effective to reorder the priority of payments under the litigation funding agreement. Mr Kenward had no actual authority to bind MDPL to its terms, nor did he purport to sign the priority letter pursuant to his power of attorney which could have entitled Mr Foggo to rely on the assumption it had been duly executed. Further, no consideration had been provided for MDPL's agreement.

Despite that, her Honour held that the priority could be reordered pursuant to the Westpac loan agreement now assigned to GRPL. The Westpac loan agreement permitted GRPL to apply monies received from MDPL to satisfy whichever debt it chose. Further, the Deed of Assignment had been signed by MDPL under Mr Kenward's power of attorney. Mr Foggo was therefore entitled to assume the Deed of Assignment had been duly executed and was treated by her Honour as if this was the case.

6.10 Application for leave to bring shareholder derivative action
(By Adam Ong, Ashurst)

In the matter of Orico Australia Pty Ltd [2019] VSC 313 (30 April 2019), Supreme Court of Victoria, Connock J

(a) Summary

The case involved an application by Ms Liping Zhu (Ms Zhu) under s. 236 and s. 237 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) for the Court to grant leave *nunc pro* *tunc* to bring proceedings against a former employee, Mr Xu. Ms Zhu is one of two directors and a 50% shareholder of Orico Australia Pty Ltd (Orica Australia).

Orica Australia had previously commenced proceeding against Mr Xu, in the Magistrates Court of Victoria for allegedly breaching the terms of his employment contract and any fiduciary duties held by him as an employee when he established a competitor company (the Primary Proceeding).

The application for leave was granted in favour of Ms Zhu upon the satisfaction of the criteria in s. 236 and s. 237 of the Corporations Act.

The primary issues in this case were, whether:

- Ms Zhu acted in good faith in applying for leave;
- it was in the best interests of Orico Australia to grant leave; and
- there was a serious question to be tried in respect of the claims sought by Orico Australia in the Primary Proceeding.

(b) Facts

(i) Background

Ms Zhu, on behalf of Orico Australia, commenced proceedings against Mr Xu, a former employee who allegedly breached his employment agreement and fiduciary duties owed to Orico Australia. It was alleged that Mr Xu was involved in establishing and becoming a director and 50% shareholder of a competitor company (Orico Australia and New Zealand Pty Ltd (Orico ANZ)) while employed with Orico Australia. It was also alleged that Mr Xu diverted major customers of Orico Australia to Orico ANZ while he was still employed with Orico Australia.

To this extent, the following information was relevant to the application for leave under s. 237(2) of the Corporations Act:

- Biyu Jin is the other director and 50% shareholder in Orico Australia. She is also Mr Xu's wife and opposed Ms Zhu's application;
- Ms Zhu alleged that Mr Xu was employed by Orico Australia from October 2014 until 1 July 2016. Preliminary documentary evidence, such as emails and delayed payment documentation were provided to support this position;
- Orico ANZ was incorporated on 14 April 2016. It was submitted that Mr Xu had used his position as an employee of Orico Australia to divert two of Orico Australia's largest purchasers to Orico ANZ as evidenced by invoices from Orico ANZ to clients on 16 May 2016 and 27 May 2016;
- Mr Xu and Ms Jin contended that Mr Xu was only employed at Orico Australia until about 31 March 2016. To this extent there was a disagreement as to the timing of Mr Xu's employment;
- Orico Australia's directors, being Ms Zhu and Ms Jin, were unable to agree that the Primary Proceeding ought to continue. Ms Zhu submitted that the inability of the directors of the company to agree was most likely due to Mr Xu being Ms Jin's husband.

The leave application was contested by Ms Jin, on the grounds that the criteria in s. 237(2) of the Corporations Act had not been satisfied.

(ii) The law

The application hearing focused on whether the requirements of s. 237(2) of the Corporations Act had been met. Connock J stated that if the criteria in s. 237(2) of the Act are made out, there is no discretion afforded to the court and leave must be granted to the applicant. Conversely, if one of the criteria cannot be made out, the Court should refuse leave.

The relevant subsections of s. 237(2) of the Corporations Act are as follows:

The court must grant the application if it is satisfied that.

(b) the applicant is acting in good faith;
(c) it is in the best interests of the company that the applicant be granted leave; and
(d) if the applicant is applying for leave to bring proceedings - there is a serious question to be tried.

In considering s. 237(2)(b), the good faith requirement, Connock J cited Palmer J in *Swansson v RA Pratt Properties Pty Ltd* (2002) 42 ACSR 313 (Swansson) with approval, stating that where an application is made by a current shareholder who has more than a token shareholding, and the derivative action would increase the share value, good faith should be relatively easy to demonstrate. This position was also held to extend to instances where the applicant is a current director or officer.

It was reiterated that s. 237(2)(c) of the Corporations Act requires the proceeding to be in the best interests of the company and not just likely to be in the company's best interests (*Swansson*). Connock J stated that where a company is solvent, the best interests will usually align with those interests of the shareholders (*Huang v Wang* (2016) 114 ACSR 586). Citing *Robash Pty Ltd v Gladstone Pacific Nickel Pty Ltd* (2011) 86 ACSR 432 with approval, Connock J held that other considerations relevant to "the best interests of the company" include the prospects of success, costs to the company, resources of the company required and the likely consequence of the proceeding for the company. It was also held that there is no fixed test to determine best interests and there is no special standard of proof or any presumption or disposition against the granting of relief. Further, in determining whether to grant leave, the fact that an applicant has a personal interest in the outcome of the action or the applicant has personal animus against other members of the company is not significant or decisive because this is common in the types of disputes that lead to a derivative action (*Huang*).

In considering s. 237(2)(d) of the Corporations Act, Connock J held that the leave application in this instance should be characterised as an application to "bring a proceeding", rather than an application to "intervene in a proceeding". Connock J, citing Palmer J in *Swansson* with approval, held that the court will not normally enter into the merits of the proposed action to any great degree and that the applicant has the same relatively low threshold as in the case of an interlocutory injunction and therefore the court does not make factual determinations concerning the case. Further, Connock J held that this "serious question to be tried" test does not turn into a trial of the substantive issues.

(c) Decision

Connock J held that:

- for s. 237(2)(b) of the Corporations Act, Ms Zhu was acting in good faith on the basis that she had a real interest in the financial position of Orico Australia, and the derivative action was directed towards enhancing or restoring the value of the shareholding. Ms Zhu also deposed her willingness to give an undertaking to the Court to repay costs, which was held to further militate in favour of good faith;

- for s. 237(2)(c) of the Corporations Act, Ms Zhu's application was in the best interests of the company on the grounds that, as the company was solvent and had no creditors, the best interests were predominately reflected in the shareholders' interests. Citing Ragless v IPA Holdings Pty Ltd (2008) 65 ACSR 700 with approval, Connock J held that the Primary Proceeding was also in the best interests of the company as it provided a successful method for resolving a deadlock between directors; and
- for s. 237(2)(d) of the Corporations Act, Ms Zhu satisfied the standard of proving that there was a serious question to be tried, on the grounds that there was a strongly contested factual issue between the two parties with respect to the date that Mr Xu left Orico Australia.

Connock J granted leave *nunc pro tunc* pursuant to s. 237 of the Corporations Act, subject to Ms Zhu giving a satisfactory undertaking to the court regarding Orico Australia's costs and any adverse costs orders.
