SAI GLOBAL

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Index info.regulatory@saiglobal.com

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

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 APRA releases second set of final prudential practice guides for superannuation

On 7 November 2013, the Australian Prudential Regulation Authority (APRA) released eight final prudential practice guides (PPGs) for the superannuation industry together with a response paper, *Second set of prudential practice guides for superannuation*.

PPGs provide guidance on APRA's view of sound practice in particular areas that may assist a registrable superannuation entity (RSE) licensee in meeting the requirements in APRA's prudential standards.

The eight superannuation PPGs are:

New PPGs

- Prudential Practice Guide SPG 160 Defined Benefit Matters;
- Prudential Practice Guide SPG 222 Management of Reserves;
- Prudential Practice Guide SPG 511 Remuneration;
- Prudential Practice Guide SPG 530 Investment Governance; and
- Prudential Practice Guide SPG 531 Valuation.

Updates to existing superannuation PPGs

- Prudential Practice Guide SPG 221 Adequacy of Resources;
- Prudential Practice Guide SPG 270 Contribution and Benefit Accrual Standards; and
- Prudential Practice Guide SPG 280 Payment Standards.

A final remaining PPG, Prudential Practice Guide SPG 310 Audit and Related Matters, will be released before the end of 2013.

The PPGs are available on the APRA website.

1.2 FRC consultation on risk management

On 6 November 2013, the UK Financial Reporting Council (FRC) published for consultation changes to the UK Corporate Governance Code, guidance for boards of listed companies and standards for auditors covering risk management and reporting. Supplementary guidance for directors of all banks is also being issued.

The proposals build on the FRC's work on "Boards and risk" and aim to raise the bar for risk management by boards and communication to the providers of risk capital about the risks faced by companies in which they invest and how they are managed or mitigated.

(a) Broader risk considerations and role of the auditor

The draft guidance sets out boards' responsibilities for setting the company's risk appetite, ensuring there is an appropriate risk culture throughout the organisation, and assessing and managing the principal risks facing the company, including risks to its solvency and liquidity. As is presently the case, boards should summarise the process applied in reviewing the effectiveness of the system of risk management and internal control. There is a new encouragement to explain what actions have been or are being taken to remedy any significant failings or weaknesses identified from that review.

Under the proposals, auditors will be required, in meeting their current requirement, to consider whether reporting is fair, balanced and understandable, and to consider and report if they are aware of any material matter in connection with the disclosure of principal risks that should be disclosed.

(b) Solvency and liquidity risks and going concern

In response to the recommendations made by Lord Sharman, the FRC proposes a new Corporate Governance Code provision and related guidance. They establish the need for a robust assessment by companies of how they manage or mitigate their principal risks, including risks to solvency and liquidity, and to explain which if any of those risks have also given rise to material uncertainties for the purposes of reporting on the company's going concern basis of accounting. The FRC is, therefore, proposing to remove the current Code provision requiring listed companies to make a "going concern" statement. That statement is focused on the narrow meaning of assessing the going concern basis of accounting, and so detracts from the broader integrated assessment and description of solvency and liquidity risks envisaged by Lord Sharman.

(c) Banking considerations

The Sharman Inquiry also looked at whether a special disclosure regime is required for banks and concluded that this should not be necessary. The Inquiry considered it important that the FRC should clarify that a conclusion that a bank is or would be reliant, in stressed circumstances, on access to liquidity support from central banks that is reasonably assured, does not necessarily mean that the bank is not a going concern or that material uncertainty disclosures or an auditor's emphasis of matter paragraph are required.

The FRC issued guidance for banks along those lines in January 2013 which found general support. Accordingly, the FRC is also now consulting on supplementary guidance to directors of banks updated only in respect of the proposed integrated guidance and developments in the regulatory regime.

The FRC expects to issue the final Code, guidance and standards in the middle of 2014 with application for financial years beginning on or after 1 October 2014.

The consultation paper as well as the associated files are available on the FRC website.

1.3 OECD publication - Supervision and enforcement in corporate governance

On 4 November 2013, the Organisation for Economic Co-operation and Development (OECD) released the fifth peer review of the OECD Principles of Corporate Governance. The publication analyses the supervision and enforcement of rules and practices relating to related party transactions, takeover bids and shareholder meetings in both private and public institutions. The review covers 27 jurisdictions and is based on a general survey of all participating jurisdictions in June 2012, as well as an in-depth review of supervision and enforcement practices in Brazil, Turkey, and the United States.

The publication is available on the OECD website.

1.4 Disclosure requirements for Islamic capital market products

On 31 October 2013, the Islamic Financial Services Board (IFSB), the International Organization of Securities Commissions (IOSCO) and the Securities Commission Malaysia (SC) announced the publication of *Disclosure Requirements for Islamic Capital Market Products*. The publication is a compilation of the issues papers and commentaries presented at the IFSB-IOSCO-SC Roundtable on Disclosure Requirements for Islamic Capital Market (ICM) Products, held in Kuala Lumpur in

September 2012.

The publication discusses the need to develop international regulatory standards and best practices relating to disclosure requirements for ICM products. It analyses the issues, risks and challenges arising from potential inadequate disclosure in the areas of Sukūk and Islamic Collective Investment Schemes, and analyses ways to strengthen disclosure standards for ICM products.

The publication is available on the IFSB website, the IOSCO website and the SC website.

1.5 Implementation of principles for financial benchmarks

On 30 October 2013, the International Organization of Securities Commissions (IOSCO) published a public communique titled *Implementation of the Principles for Financial Benchmarks*, in which it encourages administrators of benchmarks to take all the necessary measures to comply with the IOSCO Principles for Financial Benchmarks by July 2014.

In the communique, IOSCO also requests that administrators publically disclose every year the extent of their compliance with the Principles for Financial Benchmarks, which were issued on 17 July 2013.

The communique is available on the IOSCO website.

1.6 New Zealand disclosure markets need to improve: report

On 30 October 2013, a report by the New Zealand Financial Markets Authority (FMA) into prospectuses and investment statements (disclosure documents) was issued. The report highlights the need for issuers to improve their practices.

The report comes more than a year after FMA released its Guidance Note on Effective Disclosure which explains the approach FMA will take to reviewing disclosure documents for compliance with the law. The Guidance Note encourages issuers to set out information in a clear, concise and effective way to assist investors to make investment decisions.

A copy of FMA's report on effective disclosure is available on the FMA website.

The guidance note is also available on the FMA website.

1.7 Proxy advisors consultation on best practice principles

On 28 October 2013, a group of proxy advisors issued draft Best Practice Principles for Governance Research Providers for consultation.

The principles cover three areas:

- service quality;
- conflicts of interest management; and

- market communications.

The Principles are supported by guidance. The Principles are intended to operate on a "comply-or-explain" basis.

The draft Principles are available on the Best Practice Principles for Governance Research Group website.

1.8 UK and US proposals on how to regulate crowdfunding

(a) FCA proposed regulations on crowdfunding

On 24 October 2013, the UK Financial Conduct Authority (FCA) proposed new rules relating to peer-to-peer lending and equity investment based crowdfunding; the two types of crowdfunding that need regulatory oversight. The proposed rules aim to provide consumers who wish to invest in small or start-up businesses via crowdfunding platforms with clearer information about the business in which they are investing.

Crowdfunding is a way businesses, organisations and individuals can raise money. Generally, it involves a number of people pooling money through a website, often called a platform.

Consumers willing to lend money to companies through peer-to-peer crowdfunding websites will receive explanations of the key features of the loans as standard. They will also benefit from an assessment of the creditworthiness of borrowers before granting credit, and crowdfunding sites, or platforms, will need plans in place to ensure loan repayments continue even if a crowdfunding company collapses. A 14-day cooling off period will allow both borrower and lender to withdraw without penalty from the agreement if either changes their mind. New prudential requirements will also be phased in.

The FCA has also proposed new rules for investment-based crowdfunding, which is already regulated. The paper makes clear the FCA's belief that these investments should only be promoted to those who understand the inherent risks or have the financial capacity to cope with any losses.

There are a number of different crowdfunding business models, two of which require FCA regulation:

- investment-based crowdfunding; and
- loan-based crowdfunding (peer-to-peer lending), which is a consumer credit activity.

For investment-based crowdfunding platforms, the FCA is tailoring an existing rulebook rather than creating a new one, so that there are fewer proposed changes.

The key proposals include, for the retail market, that firms can only promote these platforms to:

- sophisticated investors, high net worth investors, retail clients who receive regulated investment advice or investment management services from an authorised person; or
- retail clients who certify that they will not invest more than 10% of their portfolio (i.e. excluding their primary residence, pensions and life cover) in unlisted shares or unlisted debt securities. This reflects the fact that most investments in start-up businesses result in a 100% loss of investment (between 50% and 70% of new businesses fail in the early years).

The consultation paper is available on the FCA website.

(b) SEC proposed regulations on crowdfunding

On 23 October 2013, the US Securities and Exchange Commission (SEC) voted unanimously to propose rules under the *Jumpstart Our Business Startups Act* (the JOBS Act) to permit companies to offer and sell securities through crowdfunding.

Title III of the JOBS Act created an exemption under the securities laws so that this type of funding method can be easily used to offer and sell securities as well. The JOBS Act also established the foundation for a regulatory structure for this funding method.

Under the proposed rules:

- a company would be able to raise a maximum aggregate amount of US$1 million through crowdfunding offerings in a 12-month period; and
- investors, over the course of a 12-month period, would be permitted to invest up to:
  - US$2,000 or 5% of their annual income or net worth, whichever is greater, if both their annual income and net worth are less than US$100,000; or
  - 10% of their annual income or net worth, whichever is greater, if either their annual income or net worth is equal to or more than US$100,000.

  During the 12-month period, these investors would not be able to purchase more than $100,000 of securities through crowdfunding.

The proposed rules also place disclosure obligations on companies and obligations on crowdfunding platforms.

The proposed rules are available on the SEC website.

1.9 Consultation on the fiduciary duties of investment intermediaries

On 22 October 2013, the UK Law Commission began a consultation on the fiduciary duties of investment intermediaries.

The consultation paper uses pensions as the example, tracing a chain of intermediaries from the prospective pensioner/saver to the registered shareholder of a UK company. There are well established duties on pension trustees to act in the best interests of scheme members. The Law Commission looks at how far these duties require trustees to maximise financial return over a short time scale, and how far trustees can consider other factors, such as environmental and social impact.

Research questions include:

- is the law right to allow trustees to consider ethical issues only in limited circumstances?
- are the legal obligations on trustees conducive to investment strategies in the best interests of the ultimate beneficiaries? And if not, what specifically needs to be changed?

For contract-based pensions and others in the chain, fiduciary duties are much less certain.

Research questions include:

- Should the duties on contract-based pension providers to act in the interests of members be clarified and strengthened?
- Should pension providers be duty-bound to review the suitability of investment strategies over time? And if so, how often they should do this?

- Does the regulation of investment consultants and custodians need to be reviewed?

Further information on the *Fiduciary Duties of Investment Intermediaries Project* can be found on the Law Commission website.

1.10 Corporate governance and employee interests: reports

On 22 October 2013, the UK Trade Union Congress (TUC) published two reports on corporate governance and employees' stakeholder interests. Both reports argue that allowing workers to sit on company boards would not only mean top executives' pay was set at more reasonable levels, but would also encourage the long-term success of individual firms, as both employees and directors worked together in the best interests of company performance.

In the two reports, one looking at the European experience and the other setting out the arguments why the UK should set out on a similar path, the TUC argues that the UK's short-termist approach (based on a model relying solely on shareholders to hold companies to account) has delivered neither economic success nor social justice.

Instead, a fixation with short-term gains has led to poor productivity, low investment and wages falling as a share of GDP. This, say the reports, has had the end result of hitting demand and hurting companies in the long run.

The report *Workers on Board* says that countries which have included the participation of worker representatives within their company structures are also economies with higher investment in research and development, better employment rates, stronger economic success and lower rates of poverty.

The report *Workers' Voice in Corporate Governance: A European Perspective* looks at the ways in which workers are involved in the management of European companies—from being a part of the top team to having a voice at annual general meetings and a seat on company boards.

The report finds that, far from simply being a German phenomenon, as is the common perception, employees have formal roles to play in the management of companies right across Europe, with workers being represented on company boards in 19 European countries including the Netherlands, Sweden, France and Austria.

The reports set out a number of changes that, according to the TUC, are also needed if the UK's system of corporate governance is to better help businesses focus on long-term success.

These include:

- that directors' duties should be changed so their main responsibility is the long-term success of the company, rather than the interests of shareholders.;
- that, to help minimise the influence of short-term share traders, anyone holding company investments should have to do so for a minimum of two years before being allowed a vote at company AGMs; and
- a mandatory system for the representation of workers on company boards.

The reports are available on the TUC website.

1.11 IOSCO hedge fund survey

On 21 October 2013, the International Organization of Securities Commissions (IOSCO) published the *Report on the Second IOSCO Hedge Fund Survey*, which describes the global effort by regulators to better understand the hedge fund industry and its salient features.

The aim of the IOSCO survey is to gather data from hedge fund managers and advisers about the markets in which they operate, their trading activities, leverage, funding and counterparty information. It forms part of IOSCO's efforts to support the G20 initiative to mitigate risk associated with hedge fund trading and traditional opacity.

The report covers the following areas:

- **Qualifying funds**: the hedge survey gathered data on 1,044 qualifying funds. The United States and the United Kingdom are the two predominant regions where hedge fund managers/advisers are located.
- **Assets under management**: the funds captured in the survey represented US$1.94 trillion in total net assets under management.
- **Fund domiciliation**: these funds are usually domiciled in offshore jurisdictions in order to benefit from more favorable tax and regulatory regimes. The Cayman Islands have been the predominant domicile for these funds.
- **Investment strategy**: the report indicates that the single most represented strategy among active funds is equity oriented. Macro-oriented and multi-strategy funds are also significant.
- **Use of leverage and market exposure**: the report shows how financial leverage is used by firms to increase their market exposure. This data is at the core of the systemic risk analysis that regulators aim to better understand and capture.
- **Liquidity risk**: this is a key measure by which regulators try to gauge a fund's propensity to experience financial distress. The survey indicated that under current market conditions few funds actually need to restrict investor liquidity.

The report is available on the IOSCO website.

1.12 European Union approves transparency requirement for issuers of securities

On 17 October 2013, the Council of the European Union adopted a directive updating transparency requirements introduced in 2004 for issuers of securities on regulated markets.

The so-called Transparency Directive is aimed at ensuring a high level of investor confidence throughout the EU. It requires issuers of securities traded on regulated markets to publish periodic financial information about the issuer's performance over the financial year and on-going information on major holdings of voting rights.

The agreed improvements are aimed at:

- simplifying certain obligations so as to make regulated markets more attractive for raising capital for small and medium-sized issuers;
- making obligations applicable to listed small and medium-sized issuers more proportionate, while guaranteeing the same level of investor protection, and to facilitate cross-border access to information; and
- improving legal clarity and effectiveness, notably with respect to the disclosure of corporate ownership.

The Directive also includes a requirement for listed companies operating in the oil, gas and mineral extractive as well as the forestry industry, to disclose payments to governments in countries where they operate. This follows a commitment made by members of the G8 in May 2011.

The Directive is available on the European Union website.

1.13 IOSCO launches first securities markets risk outlook

On 15 October 2013, the International Organization of Securities Commissions (IOSCO) published the *IOSCO Securities Markets Risk Outlook for 2013-2014*. The report highlights important trends, vulnerabilities and risks in securities markets that may be of concern from a systemic perspective.

The four main risks it identifies and analyzes in depth relate to the following:

Risks related to low interest rate environment

Expansionary monetary policies have reduced interest rates to the point that real rates are at times negative. While these policies may help stimulate the real economy, spill-over effects may create potential risks for securities markets. A search for yield is turning investors towards leverage products such as CDOs and leveraged real estate investment funds.

Risks related to collateral management

In response to global policy requirements, demand from investment firms for high quality collateral has increased significantly. More generally, bank holding companies with over-the-counter (OTC) dealer operations must locate high-quality collateral to meet initial and variation margin requirements for their OTC trades. Additionally, central banks have been absorbing collateral to provide needed bank funding. This growing demand has altered the balance of collateral in the system, diminishing availability of high-quality collateral and could impact pricing.

Risks related to derivatives markets

OTC derivatives markets have undergone significant reform since the financial crisis. This reform entails the mandatory clearing of derivative contracts through central counterparties (CCPs). CCPs are designed to reduce systemic risk in the derivatives market by reducing counterparty risk. But shifting the risk from bilateral OTC contracts to a single point of infrastructure is a challenging balancing act.

Risks related to capital flows of emerging markets

Emerging market economies have experienced significant capital inflows in the post-crisis era. Debt securities and non-bank lending have overtaken foreign direct investment and banking lending as the main source of these capital inflows. After the announcement of the tapering of the expansionary monetary policies of the US Federal Reserve, a sudden reversal in capital inflow occurred, highlighting the need for further structural reforms aimed at making securities markets more resilient.

The Outlook is available on the IOSCO website.

1.14 European Union approves single supervisory mechanism for banking

On 15 October 2013, the Council of the European Union adopted regulations creating a single supervisory mechanism for the oversight of banks and other credit institutions, thus establishing one of the main elements of Europe's banking union.

The single supervisory mechanism (SSM) will be composed of the European Central Bank (ECB) and the supervisory authorities of the member states. It will cover the euro area as well as non-eurozone countries that choose to participate. The ECB will have direct oversight of eurozone banks, although in a differentiated manner and in close cooperation with national supervisory authorities. It will be responsible for the overall functioning of the SSM.

The Regulation conferring supervisory tasks on the ECB is available on the Council of the European Union website.

The Regulation regarding the EBA's authority is also available on the Council website.

1.15 Regulator and government agency annual reports

Several regulators and other government agencies with responsibility for corporate law and corporate governance have recently released their annual reports for 2012-2013.

They include:

- Australian Accounting Standards Board (AASB) Annual Report 2012-13;
- Australian Auditing and Assurance Standards Board (AUASB) Annual Report 2012-13;
- Australian Office of Financial Management (AOFM) Annual Report 2012-13;
- Australian Prudential Regulation Authority (APRA) Annual Report 2012-13;
- Australian Securities and Investments Commission (ASIC) Annual Report 2012-13;
- Australian Securities Exchange (ASX) Annual Report 2012-13;
- Commonwealth Director of Public Prosecutions (CDPP) Annual Report 2012-13;
- Commonwealth Treasury Annual Report 2012-13;
- Companies Auditors and Liquidators Disciplinary Board (CALDB) Annual Report 2012-13;
- Corporations and Markets Advisory Committee (CAMAC) Annual Report 2012-13;
- Financial Reporting Council (FRC) Annual Report 2012-13;
- Australian Financial Security Authority (AFSA) (formerly ITSA) Annual Report 2012-13; and
- Takeovers Panel Annual Report 2012-13.

2. Recent ASIC Developments

2.1 Consultation on employee share scheme policy

On 14 November 2013, ASIC released a consultation paper on employee incentive schemes.

ASIC's specific revisions and new policy proposals include:

- expanding the classes of financial products which may be offered;
- expanding the categories of persons who can participate;
- providing greater flexibility in the way employee incentive schemes can be structured to better reflect market practices (e.g. amending the requirements for trust, contribution and loan arrangements);
- reducing the administrative burden of having to provide copies of documents to ASIC; and
- expanding the types of situations where unlisted bodies may offer employee incentive

schemes.

ASIC has previously published *Class Order [CO 03/184] Employee share schemes* and *Regulatory Guide 49 - Employee share schemes* and intends to retain its fundamental policy settings for granting employee incentive scheme relief by ensuring that:

- the terms of the employee incentive scheme support the long-term mutual interdependence between employer and employee;
- an employee is able to assess the value of what they are being offered and to understand the terms and conditions; and
- the employee incentive scheme is not offered for fundraising purposes.

The consultation paper is available on the ASIC website.

2.2 ASIC launches online hub to support small business

On 5 November 2013, ASIC launched a new online hub for Australia's small business owners and operators have to help them better understand their legal obligations and the role of ASIC.

In 2012, ASIC consulted key stakeholders and conducted an online survey with small businesses to better understand their needs and expectations.

This survey found that ASIC needed to engage more with small businesses because:

- they have limited knowledge about ASIC and what it does;
- they have little understanding of their compliance obligations and find it difficult to get relevant information from ASIC; and
- information provided by ASIC is often difficult to understand because it is written in legal jargon.

The hub features information on starting and closing a small business, legal requirements for small business operators, one minute guides on popular topics and access to ASIC's new quarterly small business eNewsletter.

ASIC's small business hub is part of a series of tools being developed to help the small business community.

ASIC's booklet *Your obligations as a small business operator* was released earlier this year and is available on the ASIC website.

2.3 ASIC lodges Senate Inquiry submission

On 31 October 2013, ASIC lodged its major submission to the Senate Economics Committee's inquiry into the regulator.

The submission details ASIC's record in enforcing the law in Australia's financial markets. It also details ASIC work using tools from consumer education and industry guidance to surveillance and negotiated undertakings to improve market outcomes, minimise losses and lift investor and consumer confidence.

In responding to the Inquiry's terms of reference, the submission makes a number of policy suggestions to enhance ASIC's performance and help it to achieve better market outcomes.

These policy suggestions cover:

- raising financial adviser competence through a national exam (paragraphs 563-575);
- helping remove "bad apple" advisors and managers from the industry (paragraphs 576-593);
- enhancing whistleblower protections (paragraphs 603-614);
- strengthening ASIC's licensing powers (paragraphs 615-623);
- streamlining search warrant powers (paragraphs 624-631); and
- reviewing the level, consistency and availability of penalties (paragraphs 632-653).

The submission also provides an overview of ASIC's approach to enforcement, its collaboration with other regulators and its complaints management policies.

The submission is available on the ASIC website.

ASIC has made two earlier submissions to the inquiry:

- an initial submission providing an overview of ASIC's actions on Commonwealth Financial Planning as well as context about its financial advice work; and
- a second submission dealing with ASIC's regulation of consumer credit, both before and after primary responsibility for credit regulation shifted from the states to the Commonwealth in 2010.

2.4 Focuses for 31 December 2013 financial reports

On 30 October 2013, ASIC announced its areas of focus for 31 December 2013 financial reports of listed entities and other significant economic entities.

ASIC's surveillance of 31 December 2013 financial reports will particularly focus on public interest entities such as listed entities, disclosing entities, financial institutions and other entities of public interest with a large number and wide range of stakeholders considering factors like the nature and size of the business and the number of its employees.

ASIC's reviews will include some half-year reports with particular emphasis on the impact of new accounting standards.

Particularly in challenging economic circumstances, directors and auditors should also focus on:

- disclosure in the operating and financial review (OFR);
- off-balance sheet arrangements and new standards;
- revenue recognition and expense deferral;
- asset values and impairment testing;
- going concern;
- financial instrument values;
- tax accounting;
- estimates and accounting policy judgments;
- non-IFRS financial information; and
- related party disclosures.

Further information is available on the ASIC website.

2.5 ASIC grants relief for periodic statements for quoted and listed managed funds and to facilitate quotation of ETFs on the AQUA market

On 17 October 2013, ASIC released *Report 373 - Response to submissions on CP 196*, finalising the regulator's approach to relief for periodic statements and facilitating quotation of exchange traded funds (ETFs) on the AQUA market.

REP 397 highlights that issuers of interests in registered schemes were generally supportive of ASIC's proposals.

ASIC has granted relief to issuers of AQUA quoted and listed managed investment schemes to help them overcome practical difficulties in preparing periodic statements for the scheme members.

ASIC has also granted relief to facilitate the quotation of ETFs on the AQUA market. This relief eliminates the need for issuers to apply for individual relief in most circumstances for each new ETF they quote on the AQUA market.

Report 373 is available on the ASIC website.

Class Order [CO 13/1200] Periodic statements relief for AQUA quoted and listed managed investment scheme issuer is available on the ASIC website.

Class Order [CO 13/721] Relief to facilitate quotation of exchange traded funds on the AQUA market is available on the ASIC website.

3. Recent ASX Developments

3.1 Consultation paper on the timetable for dividends and capital requirements

On 4 November 2013, the ASX released the consultation paper *Timetable for dividends and distributions: A proposal to prescribe the last election date for a dividend reinvestment plan following the record date*.

The consultation paper sets out a proposal to amend the timetable for dividends and distributions in Appendix 6A of the Listing Rules to introduce a requirement for the last election date for a dividend reinvestment plan or a distribution reinvestment plan offered on a dividend or a distribution to be set no earlier than the business day following the record date for the dividend or distribution.

The consultation paper is available on the ASX website.

3.2 ASX Clear Pty Ltd consultation on capital requirements

On 23 October 2013, ASX Clear Pty Ltd issued the paper *Consultation on Capital Requirements*, on the minimum core capital requirements for ASX Clear Participants that are subject to the risk based capital requirements. In addition the paper also discusses the possibility of a tiered minimum core capital requirement for General Participants.

The consultation paper is available on the ASX website.

3.3 ASX launches futures product for trading equity market volatility

On 21 October 2013, the ASX commenced trading of S&P/ASX 200 VIX futures, a new exchange-traded product that allows users to trade, hedge and arbitrage anticipated volatility in the Australian equity market.

The new S&P/ASX 200 VIX futures will allow market participants to trade anticipated changes in volatility in a single transaction and in a manner independent of the factors that normally complicate volatility strategies, such as expiring options and price movements in the underlying market.

Further information is available on the ASX website.

3.4 Consultation paper on the ASX 24 exchange traded derivatives and OTC interest rate derivatives client clearing service

On 17 October 2013, the ASX released the second of two Consultation Papers on its Client Clearing Service for ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives. The Consultation Paper focuses on default management procedures. The first Consultation Paper, released in August 2013, focused on client account segregation and portability features of the service.

The draft Operating Rule amendments covered by this Consultation Paper are intended to do three things:

- refine the existing default management process for OTC Interest Rate Derivatives and portfolio-margined ASX 24 Exchange Traded Derivatives, in particular by:
    - confirming ASX's power to combine House and non-ported Client portfolios of one or more defaulting Clearing Participants for the ultimate purpose of disposal either through sale or auction to non-defaulting Clearing Participants; and
    - providing greater clarity on the auction formats that ASX may utilise for default management purposes.

  These changes are relevant to ASX's OTC Dealer Clearing Service (launched on 1 July 2013) as well as the Client Clearing Service (to be launched in phases during the first half of 2014);

- introduce rules for allocating to House and Client accounts of one or more defaulting Clearing Participants the losses, costs and expenses incurred by ASX in closing out their House and non-ported Client OTC and portfolio-margined ETD positions—a method for allocating such losses is necessitated by the introduction of the Client Clearing Service; and
- refine the existing rules for "juniorisation" of OTC Commitments to enhance the incentives for OTC Clearing Participants to bid competitively in default auctions—these refinements are proposed in compliance with the requirements of Australian regulatory agencies and are not directly related to the Client Clearing Service.

The Consultation Paper is available on the ASX website.

3.5 ASX launches futures over the resources and financial sectors

On 14 October 2013, the ASX launched futures contracts over the S&P/ASX 200 Resources Index and the S&P/ASX 200 Financials-x-A-REIT Index.

Resources and financial companies make up the two largest sectors in the Australian market and each provides their own investment opportunities. The launch of the new sector futures will enable market participants to tailor their trading, hedging and exposure to these specific segments of the Australian market.

Further information is available on the ASX website.

3.6 Reports

On 6 November ASX released:

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

for October 2013.

4. Recent Takeovers Panel Developments

4.1 Hastings Rare Metals Ltd - Panel declines to conduct proceedings

On 6 November 2013, the Takeovers Panel declined to conduct proceedings on an application dated 4 November 2013 from Foon Keong (Charles) Lew in relation to the affairs of Hastings Rare Metals Ltd.

The application concerned a placement made by Hastings following a requisition of a general meeting to add two new directors (including the applicant) to the Hastings board under s. 249D of the Corporations Act 2001 (Cth) (see TP13/53).

The Panel considered that the requisition was not (in this case) a control transaction, nor was the placement a frustrating action. Even though the acquisition of shares occurred in the context of a board dispute, the Panel was not satisfied that the placement had a material effect on the control of Hastings. The Panel considered that Hasting's disclosure in relation to the requisition was not a matter for it.

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

Further information is available on the Panel website.

4.2 STI-Global Ltd - Declaration of unacceptable circumstances and orders

On 8 November 2013, the Takeovers Panel made a declaration of unacceptable circumstances and final orders on an application dated 23 October 2013 by Sasser Family Holdings, Inc in relation to the affairs of STI-Global Ltd (see TP13/51).

(a) Background

STI-Global is an unlisted public company with more than 50 members.

Redheart Investments Pty Ltd, Donald Searle and RIQ Pty Ltd, among others, are parties to a shareholders' agreement in relation to STI-Global dated 30 December 2010. Entry into the shareholders' agreement was approved under item 7 of s. 611 by STI-Global shareholders at a meeting on 23 February 2011.

Donald Searle has a relevant interest of 13.69% in STI-Global, held directly and through RIQ. Kevin Reichelt is a director of, and has a relevant interest of 12.28% in, STI-Global, held directly and through Redheart.

On 23 August 2013, Mr Searle appointed Mr Reichelt as his proxy, and RIQ authorised Mr Reichelt as a corporate representative, in relation to the 13.69% interest held by them.

On 26 August 2013, an agreement was entered under which Redheart would acquire Mr Searle and RIQ's 13.69% interest over a two year period. The agreement also irrevocably appointed Mr Reichelt as proxy for Mr Searle, and as representative for RIQ, for all future meetings of STI-Global's shareholders prior to completion.

While there is a dispute about whether the proxy and agreement are still in effect, the Panel considers it likely that they are. The Panel also considered that they may be terminated on 10 November 2013 if, notice having been given, a default is not remedied. Separately, there is a dispute about whether the shareholders' agreement is still in effect.

(b) Declaration

The Panel considers that the circumstances are unacceptable because:

- if the shareholders' agreement is not (or was not at relevant times) in effect, the proxy arrangements and share sale agreement increased the voting power of Mr Reichelt and Redheart in STI-Global from 12.28% to 25.98%. This occurred in contravention of s. 606 and has an effect on the control of STI-Global contrary to principles in s. 602; and
- alternatively, even if the shareholders' agreement was and is in effect, the proxy arrangements and share sale agreement give voting and disposal powers in Mr Searle's and RIQ's shares to Redheart (and Mr Reichelt) that were not covered by the item 7 approval obtained on 23 February 2011 and have an effect on the control of STI-Global contrary to principles in s. 602.

(c) Referral to ASIC

During the course of the matter the Panel became concerned that Sasser Family Holdings may have acquired shares in STI-Global otherwise than in accordance with the Item 7 approval given on 23 February 2011. The Panel will refer this to ASIC under Regulation 18 of the Australian Securities and Investments Commission Regulations 2001 (Cth) for ASIC to consider whether to make an application to the Panel.

(d) Orders

The Panel has cancelled the proxy arrangements and share sale agreement. The Panel requires STI-Global to re-convene and hold the shareholders' meeting adjourned from 31 October 2013 between 25 November 2013 and 10 December 2013. This provides sufficient time for shareholders to be given notice of the re-convened meeting and for ASIC to consider whether to make an application to the Panel.

5. Recent Research Papers

5.1 Australia's "two-strikes" rule and the pay-performance link: Are shareholders judicious?

To improve accountability of executive compensation, Australia introduced the "say-on-pay" legislation in 2011, which is widely known as the "two-strikes" rule. The authors investigate the consequences of this new rule for the pay-performance link in Australian firms. Employing a matched-pair design, they find that pay changes of the chief executive officer and the key management personnel were not significantly positively related to the stock returns of the firms that registered a "first strike" in 2011 under the "two-strikes" rule. However, the relations improved significantly in 2012. The results also suggest that the shareholders of the "first-strike" firms may have been over-enthusiastic about their voting power in 2011 but exercised this power more judiciously in 2012. The findings provide important insights for the global debate on governance of executive compensation.

The paper is available on the SSRN website.

5.2 Understanding the board of directors after the financial crisis

There are numerous studies on the effectiveness of boards that primarily focus on legal formalities, including gender diversity, board size, remuneration, board evaluation and the role of the chairman of the board. While attempting to design a one-size-fits-all framework, scholars approaching board independence from an agency cost perspective have been less concerned with analysing board structures that contribute to strategic decision-making and corporate performance. The authors examine the factors and board strategies that are associated with value creation and innovation by analysing the composition of high-performance and high-growth companies. The paper shows that venture capitalists, with their specific expertise and experience, continue to play an important role as independent board members in the post-IPO period. The authors specifically investigate the importance of diversity, showing that there are significant differences between the companies in terms of age, gender diversity and business expertise (which is dependent on the stage in the company life-cycle).

The paper is available on the SSRN website.

5.3 Financial innovation in East Asia

Finance is important for development. However, the Asian financial crisis of 1997-1998 and the global financial crisis of 2008 highlighted the serious risks associated with financial liberalisation and excessive innovation. East Asia's strong focus on economic growth has necessitated a careful balancing of the benefits of financial liberalisation and innovation against the very real risks inherent in financial sector development. This paper examines this issue, focusing on the role of regulation and legal and institutional infrastructure in both supporting financial development and limiting the risk of financial crises.

The paper then addresses a series of issues with particular developmental significance in the region:

- trade finance;
- mortgage markets;
- SME finance;
- non-bank finance; and
- mobile financial services.

The paper is available on the SSRN website.

5.4 The determinants of director compensation

While executive compensation has been studied extensively, relatively little is known about the compensation of outside directors. The authors study the determinants of director compensation with a dataset of over 57,000 board positions from 2006 to 2010. Their findings suggest that a director's skills and experiences are the primary drivers of their compensation. They find no evidence that director compensation depends on personal connections that are unrelated to a director's duties. Instead, they find strong support for the hypothesis that directors are compensated for workload and for their outside employment options. Overall, the evidence is consistent with the view that director compensation is determined in a competitive market.

The paper is available on the SSRN website.

5.5 Does competition matter for corporate governance? The role of country characteristics

The authors investigate the empirical relation between competition and corporate governance, and the effect of country characteristics on this relation. They find that competition is associated with lower corporate governance ratings in developed countries. In developing countries, firms from competitive industries have, on average, higher corporate governance ratings than firms from less competitive industries. They next examine the impact of corporate governance on firm value. They show that corporate governance is positively associated with greater firm value, but only in less competitive industries from developed countries. For developing countries, the evidence suggests that corporate governance is valuable mostly in competitive industries.

The paper is available on the SSRN website.

5.6 Corporate governance of banks and other financial institutions after the financial crisis

Corporate governance of banks and other financial institutions differs considerably from general corporate governance. For financial institutions the scope of corporate governance goes beyond the shareholders (equity governance) to include debtholders, insurance policy holders and other creditors (debt governance). Failures in the corporate governance of banks and other financial institutions contributed to the financial crisis. Corporate law reforms are less suited to achieve better governance of financial institutions; strengthening supervisory law requirements is more promising.

Prominent proposals include:

- clearer separation of the management and control function, possibly by a two-tier board as for Swiss and Belgian banks;
- establishment of a separate risk committee of the board or an independent chief risk officer;
- dealing with the problem of complex or opaque structure and organisation; and
- group-wide corporate governance in single entities as well as in the group.

Appropriate supervisory law requirements are needed for the internal procedures of banks and other financial institutions, specifically for risk management, internal control and compliance, and internal and external auditing. Supervisory fit and proper tests for the board, the management and major shareholders are useful. Qualification and experience of board members of banks and other financial institutions are more important than independence, though having a number of independent directors is useful. These and other requirements of the regulation and supervision of banks and other financial institutions concerning better governance are demanding and even severe, but are necessary for regulated industries such as financial institutions. However the temptation to let them spill over indiscriminately to the corporate governance of the firm must be strictly resisted.

This article analyses the economic, legal and comparative research and covers the reforms by the European Commission, the European Banking Authority, CDR IV and Solvency II up to mid 2013.

The paper is available on the SSRN website.

6. Recent Corporate Law Decisions

6.1 Acting in breach of director's fiduciary duty: Shareholders' consent may mean a director is off the hook

(By Edward Kus, DLA Piper)

Sharma v Sharma [2013] EWCA Civ 1287, England and Wales Court of Appeal (Civil Division), Jackson, McCombe and Floyd LJJ, 25 October 2013

The full text of this judgment is available here.

(a) Summary

The Court of Appeal (Civil Division) in the UK has dismissed an appeal concerning a potential breach of director's fiduciary duty under s. 175 of the Companies Act 2006 (UK) (the Companies Act).

The question on appeal was whether the appellants had consented to the director's actions, which were in breach of her fiduciary duty. The appellants' principal submission was that they had not consented with full knowledge of the relevant facts. They also submitted that the director in question had not given full disclosure of her plans.

Jackson LJ (with whom McCombe and Floyd LJJ agreed) decided that, given all the circumstances:

- consent had been provided; and
- the relevant facts had been adequately disclosed.

This meant the director had not breached her fiduciary duty by using her position to also achieve personal gain.

(b) Facts

(i) Parties

The appellants in this dispute were:

- Jagesh Kumar Sharma (Sunny), the former husband of the respondent;
- Keshbala Sharma (Kesh), Sunny's mother (to whom Sunny and Raj deferred business decisions); and
- Rajesh Sharma (Raj), Sunny's brother.

Sunny, Kesh and Raj were company secretaries of Aspire Dental Care Ltd (ADC). The respondent, Anushika Sharma (Anushika), was the sole director of ADC. Anushika is Sunny's former wife. Anushika also later owned and operated a separate company, ADCUK.

(ii) Background

Anushika qualified as a dentist in 1999. Anushika and Sunny were married in February 2001. Anushika acquired a dental practice in April 2003, and again in January 2007. In July 2007 Anushika had the opportunity to acquire a third dental practice.

Around July 2007 there was a family meeting to discuss Anushika's "expanding empire" of dental practices (the July meeting). Present at that meeting were Anushika, Sunny, Kesh, Raj and Raj's wife Hina.

It was agreed at the meeting that:

- a company (ADC) would be set up to acquire other dental practices in due course;
- the shareholders of the company would be or include Anushika, Sunny and Kesh; and
- Anushika may acquire some further dental practices in her own name in addition to her role as director of ADC. However, this possibility was not raised directly. It was raised in the context of whether Anushika acquiring additional dental practices in her own name would have adverse tax consequences for the company.

The trial judge accepted (and the Lord Justices on appeal agreed) that in the context of that discussion Kesh told Anushika that she "could acquire further practices in [her] own name in the future, if [she] wished".

The new company (ADC) was subsequently set up in the following manner:

- Anushika, Sunny, Kesh and Raj were each allotted 25% of the shares. It would help to have Sunny and Kesh involved because of their good credit rating;
- Anushika was sole director because a company could only offer dental services if the majority of its directors were qualified dentists; and
- Sunny, Kesh and Raj were appointed as company secretaries.

Between June 2008 and August 2011 ADC acquired and operated five dental practices. Over the same period Anushika (in her own name or through her own company ADCUK) acquired and operated seven dental practices.

(iii) Issues

The appeal concerned Anushika's conduct as a director of ADC. The apportionment of the legal and beneficial interests in the various businesses operated by Anushika and the Sharma family depended on the practical effect of the July meeting.

Namely, did Anushika breach her duty as a director of ADC or did the July meeting constitute a shareholder agreement that Anushika could purchase some dental practices in her own name? The trial judge decided in Anushika's favour.

The Court applied s. 175 of the Companies Act:

(1) A director of a company must avoid a situation in which he or she has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
(2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).

(c) Decision

(i) Shareholder consent can absolve a director from liability for breach of fiduciary duty

The Court of Appeal unanimously dismissed the appeal because the appellants had consented to Anushika's plans. Anushika taking personal advantage of the opportunities available to her as director of ADC would normally constitute a breach of fiduciary duty. However, Jackson LJ applied the principle that if shareholders consent (with full knowledge of the relevant facts) to a director exploiting such opportunities then that conduct is not a breach of fiduciary duty. The nature of the consent is important.

(ii) Knowledge and acquiescence can constitute consent

Jackson LJ held that all shareholders consented to Anushika's plans at the July meeting.

Kesh expressly consented to Anushika's plans by making it plain that she had no objection to Anushika's proposed personal acquisition of additional dental practices. She merely wanted Anushika to understand the tax consequences. Sunny and Raj, by their silence, consented to Anushika's plans. With respect to Sunny and Raj, Jackson LJ was persuaded by:

- Sunny and Raj's invariable deference to Kesh's business decisions;
- their failure to speak up at the time; and
- because Sunny and Raj were going to acquire shares in ADC "it behoved them to [object] promptly. It would be unconscionable for them to keep quiet initially, then to receive a large shareholding in the company (effectively as a gift) and finally raise objections after Anushika had purchased a cluster of new dental practices, some for herself and some for ADC".

This knowledge and acquiescence was sufficient to amount to a shareholder agreement. In Jackson LJ's opinion, the shareholder agreement reached at the July meeting was "not extraordinary" given the circumstances. The whole arrangement was highly favourable to the appellants. They were to receive 75% of the company in exchange for minimal input. At the time of the agreement Anushika was operating two dental practices in her own name and one in the name of ADC. In those circumstances Jackson LJ concluded "it is hardly surprising the appellants consented to Anushika's plan".

(iii) Requirement to make full disclosure

Counsel for the appellants submitted that Anushika did not make full disclosure at the July meeting. The submission suggested there were still issues to be worked out. For example, what would happen if Anushika chose to buy a dental practice close to one of the company's practices in her own name?

The Court rejected that submission. Jackson LJ stated: "[s]he made clear the essential fact that she would acquire some dental practices for the company and some in her own name. This was a relatively informal meeting between family members ... Lawyers were not present ... all the material facts were clearly put before the Sharma family".

6.2 Factors relevant to the exercise of discretion to make an order for costs against a non-party including a company director

(By Laura Robb, Corrs Chambers Westgarth)

Permark International Interiors Pty Ltd v Amoveo Pty Ltd and Procutech Targeted Supply Chain Solutions Co Limited [2013] VSC 563, Supreme Court of Victoria, Croft J, 25 October 2013

The full text of this judgment is available here.

(a) Summary

In December 2010, Permark International Interiors (Permark) commenced proceedings against Amoveo Pty Ltd (Amoveo) and Procutech Targeted Supply Chain Solutions Co Ltd (Procutech), in relation to a failed joint venture for the development, construction and supply of packaged cabins to Bunnings. No substantive claims were made against Amoveo. Between May 2012 and October 2012, Permark brought three unsuccessful applications for leave to amend its statement of claim, and was ordered to pay Procutech's costs of and incidental to those applications. On 22 October 2012, Permark was granted leave to amend. In December 2012, Permark failed to comply with an order requiring it to respond to a request for particulars and, shortly thereafter, discontinued the proceeding.

This case concerned two applications by Procutech for costs orders against four non-parties to the proceeding (the Non-Parties), namely:

- Multitech Highways & Runways Pty Ltd (Multitech) and DGC Industries Pty Ltd (DGC), two entities which loaned sums of money to Permark to enable it to conduct the proceeding; and
- Perry Gourley (Gourley) and Wayne John Smith (Smith), both directors of Permark and Multitech.

While the general principle is that only parties to proceedings may be subject to costs orders, Procutech submitted there were "exceptional circumstances" which favoured the exercise of the Court's discretion to award costs orders against the Non-Parties on the basis of the particular circumstances of the case, and the involvement and interest of the Non-Parties in the litigation.

The applications were dismissed.

(b) Facts

By two summonses filed 22 May 2013 and 4 June 2013, Procutech sought to recover its costs of the proceeding from the Non-Parties, including its costs of and incidental to Permark's applications for leave to amend.

Procutech submitted that the circumstances of the proceeding were exceptional by reason that:

- properly advised, Permark must have known, at all times, that there were problems with its case; and
- notwithstanding that, Gourley and Smith (and the entities controlled by them) facilitated Permark to press on with the proceeding, causing Procutech to incur significant legal costs.

(i) The relevant law

Section 24 of the Supreme Court Act 1986 (Vic) gives the Court full power to determine by whom, and to what extent, the costs of and incidental to matters in the Court are to be paid. That power is sufficiently broad to authorise the Court to order that a non-party to the proceeding pay the costs of a party. The authorities demonstrate that the discretion, though broad, must be exercised with caution, and that the making of a non-party costs order requires exceptional circumstances.

In *Knight v FP Special Assets* (1992) 174 CLR 178 (*Knight*), the High Court recognised a general category of case in which an order for costs could be made against a non-party in circumstances where:

- the party to the litigation is an insolvent person or "man of straw";
- the non-party has played an active part in the conduct of the litigation; and
- the non-party has an interest in the subject of the litigation.

In *Knight*, Dawson J further stated there was a long-asserted jurisdiction to award costs in appropriate cases against a non-party where that person is effectively standing behind an actual party, or where there has been a contempt or abuse of process.

Procutech submitted the Court's discretion to make a non-party costs order was not confined to well-recognised categories, and referred to a number of decisions where Courts have made costs orders against a principal director and shareholder of a company party to the proceeding.

Croft J stated the authorities make clear that for a director of a company party to be found to be the real litigant, it is necessary to show more than the director being the driving force in the company's litigation, and that any benefit flowed to the director.

(ii) A "man of straw"

Procutech submitted that Permark was a "man of straw" because it did not appear to have cash or assets, was required to borrow funds to pay its legal costs, and had failed to comply with a statutory demand. Croft J found it was uncontested that Permark was a "man of straw" at the time that Procutech's applications were made.

(iii) Involvement of the Non-Parties in the proceeding

Procutech submitted that Non-Parties were involved in the litigation and exercised some degree of control over it.

It was contended, among other things, that:

- Gourley was responsible for the initiation and day to day conduct of the proceeding, and had personally loaned $500 to Permark to fund legal fees;
- no steps were taken without consultation with Smith;
- Multitech and DGC had contributed substantial sums of money towards Permark's legal costs and that, without their involvement, it was probable that the litigation could not have been pursued by Permark; and
- Multitech and DGC were the "*alter ego*" of Smith and Gourley respectively, and that they (the companies) ultimately determined whether or not the proceeding would continue.

(iv) Interest of the Non-Parties in the proceeding

Procutech submitted that:

- Gourley had a substantial economic interest in the proceeding and that he "effectively funded the proceeding himself";
- Smith had a personal interest on the basis of his positions in Permark, Multitech and DGC; and
- Multitech and DGC were effectively "litigation funders" for Permark and given that the loans could only be recovered if the litigation was successful, had a financial interest in the outcome of the proceeding.

Gourley deposed that he did not personally fund the litigation, that Permark borrowed from Multitech, DGC and the Permark Group, and that the loans were to be repaid in due course. Smith (on his own behalf, and on behalf of Multitech and DGC) did not dispute that funds were lent to Permark for the purpose of the litigation, but submitted that this fact alone was not sufficient to warrant the making of a non-party costs order.

(v) Other discretionary factors

It was contended on behalf of the Non-Parties that Procutech's failure to make an application for security for costs, or warn the Non-Parties of a possible application for non-party costs orders being sought against them, weighed against the exercise of the Court's discretion to award costs against them. It was further submitted by Gourley that the orders sought against him should not be made on the basis that Procutech's applications were an attempt to breach the corporate veil.

(c) Decision

Croft J concluded that the material before him did not establish "exceptional circumstances".

His Honour:

- found that while Gourley had played a major role in providing instructions to Permark's lawyers, neither his nor Smith's involvement was out of the ordinary. Further, Multitech and DGC were only involved in the sense of providing loans to Permark;
- found that merely funding an action for a party is not normally sufficient to justify an adverse costs order. His Honour found that while each of the Non-Parties had a financial interest in the litigation, the loans made by them to Permark were properly documented and to be repaid. Accordingly, his Honour concluded that Permark was not merely lending its name to the proceeding. Further, Gourley and Smith's interests in Permark being successful with the claim were unsurprising and unexceptional;
- emphasised that the piercing of the corporate veil in applications of this type should not be taken lightly and that, but for exceptional circumstances, a corporate party, rather than its human agents, should bear any adverse cost consequences. His Honour noted the legal system is able to reconcile preservation of the separate legal personality of corporate entities and interests of adverse parties to corporate plaintiffs, by providing machinery in the litigation process for an adverse party to seek security for costs against a corporate plaintiff;
- noted the absence of any evidence of searches in relation to Permark's financial position, and found that Procutech's decision not to make an application for security for costs was unreasonable in the circumstances. His Honour was of the view that even if such an application had been unsuccessful, it would have focused the parties on the issue and elicited evidence as to Permark's financial position, which would have enabled Procutech, at the very least, to warn the Non-Parties of its intention to make applications for adverse costs orders; and
- found that the conduct of the proceeding by Permark was not unreasonable in any relevant sense, and that there was no basis for finding that the proceeding was not commenced *bona fide* or involved any ulterior purpose in using a limited liability corporate vehicle as a shield against adverse orders, or otherwise.

6.3 UK law of equity: Limiting the doctrine of marshalling where there is no debt due

(By Marissa Bendyk and Tom Harrison, King & Wood Mallesons)

Szepietowski (nee Seery) v The National Crime Agency (formerly the Serious Organised Crime Agency) [2013] UKSC 65, United Kingdom Supreme Court, Lord Nueberger P, Lord Sumption, Lord Reed, Lord Carnwath and Lord Hughes, 23 October 2013

The full text of this judgment is available here.

(a) Summary

This case establishes a clear test for when the equitable doctrine of marshalling is available to a second mortgagee.

Where facts exist which potentially give rise to the right to marshal, the correct approach is to consider whether, in the perception of a reasonable bystander at the date of the grant of the second mortgage, it is reasonable to conclude that the second mortgagee was not intended to be able to marshal on the occurrence of the facts which would otherwise potentially give rise to the right to marshal, taking into account:

i. the terms of the second mortgage;
ii. any contract or other arrangement which gave rise to it;
iii. what passed between the parties prior to its execution; and
iv. all the admissible surrounding facts.

Marshalling is available to a second mortgagee where:

i. their debt is secured by a second mortgage over property (the common property);
ii. the first mortgagee of the common property is also a creditor of the debtor;
iii. the first mortgagee also has security for their debt in the form of another property (the other property);
iv. the first mortgagee has been repaid from the proceeds of sale of the common property;
v. the second mortgagee's debt remains unpaid; and
vi. the proceeds of sale of the other property are not needed (at least in full) to repay the first mortgagee's debt. In such a case, the second mortgagee can look to the other property to satisfy the debt owed to them.

The UK Supreme Court held, in this case, that the National Crime Agency (NCA) had no debt that remained unpaid, and could not marshal against the appellant's property.

Background

The England and Wales High Court (at first instance) and the England and Wales Court of Appeal (on first appeal) both allowed the NCA to invoke the doctrine of marshalling (albeit for different reasons). The appellant appealed to the UK Supreme Court for an order that the NCA did not have the right to marshal.

(b) Facts

This case considers whether a second mortgagee should have the right to invoke the equitable doctrine of marshalling when there is no underlying debt owed to them.

Ms Szepietowski (the appellant) and Mr Szepietowski faced civil action by the UK's National Crime Agency (NCA), alleging several offences and seeking an order to confiscate various properties on the basis that the proceeds of crime could be followed into them.

The parties entered into a settlement deed "in full and final settlement of all of [the NCA's] claims against" the appellant and her husband. The deed contained a list of 20 properties owned by the appellant and her husband, together with details of the secured creditor of, the value of, the amount charged on, and the equity in, each property.

The deed stated that, of the 20 properties:

- 15 properties (including two properties known as Claygate) would be vested in the Trustee for Civil Recovery (the Trustee) on behalf of the NCA; and
- five properties would remain with the registered proprietors, without any security granted in favour of the NCA, including the appellant's family home (Ashford House).

All 20 properties remained subject to any existing charges. RBS had an existing charge over five of these properties (including Claygate and Ashford House), which were all registered in the appellant's name, to secure a debt of £3.225 million (the RBS Charge). The NCA took second-ranking charges against four of these properties (Ashford House being the exception), and the NCA expected that the debt owed to RBS could be repaid from selling Claygate, with the NCA recovering a further £5.4 million from the sale of the 13 other properties vested in the Trustee.

Two properties that were subject to both RBS and NCA charges were sold, but neither debt was fully repaid. Contrary to the NCA's expectation, any sale of Claygate would only provide sufficient funds to repay the debt owing to RBS, with little money left over for the NCA debt. The NCA commenced court action pursuant to the settlement deed. As a result of the Court's order, Claygate was re-transferred by the Trustee to the appellant, and the appellant granted a charge over Claygate to the NCA (the 2009 Charge). Under the terms of the 2009 Charge, the appellant promised to "apply the proceeds of sale" of Claygate, after paying the costs of sale, to the NCA "in settlement of the Secured Amount" (defined as £1.24 million). The NCA's 2009 Charge took second priority after the RBS Charge, which was not yet fully paid.

The appellant sold Claygate for an amount that was substantially less than the NCA had expected when recording values in the settlement deed. After the appellant paid the costs of sale and repaid RBS in full, the NCA recovered only £1,324.

The NCA commenced an action against the appellant to invoke the equitable doctrine of marshalling, which would allow the NCA to claim the remaining £1.2 million from the appellant by taking a charge against Ashford House (which had never been subject to a charge in favour of the NCA).

The NCA submitted that the requirements for marshalling were satisfied because:

- the appellant owned both Claygate and Ashford House;
- the RBS Charge applied to both Claygate and Ashford House;
- the NCA's 2009 Charge applied to Claygate only (as a second mortgage);
- RBS was repaid from the proceeds of the sale of Claygate, while Ashford House remained unsold; and
- the NCA was still owed £1.2 million under its 2009 Charge.

(c) Decision

Lord Neuberger P (with whom Lord Sumption and Lord Reed agreed) allowed the appeal and held that the NCA could not marshal and take a charge against Ashford House, because the NCA's 2009 Charge did not secure a debt from anybody, other than an obligation that the appellant use the proceeds of the sale of Claygate "in settlement of" the £1.24 million amount with the NCA. The appellant discharged this obligation by distributing the contingent sum of leftover proceeds, but the terms of the 2009 Charge did not oblige the appellant to pay the full amount of £1.24 million. Further facts establishing that there was no debt secured against the appellant included the terms of the original settlement deed, and the purpose of the Proceeds of Crime Act 2002 (UK) which empowered the NCA to recover specific properties rather than a sum of money.

Lord Neuberger P noted that marshalling generally has a neutral impact on a mortgagor, because the mortgagee that invokes marshalling in order to satisfy a debt by claiming against the mortgagor's other property would otherwise be an unsecured creditor of the mortgagor for the same amount. However, in this case, the NCA effectively sought to impose a second mortgage on Ashford House to secure £1.2 million, and the appellant would need to pay that sum or lose Ashford House. As the appellant owed no further debt to the NCA following the distribution of sale proceeds from Claygate, this outcome would have a negative impact on the appellant. Lord Neuberger P concluded that "as a matter of principle, marshalling is not available to a second mortgagee where, as here, the common property does not secure a debt due from the mortgagor, but is merely available as security for what the second mortgagee can extract from that property".

Even if marshalling was available to a second mortgagor where there is no underlying debt from the mortgagor, the NCA would have been precluded from marshalling as this would have been inequitable, having regard to the terms of the settlement deed and the 2009 Charge, and the circumstances in which these documents were executed.

Lord Carnwath and Lord Hughes also allowed the appeal, but limited their reasons to interpretation of the particular settlement deed between the NCA and the appellant, rather than the general law of marshalling. Their reasons reflected Lord Neuberger P's alternative conclusion that it would have been inequitable for the NCA to marshal, as Ashford House had not been specifically included in the settlement deed as a property that the NCA might seek to recover against. Lord Carnwath and Lord Hughes also found no reason, in principle, why the remedy of marshalling should be unavailable to a second mortgagee in circumstances where there is no underlying debt owed by the mortgagor.

6.4 Whether liquidator must treat fees paid in advance to college as trust moneys

(By Emma Rudd, Herbert Smith Freehills)

Re Mowbray College (in liquidation) (receivers and managers appointed) [2013] VSC 565, Supreme Court of Victoria, Robson J, 23 October 2013

The full text of this judgment is available here.

(a) Summary

The liquidator sought directions from the Court under s. 511(1)(a) of the Corporations Act 2001 (Cth) (the Act) as to whether any of the funds held by Mowbray College in a specific bank account were the subject of a trust in favour of persons who had prepaid fees. Robson J found that there was insufficient evidence to establish an intention on the part of Mowbray College to create a trust.

(b) Facts

Mowbray College is a not-for-profit company, limited by guarantee, which carried on business as the operator of a private college. Mowbray College charged fees which, in some instances, were prepaid. The prepaid fees were not kept in a separate bank account or otherwise separated from Mowbray College's own funds.

Mowbray College operated two main bank accounts, an overdraft account with the National Australia Bank (the NAB account); and a cheque account with the Commonwealth Bank of Australia (the CBA account). The NAB account was used for Mowbray College's day-to-day trading activities and all school fees (whether accrued or prepaid) were deposited into it. At all relevant times, this account was overdrawn.

Mowbray College experienced financial difficulties, and a receiver was appointed on 28 May 2012. On 4 July 2012, Mowbray College's creditors resolved that it be wound up and the administrator become its liquidator. At the time of the liquidator's appointment, the CBA account had a credit balance of $279,061.50. This amount essentially comprised money which had been transferred by Mowbray College from its NAB account in March 2012, apparently in respect of prepaid fees.

The liquidator sought a direction under s. 511(1)(a) of the Act as to whether any amount in the CBA account was trust money and, if so, how it should be treated and for whose benefit.

(c) Decision

(i) Application of s. 511 of the Corporations Act

Section 511(1) of the Act provides that a liquidator may apply to the Court:

a. to determine any question arising in the winding up of a company; or
b. to exercise all or any of the powers that the Court might exercise if the company were being wound up by the Court.

In addition, s. 511(2) requires that the Court be satisfied that the determination of the question or the exercise of the power is just and beneficial.

Robson J determined that the Court had the power under s. 511(1) to give directions to the liquidator. The question whether or not the funds in the CBA account were trust moneys was both a question arising in the winding up of Mowbray College and also involved a matter of law on which the liquidator was entitled to seek guidance from the Court under s. 511(1); *Sanderson v Classic Car Insurances Pty Ltd* (1985) 10 ACLR 115, 117 (citing *Re Australian Home Finance Pty Ltd* (1956) VR 1 and *Re Standard Insurance Co Ltd* (1963) 80 WN (NSW) 1355). In addition, given the interests of any potential beneficiaries of any trust were protected by submissions from the *amicus curae*, it was just and beneficial to give the directions to the liquidator.

(ii) Were the funds in the NAB account trust moneys?

Robson J referred to the balance of authority that a proprietary claim to a traceable product will fail if trust money is paid into an overdrawn account; McClure J in *Re Global Finance Group Pty Ltd* [2002] WASC 63 at [129]. However, as the liquidator and the *amicus curae* agreed that, on the facts of the present case, no exception to this rule could be invoked there was no need to consider this further. The funds deposited in the NAB account were not trust moneys as the NAB account was overdrawn at the time the funds were deposited.

(iii) Did an express trust arise when the funds were transferred from the NAB account into the CBA account?

Robson J found that there was insufficient evidence to establish an intention on the part of Mowbray College to create a trust.

Robson J referred to the established rule that in order to constitute a trust, the "three certainties" must be satisfied - intention, subject matter and object; *Kauter v Hilton* [1953] HCA 95; (1953) 90 CLR 86, 97 (Dixon CJ, Williams and Fullagar JJ). In ascertaining the relevant intention, it is the outwardly manifested intention that is relevant; *Byrnes v Kendle* [2011] HCA 26; (2011) 243 CLR 253, [54]-[57] (Gummow and Hayne JJ). The intention must be to create an immediately operative trust; *Harpur v Levy* (2007) 16 VR 587; [2007] VSCA 128 at [62]-[63].

Robson J then applied these legal principles to the facts:

- the mere existence of a "quarantined" fund was not sufficient to evince an intention to create a trust.
- the CBA account was not a trust account in form or in substance;
- the CBA account was an existing account, opened several years before the transfers, and had in the past been used for some day-to-day company business;
- the account name did not identify it as a trust account, nor was there documentation typical of trust accounting pertaining to transactions in and out of the account;
- the CBA account included mixed funds and the use of these mixed funds for Mowbray College's ordinary purposes was inconsistent with the intention to establish a trust; and
- while there was ample evidence of an intention to execute a trust deed, there was no evidence a trust deed was ever finalised or executed. While there may have been an intention to create a trust at a later stage, there was insufficient evidence to find that the intention had crystallised and a trust had been created that attached to the quarantined moneys.

Robson J directed the liquidator that he was justified in treating the entire balance of the CBA account as an asset of Mowbray College and available to be applied in the liquidation.

6.5 The evidentiary basis to prove an offsetting claim under s. 459H of the Corporations Act

(By Clementyne Rawlyk and Suzanne Crossland, Corrs Chambers Westgarth)

Britten-Norman Pty Ltd v Analysis & Technology Australia Pty Ltd [2013] NSWCA 344, New South Wales Court of Appeal, Beazley P, Meagher and Gleeson JJA, 21 October 2013

The full text of this judgment is available here.

(a) Summary

This case considered the discretion of the Court to set aside a creditor's statutory demand by reason of an alleged offsetting claim, pursuant to ss. 459G and 459H of the Corporations Act 2001 (Cth) (the Act). In particular, the Court of Appeal confirmed that an applicant need only provide sufficient evidence that there is a plausible contention of an offsetting claim, which is valued in excess of the statutory demand.

Britten-Norman Pty Ltd (Britten-Norman) filed an application for an order setting aside a statutory demand served on it by Analysis & Technology Australia Pty Ltd (A&T) on the basis of an offsetting claim. In the first instance judgment, Black J dismissed the application, finding that Britten-Norman had not adduced sufficient evidence to support its offsetting claim or to satisfy the Court of the quantum of its offsetting claim. Britten-Norman sought leave to appeal from that dismissal. The application for leave to appeal and the appeal were heard concurrently.

In a joint judgment granting leave to appeal and allowing the appeal, Beazley P, Meagher and Gleeson JJA held that evidence sufficient to satisfy the Court that there is a plausible basis for an offsetting claim need not conclusively prove the claim or otherwise be incontrovertible or substantially non-contestable.

(b) Facts

Britten-Norman leased a Surveillance Management System MkII (the SMS2) from A&T. The SMS2 was to be used by Britten-Norman as part of its tenders to various government agencies to provide aerial surveillance in support of bushfire fighting.

Britten-Norman verbally advised A&T that it required the SMS2 to have an accuracy of .001 nautical miles in respect of surveillance and intelligence operations over fires. The accuracy of the SMS2 was in fact between 2 to 5 nautical miles. Britten-Norman was unsuccessful in its tenders and alleged that this was as a result of the inaccuracy of the SMS2.

Britten-Norman fell behind on its lease payments in respect of the SMS2. On 4 December 2012, A&T served a statutory demand on Britten-Norman, alleging a debt of $128,421.50 in respect of outstanding lease payments and the provision of support in respect of the SMS2 (the Statutory Demand).

Britten-Norman filed an application for an order setting aside the Statutory Demand pursuant to ss. 459G and 459H of the Act, on the basis that it had an offsetting claim.

This application was supported by an affidavit of David Baddams, the managing director of Britten-Norman. Mr Baddams alleged that the managing director of A&T, Mr Fothergill, had on several occasions made verbal representations and assurances about the accuracy of the SMS2. No documentary evidence was referred to in Mr Baddams's affidavit which supported these conversations.

Mr Baddams's affidavit contended that this evidence gave rise to a cross claim that A&T had engaged in misleading and deceptive conduct and had committed a breach of contract. Britten-Norman valued its claim at an amount representing the monies it had already paid to A&T for the SMS2, the cost incurred by Britten-Norman in replacing the SMS2 with an accurate surveillance system and the profits Britten-Norman would have received in the first 12 months if it had obtained the various contracts for which it had tendered.

By an affidavit in reply dated 1 March 2013, Mr Fothergill denied that several of the alleged conversations with Mr Baddams had taken place. In particular, Mr Fothergill denied having been provided with specifications for the use of the SMS2 by Britten-Norman and denied having made any promises about the accuracy of the SMS2. He also denied Britten-Norman having ever advised A&T of any problems with the accuracy of the SMS2. Mr Fothergill further contended that Britten-Norman continued to make lease payments for the SMS2 even after the unsuccessful trials for tenders had taken place, thus evidencing an acknowledgment on the part of Britten-Norman of an indebtedness to A&T.

Mr Baddams later explained to the Court that he had refrained from raising the deficiencies of the SMS2 with A&T because of his son's employment with the company.

In dismissing the application, Black J considered that Britten-Norman had not established an offsetting claim primarily on the basis that there was insufficient documentary evidence to support the alleged assurances made by A&T as to the accuracy of the equipment. Further, Black J found that even if he had been satisfied that the evidence established a serious question as to the existence of misleading or deceptive conduct or breach of contract, the material before the Court was not sufficient to conclude that Britten-Norman had sustained loss or damage in an amount that exceeded the statutory claim.

(c) Decision

The question for determination by the Court of Appeal was whether there was sufficient evidence to satisfy the Court of the requirements of s. 459H(1)(b) of the Act; namely, that Britten-Norman had an offsetting claim in an amount that was greater than the amount claimed in the Statutory Demand.

The Court of Appeal found that Mr Baddams' affidavit asserted the existence of an offsetting claim and gave evidence capable of establishing reliance on representations by Mr Fothergill as to the performance of the SMS2.

Accordingly, the Court of Appeal granted leave to appeal and allowed the appeal. In a joint judgment by Beazley P, Meagher and Gleeson JJA, the Court set aside the finding of Black J and held that:

- the evidence before the primary judge was sufficient to establish a plausible contention that Britten-Norman had an offsetting claim for the purpose of s. 459H of the Act for misleading and deceptive conduct; and
- the quantum of the offsetting claim was in excess of the statutory demand (less the statutory minimum of $2,000).

In reaching this decision, the Court of Appeal undertook a review of the various authorities and statutes concerning the standard of proof required on an application to set aside a statutory demand on the basis of an offsetting claim. The Court determined that "all the primary judge needed to do is to determine whether there was a genuine dispute, that is one in which a plausible contention has been raised by the company on which the statutory demand was served".

The Court held that although Black J was justified in considering that the email correspondence posed difficulties for Britten-Norman, that evidence did not render Mr Baddams' asserted claim sufficiently implausible as not to merit further investigation. A finding to this effect would have involved an assessment of the credibility and weight of the evidence, which goes beyond what is required for an applicant to satisfy s. 459H of the Act.

A second question for the Court of Appeal was whether the amount of the offsetting claim was greater than the amount of the Statutory Demand less the minimum statutory amount of $2,000. Their Honours held that but for the alleged misleading or deceptive conduct, Britten-Norman would not have incurred any liability to A&T by way of monthly rental repayments. Out of an invoiced total of $190,751.00 for rental repayments, Britten-Norman had paid $62,329.50, thus leaving a balance of $128,421.50 (being the amount of the Statutory Demand). The Court held that this was sufficient to establish that the quantum of the plausible offsetting claim was in excess of the Statutory Demand less the minimum statutory amount of $2,000.

The Appeal was allowed, with the effect that the Statutory Demand be set aside, with costs payable to Britten-Norman.

6.6 When is it fair and just for a Court to extend the limitation period for an application for relief in respect of a voidable transaction?

(By Kathy Ge, Ashurst)

Clout v Andi-Co Australia Pty Ltd [2013] QSC 278, Supreme Court of Queensland, Mullin J, 17 October 2013

The full text of this judgment is available here.

(a) Summary

David Lewis Clout, in his capacity as the liquidator of Pannells Appliances Pty Ltd, applied for an order to extend the period within which he could make an application for the Court to make orders about voidable transactions against a number of unsecured creditors to Pannells Appliances Pty Ltd.

The unsecured creditors argued that the liquidator was not diligent in his investigation and there was therefore no adequate reason shown to extend the limitation period.

The Court, in considering whether or not the limitation period should be extended, applied the rule established in *BP Australia v Brown* (2003) 58 NSWLR 322 and asked the question whether it would be fair and reasonable in all the circumstances to make an extension. The Court in this case concluded that the liquidator had shown that it would be fair and reasonable for a time extension period of 10 months.

(b) Facts

David Lewis Clout became liquidator for Pannells Appliances Pty Ltd in July 2010 by way of a creditors' voluntary winding up. The liquidator made various investigations and produced a number of reports up until June 2013, but explained that the lack of funds hampered the liquidation process. The liquidator stated that he intended to commence proceedings against a number of unsecured creditors in respect of unfair preference claims prior to the expiry of the limitation period to commence proceedings, but argued that he was not financially in the position to do so. The liquidator therefore applied for a court order to extend the limitation period to bring an application for relief in respect of a voidable transaction pursuant to the Court's powers under s. 588FF3(b) of the Corporations Act 2001 (Cth).

(c) Decision

The Court made an order to extend the limitation period for a total of ten months.

In determining whether a time extension should be given, Mullin J considered the question whether or not the extension would be fair and just in all the circumstances. In determining what is fair and just, Mullins J noted the broader policy considerations identified by Spigelman CJ in *BP Australia Ltd v Brown*, which stated that a specific time limit for bringing an application for relief in respect of a voidable transaction exists because it allows a person who has had dealings with companies which become insolvent to conduct their commercial affairs with a degree of certainty about their past transactions with the company.

In this case, factors relevant to the question of whether it is fair and just in all the circumstances to extend the limitation period include:

- the adequacy of the liquidator's explanation for the delay in commencement of the

recovery proceeding;
- the prejudice caused to the respondents by the failure to take recovery proceedings against them before the expiry of the limitation period; and
- the merits of the prospective proceedings and where the merits of the prospective proceedings are unable to be assessed, a preliminary review of merits of the recovery proceedings.

The onus is on the liquidator to show that granting a time extension would be fair and just in all the circumstances.

The Court stated the lack of funds in the liquidation is a practical consideration that has some weight. Furthermore, although the liquidator could have made investigations in a more efficient and timely way, this did not mean the liquidator was not diligent to such an extent that such factor weighed heavily in the balance against an extension. The Court also noted that although the policy favours against an extension (i.e. favours giving certainty for the unsecured creditors to know when their exposure to potential recovery proceedings will end), other factors support the time extension and so the policy can be addressed to some degree by confining the extension to the shortest feasible period. In this case, ten months was considered an appropriate extension of the limitation period.

6.7 The Court has a broad power to strike out pleadings for a claim for relief from liability for contravention of a civil penalty provision in the Corporations Act if the pleadings are not relevant to the claim

(By Jonathan Hon, Ashurst)

SGB Jones Pty Ltd v Invion Limited [2013] QCA 306, Queensland Court of Appeal, Holmes and Muir JJA and Philippides J, 11 October 2013

The full text of this judgment is available here.

(a) Summary

This appeal in the Court of Appeal of the Supreme Court of Queensland concerns a purported error of law in the decision handed down by the Queensland Supreme Court. The directors of Invion Ltd (the Directors) appealed a decision by the primary judge in striking out parts of their pleadings in the amendment to their defence against a claim brought by Invion Ltd (Invion). The Directors sought to include legal advice from their lawyers in the pleadings, however the primary Court held that the legal advice was not relevant to the Directors' defence and it was struck out from evidence.

The Court of Appeal dismissed the Directors' appeal.

(b) Facts

(i) Background

The original case in the Queensland Supreme Court concerned a claim by Invion brought against its former directors. The claim concerned the conduct of the Directors in varying or purporting to vary their consultancy or employment contracts (the Contracts). The original terms of the Contracts provided that Invion could terminate the Contracts by giving six months' notice or paying the equivalent salary or fees in lieu and that the Directors could terminate the Contracts by giving not less than six months' notice.

On 25 March 2011, the board of Invion resolved to extend the notice period to be given by the Directors in the Contracts to 12 months. The Directors abstained from voting on this resolution. Instead, the Directors purported to bind Invion to revised Contracts that provided that if either Invion or the Directors gave notice, the Directors would be paid the equivalent of 12 months' salary (or fees) and the Directors would have discretion as to whether they worked any part of the 12-month period.

In October 2011, the Directors resigned their employment effective immediately and caused the equivalent of 12 months' salary (or fees) to be paid to each Director separately. Invion challenged these payments and argued that the varied contracts had no contractual effect, as they were made without authority and that the Directors knew there was no proper basis for seeking or making the payments. Alternatively, Invion claimed that if the variations did have contractual effect, the Directors breached one or more of their fiduciary duties and duties under ss. 180, 181 and 182 of the Corporations Act 2001 (Cth) (the Act). Invion sought to recover the payments made upon a restitutionary basis, or alternatively, on an account of profits, as equitable compensation or pursuant to s. 1317H of the Act.

In April 2013, the Directors amended their defences to invoke ss. 1317S and 1318 of the Act by way of a claim for statutory excusal in the event that an alleged breach was established and sought relief, in whole or in part, for liability of any such breach. The Directors' pleadings sought to include advice from McCullough Robertson lawyers, provided on 25 March 2010, which purported to support the Directors' argument that the 12 months' termination payments were proper and lawful and a belief that they did not require a resolution of the board (the Legal Advice).

On application by Invion, the primary judge exercised the power granted to the Court under the Uniform Civil Procedure Rules 1999 (Qld) (the UCPR) s. 171(1)(a) to strike out the Legal Advice pleaded by the Directors in the amendments to their defence. This was because the Legal Advice did not have a relevance to the propriety of the Directors' conduct and nor could the Legal Advice, on an objective view, have provided any reasonable basis for the Directors' conduct. Section 171(1)(a) of the UCPR provides that the Court may strike out pleadings, on application from one party, if the pleadings disclose no reasonable cause of action or defence.

(ii) Appeal

The Directors argued that the primary judge erred in striking out parts of their pleadings which sought to found a claim for excusal under ss. 1317S and 1318 of the Act and in holding that s. 171(1)(a) of the UCPR was satisfied such that the matters alleged in the amended defence could not be properly relevant to the disposition of the litigation.

(c) Decision

The Court of Appeal dismissed the Directors' appeal. The Court addressed each alleged error of the primary judge and affirmed the following:

- the express terms of the Legal Advice pleaded were relevant more to the allegations of impropriety and beach of statutory duty, rather than to the issue of authority;
- the Legal Advice was not pleaded as founding the basis for the Directors' belief that the variations to the Contracts were proper or that a board resolution was not required and that any lack of authority could thus arguably be excused;
- the Legal Advice did not connect in any meaningful way to the matters pleaded in the Directors' amendment to their defence. Therefore, the primary judged was correct in striking out the irrelevant sections of the pleadings; and
- the primary judge did not make findings of fact that were impermissible in the application to strike out the Directors' amendments to their defence.

6.8 Injunction granted to enforce a "Texas Shootout" scheme in a shareholders agreement

(By Liam Hickey, Herbert Smith Freehills)

JTA Le Roux Pty Ltd (as trustee for the FLR Family Trust) v Lawson (No 2) [2013] WASC 373, Supreme Court of Western Australia, Edelman J, 9 October 2013

The full text of this judgment is available here.

(a) Summary

This case concerned the operation of a "Texas Shootout" scheme in a dispute resolution clause in a Shareholders' Agreement.

The company the subject of the Shareholders' Agreement had two shareholders. Under the "Texas Shootout" scheme, a shareholder in the company (the Offeror) could offer to sell all of its shares in the company to the other shareholder in the company (the Offeree) for a price and on terms and conditions nominated by the Offeror. The Offeree then had two options. It could acquire the Offeror's shares for the nominated price and on the nominated terms and conditions. Alternatively, it could notify the Offeror that it would not purchase the Offeror's shares, but instead would sell its own shares to the Offeror for the price, and on the terms and conditions, that had been nominated by the Offeror (in which case the Offeror was obliged to purchase those shares). The effect of this scheme was that one shareholder would take full ownership of the company. The dispute resolution clause stipulated that if a shareholder defaulted on the acquisition of shares under the scheme, the company would be compulsorily wound up.

An offer was made by one of the company's shareholders pursuant to the scheme. The Offeree failed to respond to the offer. The ultimate issue in this case was whether this represented a default on the acquisition of shares.

Edelman J determined that the failure by the Offeree to respond to an offer made to it under the "Texas Shootout" scheme was not a default on the acquisition of shares under the Shareholders' Agreement. His Honour issued a mandatory interlocutory injunction requiring the Offeree to notify the Offeror of its intentions in respect of the offer made under the scheme.

(b) Facts

Steven and Kylie Lawson (the Lawsons) and JTA Le Roux Pty Ltd (JTA Le Roux) each held 50% of shares in Lawsons Commercial Flooring Pty Ltd (the Company), and were parties to a Shareholders' Agreement in respect of the Company. The relationship between the Lawsons and JTA Le Roux broke down, and a dispute ensued.

The Shareholders' Agreement contained a dispute resolution clause. Under that clause, the parties were to participate in informal discussions and mediation in an attempt to resolve this dispute. If this failed to resolve the dispute, what was described throughout the judgment as a "Texas Shootout" scheme was provided for (a summary of which is set out above). Finally, the dispute resolution clause provided that if a shareholder defaulted on the acquisition of shares under the "Texas Shootout" scheme, the Company would be compulsorily wound up.

Pursuant to the "Texas Shootout" scheme, the Lawsons offered to sell their shares in the Company to JTA Le Roux for $100. JTA Le Roux failed to respond to the offer.

The Lawsons sought a mandatory interlocutory injunction requiring JTA Le Roux to notify them of its intentions in respect of the offer made under the "Texas Shootout" scheme. However, JTA Le Roux, who wanted the Company wound up, argued that on the proper construction of the Shareholders' Agreement its failure to respond to the offer constituted a default on the acquisition of shares, and that this precluded the operation of the "Texas Shootout" scheme.

(c) Decision

There were two key aspects to this decision.

(i) What test should be applied when a mandatory interlocutory injunction is sought?

After reviewing the authorities, Edelman J concluded that the test to be applied for a mandatory interlocutory injunction is the same as that applied when a prohibitory interlocutory injunction is sought (this was contrary to some authorities which indicated that the test for a mandatory interlocutory injunction is more onerous). This requires analysis of whether there is a prima facie case, and where the balance of convenience lies.

A number of factors complicated the application of the test in this case:

1. JTA Le Roux conceded that in respect of the balance of convenience test there were no factors which weighed against the granting of an injunction. As such, the only "live issue" was whether the Lawsons had a *prima facie* case;
2. it was conceded by the Lawsons that a mandatory interlocutory injunction was in substance no different from the final relief they would seek, and would in effect finally determine the dispute. Therefore, it was agreed that the judge should determine the issue of the proper construction of the Shareholders' Agreement conclusively, rather than simply determining whether the Lawsons had a *prima facie* case; and
3. given the issue was simply one of construction and there was no further evidence that could be agitated at a full trial, there was no reason why the matter should be dealt with at a later stage.

Accordingly, the interlocutory hearing was in effect a final hearing of the matter. The sole issue requiring determination was whether or not JTA Le Roux's failure to respond to the Lawsons' offer under the "Texas Shootout" scheme constituted a "default on the acquisition of shares" under the Shareholders' Agreement. If it was, the mandatory interlocutory injunction sought by the Lawsons would not be issued; if it was not, the mandatory interlocutory injunction would be issued.

(ii) Did JTA Le Roux's failure to respond to the Lawsons' offer under the "Texas Shootout" scheme constitute a "default on the acquisition of shares"?

Edelman J concluded that the failure to respond to the offer did not constitute a "default on the acquisition of shares" under the Shareholders' Agreement. His Honour gave four reasons for so finding:

1. the communication of whether the Offeree intended to acquire the shares was different from, and preceded, any possible acquisition of the shares themselves;
2. under the scheme there was no firm requirement that the Offeree acquire the shares offered to it. It would be odd for the Offeree to be in default on an acquisition of shares in circumstances where the Offeree could have satisfied its obligations under the agreement by indicating that it did not intend to acquire the shares offered to it;
3. accepting JTA Le Roux's proposed construction would defeat the manifest purpose of the "Texas Shootout" scheme. It would give the Offeree the option of triggering the wind up the Company, rather than simply granting the Offeree the opportunity to buy or sell shares in the Company. There would be no "shootout" at all; and
4. the dispute resolution clause progressed from the most consensual form of dispute resolution (informal negotiations) to the least consensual (compulsory winding-up upon default of an acquisition of shares). In these circumstances, the least consensual form of dispute resolution should be construed narrowly.

His Honour therefore granted a mandatory interlocutory injunction that required JTA Le Roux to notify the Lawsons of its intentions under the "Texas Shootout" scheme.

6.9 Fiduciary duties owed by shadow directors

(By Matthew Hennessy and Ian Ranson, King & Wood Mallesons)

Vivendi SA v Richards [2013] EWHC 3006 (Ch), England and Wales High Court (Chancery Division), Newey J, 9 October 2013

The full text of this judgment is available here.

(a) Summary

Newey J in the England and Wales High Court was asked to consider the general law duties owed by shadow directors to a corporation.

His Honour held that shadow directors owe fiduciary duties to a corporation at general law, at least in respect of the directions or instructions they give to the formally appointed directors (*de jure* directors). More particularly, his Honour held that shadow directors will normally owe the duty to act in good faith in the interests of the corporation when giving such directions or instructions.

(b) Facts

Centenary Holdings III Ltd (CH3), a Scottish company, formerly called Seagram Distillers plc until May 2002, went into liquidation in June 2005. CH3 had ceased trading by 2003, but maintained some valuable assets including a number of leases. These leases also represented a significant liability to CH3, totalling an estimated £41.8 million according to its December 2002 accounts.

Vivendi SA (Vivendi) is a large French company with interests mostly in media and telecommunications. CH3 became part of the Vivendi group in 2000 when the Vivendi group acquired the Seagram group's entertainment division. Vivendi brought these proceedings pursuant to an assignment from CH3's liquidators and CH3 was joined as a co-plaintiff.

Murray Richards (formerly Murray Richard Harrod), the first defendant, originally from New Zealand, moved to Australia in 1966. Some 12 years later, Mr Richards was convicted in Australia for conspiring to cheat and defraud a company (George Hudson Pty Ltd) and its creditors, and was sentenced to ten years' imprisonment. CH3 was transferred out of the Vivendi group to a company ultimately owed by Mr Richards, pursuant to a reorganisation in 2004. Mr Richards was appointed to provide consultancy services to CH3 pursuant to an agreement dated 3 March 2004.

Stephen Bloch, the second defendant, is a British businessman who became a director of CH3 on 22 January 2004.

Before going into liquidation, CH3 made nine payments between March 2004 and February 2005 totalling more than £10 million, including a £5.814 million dividend. Some of these payments were made to companies controlled by Mr Richards.

It was alleged that in making these payments, Mr Bloch breached the duty of good faith he owed to CH3 as a director. It was alleged that Mr Richards owed a similar duty of good faith to CH3 as a shadow director, and that he breached this duty and was also liable for dishonestly assisting Mr Bloch's breaches of his duties.

(c) Decision

Newey J characterised Mr Bloch's role as director of CH3, using Mr Bloch's own term, as one of a "legman" for Mr Richards. While "he was not a mere cipher, paid for doing nothing of any substance", "he was not his own man: he acted on instructions from Mr Richards" and "gave effect to Mr Richards' decisions". In the terms of s. 741(2) of the Companies Act 1985 (UK), "Mr Bloch was accustomed to act in accordance with directions or instructions from Mr Richards" and therefore Mr Richards was a shadow director of CH3.

Lewison J in the previous case of *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) (*Ultraframe*) had held that a *de facto* director "owes directors" duties to the company in relation to which he performs those functions', but by contrast, the "indirect influence exerted by a paradigm shadow director who does not directly deal with or claim the right to deal directly with the company's assets will not usually ... be enough to impose fiduciary duties upon him".

Newey J considered the views of several commentators who have criticised the conclusion in *Ultraframe* and went on to canvass the case law, including a number of Australian decisions, attempting to set out when equity will regard a person as owing fiduciary duties. His Honour quoted the famous statement of Mason J of the High Court of Australia in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at [68]:

The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that person in a legal or practical sense.

Newey J then set out a number of reasons why shadow directors should commonly be considered to owe fiduciary duties including that:

- "[a] shadow director will have assumed to act in relation to the company's affairs ... and to ask the *de jure* directors to exercise powers that exist exclusively for the benefit of the company";
- "[a] person who gives directions or instructions to a company's *de jure* directors in the belief that they will be acted on can fairly be described as assuming responsibility for the company's affairs, at least as regards the directions or instructions he gives";
- although the UK Parliament does not include shadow directors within the definition of directors in the Companies Acts, it has provided for "important consequences to flow from that status" including liability for wrongful trading and allowing them to be the subject of proceedings under the Company Directors Disqualification Act 1986 (UK). "Such provisions presumably reflect a perception that a shadow director can bear responsibility for a company's affairs";
- "[t]here is a compelling analogy with the position of promoters" who have been held to be fiduciaries under UK law, as promoters accept and use powers "which so greatly affect the interests of the corporation" and similarly shadow directors "can be said to choose to make use of powers which 'greatly affect the interests of the corporation'";
- "[a] shadow director's role in a company's affairs may be every bit as important as that of a *de facto* director, and *de facto* directors are considered to owe fiduciary duties";
- it cannot matter that "a shadow director may not subjectively wish to assume fiduciary duties"; and
- "[p]ublic policy, so far as it may matter, points towards fiduciary duties being imposed on shadow directors".

Newey J held that:

Ultraframe understates the extent to which shadow directors owe fiduciary duties. It seems to me that a shadow director will typically owe such duties in relation at least to the directions or instructions that he gives to the *de jure* directors. More particularly, I consider that a shadow director will normally owe the duty of good faith (or loyalty) ... when giving such directions or instructions. A shadow director can, I think, reasonably be expected to act in the company's interests rather than his own separate interests when giving such directions and instructions.

His Honour found, therefore, that both Mr Richards and Mr Bloch owed the fiduciary duty of good faith to CH3.

The English case law is clear that where a company is or may soon become insolvent, a duty to act in good faith in the company's best interests can amount to a duty to act in the creditors' best interests. Newey J found that CH3 was in fact insolvent from January 2004, before the first of the nine payments was made, and that at the time each of the nine payments was made, both Mr Richards and Mr Bloch "were well aware of the company's [financial] fragility". The underlying purpose of these transactions was "to extract money from the company before it failed and to thwart the landlords' claims" for rent under the leases.

Overall, Newey J concluded:

In my view, both Mr Bloch (as CH3's *de jure* director) and Mr Richards (as a shadow director) acted in breach of duty in causing CH3 to make the various payments at issue. I do not consider that the payments were made, or believed to be, in the interests of CH3 as such or those of its creditors.

Given the finding in relation to the purpose of the transactions, his Honour found that the statutory limitations period of six years did not apply because s. 21(1)(a) of the Limitation Act 1980 (UK) contains an exception in such cases, for dishonesty. Additionally, given the purpose of the transactions, the alternative claim against Mr Richards for dishonestly assisting in Mr Bloch's breaches of duty was also successful.

6.10 Applications to set aside statutory demands under ss. 459H or 459J of the Corporations Act

(By Peter Motti, Minter Ellison)

In the matter of Vivo International Corporation Pty Limited [2013] NSWSC 1462, Supreme Court of New South Wales, Black J, 2 October 2013

The full text of this judgment is available here.

(a) Summary

The principal issues considered in this case were whether a genuine dispute arose in respect of the alleged debt and the circumstances in which an offsetting claim exists.

(b) Facts

The Plaintiff, Vivo International Corporation Pty Ltd (Vivo), sought orders under s. 459H or alternatively s. 459J of the Corporations Act 2001 (Cth) (the Act) to set aside a statutory demand (the Demand) served by the Defendant, E-Cycle Solutions Pty Ltd (E-Cycle).

The Demand claimed the amount of $235,334.25, being the amount of a debt for services provided by E-Cycle to Vivo. The alleged debt arose from a claim by E-Cycle under an agreement to provide "end of life television recycling services" in respect of a statutory scheme for the recycling of televisions (the Agreement).

Vivo claimed that the Demand should be set aside under s. 459H(1)(a) of the Act on the basis that there was a genuine dispute between the parties about the existence or amount of the debt to which the Demand related. In particular, Vivo submitted that a genuine dispute existed as to whether E-Cycle had any right to payment under the terms of the Agreement, by reason of a dispute as to whether the televisions had been recycled as required or were being instead sent to landfill.

Vivo also contended that it had an offsetting claim in the amount of $18,700 for the purposes of s. 459H(1)(b) of the Act. Section 459H(5) of the Act provides that an "offsetting claim" for the purposes of s. 459H(1)(b) is the amount of a claim or claims that a company has against the person who served the statutory demand by way of counter claim, set-off or cross demand, whether or not that amount arises out of the same transaction or circumstances as the debt to which the demand relate. Vivo argued that an arrangement was entered into with E-Cycle for Vivo to supply televisions and the amount of the invoice was to be off-set against amounts payable for recycling services. The relevant amount was $18,700.

In the alternative, Vivo contended that some other reason to set aside the Demand existed under s. 459J of the Act. Section 459J(1)(b) of the Act provides for the setting aside of a demand if the Court is satisfied that there is some other reason why the demand should be set aside. In particular, Vivo argued that E-Cycle had not complied with the dispute resolution procedure specified in the Agreement.

(c) Decision

(i) Was there a genuine dispute?

Black J considered that the issue of whether E-Cycle was in fact providing the relevant recycling services did give rise to a genuine dispute as to the debt, having regard to the terms of the Agreement.

The factual basis of the genuine dispute as to the obligation to make payment under the Agreement was set out in Mr Grassia's initial affidavit, which indicated that he was made aware that (or at least that it was alleged that) E-Cycle:

had not been providing end of life television recycling services as it held out under the Agreement but rather had been dumping televisions in landfill.

Black J noted that Mr Grassia's initial affidavit identified the source for that information, being officers of other recyclers and officers of the Commonwealth Department of Sustainability and Environment, the government department responsible for the administration of the relevant scheme. Mr Grassia's evidence was that Vivo's solicitors informed E-Cycle's solicitors of the allegations on 27 May 2013. By letter dated 28 May 2013, E-Cycle's solicitors gave notice of default by non-payment under cl. 12 of the Agreement and also invoked the dispute resolution procedure under cl. 13 of that Agreement in respect of the allegation that E-Cycle was not properly disposing of the relevant televisions.

His Honour drew attention to a further affidavit by Mr Grassia, where Mr Grassia provided additional detail of a conversation with a director of another recycling provider and referred to a meeting with representatives of the Commonwealth Department of Sustainability and Environment where, he claimed, he was advised that the Department had met with E-Cycle and it had confirmed that televisions had been placed in landfill as Vivo alleged. There was some further support for that allegation in the fact that the party which is alleged to have placed the relevant televisions in landfill was also shown as E-Cycle's preferred recycler in documents produced on subpoena.

E-Cycle did not address the substance of this allegation, other than instructing its solicitors to convey to Vivo's solicitors that the allegation "is denied".

His Honour concluded that there was at least a potential inconsistency between Mr Grassia's evidence of what he was told by the Department in mid-June 2013 and E-Cycle's evidence that there were no "issues or problems" with the Department. Black J held that it was not necessary or appropriate to reach any final determination as to that matter in an application of this kind.

Black J accepted that Vivo had not established that, in fact, E-Cycle had not provided the relevant services so as to be entitled to payment under the Agreement; however, his Honour emphasised that the question before him was not whether Vivo had established that matter in fact, but whether it had raised a genuine dispute as to that matter, and his Honour considered that such a genuine dispute had been raised.

His Honour took the view that there was a genuinely arguable claim that the effect of the relevant provisions in the Agreement was that Vivo's obligation to pay the Service Fees, being the Collection Fees and the Recycling, depended on E-Cycle's provision of the Collection Services and the Recycling Services. His Honour held that there would, therefore, be a genuinely arguable claim that Vivo was not obliged, under the terms of the Agreement, to pay the Collection Fees, the Recycling Fees or the Service Fees, if it was genuinely arguable that E-Cycle had not provided the Services.

(ii) Offsetting claim

In respect of the offsetting claim, his Honour explained that a company can establish an "offsetting claim" if there is a "serious question to be tried" or "an issue deserving of a hearing" as to whether the company has such a claim against the creditor and that claim is made in good faith and is arguable and not frivolous or vexatious: *Scanhill Pty Ltd v Century 21 Australasia Pty Ltd* [1993] FCA 618.

His Honour elucidated that:

The amount of an offsetting claim is the amount claimed by a party in good faith, so long as that claim as so quantified is not fictitious or merely colourable: *Jesseron Holdings Pty Ltd v Middle East Trading Consultants Pty Ltd (No 2)* (1994) 13 ACSR 787 at 790. If the Court is satisfied that the company has an offsetting claim, then the Court is required to calculate the "substantiated amount" of the demand by deducting any offsetting claim from the admitted amount of the debt: s 459H(2).

E-Cycle argued that an assertion of a genuine dispute excludes the ability to argue an offsetting claim in relation to the same debt, relying on *NT Resorts Pty Ltd v Deputy Commissioner of Taxation* (1998) 153 ALR 359 for that proposition. His Honour did not accept that submission, although his Honour did accept that, once a genuine dispute is established, no question of an offsetting claim arises, noting that that was the position in this case. His Honour concluded on this point by observing that "had I not found that a genuine dispute was established, I would have found that an offsetting claim in the amount of $18,700 was established".

(iii) Some other reason to set aside the Demand pursuant to s. 459J(1)(b) of the Corporations Act

Black J held that the service of the Demand did not give rise to a direct breach of the dispute resolution clause of the Agreement, since it would not amount to the commencement of litigation. Despite this, his Honour noted that the claimed debt seemed to be connected with the question whether the relevant televisions have been sent to landfill and whether that was inconsistent with E-Cycle's obligations under the Agreement. His Honour noted that that was the specific question as to which E-Cycle itself invoked the dispute resolution procedure. Black J held that this was sufficient to give rise to a genuine dispute as to the claim, for the purposes of s. 459H(1) of the Act, or alternatively was some other reason to set aside the creditor's statutory demand for the purposes of s. 459J(1)(b) of the Act.

Black J noted that it also was not strictly necessary for him to reach a finding on this issue given that he had already determined that a genuine dispute was established on other grounds.

6.11 Relevant factors where liquidator seeks orders for distribution of surplus, destruction of books and records of the relevant companies, release of the liquidator and deregistration of the relevant companies

(By Stephanies De Vere, Minter Ellison)

In the matters of RH Trevan Pty Ltd (in liquidation); Trevan Auto Service Pty Ltd (in liquidation); Trevan Car Sales Pty Ltd (in liquidation) [2013] NSWSC 1445, Supreme Court of New South Wales, Black J, 30 September 2013

The full text of this judgment is available here.

(a) Summary

This case highlights the factors the Court considers when determining whether to allow a liquidator to make a distribution of surplus, allow a liquidator to destroy the books and records of the relevant companies and whether to grant a release of a liquidator and deregistration of the relevant companies.

(b) Facts

The liquidator of RH Trevan Pty Ltd (in liquidation) (Company) sought an order under s. 488(2) of the Corporations Act 2001 (Cth) (the Act) seeking special leave to make a distribution of surplus in the winding up of the Company to its contributories and an order that his costs and expenses of the application be paid out of the Company's assets. Section 488(2) of the Act provides that a liquidator may only distribute a surplus with the Court's special leave.

The liquidator also sought an order under s. 542(3) of the Act that the books and records of the relevant companies and records in his custody, control and possession resulting from his appointment as liquidator of the Company, Trevan Auto Service Pty Ltd (in liquidation) (Auto Service) and Trevan Car Sales Pty Ltd (in liquidation) (Car Sales) (together referred to as the

Relevant Companies) be destroyed not sooner than one month after the companies deregistration. Section 542(3) of the Act provides that when a company has been wound up, the books of the company and of the liquidator that are relevant to affairs of the company at or subsequent to the commencement of the winding up, may be destroyed within a period of 5 years after the deregistration of the company, in the case of a winding up by the Court, in accordance with the directions of the Court given pursuant to an application of which at least 14 days notice has been given to ASIC. Section 542(4) of the Act provides that the liquidator is not entitled to destroy such books unless the Australian Securities and Investments Commission (ASIC) consents to their destruction. The liquidator provided evidence of a letter from ASIC whereby ASIC advised that it did not object to its application pursuant to s. 542(3) of the Act and that it would not appear at its hearing.

In addition, the liquidator sought an order under s. 480(d) of the Act that he be released as liquidator of the Relevant Companies and that ASIC deregister the companies. Section 480(d) of the Act provides that when the liquidator has realised all of the company's property or so much of that property as can, in his or her opinion, be realised without needlessly protracting the winding up and has distributed any final dividend to the creditors and adjusted the rights of the contributories, he or she may apply to the Court for an order that he or she be released and that ASIC deregister the company.

(c) Decision

(i) Application under s. 488 of the Corporations Act

Black J referred to *CGU Workers Compensation (NSW) Ltd v Ascom Service Automation (Australia) Pty Ltd* [2005] NSWSC 747 at [4] in which it was held that the purpose of s. 488(2) of the Act is to ensure that there is in reality a surplus, in that creditors' claims have been recognised and met in full, and that the correct relativities among the contributories have been observed. His Honour also noted that the principles applicable to an application under s. 488(2) of the Act were reviewed in *Brealey v Shields* [2009] NSWSC 1148 and *Re FAI Car Owners Mutual Insurance Company Pty Ltd* [2009] NSWSC 1350. In particular, Black J referred to the following principles:

- the purpose of s. 488(2) was to "instil in a liquidator a sense of care to ensure that all steps necessary to verify that a surplus in truth exists have been duly taken and that members' entitlements have been ascertained"; and
- "following the abolition of the par value concept, a distribution of surplus among members is *prima facie* to be made according to the number of shares held, although the position may be changed by the company's constitution".

The liquidator argued that a distribution of surplus was straightforward as it involved dividing the available sum between the two contributory groups in equal shares. Black J was satisfied that it was appropriate that the Court grant special leave to the liquidator to make the proposed distribution of surplus in the winding up of the Company.

(ii) Application under s. 542 of the Corporations Act

The liquidator submitted in favour of his application for the destruction of the books and records that no litigation by or against him as liquidator was on foot, contemplated or expected, no request for access to the books and records by any creditor had been made and to the best of his knowledge, no circumstances existed in relation to the companies or an associate which would result in those books and records being required within 5 years of the companies' deregistration. The liquidator also submitted that all of his lodging and reporting requirements had been satisfied.

Black J held that he was satisfied that he could properly make the order sought under s. 542 of the Act but noted that the order was not presently operative since it would not take effect until after the Relevant Companies were deregistered. His Honour also noted that s. 542(4) of the Act provided that the liquidator is not entitled to destroy the relevant books unless ASIC consents to the destruction of those books and a statement ASIC does not object to that destruction is not, in terms, a consent to that destruction. Black J held that the liquidator would not be able to take advantage of the order unless and until he obtained consent from ASIC. His Honour determined that the statement of non-objection did not amount to ASIC's consent.

(iii) Application under s. 480 of the Corporations Act

His Honour referred to *FAI Car Owners v Mutual Insurance Company Pty Ltd* [2009] NSWSC 1350 where Barrett J noted that s. 480 of the Act contemplates that an application for the release may be made where the liquidator has realised all of the Company's property, has distributed a final dividend to the creditors and adjusted the rights of contributories and made a final return to the contributories. Consequently, Black J held that it was not appropriate to make an order for the release of the liquidator in respect of the Company because that order would be premature as the surplus was still to be distributed in respect of the Company. Black J concluded that the liquidator could renew his application for release after the distribution of the surplus had been completed.

6.12 Changing ASIC register to record incorrect details about being sole director and shareholder does not without more amount to the offence of fraud under the Criminal Code

(By Amy Dunphy, Minter Ellison)

R v Saba [2013] QCA 275, Supreme Court of Queensland, Fraser JA and Applegarth and Jackson JJ, 27 September 2013

The full text of this judgment is available here.

(a) Summary

This case demonstrates the factors a Court will consider in determining whether a benefit has been obtained by dishonest conduct.

(b) Facts

Daas Ramez Saba (the Appellant) was convicted at trial of two counts of contravention of s. 408C(1)(d) of the Criminal Code 1995 (Qld) (the Criminal Code) for dishonestly gaining a benefit or advantage, pecuniary or otherwise. The Appellant brought an appeal against the convictions.

The prosecution alleged that the Appellant had dishonestly gained a benefit by changing the ASIC records in relation to two companies and was shown as the sole director and sole shareholder of the companies on the public record. In order to change the records the Appellant had used the corporate key for each of these companies.

For both contraventions, the prosecution alleged that no shares were transferred to the Appellant and the Appellant was not appointed as a director.

The first contravention related to DEEVA Development & Construction Pty Ltd. On 24 March 2009 ASIC was notified of the change of membership from the previous member to the Appellant and of the appointment of the Appellant as a director on 1 May 2009. ASIC was notified of the cessation of the former director on 22 May 2009.

The second contravention concerned DAE Insulation Pty Ltd. ASIC was notified of the change in membership to the Appellant on 24 March 2009 and the appointment of the Appellant as a director on 12 May 2009. ASIC was notified of the cessation of the previous director on 22 May 2009.

The prosecution alleged that as a result of this behaviour:

- the Appellant obtained the benefit of having control of each of the companies by acquiring the public appearance of being the legitimate controlling director;
- the change of the ASIC record was a benefit to the Appellant as it gave rise to the opportunity that members of the public might make the assumption in dealing with either company that the Appellant had legitimately been appointed as a director of the relevant

company with the authority to exercise the powers and perform the duties customarily done in that role;
- the Appellant acted dishonestly due to his knowledge of his lack of entitlement to acquire the control of the companies; and
- the fraud occurred when the relevant ASIC forms were submitted or when the ASIC records were changed.

For the two contraventions of s. 408C(1)(d) of the Criminal Code, the prosecution contended that the Appellant had committed an offence of fraud which rendered him liable to be convicted and imprisoned for a period of five years.

There was no evidence that proved the Appellant's purpose in changing the companies' details or that identified the Appellant's intended use of the status of the ASIC registers.

The issue before the Court of Appeal was whether the appearance of being a company director or shareholder on the public register confers a benefit, which could give rise to an offence under s. 408C of the Criminal Code. As a corollary of the answer to this question, the Court was called upon to determine whether to set aside or uphold the Appellant's convictions.

(c) Decision

Jackson J, with whom Fraser JA and Applegarth J agreed, delivered the leading judgment.

The Court set aside the Appellant's convictions and discharged the Appellant.

In reaching his decision, Jackson J noted the wide meaning of the term "benefit" and observed that to a certain extent the definitions of "benefit" and "property" operate circularly. The Criminal Code defines the term "benefit" to include "property" and in s. 408C the term "property" includes "benefit".

Further, his Honour noted that "benefit" is defined in s. 1 of the Criminal Code to include "advantage". Jackson J observed the difficulties with reconciling this definition with s. 408C(1)(d) of the Criminal Code, which refers to a "benefit or advantage". Citing the case of *Moylan v The State of Western Australia* [2007] WASCA 52 (Moylan) his Honour opined that a benefit could also embrace an advantage. In Moylan the accused deceived a fellow employee into believing that the employer intended to terminate the employee's service contract so that they accepted a separation arranged by the accused. The benefit was the opportunity to apply for the position left open by the other employee's departure.

His Honour found that whether a benefit is created turns upon the context in which it is used.

In the context of s. 408C of the Criminal Code, Jackson J found that the appearance of control of a company, to the extent it is created by lodging forms with ASIC, does not without more create a benefit or advantage within the meaning of the section.

Jackson J considered it important that it was not contended that at any time the Appellant had engaged in a particular transaction that involved a member of the public relying upon the changes to the ASIC register. In his Honour's view, the potential that a member of the public may make the assumption that the Appellant was a director in the future was not sufficient to establish a benefit or advantage for the purposes of s. 408C(1)(d) of the Criminal Code.

His Honour acknowledged that the submission of forms to change the ASIC register may have formed part of a scheme pursuant to which the Appellant planned to defraud each of the companies but it was not of itself a benefit under s. 408C(1)(d) of the Criminal Code. Instead, it was at most a step along the way towards gaining some unidentified advantage.

6.13 An intention to appeal is not sufficient to establish "some other reason" to set aside a

statutory demand

(By Nicole Schaillee and Cameron Belyea, Clayton Utz)

Re Mio Amico Pty Limited [2013] NSWSC 1292, New South Wales Supreme Court, Black J, 30 August 2013

The full text of this judgment is available here.

(a) Summary

Mio Amico (the Company) failed to set aside a statutory demand because it proposed to appeal against a decision dismissing a cross-claim it brought against the Bank which had served the statutory demand.

The success of the appeal would do nothing more than allow the Company's cross-claim to be determined; the appeal itself would not give rise to a judgment for money. The pending appeal did not establish "some other reason" why the demand should be set aside.

This case is distinguishable from those cases in which the appeal had been commenced at the time the application to set aside the statutory demand was heard.

(b) Facts

The Bank obtained judgment against the Company for just under $3.3 million (the Common Law proceeding). That judgment debt formed the basis of the statutory demand served by the Bank on the Company.

During that Common Law proceeding, the Company cross-claimed against the Bank claiming a loss of between $3.7 million and $4.9 million (that is, higher than the judgment debt). On the day after the statutory demand was served on the Company it filed a notice of intention to appeal against the dismissal of its cross-claim.

The Company applied to the NSW Supreme Court for an order setting aside the statutory demand and an order under s. 459F(2)(a)(i) of the Corporations Act 2001 (Cth) (the Act) extending the time for compliance with the statutory demand until 21 days after the hearing of the appeal.

(c) Decision

The Company did not establish "some other reason" to set aside the statutory demand.

(i) Preliminary issue

A preliminary issue arose as to whether it was open to the Company to rely on the proposed appeal as the basis of its application to set aside the statutory demand.

Black J took the view that the ground (the proposed appeal) was satisfactorily disclosed in the affidavit supporting the application, and sufficiently elaborated on in the submissions, so as to accord with the general principle that before a ground of opposition may be relied upon to set aside a statutory demand it must be identified (*Graywinter Properties v Gas and Fuel Corp Superannuation Fund* (1996) 70 FCR 452).

(ii) Main issue

The Company applied under s. 459J(1)(b) of the Act to have the Court set aside the statutory demand. Section 459J(1)(b) of the Act provides that the Court may set aside the statutory demand if it is satisfied that there is some other reason why the demand should be set aside.

The Company argued that its intention to appeal against the dismissal of its cross-claim is sufficient to establish "some other reason" upon which the Court could rely in exercising its discretion to set aside the statutory demand.

Black J found that success on the appeal would result in nothing more than the cross-claim being determined by the Court of Appeal itself or another judge. It was not the case here, as it was in *Ryledar Pty Ltd v Euphoric Pty Ltd* [2006] NSWSC 1288 (*Ryledar*), that the appeal would give rise to a judgment of money. Rather, Justice Black considered that the appeal is merely anterior to an opportunity for determination of the Company's cross-claim.

His Honour also found that it was not enough that the company intended to appeal. The appeal had not been commenced at the time the application to set aside the statutory demand was determined. That fact was plainly relevant to the determination. This case is distinguished from those in which the appeals had been commenced (namely *Ryledar* and *Eumina Investments Pty Ltd v Westpac Banking Corp* [1998] FCA 824 (*Eumina*)).

Finally, there was no basis for the applicant asserting that a refusal of its application would have the result that the Company would go into liquidation and, consequently, would be unable to appeal the Common Law proceedings. Rather, Black J held that the principle that the Court has the discretion to adjourn a winding up application applies in respect of the Company's suggested cross-claim.

By way of comment only his Honour opined that the principle in *Eumina* (that the Court may set aside a demand which is based on a judgment or order which is subject to an appeal) is still good law notwithstanding the High Court decision in *Deputy Commissioner of Taxation v Broadbeach Properties Pty Ltd* [2008] HCA 41, which in the opinion of his Honour, was confined to the particular statutory and policy context of statutory demands served by the Commissioner of Taxation.

Counsel for the Company suggested that the Court make an order setting aside the statutory demand on the condition that the appeal be pursued.

Without turning to any authorities on this point, his Honour considered it would not be proper to do so because:

- evidence given established that the Company's director had medical concerns which meant he could not properly prepare for the cross-claim at first instance and this may also happen on the appeal;
- the Company's ability to conduct the appeal depends on a loan from the director's stepson and steps to obtain that loan have not occurred;
- the Court should be reluctant to take a step which would require a person to commence an appeal; and
- there was no obvious mechanism to address the detriment to the Bank if the statutory demand is set aside subject to the condition and the Company cannot or does not comply with that condition.

6.14 Court opts for conservative approach when determining how to implement a DOCA termination

(By Clayton Utz)

In the matter of Streetscape Projects (Australia) Pty Ltd (deed of company arrangement) [2013] NSWSC 1289, New South Wales Supreme Court, Black J, 21 August 2013

The full text of this judgment is available here.

(a) Summary

The Council of the City of Sydney (the City) as plaintiff, applied to the Court for the termination of a deed of company arrangement (DOCA) between Streetscape Projects Australia Pty Ltd (the Company) and its deed administrators.

After the action was initiated, the Company agreed to the termination of the DOCA by consent.

Thereafter, the case focused on:

- the extent of the Court's powers in making an order terminating a DOCA for "some other reason" as described in s. 445D(1)(g) of the Corporations Act 2001 (Cth) (the Act); and
- the Court's considerations in implementing the termination of a DOCA, including the effect on creditors' priority payments in relation to the question of costs.

(b) Facts

The City and the Company agreed on certain orders resulting in the DOCA being terminated and the Company being placed in liquidation with David Lombe being appointed as liquidator.

Section 445D(1) allows the Court to terminate a DOCA if it is satisfied that certain criteria have been met, including, among other things, that information about the company's business, property, affairs or financial circumstances which was given to the administrator or to creditors was false or misleading and could be reasonably expected to have been material to creditors of the company in deciding whether to vote in favour of the resolution that the company executed the DOCA (sub-paragraph (a)). Sub-section (g) includes the catch all power for a Court to terminate the DOCA "for some other reason".

Despite the case not being heard on the merits of the City's allegations as to why a DOCA termination was necessary, the Court understood the City's allegations to include:

- discrimination between creditors;
- a future risk of insolvency of the Company by reason of adverse costs orders in the litigation between the City and the Company;
- criticisms of the adequacy of the administrators' report in respect of certain matters; and
- dealings between persons associated with the Company and certain creditors in respect of proxies at the second meeting of creditors.

Section 446B has the effect that, where a DOCA has been terminated under s. 445D, the Company is taken to have passed a special resolution under s. 491 that it be wound up voluntarily (r. 5.3A.07 of the Corporations Regulations 2001 (Cth)).

However, the City sought an order under s. 447A (the Court's general power to make orders) that the Company should be wound up in insolvency pursuant to s. 459A of the Act, the consequence of which was to invoke the power of s. 556(1), the statutory order of priorities, in order to achieve a position that the City's costs of the winding up would rank with a high level of priority in the winding up.

The City argued that once the DOCA was to be set aside, the Company would be insolvent, and its winding up, whether a Court appointed winding up or a voluntary winding up, would be a winding up in insolvency.

The Administrators, who otherwise had made a submitting appearance, indicated a concern that the form of order sought by the City may have an adverse effect on other creditors, in so far as it would promote the priority available to the City's claim for costs and potentially reduce the recoveries that may be available to other creditors.

(c) Decision

(i) Section 445D(1)(g): "any other reason"

His Honour was satisfied that "some other reason" to set aside the DOCA was established because the City (being the Company's largest single creditor by a substantial margin) and the Company had formed a view, which no other creditor or the administrators contested, that it is appropriate that the DOCA be terminated and a liquidator be appointed.

(ii) Court's powers under s. 447

His Honour accepted that the Court had the power to make an order setting aside the DOCA and ordering a Court ordered winding up under s. 447A.

However, his Honour declined to order a Court winding up (with the consequent priority implications). His Honour noted that the legislature could have readily (but did not) provide that the result of a successful application under s. 445D was to bring about a Court ordered winding up.

His Honour also noted that the matter had been decided without a determination on the merits.