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Bulletin No. 271

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Legislation Hotline

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1. Recent Corporate Law and Corporate Governance Developments

1.1 IOSCO report examines how existing regulatory principles could apply to stablecoins

23 March 2020 - The Board of the International Organization of Securities Commissions (IOSCO) has published a report identifying the possible implications of global stablecoin initiatives for securities markets regulators.

The report entitled Global Stablecoin Initiatives (the Report) examines the regulatory issues arising from the use of global stablecoins and explores how existing *IOSCO Principles and Standards* could apply to these arrangements. IOSCO's Fintech Network prepared the Report as part of an effort to evaluate global stablecoin proposals from a securities market regulator's perspective.

The Report finds that, depending on its structure, a global stablecoin may fall within securities market regulatory frameworks. Whether *IOSCO Principles and Standards* are relevant to stablecoins depends on the specific design of each initiative and its legal and regulatory characteristics and features.

IOSCO's Report describes a Hypothetical Case Study that is based on a hypothetical stablecoin used for domestic and cross-border payments. The hypothetical coin uses a reserve fund and intermediaries to try to achieve a stable price vis-a-vis a basket of low volatility currencies. The Report analyses how different IOSCO Principles and Recommendations, such as the IOSCO Policy Recommendations for Money Market Funds, the IOSCO Principles for ETFs, the Final Report on Crypto-Asset Trading Platforms and IOSCO work on Market-Fragmentation, Cyber

Resilience, and Client Assets could apply to the case study or similarly structured stablecoins, depending on their proposed design or function.

In parallel, together with the Committee on Payments and Market Infrastructures (CPMI), IOSCO has carried out a separate preliminary analysis on the application of the *CPMI-IOSCO Principles for Financial Market Infrastructures* (PFMI) which is attached at Annex 1 of the Report. That preliminary analysis concludes that the PFMI apply to global stablecoin arrangements where such arrangements perform systemically important payment system functions or other FMI functions that are systemically important; and could therefore apply to the Hypothetical Case Study.

Given the potential cross-border and cross-agency reach of existing and new stablecoin structures, IOSCO is working with other international bodies and standard setters, including the Financial Stability Board (FSB), to better understand stablecoin proposals and risks. The FSB is currently examining the regulatory issues raised by global stablecoin arrangements as mandated by the G20 in June 2019 and will publish a consultative report in April 2020.

1.2 Law Council of Australia releases guidance on contingency plans for AGMs

23 March 2020 - Companies planning their annual general meeting (AGM) or other general meetings during the current pandemic, should be considering developing contingency plans, says the Law Council of Australia.

This follows the release of a guidance note, developed by the Law Council of Australia in partnership with the Governance Institute of Australia and the Australasian Investor Relations Association.

Companies will need to make sure that arrangements for an AGM provide a reasonable opportunity for shareholders to participate in the meeting, including having a reasonable opportunity for shareholders to ask questions, make comments and to vote.

1.3 APRA adapts 2020 agenda to prioritise COVID-19 response

23 March 2020 - The Australian Prudential Regulation Authority (APRA) has suspended the majority of its planned policy and supervision initiatives in response to the impact of Coronavirus (COVID-19).

The decision is intended to allow APRA-regulated entities to dedicate time and resources to maintaining their operations and supporting customers, while also enabling APRA to intensify its focus on monitoring and responding to the impact of a rapidly changing environment on entities' financial and operational capacity.

APRA is therefore suspending all substantive public consultations and actions to finalise revisions to the prudential framework that are currently underway or upcoming, including consultations on prudential and reporting standards. It will keep the situation under review, but presently does not plan to recommence consultation on any non-essential matters before 30 September 2020.

APRA may continue to progress certain data reporting initiatives where they are critical to meeting its mandate in the current environment, including new data collections related to the impacts of COVID-19.

Over the period ahead, APRA's primary supervision focus will be on monitoring the impact of COVID-19 on the financial and operational capacity of regulated institutions. As a result, APRA's supervision priorities outlined in January 2020 will be largely suspended until at least 30 September, particularly where they involve intensive engagement with regulated entities. APRA's refocused supervision effort will involve frequent communication with entities, monitoring key financial settings, such as capital and liquidity, and responding accordingly. These engagements will be conducted virtually, unless absolutely necessary, and will continue as long as necessary.

APRA is also reconsidering the implementation dates and transition timeframes for prudential and reporting standards that have been recently finalised but not yet implemented. Further details on any adjustments will be provided shortly.

1.4 Government economic response to COVID-19

22 March 2020 - The Australian Government has published details of temporary relief that will be provided to businesses facing financial distress due to the COVID-19 outbreak.

The economic impacts of COVID-19 and health measures to prevent its spread could see many otherwise profitable and viable businesses temporarily face financial distress. It is important that these businesses have a safety net to make sure that when the crisis has passed they can resume normal business operations. One element of that safety net is to lessen the threat of actions that could unnecessarily push them into insolvency and force the winding up of the business.

The elements of the package are:

- a temporary increase in the threshold at which creditors can issue a statutory demand on a company and the time companies have to respond to statutory demands they receive;
- a temporary increase in the threshold for a creditor to initiate bankruptcy proceedings, an increase in the time period for debtors to respond to a bankruptcy notice, and extending the period of protection a debtor receives after making a declaration of intention to present a debtor's petition;
- temporary relief for directors from any personal liability for trading while insolvent; and
- providing temporary flexibility in the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) to provide targeted relief for companies from provisions of the Act to deal with unforeseen events that arise as a result of the COVID-19 health crisis.

For owners or directors of a business that are currently struggling due to COVID-19, the Australian Taxation Office (ATO) will tailor solutions for their circumstances, including temporary reduction of payments or deferrals, or withholding enforcement actions including Director Penalty Notices and wind-ups.

Temporary higher thresholds and more time to respond to demands from creditors
A creditor issuing a statutory demand on a company is a common way for a company to enter

liquidation. The Australian Government is temporarily increasing the current minimum threshold for creditors issuing a statutory demand on a company under the Corporations Act from $2,000 to $20,000. This will apply for six months.

Not responding to a demand within the specified time creates a presumption that the company is insolvent. The statutory timeframe for a company to respond to a statutory demand will be extended temporarily from 21 days to six months. This will apply for six months.

To assist individuals, the Government will make a number of changes to the personal insolvency system regulated by the Bankruptcy Act 1966 No. 33 (Cth). The threshold for the minimum amount of debt required for a creditor to initiate bankruptcy proceedings against a debtor will temporarily increase from its current level of $5,000 to $20,000. This will apply for six months.

Failure to respond to a bankruptcy notice is the most common act of bankruptcy. The time a debtor has to respond to a bankruptcy notice will be temporarily increased from 21 days to six months. The extension will give a debtor more time to consider repayment arrangements before they could be forced into bankruptcy. This will apply for six months.

When a debtor declares an intention to enter voluntary bankruptcy by making a declaration of intention to present a debtor's petition there is a period of protection when unsecured creditors cannot take further action to recover debts. This period will be temporarily extended from 21 days to six months. This will give debtors more time to consider the options that are best for them.

This will apply for six months. Creditors, many of whom are themselves small businesses, will still have the right to enforce debt against companies or individuals through the courts.

Temporary relief from directors' personal liability for trading while insolvent
Directors are personally liable if a company trades while insolvent. This can lead to boards of directors feeling under pressure to make quick decisions to enter into an insolvency process if there is any risk that the company will experience periods where it will be trading while insolvent.

To make sure that companies have confidence to continue to trade through the COVID-19 health crisis with the aim of returning to viability when the crisis has passed, directors will be temporarily relieved of their duty to prevent insolvent trading with respect to any debts incurred in the ordinary course of the company's business. This will relieve the director of personal liability that would otherwise be associated with the insolvent trading. It will apply for six months.

Temporary relief from personal liability for insolvent trading will apply with respect to debts incurred in the ordinary course of the company's business. Egregious cases of dishonesty and fraud will still be subject to criminal penalties. Any debts incurred by the company will still be payable by the company.

Providing the Treasurer an instrument-making power under the Corporations Act
The impact of COVID-19 and the health measures in place to limit its spread, in particular social distancing, is giving rise to unprecedented issues for businesses' ability to comply with the provisions of the Corporations Act.

The Australian Securities and Investment Commission (ASIC) has the power to offer relief from some provisions or to take no action for not complying with some provisions. But this can require companies to make individual requests to ASIC, which takes time. Importantly, it can still leave companies open to legal action from others, such as shareholders or creditors.

Companies are needing to make very quick decisions in the context of very uncertain trading conditions. To encourage business to make the hard decisions, it is important that the Government can provide regulatory certainty and provide it as quickly as possible. And the unprecedented nature of the COVID-19 health crisis makes it difficult to predict what regulatory issues will arise.

To deliver regulatory certainty at a time when Parliamentary sittings will also be disrupted, the Treasurer will be given a temporary instrument-making power in the Corporations Act to temporarily amend provisions of the Act to provide relief from specific obligations or to modify obligations to enable compliance with legal requirements during the crisis. The instrument-making power will apply for six months. Any instrument made under this power will apply for up to six months from the date it is made.

Information is provided on the Treasury website.

1.5 Government to help small businesses get access to credit

20 March 2020 - To help small businesses get access to credit quickly and efficiently, the Australian Government has stated that it is providing greater certainty by ensuring that responsible lending obligations do not apply to the provision of credit to small businesses.

Currently, responsible lending obligations do not apply to lending which is predominantly for business purposes. To fall within this exemption, a lender must undertake due diligence to confirm that the money borrowed meets this test.

To allow lenders the ability to move quickly to support small businesses, the Australian Government will provide an exemption from responsible lending obligations for a period of six months in relation to the credit they extend to their existing small business customers, provided there is an existing borrowing relationship and some proportion of that credit is used for business purposes.

The exemption will apply to new credit, credit limit increases and credit variations and restructures.

Credit providers regulated by APRA will remain subject to APRA's prudential standards while the exemption applies, and providers who subscribe to an industry code will remain obliged to abide by that code. The Australian Financial Complaints Authority will retain its current jurisdiction to resolve complaints relating to lending.

1.6 Report on the Crimes Legislation Amendment (Combatting Corporate Crime) Bill 2019

17 March 2020 - The Senate Legal and Constitutional Affairs Legislation Committee (the Committee) has published its report on the Crimes Legislation Amendment (Combatting Corporate Crime) Bill 2019 (Corporate Crime Bill) 2019 (Cth).

The Bill seeks to address challenges associated with detecting and addressing serious corporate crime by:

- amending the existing offence of bribery of a foreign public official in Schedule - The Criminal Code to the Criminal Code Act 1995 No. 12 (Cth) (the Criminal Code);
- introducing a new offence of failure of a body corporate to prevent foreign bribery by an associate;
- implementing a Commonwealth deferred prosecution agreement (DPA) scheme; and
- repealing the existing definition of 'dishonest' in the Criminal Code and inserting a new definition of 'dishonest' into the Criminal Code's Dictionary. The new definition provides that 'dishonest' means 'dishonest according to the standards of ordinary people'. The explanatory memorandum explains that this proposed definition "will align the Criminal Code definition of 'dishonest' with the test for dishonesty endorsed by the High Court of Australia (HCA) in *Peters v The Queen* (1998) 192 CLR 493. Under the test adopted in *Peters*, there is no requirement to prove that the defendant was aware that their knowledge, belief or intent was dishonest according to the standards of ordinary people".

A number of submissions were critical of aspects of the Bill, particularly the proposed new definition of "dishonest". However, the majority of the Committee recommended that the Bill be passed without amendment for the following reasons:

- "2.65 Corporate crime and foreign bribery can cause significant harm to the Australian people and economy. The committee strongly supports measures to combat corporate crime, such as those contained in the bill. The committee acknowledges that, as discussed in this report, there was broad support for this bill among inquiry participants";
- "2.66 The proposed amendments relating to foreign bribery will ensure that Australia's law enforcement agencies are able to effectively combat corporate crime. In particular, the proposed new offence of failure to prevent foreign bribery will ensure that companies cannot be wilfully blind to corrupt practices within their businesses";
- "2.67 The *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* [(the Royal Commission)] made significant findings regarding corporate conduct. The committee is pleased that the department reviewed the Royal Commission's final report against the proposed DPA scheme, and concurs with the department that the proposed scheme forms part of an appropriate response to the Royal Commission's final report";
- "2.68 The committee acknowledges some concerns regarding how the proposed DPA scheme would operate. However, the committee is satisfied that the proposed scheme contains appropriate safeguards to ensure that the public can have confidence in the system. The committee is also reassured by the department's advice that the DPA scheme would serve as an additional enforcement tool and not as a substitute for the robust investigation and prosecution of corporate crime";
- "2.69 The committee further considers that the proposed definition of dishonesty has been appropriately considered by the department and other government agencies. Evidence from the department and the AFP demonstrate that the proposed amendments are important to ensuring that Australia's law enforcement agencies can effectively prosecute dishonest corporate conduct"; and
- "2.70 The committee considers that the bill will make an important contribution to Australia's efforts to combat corporate crime".

The Labor members of the Committee published a dissenting report in which they recommended that the proposed DPA scheme should not be introduced in its current form and that the proposed definition of "dishonest" should not be introduced. The Green member of the Committee recommended that the Senate suspend consideration of the Bill until after the Attorney-General has tabled the Australian Law Reform Commission's forthcoming report into Australia's corporate criminal responsibility.

The report is available on the Committee's website.

1.7 FSI paper on bank boards - a review of post-crisis regulatory approaches

17 March 2020 - The Financial Stability Institute has published a paper providing a review of post-crisis regulatory approaches to bank boards.

Prudential authorities control the quality of individuals that serve on bank boards through their "fit and proper" (F&P) assessment process. Despite these requirements, failures in bank governance were a root cause of the Great Financial Crisis, which subsequently led standard setters to tighten their governance requirements. This paper surveys 19 jurisdictions and reviews their post-crisis F&P assessment criteria for bank directors, and the related guidance on board composition and structure.

While all jurisdictions prescribe F&P criteria, some have no regulatory powers to approve board candidates, or they do not require prior approval of all bank directors. Where prior regulatory approval is required, regulatory decisions are driven by the fitness criterion, which comprises a range of different factors.

When it comes to board composition, nearly all authorities require the chair and the CEO roles to be separated, and many prescribe an appropriate mix of executive directors, non-executive directors (NEDs) and independent non-executive directors (INEDs) on the board. In this context, all jurisdictions provide guidance on what is not considered "independent", focusing on the relationship between a bank and a director. Several jurisdictions also impose tenure limits for INEDs and NEDs. As for board structure, most authorities require banks to establish risk, audit, and remuneration committees, while ethics and culture committees are rare.

Based on the FSI stocktake, the FSI also identifies areas where additional guidance on aspects of board governance can help to further strengthen the quality of bank boards which, in turn, may enhance confidence in the financial system.

View the Executive summary and FSI paper No 25.

1.8 SEC adopts amendments to reduce unnecessary burdens on smaller issuers by more appropriately tailoring the accelerated and large accelerated filer definitions

12 March 2020 - The US Securities and Exchange Commission has adopted amendments to the accelerated filer and large accelerated filer definitions. The amendments will more appropriately tailor the types of issuers that are included in the definitions, thereby reducing unnecessary

burdens and compliance costs for certain smaller issuers while maintaining investor protections. The amendments are consistent with the Commission's and Congress's historical practice of providing scaled disclosure and other accommodations to reduce unnecessary burdens for new and smaller issuers.

Following the adoption of the amendments, smaller reporting companies with less than US $100 million in revenues will continue to be required to establish and maintain effective internal control over financial reporting (ICFR). Their principal executive and financial officers must continue to certify that, among other things, they are responsible for establishing and maintaining ICFR and have evaluated and reported on the effectiveness of the company's disclosure controls and procedures. In addition, these smaller companies will continue to be subject to a financial statement audit by an independent auditor, who is required to consider ICFR in the performance of that audit. As a result of these amendments, and unlike larger issuers, these smaller companies will no longer be required to obtain a separate attestation of their ICFR from an outside auditor. These smaller issuers will be able to redirect the associated cost savings into growing their businesses. Business development companies will receive analogous treatment as a result of the amendments.

The final amendments will become effective 30 days after publication in the Federal Register and apply to an annual report filing due on or after the effective date.

View the Factsheet and Final Rule.

1.9 FCA announces proposals to improve climate-related disclosures by listed companies

6 March 2020 - The United Kingdom (UK) Financial Conduct Authority (FCA) has published proposals outlining new climate-related disclosure requirements for premium listed issuers.

The new rule will require all commercial companies with a premium listing to either make climate related disclosures consistent with the approach set out by the Taskforce on Climate-related Financial Disclosures (TCFD) or explain why not. The FCA will consider consulting on extending this rule to a wider scope of issuers.

The proposals set out in the Consultation Paper build upon the recommendations of the TCFD, an existing global standard.

The FCA is also seeking feedback on clarifications to how existing requirements applicable to all listed companies already require climate- and other sustainability-related disclosure.

The FCA recognises that standards for disclosure and companies understanding of the financial impacts of climate change are evolving. For this reason, where companies are not yet able to make full disclosures, they should provide an explanation of the reasons why.

The work of the Climate Financial Risk Forum - an industry group that the FCA launched jointly with the Bank of England's Prudential Regulation Authority in March 2019 - will also help to build disclosure capabilities.

The Forum will soon be publishing industry guidance, covering climate-related disclosures, risk management, scenario analysis and innovation. These guidance materials are also grounded in the TCFD's recommendations and will complement the proposed new rule.

The FCA is also currently considering how best to enhance climate-related disclosures by regulated firms, including asset managers and life insurers, to ensure a coordinated approach. The FCA is working closely with UK Government and other regulators, including through a Taskforce established by the UK Treasury, under the UK Government's Green Finance strategy.

View:

- CP20/3: Proposals to enhance climate-related disclosures by listed issuers and clarification of existing rules;
- Discussion Paper: DP18/8; and
- Feedback Statement 19/6.

1.10 Government response to Australian Charities and Not-for-Profits Commission legislation review

6 March 2020 - The Australian Government has published its response to the Australian Charities and Not-for-profits Commission (ACNC) legislation review. The final report of the review, "Strengthening for Purpose: Australian Charities and Not-for-profits Commission Legislative Review 2018", was tabled in Parliament on 22 August 2018.

The Australian Government supports some of the recommendations, including that:

- the ACNC should continue to prioritise its education and research functions, including the use of behavioural insights and incentives;
- that registered entities be required to disclose related party transactions;
- minimum reporting requirements for small registered entities should be amended to allow in an Annual Information Statement an option to provide a simplified balance sheet or a statement of resources;
- large registered entities should be required to disclose the remuneration paid to responsible persons and senior executives on an aggregated basis; the Commissioner should be given a discretion to disclose information about regulatory activities (including investigations) when it is necessary to protect public trust and confidence in the sector; and
- the Commissioner should be authorised to collect the personal details of responsible persons involved in unlawful activity.

Other recommendations are not supported including the recommendation that the Australian Charities and Not-for-profits Commission Act 2012 No. 168 (Cth) should be amended to include functions and duties that align with the objects (as the Government does not consider this will enhance the ACNC's effectiveness as a regulator) and the recommendation that the powers of the Commissioner to replace a responsible person should be removed.

The 2018 report also recommended that the Corporations Act 2001 No. 50 (Cth) should be amended to turn on the duties and other provisions previously turned off in relation to charitable companies. This was on the bases that this would "reduce the ambiguity about whether directors' duties for charitable companies applied and strengthen the rights of members to take action against directors in the case of a breach of duties".

In its response, the Government notes the recommendation and states that it will release a consultation paper seeking the views of the sector on the merits and risks of turning on the directors' duties under the Corporations Act for charitable companies.

1.11 Parliamentary Committee to examine class action system and litigation funding

5 March 2020 - Attorney-General Christian Porter has announced that the federal government will be referring an inquiry to the Parliamentary Corporations and Financial Services Joint Committee (the Committee) which "will be given broad terms of reference to inquire into all aspects of the class action system, including whether further regulation of litigation funders is needed to improve justice outcomes".

According to Mr Porter, the Committee will examine "[w]hether the present level of regulation applying to Australia's growing class action industry is impacting fair and equitable outcomes for plaintiffs", including consideration of:

- what evidence is available regarding the quantum of fees, costs and commissions earned by litigation funders and the treatment of that income;
- the potential impact of proposals to allow contingency fees and whether this could lead to less financially viable outcomes for plaintiffs;
- the financial and organisational relationship between ligation funders and lawyers acting for plaintiffs in funded litigation and whether these relationships have the capacity to impact on plaintiff lawyers' duties to their clients;
- the Australian financial services regulatory regime and its application to litigation funding;
- the regulation and oversight of the litigation funding industry and litigation funding agreements; and
- factors driving the increasing prevalence of class action proceedings in Australia.

The Committee is expected to report by 9 November 2020.

1.12 European IPO Task Force report on how to improve conditions for European IPO markets

2 March 2020 - Since the launch of the *Capital Markets Union Plan* in 2015 the number of European initial public offerings (IPOs) has decreased. The European IPO Task Force has published a report that addresses what needs to be done to reverse this trend. The report provides an overview of issues that companies, investors, exchanges and other market participants are facing in trying to promote companies' access to capital market financing and suggests measures that European policy makers could implement in order to address these challenges.

The report discusses the following six key issues that require attention:

- IPO ecosystems be improved, specifically for companies and investors;
- investors' participation in IPO markets be improved;
- a European equity culture be created;
- tax incentives for investment in IPOs and equity be implemented;
- a regulatory framework that favours technological innovation be created; and
- capital markets be supported in the transition to a sustainable economy.

View the European IPO Report 2020.

1.13 House of Representatives Standing Committee on Economics review of APRA and ASIC annual reports

2 March 2020 - The House of Representatives Standing Committee on Economics (the Committee) has published its reviews of the annual reports of the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC).

In its Review of the APRA 2019 Annual Report, the Committee examines current issues in prudential regulation including improving APRA's capability (leadership and culture, resourcing, enforcement, supervision, and cooperation between regulators), rebuilding trust in the financial services sector (the Banking Executive Accountability Regime and other matters), and superannuation.

In its Report of the ASIC 2018 Annual Report, the Committee examines current issues in financial systems regulation, focussing on the Financial Services Royal Commission (implementation of the Royal Commission's recommendations, ASIC's new enforcement approach, ASIC's new supervisory approach, and measuring performance and implementation of recommendations), consumer protections (disclosure, design and distribution obligations and product intervention powers), superannuation (surveillance of underperforming funds and self-managed super funds), mortgages (responsible lending and tracker mortgages), audit inspection reviews, non-financial risk management (disclosure of climate change related risks and opportunities), the retail corporate bond market and a beneficial ownership register.

1.14 Parliamentary Committee interim report on the regulation of auditing

27 February 2019 - the Parliamentary Joint Committee on Corporations and Financial Services (the Committee) has published an interim report titled Regulation of Auditing in Australia.

The report comprises the following main chapters:

- Chapter 2 provides an overview of Australia's legislative and regulatory framework for audit;
- Chapter 3 reviews matters relevant to the state of audit quality in Australia;
- Chapter 4 discusses threats to auditor independence, as a key component of audit quality, as well as potential solutions to these threats; and

- Chapter 5 examines the gap that exists between the regulatory requirements pertaining to audit and the public's expectations of the functions of an audit, as well as proposals to expand the scope of audit to better meet user needs.

The Committee makes 10 recommendations in the report.

Recommendation 1
The Committee recommends that ASIC:

- formally review the manner in which it publicly reports the periodic findings of its audit inspection program, giving appropriate consideration to approaches used internationally; and
- based on this review, develop and implement, by the end of the 2020-21 reporting period for its audit inspection program, a revised framework for reporting inspection findings, with a focus on the transparency and relative severity of identified audit deficiencies.

Recommendation 2
The Committee recommends that the Australian Government introduce, by the end of the 2020 - 21 financial year, through appropriate legislation, a requirement that ASIC publish all future individual audit firm inspection reports on its website once ASIC has adopted a revised reporting framework referred to in Recommendation 1.

Recommendation 3
The Committee recommends that the Financial Reporting Council (FRC), in partnership with ASIC, by the end of the 2020 - 21 financial year, oversee consultation, development and introduction under Australian standards of:

- defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and
- a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.

Recommendation 4
The Committee recommends that the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) be amended so that an auditor's independence declaration is expanded to require the auditor to specifically confirm that no prohibited non-audit services have been provided.

Recommendation 5
The Committee recommends that the Australian Professional and Ethical Standards (APES) Board consider revising the *APES 110 Code of Ethics* to include a safeguard that no audit partner can be incentivised, through remuneration advancement or any other means or practice, for selling non-audit services to an audited entity.

Recommendation 6
The Committee recommends that the FRC, by the end of the 2020 - 21 financial year, oversee the revision and implementation of Australian standards to require audited entities to disclose auditor tenure in annual financial reports. Such disclosure should include both the length of tenure of the entity's external auditor, and of the lead audit partner.

Recommendation 7
The Committee recommends that the Corporations Act be amended to implement a mandatory

tendering regime such that entities required to have their financial reports audited under the Act must:

- undertake a public tender process every ten years; or
- if an entity elects not to undertake a public tender process, the entity must provide an explanation to shareholders in its annual report as to why this has not occurred.

The Committee further recommends that such a tender process be implemented by 2022 for any entity that has had the same auditor for a continuous period of ten years since 2012.

Recommendation 8
The Committee recommends that the FRC oversee a formal review, to report by the end of the 2020-21 financial year, of the sufficiency and effectiveness of reporting requirements under the Australian standards in relation to:

- the prevention and detection of fraud; and
- management's assessment of going concern.

Recommendation 9
The Committee recommends that the Corporations Act be amended such that entities required to have their financial reports audited under the Act must establish and maintain an internal controls framework for financial reporting.

In addition, such amendments should require that:

- management evaluate and annually report on the effectiveness of the entity's internal control framework; and
- the external auditor report on management's assessment of the entity's internal control framework.

Recommendation 10
The Committee recommends that the Australian Government take appropriate action to make digital financial reporting standard practice in Australia.

1.15 APRA outlines plans for climate risk prudential guidance and vulnerability assessment

24 February 2020 - APRA has published its letter to all APRA-regulated institutions outlining plans to develop a prudential practice guide focused on climate-related financial risks, as well as a climate change vulnerability assessment.

The letter also outlines APRA's intention to update superannuation *Prudential Practice Guide SPG 530 Investment Governance*, which includes paragraphs related to environmental, social and governance (ESG) investments.

The letter is available on the APRA website.

1.16 Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 (Cth)

February 2020 - The Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 No. 6 (Cth) amends the legislation listed below.

According to the explanatory memorandum, the amending Act:

- introduces new phoenixing offences to prohibit creditor-defeating dispositions of company property, penalise those who engage in or facilitate such dispositions, and allow liquidators and ASIC to recover such property;
- ensures directors are held accountable for misconduct by preventing directors from improperly backdating resignations or ceasing to be a director when this would leave the company with no directors;
- allows the Commissioner of Taxation (the Commissioner) to collect estimates of anticipated goods and services tax (GST) liabilities and make company directors personally liable for their company's GST liabilities in certain circumstances; and
- authorises the Commissioner to retain tax refunds where a taxpayer has failed to lodge a return or provide other information to the Commissioner that may affect the amount the Commissioner refunds.

This affects the following legislation:

- A New Tax System (Goods and Services Tax) Act 1999 No. 55 (Cth);
- Aged Care (Accommodation Payment Security) Act 2006 No. 26 (Cth);
- Banking Act 1959 No. 6 (Cth);
- Corporations (Aboriginal and Torres Strait Islander) Act 2006 No. 124 (Cth);
- Corporations Act 2001 No. 50 (Cth);
- Insurance Act 1973 No. 76 (Cth);
- Life Insurance Act 1995 No. 4 (Cth); and
- Taxation Administration Act 1953 No. 1 (Cth).

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2. Recent ASIC Developments

2.1 ASIC recalibrates its regulatory priorities to focus on COVID-19 challenges

23 March 2020 - In coordination with the Council of Financial Regulators, ASIC will focus its regulatory efforts on challenges created by the COVID-19 pandemic. Until at least 30 September 2020, the other matters that ASIC will afford priority are where there is the risk of significant consumer harm, serious breaches of the law, risks to market integrity and time-critical matters.

ASIC is committed to working constructively and pragmatically with the firms it regulates, mindful they may encounter difficulties in complying with their regulatory obligations due to the impact of COVID-19.

ASIC has immediately suspended a number of near-term activities which are not time-critical. These include consultation, regulatory reports and reviews, such as the ASIC report on executive remuneration, updated internal dispute resolution guidance and a consultation paper on managed discretionary accounts. Stakeholders will shortly be notified of deferred consultation and publications relevant to them.

ASIC will also suspend its enhanced on-site supervisory work such as the *Close and Continuous Monitoring Program*.

In issuing information-gathering notices, ASIC has provided new guidance to its staff - mindful that many notice recipients may be facing significant disruption.

By taking these actions, industry participants will be better placed to focus on their immediate priorities and the needs of their customers at this difficult time.

Where warranted, relief or waivers from regulatory requirements will also be provided. This will include requirements on listed companies associated with secondary capital raisings and audits. ASIC has already indicated a 'take no action' stance in relation to the timing of annual general meetings (AGMs) until 31 July and the conduct of AGMs by electronic means (see item 2.2 below).

ASIC will also work with financial institutions to further accelerate the payment of outstanding remediation to customers.

ASIC will take account of the circumstances in which lenders, acting reasonably, are currently operating when administering the law.

ASIC will maintain its enforcement activities and continue to investigate and take action where the public interest warrants ASCI to do so against any person or entity that breaks the law. However, it will focus on action necessary to prevent immediate consumer harm, egregious illegal conduct and other time critical matters.

Key business as usual functions will be maintained including registry operations and services, receipt of whistleblower, breach and misconduct reports and general contact points for industry.

More about COVID-19

2.2 Guidelines for meeting upcoming AGM and financial reporting requirements

20 March 2020 - COVID-19 may temporarily impact on companies' ability to hold an AGM. This issue is most immediately relevant for listed and unlisted public companies with 31 December balance dates that are required to hold an AGM by 31 May 2020.

For these entities, ASIC:

- confirms it will take no action if the AGMs are postponed for two months, that is, until the end of July 2020; and
- supports the holding of AGMs using appropriate technology.

ASIC cautions entities against holding an AGM while there are restrictions on large gatherings, unless the entity can provide members as a whole with a reasonable opportunity to participate in the meeting.

Financial reporting obligations
ASIC is closely monitoring developments that may affect financial reporting, talking to market participants and auditors, and considering possible impacts and responses. At present, there appear to be no widespread indications of any significant issues for entities in meeting their full-year and half-year financial reporting obligations at 31 December 2019.

Entities with 31 March or 30 June balance dates
ASIC will carefully monitor how market conditions and COVID-19 are affecting financial reporting and AGM obligations for these entities and may update this guidance if needed.

ASIC's formal "no-action" position on AGMs due by 31 May
Entities with a financial year end of 31 December may find it difficult to hold their AGM by the deadline of 31 May 2020 due to the restrictions on large gatherings, travel restrictions and concerns from members about attending large-group meetings in the COVID-19 situation.

ASIC does not have the power to grant extensions of time to hold an AGM on a "class basis", i.e. to all entities with a financial year ended 31 December 2019. ASIC has therefore provided a 'no-action' position on upcoming AGMs that need to be deferred or that are held online.

Two-month extension by "no-action" position
ASIC has adopted a two-month "no-action" position for entities with a financial year end of 31 December 2019 that do not hold their AGM by 31 May 2020. At present, these entities ideally will be able to hold their AGM by the end of July 2020, but the situation will remain under review.

This "no-action" position means that ASIC will not take action against an entity with a financial year end of 31 December 2019 who fails to comply with s. 250N(2) of the Corporations Act 2001 provided the entity holds the AGM by 31 July 2020 or such later date as ASIC advises (the "extension period").

Hybrid and virtual AGMs
Some entities may wish to proceed with holding their AGM by 31 May 2020 or during the extension period, using technology to comply with COVID-19 restrictions. This may include a "hybrid" AGM (where there is a physical location and online facilities) or a "virtual" AGM that is conducted solely online.

ASIC understands the benefit of hybrid and virtual AGMs in the current circumstances, including encouraging members to vote by proxy and participate electronically. In circumstances where a notice of meeting has already been dispatched to members, ASIC supports entities sending supplementary instructions to their members electronically, on their website and via market announcement.

Legal status of hybrid and virtual AGMs
ASIC considers that hybrid AGMs are permitted under the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) but entities need to check whether their constitution restricts meetings being held in this way. ASIC does not have the power to modify the Corporations Act to facilitate hybrid AGMs where they are not permitted under an entity's constitution.

There is some doubt as to whether the Corporations Act permits virtual AGMs and there may also be doubt as to the validity of resolutions passed at a virtual AGM. ASIC does not have the power to modify the Corporations Act to facilitate virtual AGMs. However, ASIC has provided a no-action position on virtual AGMs - see below. Entities should also consider whether they can hold a virtual meeting under their constitution.

Entities that are concerned about the validity of virtual meetings may wish to seek legal advice on s. 1322 of the Corporations Act. Various irregularities associated with meetings held for the purposes of the Act are not invalidated unless the Court makes a contrary declaration. A person may be also able to apply to the Court for an order addressing other irregularities.

No-action position on virtual AGMs
ASIC intends to take a no action position on non-compliance with provisions of the Corporations Act that may restrict the holding of virtual AGMs where an entity elects to hold a virtual AGM in order to comply with the statutory 31 May 2020 deadline or during the extension period.

This no-action position on virtual AGMs is conditional on the technology providing members as a whole a reasonable opportunity to participate (s. 249S of the Corporations Act).

In ASIC's view, this would include:

- members being able to ask questions of the auditor and about management; and
- voting occurring by a poll rather than a show of hands.

Entities should make an assessment of their AGM-facilitating technologies in advance of holding of the meeting and consider whether it adequately addresses these conditions. If there are concerns, entities can instead postpone the AGM and hold it later in reliance on ASIC's no-action position on deferred AGMs.

No-action on sending supplementary notices electronically
ASIC also intends to take no action on any contravention of the Corporations Act if an entity has dispatched a notice for a meeting to be held on or before 31 May 2020 and at least two business days before the meeting is held, the entity sends members supplementary instructions for on-line participation by:

- electronic message (if the member has provided the relevant details); a notice on the entity's website; and
- a market announcement if the entity is listed on a market.

The no-action position covers any failure of the supplementary instructions to comply with s. 249J of the Corporations Act.

What if the entity cannot facilitate online participation in their meeting?
Entities that have a constitution that restricts on-line participation in an AGM or that cannot otherwise provide effective on-line participation for logistical or technical reasons can also rely on ASIC's no-action position for deferral of AGMs. Postponing an AGM where an entity has made advanced preparation may cause significant cost and inconvenience, but holding an AGM where few members can participate either in person or online might not comply with the Corporations Act and produce an unsatisfactory outcome.

Note on status of ASIC's "no-action" positions for AGMs
ASIC's general policy on no-action positions and their status is set out in Regulatory Guide 108 No-action letters.

In particular, it should be noted:

- a no-action letter is an expression of regulatory intention about how to exercise ASIC's powers. The purpose of a 'no-action' letter is to provide an indication as to the future regulatory action that ASIC might take; and
- an ASIC no-action letter does not necessarily preclude third parties (including the Office of Director of Public Prosecutions) from taking legal action in relation to the same conduct or conduct of that kind. Nor does it prevent a court from holding that particular conduct infringes the relevant legislation. ASIC does not represent that the conduct covered by the no-action letter will not be held to contravene the relevant legislation. Nor does ASIC undertake to intervene in an action brought by third parties in respect of such conduct.

2.3 New regulatory framework for foreign financial services providers

10 March 2020 - ASIC has released its new regulatory framework for foreign financial services providers (FFSPs) providing financial services to Australian wholesale clients.

The new framework has two key elements:

- a new foreign Australian financial services (AFS) licensing regime for FFSPs; and
- licensing relief for providers of funds management financial services seeking to induce some types of professional investors.

It replaces ASIC's previous licensing exemptions for foreign providers. ASIC has developed this new framework through extensive consultation with industry and overseas regulators.

ASIC's updated *Regulatory Guide 176 Foreign financial services providers* contains the details of the new framework. There is a two-year transition period to this new regime.

Foreign AFS licensing regime
From 1 April 2020, new foreign providers may apply to obtain a foreign AFS licence to provide financial services in Australia to wholesale clients. To be eligible, the foreign provider must be authorised under an overseas regulatory regime that ASIC has assessed as sufficiently equivalent to the Australian regulatory regime.

An FFSP holding a foreign AFS licence will be exempt from certain obligations that apply to AFS licensees, such as financial requirements, as ASIC acknowledges that similar regulatory supervision and outcomes will be achieved by the equivalent overseas requirements.

Foreign providers currently relying on pre-existing relief will have a two-year transition period until 31 March 2022 to make arrangements to continue their operations in Australia, which may include applying for a foreign AFS licence.

Funds management licensing relief
Funds management licensing relief will commence on 1 April 2022. The relief is available to foreign providers inducing certain types of Australian professional investors to use the funds management financial services it provides. Under the relief, a licence is not needed for that inducing conduct. Inducing conduct includes attempts to persuade, influence or encourage a particular person to become a client, for example, mass marketing campaigns.

Foreign providers must separately consider if they need to hold a licence to actually provide financial services.

View:

- RG 176 Foreign financial services providers;
- REP 656 Response to submissions on CP 301 and CP 315 on foreign financial services providers;
- ASIC Corporations (Foreign Financial Services Providers - Foreign AFS licensees) Instrument 2020/198;
- ASIC Corporations (Foreign Financial Services Providers - Funds Management Financial Services) Instrument 2020/199;
- ASIC Corporations (Amendment) Instrument 2020/200;
- CP 301 submissions; and
- CP 315 submissions.

2.4 Consultation on proposals about advice fee consents and independence disclosure

10 March 2020 - ASIC has issued *Consultation Paper 329 Implementing the Royal Commission recommendations: Advice fee consents and independence disclosure* (CP 329).

CP 329 seeks feedback on:

- draft legislative instruments that deal with advice fee consents and independence disclosure; and
- a proposal to issue more guidance in *Regulatory Guide 245 Fee Disclosure Statements* (RG 245) to help industry meet obligations around ongoing fee arrangements, including renewal notices and fee disclosure statements.

ASIC's draft legislative instruments are based on the Government's exposure draft legislation for reforms arising from the recommendations of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (the Royal Commission) (see Background).

They set out the requirements proposed for:

- written consent to deduct, or to arrange to deduct, fees from a client account as part of an ongoing fee arrangement (Recommendation 2.1). See *ASIC Corporations (Consent to Deductions-Ongoing Fee Arrangements) Instrument 2020/XX*;
- written consent to deduct fees from a superannuation account under an arrangement that is not an ongoing fee arrangement (Recommendation 3.3). See *ASIC Superannuation (Consent to Pass on Costs of Providing Advice) Instrument 2020/XX*; and
- written statement that discloses advice providers' lack of independence (Recommendation 2.2). See *ASIC Corporations (Disclosure of Lack of Independence) Instrument 2020/XX.*

The final form of these instruments is subject to change depending on the form of the enabling legislation, and the feedback received in response to CP 329. The instruments will not commence until the legislation takes effect.

CP 329 also seeks feedback on additional issues relating to ongoing fee arrangements, including renewal notices and fee disclosure statements. ASIC is proposing to update RG 245 in mid-2020. To offer more clarity and certainty to industry, the updated guidance will address the key areas of non-compliance identified in Report 636 Compliance with the fee disclosure statement and renewal notice obligations.

View Consultation Paper 329: Implementing the Royal Commission recommendations: Advice fee consents and independence disclosure and draft instruments.

2.5 Information sheet on document production guidelines

2 March 2020 - ASIC has released an information sheet covering document production guidelines for people who produce books, including documents and any other record of information, to ASIC in connection with investigations or surveillance activities.

Information Sheet 242 Document production guidelines (INFO 242) will help people understand how to produce documents to ASIC. This can be in response to a notice to produce or on a voluntary basis.

INFO 242 explains:

- the preferred methods for producing books to ASIC in electronic and hard copy form;
- the benefits of producing books in accordance with the guidelines;
- the consequences of not following the guidelines; and
- how ASIC requests books to be produced when using a litigation support system.

INFO 242 addresses requirements in the following legislation:

- Australian Securities and Investments Commission Act 2001 No. 51 (Cth);
- National Consumer Credit Protection Act 2009 No. 134 (Cth);
- Superannuation Industry (Supervision) Act 1993 No. 78 (Cth); and
- Insurance Contracts Act 1984 No. 80 (Cth).

View Information Sheet 242 Document production guidelines (INFO 242).

2.6 Update on enforcement and regulatory work

26 February 2020 - ASIC has provided the latest six monthly update on its enforcement and regulatory work since September 2019. The update covers ASIC's implementation of the recommendations of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (the Royal Commission), its enhanced supervision program and how ASIC is using its new regulatory tools and powers in identifying and addressing misconduct and poor consumer outcomes.

It also sets out key elements of ASIC's enforcement work, including progress on referrals and case studies arising from the Royal Commission. More details about ASIC enforcement work will be set out in the upcoming Enforcement Update.

View the update.

2.7 Consultation on relief for companies planning an initial public offering

24 February 2020 - ASIC is seeking feedback on proposals to grant conditional relief for voluntary escrow arrangements and pre-prospectus communications in connection with an IPO.

ASIC is seeking feedback on proposals to grant relief through a legislative instrument in the context of an IPO to:

- allow public companies, professional underwriters and lead managers who have obtained relevant interests as a result of voluntary escrow arrangements to disregard them for the purposes of the takeover provisions (but not substantial holding provisions); and
- permit companies to communicate certain factual information to security holders and employees before the company lodges an IPO prospectus.

Currently companies that are considering undertaking an IPO must apply to ASIC for individual relief and pay application fees. ASIC is seeking feedback on proposals to reduce and simplify the regulatory costs for companies undertaking an IPO while maintaining investor protection and market integrity.

View Consultation Paper 328 Initial public offers: Relief for voluntary escrow and pre-prospectus communications.

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3. Recent ASX Developments

3.1 Amendments to ASX Listing Rules - Guidance Note 8

On 28 February 2020, ASX released an update to the *ASX Listing Rules Guidance Note 8 Continuous Disclosure: Listing Rules 3.1 - 3.1B* (GN 8).

The amendments reflect additional guidance on the requirement to name counterparties in announcements about market sensitive contracts (s. 4.15), an update on the materiality threshold an entity should use to determine whether it should update any earnings guidance given to the market (s. 7.3), and additional guidance on the measures ASX may impose to address a breach of Listing Rule 3.1 or 3.1B (section 8.8).

The updated GN8 can be found on the ASX website.

3.2 S&P/ASX All Technology Index

On 21 February 2020, ASX, in partnership with S&P Dow Jones Indices, launched the S&P/ASX All Technology Index. The new index captures ASX-listed companies in the fast-growing technology sector.

The media release is available on the ASX website.

3.3 Public consultations - Tranche 2 CHESS Replacement

On 21 February 2020, ASX released a consultation paper on the second of three tranches of operating rule amendments required to facilitate the implementation of the new system that will replace CHESS. These relate to corporate actions, mFund and RTGS payment aspects for "Day 1" implementation of CHESS Replacement system functionality.

The consultation paper is available on the ASX website.

3.4 Response to consultation - Changes to the 3 and 10 Year Bond Futures Roll

On 26 February 2020, ASX released its response to submissions on its consultation paper proposing changes to the 3 and 10 Year Bond Futures Roll. ASX intends to implement a reduction to the 3 and 10 Year Bond Futures minimum price during the week of the Roll.

The response can be found on the ASX website.

3.5 Report

On 5 March 2020, ASX released the ASX Monthly Activity Report for February 2020.

4. Recent Takeovers Panel Developments

4.1 Takeovers Panel 20th anniversary

12 March 2020 - the Takeovers Panel issued a media release noting that 13 March 2020 marks the 20th anniversary of the establishment of the Panel in its current form. The Panel has resolved 567 applications since 13 March 2000, many of which were high profile including Goodman Fielder (2003), Qantas (2007), Rinker (2007), Foster's Group (2011), Billabong (2013) and Spotless (2017). Last year was the Panel's second busiest year on record (having resolved 38 applications). On average, it takes approximately 16 calendar days for the Panel to make a decision on an application.

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5. Recent Research Papers

5.1 Regulating environmental, social, and governance disclosure by listed companies: A comparison of major financial markets

As socially responsible investing (SRI) is becoming more and more popular, it has become the norm to integrate environmental, social and governance (ESG) factors into investment processes and decision-making. ESG factors cover a wide spectrum of issues that traditionally are not part of financial analysis, yet may have financial relevance such as companies' responses to issues such as climate change. In response to the development of such trend in the financial world, regulators in many financial markets have introduced regulations on ESG disclosure and reporting. This article examines the rise of SRI in major financial markets and compares the approaches adopted by regulators in these financial markets to ESG disclosure and reporting. It is argued that ESG investing has matured to the point where it is greatly accelerating market transformation and it has become an international trend for regulators to impose a higher level of reporting.

Regulating Environmental, Social, and Governance Disclosure by Listed Companies: A Comparison of Major Financial Markets

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5.2 The illusory promise of stakeholder governance

Corporate purpose is now the focus of a fundamental and heated debate, with rapidly growing support for the proposition that corporations should move from shareholder value maximization to "stakeholder governance" and "stakeholder capitalism". This article critically examines the increasingly influential "stakeholderism" view, according to which corporate leaders should give weight not only to the interests of shareholders but also to those of all other corporate constituencies (including employees, customers, suppliers, and the environment). The authors conduct a conceptual, economic, and empirical analysis of stakeholderism and its expected consequences. They conclude that this view should be rejected, including by those who care deeply about the welfare of stakeholders.

Stakeholderism, the authors demonstrate, would not benefit stakeholders as its supporters claim. To examine the expected consequences of stakeholderism, they analyze the incentives of corporate leaders, empirically investigate whether they have in the past used their discretion to protect stakeholders, and examine whether recent commitments to adopt stakeholderism can be expected to bring about a meaningful change. Their analysis concludes that acceptance of stakeholderism should not be expected to make stakeholders better off.

Furthermore, the authors show that embracing stakeholderism could well impose substantial costs on shareholders, stakeholders, and society at large. Stakeholderism would increase the insulation of corporate leaders from shareholders, reduce their accountability, and hurt economic performance. In addition, by raising illusory hopes that corporate leaders would on their own provide substantial protection to stakeholders, stakeholderism would impede or delay reforms that could bring meaningful protection to stakeholders. Stakeholderism would therefore be contrary to the interests of the stakeholders it purports to serve and should be opposed by those who take stakeholder interests seriously.

The Illusory Promise of Stakeholder Governance

5.3 Stewardship and collective action: The Australian experience

Institutional shareholder stewardship codes exist in many jurisdictions. They reflect the growing importance of institutional shareholders in capital markets, and a belief that increased engagement by institutional shareholders improves corporate decision-making and provides protection against excessive risk-taking.

In theory, there is considerable sense in shareholders undertaking their stewardship activities collectively. By acting collectively, shareholders leverage their power, pool their resources and share costs, thereby making stewardship more feasible and less speculative. Consistently, the stewardship codes of many jurisdictions refer to, and implicitly support, collective action by institutional investors.

This paper examines the role of collective action as a form of stewardship, with particular reference to the Australian context. Australia provides favourable conditions for institutional investor stewardship and is, therefore, an interesting case study concerning the potential of collective action as a stewardship tool.

This paper's examination of collective action in Australia reveals, however, a nuanced image of this governance practice. Evidence indicates that investors do not routinely engage in direct forms of collective action, such as forming a coalition for the purpose of intervening in a company's governance. Instead, investors more typically leverage their collective influence through intermediary organisations, such as industry bodies and service providers that undertake behind-the-scenes engagement activities for investors.

The nuanced image of collective action emerging from the Australian experience highlights that collective action by institutional shareholders is by no means a simple governance phenomenon. The paper explores the implications of this insight for how securities and takeover laws apply to collective action, and how the issuers of stewardship codes frame their codes' expectations regarding collective action. This analysis is relevant to policy makers, regulators and researchers who are interested in the role and regulation of collective action as a corporate governance tool.

Stewardship and Collective Action: The Australian Experience

5.4 Private company lies

Rule 10b-5's antifraud catch-all is one of the most consequential pieces of American administrative law and most highly developed areas of judicially-created federal law. Although the rule broadly prohibits securities fraud in both public and private company stock, the vast majority of jurisprudence, and the voluminous academic literature that accompanies it, has developed through a public company lens.

This article illuminates how the explosive growth of private markets has left huge portions of U.S. capital markets with relatively light securities fraud scrutiny and enforcement. Some of the largest private companies by valuation grow in an environment of extreme information asymmetry and with the pressure, opportunity, and rationalizing culture that can foster misconduct and deception. Many investors in the private markets are sophisticated and can bear high levels of risk and significant losses from securities fraud. It is increasingly evident, however, that private company lies can harm a broader range of shareholders and stakeholders as well as the efficiency of allocating billions of dollars for innovation and new business. In response to this underappreciated problem, this article explores a range of mechanisms to improve accountability in the private markets and ultimately argues for greater public oversight and enforcement.

Private Company Lies

6. Recent Corporate Law Decisions

6.1 We are family - Pooling order allows liquidators to treat a group of companies as if they were a single entity

(By Daniel Byrne and Daniel Gordon, Corrs Chambers Westgarth)

Hutson (liquidator), in the matter of WDS Limited (in liq) (Receivers and Managers Appointed) [2020] FCA 299 (11 March 2020) Federal Court of Australia, Markovic J.

(a) Summary

After the receivers of the WDS group of companies had realised assets and paid the secured creditor (GE), there was a surplus of $9.7 million to be distributed to unsecured creditors, including priority creditors (i.e. employees). The liquidators of the WDS group applied to the Court for orders in connection with the distribution of the surplus. This included seeking a pooling order under s. 579E of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).

In considering whether to grant the pooling order, the Court had regard to an alternative situation proposed by the liquidators, namely the Court giving a judicial direction that would permit the liquidators to allocate the surplus between three different operating divisions of the group, and then distribute the surplus to creditors on this basis.

Although a pooling order would benefit the priority unsecured creditors to the disadvantage of the unsecured creditors, the Court found that this disadvantage was not material given the minimal level of return expected to those creditors in the alternative judicial direction scenario, and proceeded to make the pooling order sought by the liquidators.

(b) Facts

WDS Limited (WDS) was a publicly listed company on the ASX with 11 wholly owned subsidiaries (together, the WDS Group). WDS and its 11 subsidiaries traded as a single entity and structured their operations between three principal divisions, namely "mining", "energy" and "corporate".

WDS had entered into a Major Works Construct Only Contract as contractor with Eagle Downs Coal Management Pty Ltd (EDCM). Pursuant to the terms of that contract, WDS was required to give security, namely an unconditional and irrevocable undertaking, which WDS procured from Assetinsure Pty Ltd as agent for Swiss Re International SE in the amount of $14,280,638 (the Performance Bond).

Following issues at the mine site, EDCM cashed the Performance Bond, which gave rise to a corresponding obligation on the part of WDS to indemnify Assetinsure for the full amount of $14,280,638. About a week later, WDS and the other companies in the group entered into voluntary administration, and the creditors then subsequently resolved that the companies be wound up. Following the appointment of the administrators, GE had appointed receivers to the group. After realising assets and paying out GE in full, there was a surplus of $9.7 million (the Surplus) remaining.

The case concerned how the liquidators should distribute the Surplus to creditors. The amount owing to creditors was $45,862,232 and that amount included outstanding employee entitlements of $13,398,810. The liquidators applied to the Federal Court for the judicial direction referred to above and, further or alternatively, the pooling order referred to above.

(c) Decision

One of the driving factors behind the liquidators' decision to seek the judicial direction was the difficulty they had encountered in determining the asset and liability position of each company within the group. Without further investigation, which would involve significant time and cost, the liquidators could not be certain as to asset ownership within the group.

In the circumstances, the liquidators conducted extensive analysis to determine the way in which to distribute the Surplus so that it would yield the best return for creditors as a whole while having regard to statutory priorities (i.e. the employee entitlements). The approach recommended by the liquidators was the "divisional asset allocation" approach, and the liquidators observed that this approach was consistent with the way in which the WDS Group reported internally and operated in practice.

Without a pooling order, the divisional asset allocation approach would result in unsecured non-priority creditors receiving 0.08 cents in the dollar.

The Court concluded that it was appropriate for a direction to be made in the terms sought by the liquidators, noting that the liquidators could come under scrutiny from unsecured creditors, including potentially allegations of breach of duty, if they took the divisional asset allocation approach. Given the benefits of the approach, it was appropriate for the judicial direction to be made to give the liquidators an added layer of protection.

The Court acknowledged that any pooling order would, in effect, subsume the judicial direction referred to above. That said, the judicial direction remained relevant because it provided the counterfactual scenario which allowed the Court to assess whether or not it was appropriate for a pooling order to be made in the circumstances of this case, including:

- whether it would be "just and equitable" to do so, that being an essential precondition to a pooling order under s. 579E of the Corporations Act; and
- whether there would be any "material disadvantage" for eligible unsecured creditors in the making a pooling order which, if shown, could prevent the Court from making a pooling order by reason of s. 579E(10) of the Corporations Act.

The Court observed that, if the pooling order was made, priority creditors (i.e. the employees) would be advantaged. They would have priority claims to the whole of the pooled surplus assets of the group irrespective of which entities previously owned the assets. In those circumstances, the employees would receive 100% of their entitlements in respect of wages, superannuation and leave and about 28% of their entitlements in respect of payments in lieu of notice and redundancy payments. Those payments would exhaust the Surplus meaning that the ordinary unsecured creditors would receive no dividend.

If the pooling order was not made, the employees would only have statutory priority in respect of the assets held by the relevant employing entities within the group. To the extent the employee entitlements were not satisfied from the assets of those companies, the employees would be left with contractual claims against other companies within the WDS Group which would rank pari passu with the claims of other ordinary unsecured creditors.

The Court ultimately concluded that it was just and equitable for a pooling order to be made, and that it had not been established that there would be "material disadvantage" for eligible unsecured creditors.

In the counterfactual scenario based on the divisional asset allocation approach without any pooling order being made, ordinary unsecured creditors would only receive a dividend of 0.08 cents in the dollar. This return was not material considering that the return in this scenario to the largest unsecured creditor, Assetinsure who had a debt of $14.2 million in respect of the Performance Bond, would only be $11,854.10. The second largest unsecured creditor was owed $2.3 million, and was only expected to receive a dividend of less than $2,000. In the circumstances, it was difficult to see how the making of the pooling order would disadvantage ordinary unsecured creditors.

Noting that the pooling order would also minimise cost and delay and increase administrative efficiency in the winding up by obviating the need for the liquidators to conduct multiple liquidations, the Court was satisfied that a pooling order should be made and proceeded to do so.

This case is a useful reminder of the utility of pooling orders in complex group liquidations where the group in effect traded as a single economic entity. In such cases, early consideration should be given to whether a pooling order is appropriate.

In applying for a pooling order, it will be necessary to explore and explain how creditors will be impacted if a pooling order is, or is not, made (as the liquidators did in this case).

6.2 ASIC v King: definition of "officer" in the Corporations Act
(By Sarah Lethlean, King & Wood Mallesons)

Australian Securities and Investments Commission v King [2020] HCA 4 (11 March 2020), High Court of Australia, Kiefel CJ, Gageler, Keane, Nettle and Gordon JJ.

(a) Summary

On 11 March 2020, the High Court of Australia handed down its unanimous decision that a person does not need to hold a recognised position within a corporation to be an "officer" of that corporation under s. 9(b)(ii) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), and thus attract the rights and duties of an officer.

The relevant test is whether, as a matter of fact and circumstance, a person has the requisite capacity to significantly affect the financial standing of the company. Further, for corporate groups, emphasis is placed on the overall position of influence the person has within that group's affairs, rather than a strict reading of the "office" held by the person.

(b) Statutory provision

The term "officer of a corporation" is defined by s. 9 of the Corporations Act as follows:

"Officer of a corporation means:
(a) a director or secretary of the corporation; or
(b) a person:
(i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
(ii) who has the capacity to affect significantly the corporation's financial standing; or
(iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by
the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation) ... "

(c) Facts

Michael King was the Chief Executive Officer (CEO) and an executive director of MFS Ltd, the parent company of the MFS Group of companies (MFS Group). The largest managed investment scheme of MFS Group was Premium Income Fund (PIF), for which MFS Investment Management Pty Ltd ("MFSIM") was the responsible entity. MFS Group had overall responsibility for MFSIM as a member of the MFS Group. On 29 June 2007, MFSIM entered into a $200 million loan facility with the Royal Bank of Scotland (the RBS facility) to be used solely for the purposes of PIF.

On 27 November 2007, MFSIM and senior MFS Group personnel (including Mr King) arranged to draw down $150 million under the RBS facility. This money was then improperly disbursed to MFS Administration Pty Ltd (MFS Administration), the treasury company of the MFS Group, to pay the debts of another company in the Group.

The subject of the High Court appeal was the $130 million disbursement paid by MFSIM from the funds drawn down from the RBS facility to MFS Administration. Upon receiving these funds, MFS Administration paid $103 million to Fortress Credit Corporation (Australia) II Pty Ltd

("Fortress"), to meet a debt owing to it by MFS Castle Pty Ltd (a wholly owned subsidiary of MFS Ltd). There was no agreement, consideration nor security in place, exposing PIF (and indirectly, the retail investors of the fund) to the risk that PIF's money would not be repaid to it.

The MFS Group subsequently collapsed, and investors of PIF were left unpaid a substantial amount.

Relevantly, ASIC alleged that Mr King had breached his duties as an "officer" of MFSIM under s. 601FD of the Corporations Act despite the fact that he ceased to be a director of MFSIM on 27 February 2007. However, ASIC contended that Mr King remained an "officer" of MFSIM within the definition of s. 9(b)(ii) because he was the CEO and executive director of MFS Ltd with overall responsibility for MFSIM. Further, the executive director of MFSIM (Mr White) reported directly and frequently to Mr King, and customarily acted in accordance with Mr King's instructions and wishes in the performance of his role.

(d) First instance decision

Douglas J first heard the case in the Supreme Court of Queensland. His Honour found in favour of ASIC, that Mr King was an "officer" of MFSIM because he had the capacity to affect significantly MFSIM's financial standing.

(e) Queensland Court of Appeal decision

Mr King unsuccessfully appealed in 2018, with the Court of Appeal concluding (consistent with Justice Douglas' findings of fact), Mr King authorised the transaction in question, and that he acted as the "overall boss of the MFS Group" and assumed "overall responsibility for MFSIM".

However, the Court found that it was necessary for ASIC to prove that Mr King had 'acted in an office' of MFSIM, in the sense of 'a recognised position with rights and duties attached to it'. The Court of Appeal determined Mr King was not an "officer" of MFSIM because he did not have the capacity to affect MFSIM's financial standing within the meaning of s. 9(b)(ii) of the Corporations Act, and therefore he had not breached the Act as such.

(f) High Court decision

The High Court of Australia unanimously decided that the Queensland Court of Appeal erred in this finding and their reasoning departed from the literal application of the text of s. 9 of the Act. Their Honours determined that, when properly construed, s. 9 (b)(i) and (b)(ii) captured those persons who do not hold an office within the company but who were engaged in the corporation's decision-making qua management. There is no requirement that such individuals hold a recognised office.

The Court found that although Mr King ceased to be director of MFSIM, his involvement in and impact on MFSIM and its business remained extensive and significant. Without holding a formal office, Mr King had a degree of influence over the general conduct of MFSIM which had the capacity to affect significantly MFSIM's financial standing.

The Court reiterated that s. 9(a) of the Corporations Act captures individuals who hold a named office in a corporation, and s. 9(b) captures those who do not hold such an office, but are "officers" by reference to the facts of the relationship between the individual and the corporation. Nettle and Gordon JJ added that s. 9(b) applies to persons who are involved in the management of a corporation and who, by their actions (including inaction), have the capacity to affect the whole or substantial part of the business of the corporation. This is a question of fact and degree. The person's contribution to decision making must be assessed, and the decision must be one which affects the whole, or a substantial part, of the business of the corporation.

The Court identified certain factors as being relevant to this determination on a case by case basis, including:

- the identification of the role of a person in relation to the corporation;
- what they did or not do to fulfil that role; and
- the relationship between their actions or inaction and the financial standing of the corporation, noting that this may vary significantly depending on a company's size, structure and circumstance.

The Court found that the literal interpretation of s. 9(b) of the Corporations Act would be unlikely to unintentionally capture external consultants, advisors, bankers and the like because an "officer" must be "of" the corporation. Further, as clarified by Kiefel CJ, Gageler and Keane JJ, this will only become an issue where the advisor or consultant/lender is involved in the management of the corporation and is thereby able to ensure that the advice will be implemented.

Finally, their Honours considered it was not consistent with the legislative purpose of the section for the CEO of a parent company to act in relation to other companies in the group without being subject to the duties or consequence attaching to officers of each of the companies in the group, as shareholders and creditors would be left exposed to obvious risk.

6.3 Equitable assignment and secured creditors: New South Wales Supreme Court declares plaintiff company a secured creditor in relation to debt owed to de-registered company
(By Alice Lloyd, King & Wood Mallesons)

In the matter of Azmac Pty Limited (in liquidation) [2020] NSWSC 204 (10 March 2020), Supreme Court of New South Wales, Rees J.

(a) Summary

The New South Wales Supreme Court has found a Plaintiff company to be a secured creditor of the Second Defendant within the meaning of s. 51E of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) by virtue of an enforceable agreement that (i) the debt owed by the Second Defendant to another, since de-registered company, would instead be paid to the Plaintiff company and (ii) that the repayment of the debt would be secured over the Second Defendant's land, where such repayment was in fact secured by a subsequent equitable charge over the Second Defendant's land which was left undisturbed for two years until the Second Defendant entered into liquidation.

(b) Facts

Stylequity Advisory (Australia) Pty Ltd (the Plaintiff) applied to the New South Wales Court of Appeal (Court) for a declaration that it was a secured creditor of Azmac Pty Limited (the Second Defendant) in the amount of $423,935.53, and an order reversing the decision of Azmac's liquidator (the First Defendant) to reject the Plaintiff's proof of debt.

The disputed security interest concerned invoices for business advisory services rendered by a former corporate entity called Stylequity Advisory Pty Ltd (Stylequity Advisory) to the Second

Defendant and its associated entity, Macaz Pty Ltd (Macaz) (together, the Macaz Group). The sole director of the Plaintiff, Mr Bryant, had been a director of Stylequity Advisory, along with his business partner, Mr Barraclough, before the two parted amicably and set up their own separate companies (with Mr Bryant's new company being the Plaintiff company). Prior to dissolving Stylequity Advisory, Mr Bryant and Mr Barraclough agreed to split (50/50) all fees owing to Stylequity Advisory by the Macaz Group, with the fees being re-invoiced in equal proportions to each of the Plaintiff company and Mr Barraclough's newly incorporated entity.

In March 2013, Mr Bryant sent an email to Mr Barraclough and the Macaz Group directors entitled "Could you all please return this email - agreed" (the March 2013 Email) proposing a payment plan for all backlogged fees owed by the Macaz Group to be billed out of his and Mr Barraclough's new entities, and for those debts to be secured over the Second Defendant's property. The Macaz Group directors replied to the March 2013 Email saying they agreed. In May 2013, the Plaintiff sent a letter agreement to the Macaz Group directors (the May 2013 Letter) which contained a term that security was to be provided to Stylequity Advisory for the total outstanding debt. One of the Macaz Group directors signed the May 2013 Letter on behalf of the Macaz Group companies (although the letter was not signed by Mr Barraclough). The Plaintiff sought permission from the Macaz Group to lodge, and subsequently lodged, a caveat over the Second Defendant's land citing an equitable interest pursuant to a mandate for repayment of debts (per the May 2013 Letter). The Plaintiff also registered a security interest on the Personal Property Security Register (PPSR) in respect of both Macaz Group companies.

Over two years later, both companies in the Macaz Group went into liquidation and the First Defendant was appointed as liquidator. Upon sale of the Second Defendant's land, the First Defendant reviewed the proof of debt offered by the Plaintiff and advised that he considered the Plaintiff to be an unsecured creditor on the basis that (i) there had not been a valid assignment at law or in equity of Stylequity Advisory's rights to the debt (ie the Macaz Group's unpaid fees for service) to the Plaintiff and (ii) neither of the Macaz Group companies had granted a charge over real property or a security interest capable of registration on the PPSR in favour of the Plaintiff.

(c) Decision

Rees J held that the Plaintiff was a secured creditor of the Second Defendant within the meaning of s. 51E of the Corporations Act. In reaching this decision her Honour considered firstly whether there was an enforceable agreement between the relevant parties that monies owed by the Macaz Group to Stylequity Advisory would instead be paid to the Plaintiff and secondly, whether repayment of those monies had, in fact, been secured over the Second Defendant's land.

(i) Was there an enforceable agreement?

The Plaintiff alleged that there had been either an equitable assignment from Stylequity Advisory of the debt, a novation of the underlying debt, or an agreement between the relevant parties by which the Second Defendant and Macaz became responsible to pay 50% of the outstanding debt to the Plaintiff.

Her Honour accepted pre and post-contractual evidence that the parties had entered into a binding contract, including evidence of the discussions between Mr Bryant and Mr Barraclough to end their business relationship and further discussions with the directors of the Macaz Group with respect to the payment of the outstanding fees, the March 2013 Email, the May 2013 Letter, an invoice issued in respect of all fees outstanding, an email from one of the Macaz Group directors consenting to the Plaintiff lodging a caveat over the Second Defendant's land, and the caveat itself which had remained undisturbed for more than two years before the Second Defendant was placed in liquidation. Irrespective of the absence of a formalised deed or contract, Rees J found that this evidence indicated the existence of a contract between the parties to the effect that a specified portion of the monies owed by Macaz to Stylequity Advisory would instead be paid to the Plaintiff, repayment of which could be secured over the Second Defendant's land.

As to the Plaintiff's submission that there had been a novation of the underlying debt, Rees J rejected the First Defendant's submission that consent to novate had not been given, finding the evidence (listed above) to clearly indicate that all relevant parties had consented to the new arrangement.

With regard to the argument for an equitable assignment, the Plaintiff submitted that the assignor (Stylequity Advisory) had manifested an intention to transfer the chose in action (the debt) to the assignee (the Plaintiff) in a manner binding upon the assignor (*Shepherd v Federal Commissioner of Taxation* (1965) 113 CLR 385 at 397 (Kitto J)), noting that a debt can be assigned in equity without consideration: Shepherd at 396-397; *Norman v Federal Commissioner of Taxation* (1963) 109 CLR 9. On the basis of the evidence already considered in relation to the formation of an agreement, Rees J found a clear intention on the part of Stylequity Advisory to transfer the chose in action to the Plaintiff (rejecting the First Defendant's submission to the contrary).

(ii) Did the plaintiff have a security interest in the land?

The Plaintiff pointed to the wording of the March 2013 Email ("[i]t is time we took our security over our outstanding debt. Third ranking over the land and buildings ..."), the Macaz directors' acceptance of the terms of this email, and their agreement to the Plaintiff lodging a caveat over the Second Defendant's land, to support its submission that it held an equitable charge over the proceeds of the sale of the land.

Rees J accepted that under the agreement between (relevantly) the Plaintiff and the Second Defendant, the Second Defendant agreed to grant an equitable charge over its land to secure repayment of the debt owed to the Plaintiff. This did not in itself create an equitable charge, however the Second Defendant subsequently granted that charge by consenting to the lodgement of a caveat over its land, which remained undisturbed until the company's liquidation. The lodgement of the caveat (and the fact that the Second Defendant had not sought to remove the caveat in the two years since it was first lodged) carried an implication that the relevant equitable interest existed: Mahoney JA (with whom Priestly and Meagher JJA agreed) in *Troncone v Aliperti* (1994) 6 BR 13, 291, 292.

This equitable charge fell within the definition of "charge" in s. 9 of the Corporations Act, and accordingly the Plaintiff was a "secured creditor" of the Second Defendant within the meaning of s. 51E of the Corporations Act (the relevant debt being secured by a "security interest" within the meaning of s. 51A).

6.4 Inadvertent failure to meet ASIC reporting requirements

(By Elaine Stops, DLA Piper)

In the matter of DAC Finance (NSW/Qld) Pty Ltd & other companies [2020] NSWSC 182 (6 March 2020), Supreme Court of New South Wales, Gleeson J.

(a) Summary

For a period of over ten years, DAC Group, a group of ten companies, failed to meet ASIC's reporting requirements as per a *98 Class Order* made under s. 341 of the Corporations Act 2001

No. 50 (Cth) (Cth) (the Corporations Act). In late 2019, the company group discovered these issues and were issued notices by ASIC under s. 1274(11) of the Corporations Act, and the plaintiffs sought relief under s. 1322(4)(c). Gleeson J held that it was an honest error by the company, in part because of poor external advice, and that there would not be substantial injustice if relief were provided.

(b) Facts

(i) Background

The ten plaintiff companies are members of the DAC Group of companies (the DAC Group) that provide aged care residential services across a number of states in Australia. The tenth plaintiff, DAC Finance Pty Ltd, is the parent company of the other nine companies, as wholly owned subsidiaries.

For a group of companies, financial reporting requirements are often extensive, so in 2008, ASIC made a *98 Class Order* under s. 341 of the Corporations Act to provide relief to the reporting requirements of wholly owned subsidiaries if certain conditions are met, such as preparing consolidated reports to cover subsidiaries, lodging annual reports with ASIC, and entering into a deed of cross-guarantee between the holding company and the subsidiaries, among others.

In 2008, DAC Group entered into a deed of cross-guarantee with all the current subsidiaries and reduced the financial documents lodged with ASIC. However, they failed to lodge the 'opt-in' notices to the order. In 2015, DAC Group acquired additional entities as subsidiaries, but they were not added to the deed of cross-guarantee. It was only in 2019, during an internal review, that the group's failure to meet these requirements was identified, and ASIC issued notices under s. 1274(11) of the Corporations Act.

(ii) Admissions & Relief sought

All plaintiffs admitted that they failed to do the following from time to time:

- file an 'opt-in' notice within the first four months after end of financial year;
- pass annual resolutions regarding class order relief and the deed of cross-guarantee;
- provide financial statements specific to the deed of cross-guarantee;
- provide documents regarding whether members will be able to meet liabilities subject to the deed of cross guarantee; and
- meet auditing requirements.

The plaintiffs sought relief under s. 1322(4)(c) of the Corporations Act to relieve the past and present directors and officers from any liability arising from the contraventions.

To qualify for the relief, it had to be concluded that:

- the issue was generally procedural in nature;
- the failure to act was an honest one; and
- it is just and equitable that the order be made.

(c) Decision

When addressing DAC Group's failure to meet the requirements under the *98 Class Order*, Gleeson J acknowledged both the group's failure to provide certain information to their various external advisers, but also the advisor's inadequate preparation and completion of relevant documents and actions. This was first acknowledged regarding the June 2008 decision to obtain relief under the class order, where DAC Group engaged the services of a professional consulting firm. It was again acknowledged regarding the failure to add additional entities to the deed of cross-guarantee in June 2015, when DAC Group sought advice from a law firm. It was due to these failings, and staff changes in the management of the DAG Group over the ten year period, that Gleeson J decided that the failures to report and lodge financial documents were not dishonest but inadvertent.

Gleeson J further determined that there would be no substantial injustice by granting relief as (1) the DAC Group remained solvent, (2) new audits indicated that the financials provided since 2008 by the company were a true and fair view of the financial position of the group, and (3) no shareholders had expressed concern.

6.5 Relevant considerations of the Federal Court in granting leave to the ACCC to continue proceedings under s. 500(2) of the Corporations Act
(By Lucinda Sergiacomi, MinterEllison)

Australian Competition and Consumer Commission v Smart Corporation Pty Ltd (No 2) [2020] FCA 284 (6 March 2020), Federal Court of Australia, Jackson J.

(a) Summary

The Australian Competition and Consumer Commission (ACCC) sought leave to proceed against Smart Corporation Pty Ltd (Smart Corporation) under s. 500(2) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). The basis of the proceedings are that Smart Corporation allegedly engaged in deceptive and misleading conduct in contravention of the unfair contract terms in s. 24 of the *Australian Consumer Law* (the ACL) in Schedule 2 to the Competition and Consumer Act (2010) 1974 No. 51 (Cth) (the Competition and Consumer Act 2010) and allegedly engaged in unconscionable conduct in contravention of s. 21 of the ACL.

The Federal Court of Australia considered the well-established principles for consideration in applications for leave of this kind, while noting that factors to be considered by the Court are not fixed. The pursuance of proceedings in the public interest was found to be a particularly relevant factor in this case.

The Court held that leave should be granted to the ACCC on the following basis:

- there was a serious question to be tried;
- relief sought cannot be claimed by way of a proof of debt procedure;
- there is public interest in enforcing breaches of the ACL; and
- the claim will not result in any prejudice to the creditors of Smart Corporation.

(b) Facts

The application for leave to proceed against the first respondent in the proceedings is necessary because on 23 December 2019 Smart Corporation went into a creditors' voluntary liquidation. Therefore, the ACCC must request the leave of the Court under s. 500(2) of the Corporations Act in order to proceed.

The ACCC based its application on three allegations:

- Smart Corporation engaged in deceptive and misleading conduct in relation to representations made to its customers or prospective customers;
- the standard form contracts between Smart Corporation and its customers contain terms that are unfair contract terms within the meaning of s. 24 of the ACL; and
- Smart Corporation engaged in conduct that was unconscionable in contravention of s. 21 of the ACL.

The ACCC sought various forms of relief including declarations that Smart Corporation contravened the ACL, injunctions preventing further similar contraventions of the ACL, pecuniary penalties for breaches of the ACL and other non-punitive orders.

(c) Decision

(i) Key principles for applications for leave to proceed

The Court stated that the applicable principles for an application for leave to proceed in circumstances such as the present case are well established (citing Foster J in *Rushleigh Services Pty Ltd v Forge Group Ltd (In Liq) (Receivers and Managers Appointed); In the Matter of Forge Group Ltd (In Liq) (Receivers and Managers Appointed)* [2016] FCA 1471 at [15]) and are summarised as:

- decisions under s. 500 of the Corporations Act involve judicial discretion;
- s. 500 restricts corporations in liquidation being subjected to a multiplicity of actions which would be expensive, time consuming and in some cases unnecessary;
- generally speaking, a claimant should proceed by way of lodgement of a proof of debt unless they have good reason to depart from procedure; and
- relevant circumstantial factors are the amount and seriousness of the claim, the degree of complexity of the legal and factual issues involved, and the stage to which proceedings have progressed.

However, the Court also considered the notion that each application should be considered in its own circumstances and the question cannot be approached as a "shopping list" of factors as discussed in *Australian Competition and Consumer Commission v Phoenix Institute of Australia Pty Ltd (Subject to Deed of Company Arrangement)* [2016] FCA 1246; (2016) 116 ACSR 353 at [86].

(ii) Whether there is a serious question to be tried against the first respondent

The Court outlined the key factors in the exercise of its discretion to grant the application. The first related to the seriousness of the question being brought in the proceedings. The Court determined there to be a serious question to be tried by reasoning that if the alleged facts are proved, there would be a serious question whether to grant the relief sought.

The Court considered the nature of the allegations against Smart Corporation and the material evidence before it, in relation to each of the three key allegations made by the ACCC. After analysing the face value and potential significance of the materials before the Court with regards to each head of claim, the Court concluded that the claim against Smart Corporation raises serious questions to be tried.

(iii) Whether the relief sought can be claimed by way of a proof of debt procedure

The Court found the fact that the particular relief sought by the ACCC could not be claimed by way of proof of debt procedure.

(iv) Whether there is public interest in enforcing breaches of the ACL

The Court emphasised that the public interest in enforcing breaches of the Competition and Consumer Act 2010 was of considerable importance in the case. Due to the serious nature of the question to be tried and the clarification of rights and obligations of Smart Corporation and potentially customers, it was accepted that it would be in the public interest for the ACCC to pursue the proceedings.

(v) Whether the claim would result in any prejudice to the creditors of Smart Corporation

The Court considered the fact that the liquidators did not oppose leave being granted and that they are unlikely to incur any expense in the defence of the proceedings. The Court also considered that the ACCC indicated it would be prepared to submit to a condition that the ACCC would not enforce monetary relief against Smart Corporation without further leave of the Court if given a grant of leave to continue the proceedings. The Court was satisfied that this kind of condition would be appropriate.

(d) Conclusion

The Court exercised the discretion afforded under s. 500(2) of the Corporations Act to grant leave.

(e) Orders

Leave was granted to the ACCC to continue proceedings against Smart Corporation, pursuant to s. 500(2) of the Corporations Act. The ACCC must not enforce any monetary relief granted against Smart Corporation without prior leave of the Court.

6.6 Relief granted to facilitate a coordinated approach to finalising a 30-year liquidation of the Equiticorp group
(By Lin Ma and Madeleine Noonan, Ashurst)

In the matter of Equiticorp Australia Ltd (in liq) [2020] NSWSC 143 (27 February 2020), Supreme Court of New South Wales, Gleeson J.

(a) Summary

The winding-up of the Equiticorp Group has been continuing for more than thirty years since its collapse in 1989.

The plaintiffs, Barry Hogan and Shaun Fraser are the current liquidators of four subsidiaries of the Equiticorp Group, (i) Equiticorp Australia Limited (EAL), (ii) Equiticorp Tasman Limited (ETL), (iii) Sowani (No 2) Pty Ltd (Sowani), and (iv) Equiticorp Investments (Australia) Limited (EIAL), together the "Companies". The plaintiffs applied to the Court for a range of relief with a view to finalising the liquidation of the Companies in a coordinated and efficient manner.

(b) Facts

After earlier distributions to creditors since the start of their winding-up, the Companies' remaining assets consisted of cash and debt claims against other entities of the Equiticorp Group. To facilitate finalising the liquidation, the plaintiffs sought and obtained endorsement from the creditors of EAL and ETL to undertake a comprehensive investigation of the remaining Equiticorp Group entities. Through the investigations, the plaintiffs identified that a majority of the Equiticorp Group entities had been wound up and deregistered, and that there were 13 entities within the Equiticorp Group which had a debtor and creditor relationship (the Continuum Entities). The plaintiffs concluded that the winding up of other Equiticorp Group entities cannot be fully finalised until final distributions are made by the Continuum Entities. To that end, the plaintiffs prepared a detailed financial model (the Model) detailing all the funds that need to be exhausted to facilitate the liquidation of the Equiticorp entities.

In August 2018, the plaintiffs and external administrators of the Continuum Entities executed a non-binding term sheet, which was intended to achieve, among other things, (i) a coordinated distribution of the assets based on the Model prepared by the plaintiffs and (ii) appointment of the plaintiffs as voluntary administrators of the Companies and to oversee the execution of the deed of company arrangement.

In March 2019, the plaintiffs issued a report to the creditors of the Companies, which identified the results of its investigations (including the Model), the plaintiff's strategy to achieve a coordinated distribution and the benefits of such an approach. The plaintiffs provided sufficient evidence to the Court that the creditors and liquidators of the Companies unanimously supported the plaintiffs' arrangement.

The plaintiffs applied to the Court for the following relief under the Corporations Act 2001 No. 50 (Cth) (the Corporations Act):

- leave for their appointment as voluntary administrators of the Companies pursuant to s. 436B and s. 448C of the Corporations Act in light of the plaintiff's ability to execute the arrangement in respect of final distributions;
- modification of the operation of Pt 5.3A of the Corporations Act in relation to the administration of the Companies to achieve a liquidation that can maximise recoveries of the creditors by saving costs and increasing efficiencies; and
- stay of the current winding up of the Companies so as to facilitate an accelerated final liquidation of the Companies.

(c) Decision

(i) Leave for the liquidators to be appointed as voluntary administrators

It is worth noting that the Court, as a preliminary question, held that Pt. 5.3A of the Corporations Act applies to each Company despite the fact that each of them was incorporated and wound up prior to the enactment of the Act.

The Court held that it is appropriate for the liquidators, Mr Kogan and Mr Fraser, to be appointed as administrators of the Companies, considering that (i) the creditors supported the plaintiffs' arrangements, (ii) the plaintiffs are familiar with business of the Companies given their substantial involvement in the liquidations of the Companies, (iii) the cost-efficiency of the plaintiffs' arrangements, which will benefit the creditors, and (iv) appointment of the plaintiffs does not present a conflict of interest.

The plaintiffs therefore satisfied the Court and were granted leave in accordance with ss. 426B(2) and 447C of the Corporations Act.

(ii) Orders seeking modification of the operation of Pt 5.3 of the Act

The Court also granted relief to plaintiffs with respect to modifying the operation of Pt 5.3 of the Corporations Act, including dispensing with (i) the requirement relating to convening of creditors' meetings, (ii) delivery to the plaintiffs of reports relating to the Companies' business, property, affairs and financial circumstances, and (iii) certain other procedural and notice requirements in relation to notifying creditors. The Court agreed to deviation of procedures from Pt 5.3 primarily because those procedures are intended to protect the creditors. Therefore, enforcing such procedures in this case will not promote the creditors' interests given that the creditors had already granted consent to the plaintiff's arrangement. Imposing such procedures will delay the liquidation process and increase costs.

(iii) Directions under s. 90-15(1) of the Insolvency Practice Schedule (Corporations)

The plaintiffs also sought directions under s. 90-15(1) of the Insolvency Practice Schedule (Corporations) to the Corporations Act as to the requirement procedures of (i) receiving any "Report as to Affairs" or "Report on Company Activities and Property" from any directors or past directors of the Companies, and (ii) conducting investigations into, or reporting to creditors about, possible recovery actions that may be available in the event that any of the Companies were to proceed into liquidation under the Corporations Act.

The Court held that it is proper for the Court to make such orders as it thinks fit in relation to the external administration of a company pursuant to s. 90-15(1) and the plaintiffs should be permitted to dispense with the procedures above for the same reasons that the Court granted relief in relation to Pt 5.3 of the Corporations Act.

(iv) Stay of the liquidations

The Court held that the power to grant a stay of liquidation is discretionary, and the stay was granted in this case in light of (i) the purpose of the stay was to facilitate a coordinated liquidation of the Companies, and (ii) the support from the creditors for the plaintiff's arrangement.

6.7 Federal Court grants leave for derivative action proceedings against a company's directors over a merger
(By Andrew Hay and Maggie Skow, Clayton Utz)

De Tocqueville, in the matter of Pacific Current Group Limited v Pacific Current Group Limited [2020] FCA 172 (20 February 2020), Federal Court of Australia, Moshinsky J.

(a) Summary

In this matter, the court granted leave under s. 237(1) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) for a shareholder to bring proceedings on behalf of a company against its directors and former directors for breach of duty of care and diligence in approving the Company's 2014 merger. The Court held the matters set out in s. 237(2) of the Corporations Act were satisfied and in particular, that it was in the best interests of the company to bring the proceedings.

(b) Facts

Mr de Tocqueville, is a 0.84% shareholder and former director (1998 to 2002) of Pacific Current Group Limited (PAC), a funds management company. Mr de Tocqueville also controls ASI Mutual Pty Ltd (ASI), which is a 0.11% shareholder of PAC (together, the Plaintiffs). In 2014, PAC entered into a merger with Northern Lights Capital Group LLC (Northern Lights), a US based asset manager.

In 2017, Mr de Tocqueville brought proceedings and was granted an order to inspect PAC's records and documents relating to the merger. He retained solicitors who formed the view that PAC had claims against the directors of PAC at the time of the 2014 merger (the 2014 Directors) for breach of duty of care and diligence (the Proposed Proceedings).

Specifically, the statement of claim provides that the 2014 Directors, among other things:

- failed to obtain shareholder approval for the merger;
- failed to quantify the position of PAC if the merger didn't take place; and
- made "inadequate and imprudent decision making" during board meetings when deciding to go ahead with the merger. This was due to a lack of evidence that it would be value enhancing for the shareholders, the potential overvaluation of Northern Lights and the fact that the terms exposed PAC to foreseeable disadvantages.

The Plaintiffs secured litigation funding for the Proposed Proceedings from IMF Bentham (Fund 5) Australian Investments Pty Ltd (IMF Bentham). The Plaintiffs proposed undertakings that IMF Bentham would pay and indemnify PAC against all costs incurred by the Plaintiffs in bringing and maintaining a claim and pay and indemnify PAC against all orders for costs.

(c) Decision

The court granted leave under s. 237(2) of the Corporations Act for the Plaintiffs to bring the Proposed Proceeding on behalf of and in the name of PAC against the 2014 Directors for breach of duty of care and diligence (under general law and s. 180(1) of the Corporations Act), conditional upon revised undertakings.

Section 237(2) of the Corporations Act relevantly provides that: a court must grant the application if it is satisfied:

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

The court considered the factors in s. 237(2) of the Corporations Act and held there was no issue with the requirement in paragraph (a), as PAC will not itself bring the proposed proceeding and (e), as the Plaintiffs gave the required notice.

(i) Good faith (s. 237(2)(b))

The Court was satisfied Mr de Tocqueville was acting in good faith (s. 237(2)(b)), as there was nothing to suggest he was bringing the Proposed Proceedings for a collateral purpose. Whilst correspondence between the parties demonstrated "a degree of anger towards the board and management" in relation to the merger, this differed from an absence of good faith.

(ii) Serious question to be tried (s. 237(2)(d))

Moshinsky J found that the Proposed Proceedings raised a serious question to be tried, as there was at least "a proper basis for the claims against the directors". Whilst it was only possible to form a tentative view at this point, it was held that there was, at least a prospect that the claim would be successful.

(iii) Best interests of PAC (s. 237(2)(c))

The judgment focused, to a large extent, on whether bringing the Proposed Proceedings was in the best interests of PAC. Moshinsky J held that "in summary, the potential 'upside' of the Proposed Proceedings is considerable (a substantial award of damages or a substantial settlement), while there is very little 'downside' in bringing the Proposed Proceeding given the litigation funding arrangements" and $60 million directors' and officers' (D&O) insurance policy.

PAC raised concerns about IMF Bentham's funding terms, under which IMF Bentham would get 30% of any settlement or judgment reached in the next 12 months and 35% of any settlement or judgment reached thereafter. However, it was held that these terms were not unreasonable and there was no evidence better terms could be agreed to with another funder. Moshinsky J also dismissed PAC's arguments that the case would be disruptive to its business and the fact that the PAC board formed the view that it was in the best interest of PAC not to commence proceedings against the 2014 directors.

6.8 Caught short: Short seller activist found to have misled
(By Kam Jamshidi, Herbert Smith Freehills)

Rural Funds Management Limited as Responsible Entity for the Rural Funds Trust and RF Active v Bonitas Research LLC [2020] NSWSC 61 (12 February 2020), Supreme Court of New South Wales, Hammerschlag J.

(a) Summary

Short seller activism and the use of negative research reports in Australia are on the rise. The NSW Supreme Court has recently handed down its judgment in *Rural Funds Management Limited v Bonitas Research LLC* [2020] NSWSC 61, the first Australian case regarding a short seller negative research campaign.

The decision provides useful guidance for listed companies on the conduct of short sellers that publish negative research, including that:

- the courts will expect short sellers to exercise care in publishing their allegations, including enquiring with the targeted company beforehand;
- attempts to circumvent Australian corporations law, for example by only giving access to research to readers outside of Australia, will fail where the statements made are clearly intended to induce persons in Australia; and
- the corporate targets of these short attacks may recover the costs of responding to the short seller campaign, but damages may not compensate for the loss suffered by their shareholders unless shareholders bring their own action.

(b) Facts

(i) The Bonitas Campaign against Rural Funds

In August 2019, Bonitas Research LLC's (Bonitas) published research claiming Rural Funds Management Limited (Rural Funds) had misstated its financial performance and that its securities were worthless.

Key claims made by Bonitas in its research that the Court ultimately found to be misleading included that Rural Funds Management had:

- artificially inflated its income;
- dishonestly received certain income to the detriment of the unitholders of the Rural Funds Trust, which it managed; and
- breached the Rural Funds Trust's constitution regarding the cap on management fees.

Shortly after Bonitas published its research, Rural Funds responded with a rebuttal of the allegations, supported by an independent investigation by Ernst & Young.

Bonitas took steps aimed at avoiding the Australian corporations law from applying to its research. For example, those accessing the research were required to confirm they resided outside of Australia. This gave rise to an unsatisfactory state of affairs, where some shareholders could access the report and others could not - creating information inefficiencies in the market for Rural Funds' securities.

Rural Funds securityholders were vulnerable. Their securities fell 42% on the day the Bonitas research was released, only to recover 40% in the following days where they have settled. During this volatility, Australian securityholders were notionally not permitted to access the Bonitas report, creating information asymmetry in the market.

(c) Decision

(i) Jurisdictional question

Rural Funds commenced proceedings against Bonitas in the NSW Supreme Court in October 2019.

The Bonitas response to the litigation was defiant:

"You have commenced litigation in Australia and invited us to participate. We respectfully decline the invitation. Australian courts have no jurisdiction over us, and we will contest the enforcement of any orders or judgments you obtain."

Bonitas' dismissiveness raised the question - are short seller activists really above our corporations laws?

A position whereby offshore funds are not governed by the laws designed to keep our markets efficient, would clearly be an unlevel playing field. Corporate targets of negative research campaigns are bound by a strict disclosure and liability regime. It must follow that short sellers too are accountable for their statements in order to preserve the integrity of our markets.

The NSW Supreme Court has now confirmed this - short sellers will be held accountable where their statements are intended to induce persons in Australia.

(ii) Bonitas' contraventions

In respect of Bonitas' misleading statements set out above, the NSW Supreme Court held that Bonitas and its CEO had breached the following sections of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) that prohibit a person from:

- s. 1041E: making false or misleading statements likely to induce a person to dispose of financial products where the person making the statement does not care whether the statement is true or false;
- s. 1041F: inducing a person to deal in financial products by publishing a statement, if the person is reckless as to whether the statement is misleading; and
- s. 1041H: engaging in conduct in relation to a financial product that is misleading or deceptive.

Rural Funds also sought a finding that Bonitas had contravened s. 1041D, with the aim of having profits made by Bonitas as a result of the conduct included in the assessment of damages.

That section requires that:

- information be circulated to the effect that the price for securities is likely to fall;
- the fall in price be because of a transaction in respect of the securities; and
- the transaction constitutes a contravention of ss. 1041E or 1041F (or several other sections) of the Corporations Act.

Hammerschlag J did not find a breach of s. 1041D of the Corporations Act in this case. The Court held that s. 1041D requires both the dissemination of information and a transaction that contravenes ss. 1041E or 1041F. In this case there was no such transaction.

(d) Commentary

The decision is a welcome development, and should give boards and legal and investor relations teams stronger footing in combating negative research campaigns.

(i) Recovering shareholders' loss

Section 1041(I) of the Corporations Act permits a person who suffers loss as a result of the contravention of the above provisions to recover damage from any person involved in the contravention. Rural Funds relied on this provision to seek to recover its costs in responding to the Bonitas research. The Court is yet to assess damages in the case.

Of course, the greater quantum of loss is likely to have been suffered by Rural Funds securityholders that sold their securities soon after the release of the Bonitas report.

Rural Funds is unable to recover loss on behalf of those shareholders, and while a class action supported by a litigation funder is possible, litigation funders have not been active in this space, presumably in part due to the lack of judicial guidance in the area.

Interestingly, it is open for ASIC to exercise its power under s. 50 of the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) to bring proceedings against Bonitas on behalf of the affected Rural Funds securityholders, if ASIC believes it is in the public interest to do so. Use of the power has been rare.

(e) Conclusion

Bonitas claimed the Rural Funds' litigation was an attempt to abrogate the First Amendment right to freedom of speech in the US Constitution. One can be supportive of that freedom of speech, provided it does not cut across the principle of efficient and informed markets.

Ultimately, short sellers will continue to be part of the Australian corporate landscape. The Rural Funds decision is a timely message that short sellers are not above our corporations law.
