SAI Global Corporate Law Bulletin No. 192>

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Bulletin No. 192

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 Supreme Court of Victoria Commercial Law Conference 2013

On 9 September 2013, the Supreme Court of Victoria will hold its annual *Commercial Law Conference*. A program of eminent speakers will address topical and important commercial law issues.

The conference details are as follows:

Date	Monday 9 September 2013
Venue	Banco Court, Supreme Court of Victoria 210 Williams St, Melbourne
Time	2.30pm - 5.00pm
Cost	$220 (including GST)
Program	"Fiduciary Breaches - The Endless Wrangling over Remedies" Speaker: Professor Sarah Worthington, University of Cambridge Comment: The Hon Justice Neave AO "Commercial Litigation and the Adversarial System - Time to Move On" Speaker: The Hon John Doyle AC CC Comment: The Hon Ray Finklestein QC "The Evidence Act and Developments in Legal Professional Privilege" Speaker: Dr Sue McNicol SC Comment: The Hon Justice Tim Ginnane

The conference flyer and registration details are available here.

1.2 APRA annual regulatory plan

On 21 August 2013, the Australian Prudential Regulation Authority (APRA) released its *Annual Regulatory Plan* (ARP) for 2013-2014, which provides a summary of APRA's planned activities for regulatory changes in the current financial year as well as a summary of APRA's finalised regulatory changes in the past financial year. The publication of the ARP is a key component of APRA's compliance with the government's best practice regulation requirements.

The ARP is available on the APRA website.

1.3 New governance guidelines for super funds

On 21 August 2013, the Australian Council of Superannuation Investors (ACSI) published updated advice to corporate Australia on how it will be assessing public company directors' behaviours and performance.

The revised Governance Guidelines will underpin ACSI's proxy-voting recommendations to its 38 Australian member-funds, which collectively manage over $350 billion in assets on behalf of eight million Australians.

The Guidelines now articulate the issues considered by ACSI when making voting recommendations on director elections, remuneration reports, the ratification of capital raisings and board spill proposals.

The Governance Guidelines are available on the ACSI website.

1.4 Shareholders' Association releases corporate governance policy discussion paper

On 18 August 2013, the Australian Shareholders' Association released a policy discussion paper ahead of the 2013 AGM season which focuses on board structures, shareholder engagement and executive remuneration.

In terms of specific policy changes, some of the key shifts signalled in the discussion paper include:

- a 12 year tenure limit for both independent directors and audit firms;
- opposition to male-only boards in the sense that ASA believes all ASX200 companies should have at least one female director;
- a "two strikes" regime where ASA will vote against non-executive directors who have clearly contributed to poor performance on two separate public company boards;
- a "one strike" policy where ASA will consider opposing a long-serving CEO or chairperson of a major company who was clearly responsible for decisions which led to material losses for investors;
- ASA will increasingly vote against directors who raise capital on unfavourable terms for retail investors. The fairest capital raising method is a renounceable entitlement offer with a single book build at the end to compensate institutional and retail non-participants on the same terms;
- acceptance that senior executives can hold a single non-executive board seat elsewhere;
- retention of ASA's limit of five board seats for non-executive directors (where a chairpersonship counts for two) while also considering unlisted commitments when weighing up workload concerns;
- a new formula for long-term incentive schemes whereby 30% of the award can vest after outperformance (i.e. 50.1 percentile) and a four year performance period, rising in a straight line to 100% at the 85th percentile. The current policy advocates only 10% at the 50th percentile rising steeply to 100% at the 75th percentile. ASA remains opposed to performance periods of less than four years;
- general discouragement of short-term incentive schemes and where they do exist, support for a holding lock of at least two years and payment in equity;
- endorsement of Relative Total Shareholder Return against a basket of industry peers as the most favoured performance metric for a long-term incentive scheme; and
- a reduction in the reliance on accounting and valuation models when determining the size of long-term incentive scheme payments so that retail investors can better understand the metrics.

The discussion paper is available on the ASA website.

1.5 Point of sale disclosure in the insurance, banking and securities sectors - consultative

report

On 18 August 2013, the Bank for International Settlements released a consultative report. Point of Sale disclosure in the insurance, banking and securities sectors identifies and assesses differences and gaps in regulatory approaches to point of sale (POS) disclosure for investment and savings products across the insurance, banking and securities sectors.

The report considers whether regulatory approaches to POS disclosure need to be further aligned across sectors, and it makes a number of recommendations, mainly to policymakers and supervisors, to assist them in considering, developing or modifying their POS disclosure regulations:

- jurisdictions should consider implementing a concise written or electronic POS disclosure document for the product sample identified in the report, taking into account the jurisdiction's regulatory regime;
- the POS disclosure document should be provided to consumers free of charge, before the time of purchase;
- a jurisdiction considering POS disclosure should consider requiring that a POS disclosure document disclose key characteristics including costs, risks and financial benefits or other features of a given product and any underlying or referenced assets, investments or indices, irrespective of the financial sector from which the products are derived;
- the POS disclosure document should be clear, fair, not misleading and written in a plain language designed to be understandable by the consumer;
- the POS disclosures should include the same type of information to facilitate comparison of competing products;
- the POS disclosure document should be concise, set out key information about a product and may include, as appropriate, links or refer to other information. It should make clear that it does not provide exhaustive information;
- allocation of responsibility for preparing, making available and/or delivering the POS disclosure document should be clearly established, and the POS disclosure document should identify which entity is responsible for its content; and
- a jurisdiction considering POS disclosure should consider how to use its capabilities and powers to implement these POS recommendations, taking into account the jurisdiction's regulatory regime.

1.6 Longevity risk transfer markets: market structure, growth drivers and impediments, and potential risks - consultative report

On 15 August 2013, the Bank for International Settlements released a consultative report on longevity risk transfer markets. The ageing population phenomenon being observed in many countries poses serious social policy challenges. Longevity risk - the risk of paying out on pensions and annuities longer than anticipated - is significant when measured from a financial perspective. Longevity risk transfer markets: market structure, growth drivers and impediments, and potential risks is a report released by the Joint Forum on longevity risk transfer (LRT) markets.

It makes the following recommendations to policymakers and supervisors:

- supervisors should communicate and cooperate on LRT internationally and cross-sectorally in order to reduce the potential for regulatory arbitrage;
- supervisors should seek to ensure that holders of longevity risk under their supervision have the appropriate knowledge, skills, expertise and information to manage it;
- policymakers should review their explicit and implicit policies with regards to where longevity risk should reside to inform their policy towards LRT markets. They should also be aware that social policies may have consequences on both longevity risk management practices and the functioning of LRT markets;
- policymakers should review rules and regulations pertaining to the measurement, management and disclosure of longevity risk with the objective of establishing or maintaining appropriately high qualitative and quantitative standards, including provisions

and capital requirements for expected and unexpected increases in life expectancy;

- policymakers should consider ensuring that institutions taking on longevity risk, including pension fund sponsors, are able to withstand unexpected, as well as expected, increases in life expectancy;
- policymakers should closely monitor the LRT taking place between corporates, banks, (re)insurers and the financial markets, including the amount and nature of the longevity risk transferred, and the interconnectedness this gives rise to;
- supervisors should take into account that longevity swaps may expose the banking sector to longevity tail risk, possibly leading to risk transfer chain breakdowns; and
- policymakers should support and foster the compilation and dissemination of more granular and up-to-date longevity and mortality data that are relevant for the valuations of pension and life insurance liabilities.

1.7 FSB consults on implementation guidance for the key attributes of effective resolution regimes

On 12 August 2013, the Financial Stability Board (FSB) launched a public consultation on the application of the Key Attributes of Effective Resolution Regimes for Financial Institutions (the Key Attributes) to non-bank financial institutions and on principles governing information sharing for resolution purposes.

(a) Resolution of insurer, FMI and the protection of client assets

The FSB in conjunction with relevant standard-setters (Committee on Payment and Settlement Systems - CPSS, International Association of Insurance Supervisors - IAIS and International Organization of Securities Commissions - IOSCO) has developed Annexes to the Key Attributes that set out guidance on:

- resolution of Financial Market Infrastructure (FMI) and resolution of systemically important FMI participants;
- resolution of insurers; and
- client asset protection in resolution.

The Key Attributes are a central component of the FSB policy measures endorsed by G20 leaders to address the "too big to fail (TBTF)" problem associated with systemically important financial institutions (SIFIs). They set out the core elements considered necessary to make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss. They constitute an "umbrella" standard that applies for all parts of the financial sector that could cause systemic problems.

The proposed guidance is designed to assist jurisdictions and authorities in implementing the Key Attributes with respect to resolution regimes for FMIs (including central counterparties (CCPs), central securities depositories and securities settlement systems), insurers and firms with holdings of client assets.

The proposed guidance on FMI resolution accompanies the consultative report on FMI recovery published by CPSS and IOSCO to provide a comprehensive set of guidance on recovery and resolution for different kinds of systemically important FMI. The guidance on resolution of insurers complements the policy measures for global systemically important insurers (G-SIIs) published by the IAIS on 18 July, which include recovery and resolution planning requirements for G-SIIs. The guidance on Client asset protection in resolution builds on IOSCO's Consultation Report on Recommendations Regarding the Protection of Client Assets of February 2013.

(b) Information sharing for resolution purposes

The FSB is also consulting on a set of principles for the design of national legal gateways and confidentiality regimes to allow the sharing of non-public information between domestic and foreign authorities that is necessary for planning and carrying out resolution. They also include the provisions on information sharing and confidentiality that should be included in the institutionspecific cross-border cooperation agreements (COAGs) that are required for all global systemically important financial institutions (G-SIFIs) by the Key Attributes.

1.8 Report on authorities' access to trade repository data

On 12 August 2013, the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) published a report entitled Authorities' access to trade repository data.

Trade repositories (TRs) are entities that maintain a centralised electronic record of over-the-counter (OTC) derivatives transaction data. TRs play a key role in increasing transparency in the OTC derivatives markets by improving the availability of data to authorities and the public in a manner that supports the proper handling and use of the data. For a broad range of authorities and international financial institutions, it is essential to be able to access the data needed to fulfil their respective mandates while maintaining the confidentiality of the data pursuant to the laws of relevant jurisdictions.

The purpose of the report is to provide guidance to TRs and authorities on the principles that should guide authorities' access to data held in TRs for typical and non-typical data requests. The report describes the expected data access needs of authorities using a functional approach complemented by an illustrative data access mapping that aligns each function to the minimum level of access authorities would typically require in support of their mandates and responsibilities. The report also sets out possible approaches to addressing procedural and legal constraints to data access as well as confidentiality concerns. Authorities and TRs are encouraged to develop and maintain access policies and arrangements informed by the guidance and mapping outlined in the report.

1.9 Recovery of financial market infrastructures: consultative report

On 12 August 2013, the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) published for public comment a consultative report on the Recovery of financial market infrastructures. Financial market infrastructures (FMIs), which include payments systems, securities settlement systems, central securities depositories, central counterparties and trade repositories, play an essential role in the global financial system. The disorderly failure of an FMI could lead to severe systemic disruption if it caused markets to cease to operate effectively.

The report provides guidance to financial market infrastructures such as CCPs on how to develop plans to enable them to recover from threats to their viability and financial strength that might prevent them from continuing to provide critical services to their participants and the markets they serve. It also provides guidance to relevant authorities in carrying out their responsibilities associated with the development and implementation of recovery plans and tools.

The report supplements the CPSS-IOSCO Principles for financial market infrastructures (PFMI), the international standards for financial market infrastructures (FMIs) published in April 2012. It provides guidance on how FMIs can observe the requirements in the PFMI that they have effective recovery plans.

1.10 Implementation of Basel III liquidity framework in Australia

On 8 August 2013, the Australian Prudential Regulation Authority (APRA) released a note for authorised deposit-taking institutions (ADIs) providing further detail on its approach to the implementation of the Basel III liquidity framework and, in particular, on the operation of the committed liquidity facility (CLF).

In December 2010, the Basel Committee on Banking Supervision released a series of measures designed to strengthen liquidity buffers to promote a more resilient global banking system. APRA has been consulting on the implementation of the main elements of the Basel III liquidity reforms in Australia. The reforms introduce a global liquidity standard, the liquidity coverage ratio (LCR), that requires banking institutions to hold sufficient high-quality liquid assets (HQLA) to withstand a minimum of 30 days severe liquidity stress.

Due to the relatively short supply of Australian dollar HQLA, the Reserve Bank of Australia (RBA) will allow "scenario analysis" ADIs to establish a secured CLF sufficient in size to cover any shortfall between the ADI's holdings of HQLA and the requirement to hold such assets under the LCR.

The note provides details on APRA's role in determining the appropriate size of the CLF for each scenario analysis ADI.

The note is available on APRA's website.

APRA is undertaking a trial exercise with all scenario analysis ADIs in 2013. APRA will release further details on the CLF process once it has completed this exercise.

1.11 Report on improving corporate governance and shareholder engagement

On 6 August 2013, the Association of British Insurers (ABI) published a report on "Improving Corporate Governance and Shareholder Engagement".

The report considers critically the different roles and responsibilities of all the principal elements within governance - or stewardship - including:

- non-executives' ability to provide constructive challenge;
- the variety of approaches institutional investors take in holding companies to account; and
- the relationship between, and different responsibilities of, asset managers and asset owners.

The report also provides a review of major institutional investors' current approaches to corporate governance analysis and engagement and makes a number of proposals aimed at improving shareholder engagement.

A copy of the report is available on the ABI website.

1.12 Further market integrity rules on dark pools and high frequency trading

On 2 August 2013, Minister Assisting for Financial Services and Superannuation David Bradbury announced a package of market integrity rules directed at better protecting investors and the stability of Australia's financial markets.

The rules provide for:

- public disclosure of information so that market users can understand how their orders may be handled and executed;

- details on the operation of the dark pool to be disclosed to clients;
- dark pools to be operated by a common set of procedures, which do not unfairly discriminate between users;
- investor choice to opt-out of trading in the dark pool if they wish;
- dark pool operators to monitor orders and trades for compliance with the common set of procedures, and report suspicious activity to ASIC;
- extension of existing automated order processing rules to dark pools;
- dark pool operators to notify users and ASIC about system issues as soon as practicable;
- clarification that tick sizes on dark pools are to be the same as those on lit markets;
- improved management of dark pool operator's conflict of interest issues;
- prohibition of negative commissions as payment for order flow; and
- harmonisation of market manipulation rules across markets.

These rules will come into force in stages over a nine month period. ASIC will also issue guidance to clarify the new rules and expectations of market operators and participants.

Once the new rules are registered they will be available on the ASIC website.

1.13 Women on boards: Canadian consultation

On 2 August 2013, the Ontario Securities Commission published a consultation paper seeking input on a proposal that would require TSX-listed companies to provide disclosure regarding women on their boards and in senior management.

(a) Status of women on boards and in senior management in Canada

A number of reports discuss gender diversity in Canada.

The following is a snapshot of some of the current statistics on the level of representation of women on boards and in senior management:

- in 2011, 10.3% of directors of public companies were women;
- in 2011, 43% of companies on the S&P/TSX composite index did not have a single female board member; and
- in 2012, women held 15% of senior officer positions in public companies and 35.9% of public companies had no women senior officers.

The Commission states that it is apparent from these figures that women continue to be underrepresented on boards and in positions of senior management in Canada.

(b) Disclosure of women on boards and in senior management

Under the potential disclosure model TSX-listed companies would provide disclosure, as part of their annual summary of corporate governance practices, in the following areas:

- policies regarding female representation on their boards and in senior management;
- consideration of the representation of women in the director selection process;
- consideration of the representation of women in the board evaluation process; and
- measurement regarding the representation of women in the organization, on the board and in senior management.

1.14 Institutional investors views on company boards

On 31 July 2013, the Australian Council of Superannuation Investors (ACSI) released the "Board Confidence Survey: A Report on Institutional Investor Confidence in Boards of S&P/ASX200 Companies".

A total of 41 institutional investors participated in the research study, collectively managing $265 billion of Australian equities. Participants were asked 17 individual questions about their perceptions across six key areas of board responsibility:

a. leadership;
b. oversight;
c. influence and responsiveness;
d. strategic decision making;
e. composition; and
f. remuneration.

Confidence was indicated on a five-point scale, with "one" indicating low confidence, "five" indicating high confidence and "three" a neutral score. Results across the participants were then aggregated.

Key findings of the 2013 research include:

Highest levels of confidence (the top three above neutral) - across the 17 questions, the highest levels of confidence were expressed in boards having *Relevant business experience* (3.53); the view that boards *Act in the interests of all shareholders* (3.36) and that they are competent at *Setting strategy* (3.27).

Lowest levels of confidence (the bottom two below neutral) - in contrast, the lowest confidence scores were given for board oversight of mergers and acquisitions (*M&A*) (2.96) and the level of *Independence from management* (2.95).

Interesting contrasts and other observations - within the survey data a number of other interesting contrasts and findings are present, including that:

- there is relatively high confidence in the ability of boards to set remuneration levels (including *Chairperson pay levels* at 3.03 and *Executive pay levels* at 3.07 through to *NED pay levels* at 3.19), despite the perception that investors and boards often clash over this issue;
- while there are higher scores for *Relevant business experience* (3.53) and *Setting strategy* (3.27), these stand out against the lower scores for oversight of *M&A* (2.96) and *Independence from management* (2.95) - all of which are hallmarks of board leadership;
- lack of confidence in oversight of *M&A* does not, however, extend to other *Capital Management* activities, as the average score in this area was 3.13;
- confidence in boards' *Responsiveness to investor feedback* was above neutral at 3.11, but in contrast investors were less confident in the responsiveness of boards to counter the influence of management with *Influence from management* being an average score of 2.95; and
- boards' *Oversight of financial reporting* scored relatively highly at 3.23, as did their *Oversight of management teams* at 3.17.

The 2013 study is intended to be the first in a series of annual studies, assessing investor perceptions of board performance over time.

A copy of the full report including a more detailed discussion of the results is on the ACSI website.

1.15 IOSCO publishes recommendations for supervisory colleges for CRAs

On 30 July 2013, the International Organization of Securities Commissions (IOSCO) published the final report on Supervisory Colleges for Credit Rating Agencies, which recommends establishing supervisory colleges for internationally active credit rating agencies (CRAs), and provides preliminary guidelines on how to constitute and operate them.

The recommendations are aimed at improving the integrity of CRAs, as part of IOSCO's effort to enhance investor protection and the fairness, efficiency and transparency of securities markets. G20 leaders are also concerned with the integrity of CRAs and have repeatedly encouraged IOSCO to work to improve their effectiveness.

The dispersion of internationally active CRA affiliates worldwide poses a challenge to supervisors, as their perspective may be limited to the CRA activities in their jurisdiction. The creation of a CRA college could ultimately enhance the effectiveness of supervisors' risk assessment and oversight of internationally active CRAs by facilitating information exchange and cooperation among them.

IOSCO defines a supervisory college as a collaborative arrangement between supervisors that seek to promote information sharing, consultation, and cooperation in order to enhance risk assessment of internationally active CRAs and to support effective supervision of such CRAs.

The type of information that might be discussed or shared, where appropriate, could include inspection or examination of findings with respect to the following:

- the CRA's compliance with local or regional laws and regulations;
- the CRA's implementation and adherence to the IOSCO Code Of Conduct for CRAs; and
- the establishment and operation of rating models and methodologies, internal controls, procedures to manage conflicts of interest, and procedures for handling material non-public information.

The role of the CRA college would be to create a mechanism for sharing and discussing this type of information with the goal of promoting a better understanding of the risks faced or posed by an internationally active CRA and how relevant supervisors are addressing these risks. Where desired by members, a CRA college may facilitate consensus recommendations on how to address key risks faced or posed by the CRA through heightened supervision and/or targeted examination and inspection activities, consistent with national laws.

1.16 Corporations Amendment (Derivatives Transactions) Regulation 2013

On 27 July 2013, the Corporations Amendment (Derivatives Transactions) Regulation 2013 (Cth), which amends the Corporations Regulations 2001 (Cth) commenced.

According to the explanatory statement, the amending Regulation implements a measure that temporarily restricts the Australian Securities and Investments Commission's (ASIC's) rule making power in relation to end users, and operational measures to ensure the derivatives trade reporting regime has appropriate regulations governing the enforcement of trade reporting rules and regulations for confidential information.

Specifically, the amending Regulation:

- temporarily restricts ASIC's rule making power from imposing requirements on end users by specifying persons on whom requirements cannot be imposed under derivative transaction rules;
- inserts an enforceable undertaking regime as an alternative enforcement mechanism in relation to breaches of derivative transaction rules and derivative trade repository rules, including that if a person breaches these undertakings, ASIC is able to apply to a Court to make an order that the Court considers appropriate, including orders directing the person to comply with the undertaking, to pay the benefit obtained by the breach to the Commonwealth, or to compensate a person who has suffered loss from the breach;

- prescribes an infringement notice regime in respect of breaches of market integrity rules, including to prescribe the circumstances in which an infringement notice may be given, and the form of the infringement notice; and
- makes other minor and related amendments, including to provide that information provided to ASIC by the operator of a licensed derivative trade repository will be treated as being provided in confidence, unless it had been made publicly available under the relevant provisions.

1.17 IAASB proposes standards to fundamentally transform the auditor's report to focus on communicative value to users

On 25 July 2013, the International Auditing and Assurance Standards Board (IAASB) released proposals to enhance the auditor's report. The IAASB's Exposure Draft, Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs), responds to calls from investors, analysts, and other users of audited financial statements in the wake of the global financial crisis for the auditor to provide more relevant information in the auditor's report based on the audit that was performed.

The Exposure Draft includes a new proposed ISA titled Communicating Key Audit Matters in the Independent Auditor's Report. This proposed ISA directs auditors of financial statements of listed entities to communicate in their report those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements.

Among other enhancements, the IAASB is also proposing requirements for auditors to include specific statements about going concern in their reports, to make an explicit statement about the auditor's independence from the audited entity and, for listed entities, to disclose the name of the engagement partner in the auditor's report. The Exposure Draft includes example reports that illustrate the application of the proposed new and revised ISAs in various circumstances.

1.18 Proposals to promote a more competitive audit market in the UK

On 22 July 2013, the UK Competition Commission (CC) published a provisional decision regarding the remedies it is considering introducing when it publishes its final report on the supply of statutory audit services to large companies in the UK later this year.

In a summary of its provisional decision on remedies, the CC has put forward a package of measures to promote competition and to ensure that competition is directed towards satisfying the demands of shareholders. The remedy package includes measures to improve the bargaining power of companies and encourage rivalry between audit firms; measures to enhance the influence of the Audit Committee; and measures to promote shareholder engagement in the audit process.

In its provisional findings report published in February, the CC said that competition was restricted in the audit market due to factors which inhibit companies from switching auditors and by the incentives that auditors have to focus on satisfying management rather than shareholder needs.

The main measures the CC has proposed are as follows:

- FTSE 350 companies should put their statutory audit engagement out to tender at least every five years. Companies may defer this obligation to go out to tender by up to two years in exceptional circumstances. There will be a transitional period of five years before the measure comes into full effect;
- the Financial Reporting Council's (FRC's) Audit Quality Review (AQR) team should review

every audit engagement in the FTSE 350 on average every five years. The Audit Committee should report to shareholders on the findings of any AQR report concluded on the company's audit engagement during the reporting period;

- a prohibition of "Big-4-only" clauses in loan documentation (i.e. clauses that limit a company's choice of auditor to a preselected list);
- a shareholders' vote on whether Audit Committee Reports in company annual reports contain sufficient information;
- measures to strengthen the accountability of the external auditor to the Audit Committee and reduce the influence of management, including a stipulation that only the Audit Committee is permitted to negotiate and agree audit fees and the scope of audit work, initiate tender processes, make recommendations for appointment of auditors and authorise the external audit firm to carry out non-audit services; and
- the FRC should amend its articles of association to include a secondary objective to have due regard to competition.

The CC has decided against bringing in measures requiring mandatory switching of auditors, further constraints on audit firms providing non-audit services, joint audits, shareholder or FRC responsibility for auditor reappointment or independently resourced Risk and Audit Committees.

1.19 FCA fines US based high frequency oil trader US$903K for market manipulation

On 22 July 2013, the UK Financial Conduct Authority (FCA) fined US based high frequency trader, Michael Coscia, US$903,176 (€597,993) for deliberate manipulation of commodities markets.

This is the first time the FCA has taken enforcement action against a high frequency trader, and reflects the FCA's objective of enhancing the integrity of the UK's financial markets.

Between 6 September 2011 and 18 October 201, Mr1 Coscia used an algorithmic program of his own design to instigate an abusive trading strategy known as "layering".

During this time, Mr Coscia placed thousands of false orders for Brent Crude, Gas Oil and Western Texas Intermediate (WTI) futures from the US on the ICE Futures Europe exchange (ICE) in the UK.

The Final Notice to Mr Coscia sets out the reasons why the FCA took action against him. An appendix contains an animated illustration of the abusive trading pattern. Mr Coscia's layering strategy typically meant placing a small order which he intended to trade on one side of the order book followed by a series of large orders on the opposite side of the order book which were not genuine. These larger orders - typically 20 times the average size of orders placed by other market participants - were designed to create a false and misleading impression of liquidity for those products, and induce the market to trade the smaller orders. The execution of the small order would then trigger the immediate cancellation of the large orders. This pattern would then be repeated on the opposite side of the order book in order to make a profit from price movements generated by the trading strategy.

1.20 FSB identifies global systemically important insurers (G-SIIs) and the policy measure that will apply to them

On 18 July 2013, the Financial Stability Board (FSB) released policy measures following the G20 Leaders endorsement of the implementation of an integrated set of policy measures to address the risks to the global financial system from systemically important financial institutions (G-SIFIs). These policy measures are to apply to G-SIFIs identified by the FSB in collaboration with the standard-setters and national authorities.

The International Association of Insurance Supervisors (IAIS) published a set of policy measures that are consistent with the FSB policy framework endorsed by G20 Leaders and comprise:

- recovery and resolution planning requirements;
- enhanced group-wide supervision; and
- higher loss absorbency requirements.

The FSB, in consultation with the IAIS and national authorities, identified an initial list of G-SIIs to which the IAIS policy measures will apply, which was published on 18 July 2013. These G-SIIs have been identified using the IAIS assessment methodology. Going forward, the list of G-SIIs will be updated each year in November, starting from next year.

For the institutions identified in 2013, implementation of enhanced group-wide supervision commences immediately, crisis management groups should be established by July 2014, and the recovery and resolution planning requirements under the FSB Key Attributes for Effective Resolution Regimes should be met by end-2014. As a foundation for higher loss absorbency requirements for G-SIIs, the IAIS will as a first step develop straightforward, backstop capital requirements to apply to all group activities, including non-insurance subsidiaries, to be finalised by the time of G20 Summit in 2014. Implementation details for higher loss absorbency requirements will be developed by end-2015 and will apply starting from January 2019 to those G-SIIs identified in November 2017.

1.21 Consultation on public sector governance

On 17 June 2013, the International Federation of Accountants (IFAC), the global organization for the accountancy profession with 172 members and associates in 129 countries, and the Chartered Institute of Public Finance and Accountancy (CIPFA) issued for public comment a Consultation Draft for an International Framework on governance in the public sector.

The draft Good Governance in the Public Sector encourages better service delivery and improved accountability by establishing a benchmark for good governance in the public sector.

The Framework is not intended to replace national and sectoral public sector governance codes. Instead, it is designed as a reference document for those who develop and set national governance codes for the public sector when updating and reviewing their own codes. Where codes and guidance do not exist, the Framework provides a shared understanding of what constitutes good governance in the public sector and a powerful stimulus for positive action.

1.22 Updates on global mergers and acquisitions activity for the second quarter of 2013

The International Institute for the Study of Cross Border Investment and M&A has published data on the global mergers and acquisitions activity for the second quarter of 2013.

Key findings are:

- global M&A volume in Q2 was US$498 billion, roughly the same as Q1 but down 25% from the same quarter last year;
- the United States had another comparatively strong quarter, accounting for four of the five largest deals globally in the quarter and 43% of global M&A volume in the first half of 2013;
- cross-border M&A volume in the first half of 2013 accounted for 30% of total global M&A

volume, down as compared to the corresponding period in 2012;

- growing stability in U.S. markets, strong corporate earnings, readily available cash and the continued availability of cheap financing for certain borrowers continue to drive M&A activity, but concerns about rising interest rates and volatility in certain developed and developing markets would appear to be restraining deal activity. Global M&A volume is on pace to reach just under US$2.0 trillion for the year, down from 2012; and
- notwithstanding a 53% decline in private equity-backed M&A compared to Q1, private equity deals accounted for 16% of global M&A volume in the first half of 2013, an increase of 43% over the corresponding period in 2012.

Further information and a copy of the full report for the second quarter of 2013 is available on the Institute website.

2. Recent ASIC Developments

2.1 Guidance on rules for ASX 24

On 21 August 2013, ASIC released regulatory guidance on the market integrity rules for the Australian Securities Exchange Limited derivatives market (ASX 24).

The rules were registered in May 2013 and can be found on the ASIC website.

Regulatory Guide 250 "Guidance on ASIC market integrity rules for risk management and other requirements: ASX 24" gives guidance on the obligations of market participants of the ASX 24 market on risk management for house accounts, supervisory policies and procedures, and minimum presence requirements for foreign market participants.

The guidance also explains a waiver ASIC has granted to principal traders market participants who trade only on their behalf - for certain risk management obligations in circumstances where the principal trader accesses the market as client of another market participant, as their order and position limits are set by that market participant.

Regulatory Guide 250 is available on the ASIC website.

2.2 Sixth market supervision report released

On 21 August 2013, ASIC published its sixth report on the supervision of Australian financial markets and market participants.

Report 366 "ASIC supervision of markets and participants: January to June 2013" highlights the significant volume of market and participant-related outcomes achieved by ASIC in the first half of this year.

Key outcomes include:

- 20,938 trading alerts produced;
- 94 market inquiries conducted;
- 35 matters referred for further investigation;
- 45 risk-based assessment visits conducted;
- 88 surveillances completed;
- 19 instances of pre-emptive supervision action;
- five enforcement outcomes for insider trading offences; and
- two infringement notices issued by the Markets Disciplinary Panel.

Report 366 is available on the ASIC website.

2.3 Report on hybrids

On 20 August 2013, ASIC released Report 365 "Hybrid securities" which discusses recent offers of hybrids in Australia. Hybrid securities often promise "high yields" and are issued by well-known companies with trusted brands, but investors need to very carefully consider the features and risks before investing. The terms and conditions of each hybrid issue vary and in some cases they include features that mean they rank closer to equity than debt.

There has been more than $18 billion of hybrids issued by banks and corporates since November 2011. There were approximately 75,000 investors in hybrid securities last year, two thirds of whom were self-managed superannuation funds.

ASIC has reviewed the selling methods and sales processes of issuers and brokers. Report 365 discusses the findings of the review in detail. Based on the findings in the report, ASIC will now focus on possible misleading conduct in the sale of hybrids. This includes inappropriate labelling of hybrids and unwarranted comparison of hybrids to different, less risky products e.g. covered bonds or senior debt. In addition, ASIC will explore whether new strategies can be developed to help investors check their understanding of hybrids before investing in them.

Report 365 is available on the ASIC website.

2.4 Update on financial advice stakeholder engagement

On 31 July 2013, ASIC released reports following the completion of two significant engagement programs with AFS licensees who advise retail clients. These programs are part of ASIC's gatekeeper monitoring and ensuring these gatekeepers are adequately informed and resourced for the functions they undertake.

Report 362 "Review of financial advice industry practice: Phase 2" (REP 362), summarises the findings of ASIC's recent review of the business and risk practices of the top 21 to 50 Australian financial services (AFS) licensees that provide personal financial advice.

The report highlights that:

- licensees are focused on risk management and compliance, though different licensees identified different key risks;
- licensees employ different methods to manage risks, and some deploy significantly more resources than others to risk management;
- proactive licensee monitoring should be instrumental in detecting incidents and breaches; and
- advisers should not rely on risk profiling tools without also considering if the outcomes are appropriate for their clients' circumstances.

ASIC is providing individual feedback to the participating licensees on their business and compliance practices.

Report 362 completes ASIC's review of the top 50 licensees. ASIC's findings on the top 20 licensees are discussed in Report 251 Review of financial advice industry practice (REP 251).

ASIC has recently visited 24 newly licensed financial advice businesses, representing a quarter of the advice licensees that obtained their AFS licence between July 2011 and June 2012. These visits aimed to help the new licensees better comply with AFS licence obligations.

ASIC asked licensees questions about their business model, advice processes and approach to risk and compliance. Key findings from the project include:

- licensees need to carefully consider whether their advisers are adequately trained for the advice they are authorised to give. For example, while 83% of the licensees offered self-managed superannuation fund (SMSF) services, only 48% of those licensees required their advisers to complete additional training on SMSFs;
- use of external compliance service providers is very common among new advice licensees. 86% of the licensees visited used a compliance service provider on an ongoing basis. Licensees need to be mindful that they retain responsibility for achieving compliance and should consider their appointment of external compliance service providers very carefully, and
- 67% of the new licensees, even those with a small number of advisers and clients, had a paraplanning function. This suggests licensees recognised the value in allowing paraplanners to perform more routine or administrative functions, freeing up advisers' time to focus on services that add value to their clients.

The reports are available on ASIC's website: REP 362 and REP 251.

2.5 ASIC to boost record-keeping obligations

On 31 July 2013, ASIC put forward a number of proposals to update the record-keeping obligations for those who provide financial advice.

Consultation Paper 214 "Updated record-keeping obligations for AFS licensees" outlines the types of records that must be kept, including:

- records to prove that the licensee and its representatives have complied with the best interests duty and related obligations;
- records of ongoing fee arrangements entered into with a client;
- copies of documents - such as, fee disclosure statements and renewal notices - that fee recipients must receive for an ongoing fee arrangement; and
- records to prove the licensee and its representatives have complied with the ban on conflicted remuneration.

Consultation Paper 214 is available on the ASIC website.

2.6 Claiming on consumer credit insurance - report

On 31 July 2013, ASIC released a report which found that there is significant room for improvement on consumers' claims experiences for credit card-related consumer credit insurance (CCI). This includes cases where consumers received a payment or benefit under their policy.

CCI is designed to protect consumers if something happens to them that affects their ability to meet their credit repayments. Typically, CCI covers consumers in the event of loss of income due to injury, illness, involuntary unemployment and death.

Report 361 "Consumer credit insurance policies: consumers' claims experiences" found that process of claiming on a CCI policy can be stressful and costly for consumers who are already experiencing significant events in their life like the loss of a job or illness.

While consumers whose claims were accepted were generally pleased to receive a benefit payment that assisted them, they were not always happy with their experience, because:

- their benefit payment was less than they had expected; or
- payments were not made in a timeframe consistent with credit card repayment due dates.

Consumers whose claims were denied generally felt that they were worse off for making a claim, given the time, money and effort they spent to complete forms and evidence their claim.

Also, these consumers:

- were often upset that they had been sold a policy without being made aware at the time that important exclusions and conditions on their policy could or did apply to them; and
- generally thought that if their credit card provider had offered them their policy then they must be covered.

Report 361 is available on the ASIC website.

2.7 Enforcement report - January to June 2013

On 24 July 2013, ASIC released the fourth of its six-monthly enforcement reports, detailing enforcement outcomes achieved in the period 1 January 2013 to 30 June 2013: Report 360.

For the period reported on, ASIC achieved 371 outcomes. This included criminal action as well as civil and administrative action, enforceable undertakings (EU), and negotiated outcomes.

There were 78 enforcement outcomes achieved in the market integrity, corporate governance and financial services areas, and 293 in the small business area.

Report 360 is available on the ASIC website.

3. Recent ASX Developments

3.1 Consultation paper on third edition of CGC Principles and Recommendations

On 16 August 2013, the ASX Corporate Governance Council released for public comment:

- a consultation paper entitled Review of the Corporate Governance Principles and Recommendations;
- a draft of the proposed third edition of the Principles and Recommendations;
- a copy of the current edition of the Principles and Recommendations for comparison; and
- translation tables showing the linkages between the proposed new recommendations in the third edition and the existing recommendations in the current edition, and vice versa.

The Council's communiqué is available here.

Some changes are needed to the ASX Listing Rules to give effect to the reforms proposed in the third edition of the Principles and Recommendations. ASX issued a separate consultation paper about those Listing Rule changes, which is available on the ASX website.

3.2 Rule amendments - admission of licensed banks as Participants

On 14 August 2013, amendments were made to the admission of licensed banks as Participants. Amendments have been made to the ASX Clear and ASX Settlement Operating Rules to remove the impediments to Australian-owned banks becoming direct Participants in ASX Clear and ASX Settlement. The amendments are intended to ensure that references to requirements applying to a "Participant" in the relevant Operating Rules appropriately deal with the Participant in its capacity as a Participant and not in relation to its other business activities (except to the extent that its other business activities affect its ability to comply with the Rules).

Historically, the operation of the rules extended to parts of a Participant's business that were not related to the ASX facilities creating additional compliance burdens on both the Participant and ASX. This encouraged the use of a specialised subsidiary to operate in order to be able to comply with the rule requirements. The amendments will assist in removing the necessity to use a specialised subsidiary.

The ASX Clearing Corporation Notice is available on the ASX website.

3.3 Rule amendment to facilitate multiple participant identifier structures

On 9 August 2013, amendments were made to facilitate multiple participant identifier structures. The ASX Clear Operating Rules and Procedures and ASX Settlement Operating Rules and Procedures have been amended to facilitate ASX Clear Participants being able to use multiple participant identifier (PID) structures. The changes also clarify the settlement outcomes and requirements for ASX Settlement Participants who use a multiple PID structure (which already applies).

ASX Clear has received several applications/enquiries from clearing participants over the past two years seeking to establish a multiple PID structure under a single participation. The key drivers for such an arrangement have been the segregation of post trade business workflows (i.e. wholesale and retail) or to facilitate an additional back office system.

While several ASX Settlement Participants already operate multiple PIDs, the changes proposed to the ASX Settlement Operating Rules help to clarify the operation of settlement calculations on a per PID (rather than per Participant) basis and expressly provide for the framework by which more than one PID (initially limited to 5) can be sought, including the need for a separate Payment Facility to facilitate settlement of all CCP Batch Instructions in respect of a PID.

The ASX Clearing Corporation Notice is available on the ASX website.

3.4 Reports

On 6 August 2013, 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 July 2013.

3.5 Expansion of ASX equity research scheme

On 31 July 2013, ASX announced that it is expanding the ASX Equity Research Scheme for a further 12 months, with funding doubled to $2 million and with the participation of more research providers (17), covering more companies (approximately 1,314).

The ASX Equity Research Scheme supports the production of high-quality, independent research on ASX-listed companies with a market capitalisation below $1 billion (around 92% of all listed companies) that may not have been covered by research before.

A list of participating companies and research providers can be viewed on the ASX website.

3.6 Consultation Paper - financial stability standard implementation

On 29 July 2013, the ASX released a consultation paper on the implementation of financial stability standards.

In December 2012 the Reserve Bank of Australia (RBA) released new Financial Stability Standards (FSS) for Financial Market Infrastructures. These were a response to the new international standards for the regulation and conduct of Clearing and Settlement facilities developed by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO). They form part of a global tightening of financial markets regulation in the wake of the Global Financial Crisis.

The new FSS took effect on 29 March 2013. They apply to licensed clearing and settlement facilities, including ASX Clear, ASX Clear (Futures), ASX Settlement and Austraclear.

ASX has received transitional relief until 31 March 2014 for central counterparty (CCP) requirements for the new standards relating to Segregation and Portability, and Liquidity Risk. The RBA Payments System Board, in granting this relief, acknowledged the significant industry-wide changes needed to implement certain elements of these standards. This consultation paper now seeks industry feedback on those changes - recognising that compliance with the new FSS is mandatory for ASX Clear.

This is ASX's second consultation resulting from the new regulatory requirements. A previous ASX consultation was released on Derivatives Account Segregation and Portability in October 2012. ASX is seeking feedback on the new regulatory requirements including the choice of cash equity market account structures. ASX would particularly like feedback on the likely benefits as well as establishment and additional ongoing operational and settlement costs of the different choices. ASX has also put forward a proposal which will remove the need to reschedule cash equity market settlements in the event that a Clearing Participant is not able to meet a payment obligation.

ASX would also like feedback on the impact of these proposals on operational costs, together with estimates of costs and required timescales for implementation. Suggestions for alternative approaches that efficiently achieve the same policy objectives and regulatory standards are specifically sought.

The Consultation Paper is available on the ASX website.

3.7 Long-term investing report 2013

On 24 July 2013, the 15th edition of the annual report commissioned by ASX and prepared by Russell Investments, was released. The report provides an analysis of the investment returns of different asset classes over the past ten- and 20-year periods.

The report considers the impact of tax, costs and borrowing on ultimate investment returns to provide investors with insight into how different investments have performed over the medium to long term.

The Report is available on the Russell Investments website.

3.8 Listed entities announcement notification enhancement

On 20 July 2013, the announcement notification functionality in ASX Online Companies was unveiled. The notification functionality has been enhanced to allow a listed entity to include email addresses for external groups or individuals. From 20 July ASX Online Companies can add up to 30 external recipients which will receive the same email acknowledgment as ASX Online Companies users for the listed entity.

Adding and maintaining the list of external email addresses is the responsibility of the Listed Entity through its ASX Online Companies administrators.

The Listed Entities Update announcing this change is available on the ASX website.

3.9 ASX finalises Code of Practice and membership of forum

On 18 July 2013, ASX released the Code of Practice for Clearing and Settlement of Cash Equities in Australia (the Code), which took effect on 9 August 2013.

ASX developed the Code following an announcement by the former Deputy Prime Minister and Treasurer on 11 February 2013, to defer a decision on any licence application from a central counterparty seeking to offer cash equities clearing services in Australia for a period of two years.

The Code sets out ASX's commitment to:

- establish an ongoing advisory forum (the Forum) that allows users of ASX's clearing and settlement services and other industry stakeholders to provide input to the Boards of ASX Clear and ASX Settlement;
- transparent and non-discriminatory pricing of clearing and settlement services; and
- transparent and non-discriminatory terms of access to clearing and settlement services.

The Code and the representatives who have been appointed members of the Forum are available on the ASX website.

4. Recent Takeovers Panel Developments

4.1 Billabong International Limited - Panel decision

On 21 August 2013, the Takeovers Panel (the Panel) announced that following the execution of revised agreements between Billabong International Limited and the Altamont Consortium, the Panel has declined to make a declaration of unacceptable circumstances in response to an application dated 18 July 2013 from Oaktree Capital Management L.P. and Centerbridge Partners L.P. in relation to the affairs of Billabong.

On 16 July 2013, Billabong announced that it had entered into:

- agreements with the Altamont Consortium, including a US$294 million bridge facility, the sale of the DaKine business and the issue of 84,519,582 options (representing 15% of the share capital of Billabong including the options); and
- commitment letters with the Altamont Consortium and GE Capital to provide a long term financing package for Billabong, comprising a loan of US$294 million ('the loan), including a US$40 million tranche, convertible into redeemable preference shares if shareholder approval was obtained, and a US$160 million revolving credit facility.

If all the options were exercised and the redeemable preference shares converted, they would have represented an interest of up to approximately 40% in Billabong. Accordingly, while financing arrangements are typically a matter for a company board, these arrangements were inter-linked with the acquisition of a controlling interest in Billabong.

The bridge facility and long term financing were negotiated in the context of Billabong's urgent need for funds and a public sale/refinancing process over more than 12 months.

While the Panel took these factors (among others) into account, it considered there were unacceptable circumstances in relation to the following terms:

- a bridge facility termination fee of 20% of the principal amount, payable if, among other things, there was a change of control of Billabong before 15 January 2014 and as a result the bridge facility was repaid on or before 31 December 2013. The magnitude of the fee acted as a lock-up device, with the effect of deterring rival proposals
- the interest rate on the US$40 million tranche of the long term financing was 35% if shareholder approval to permit conversion of the tranche into redeemable preference shares, and the issue of some of the options, was not obtained, and 12% if approval was obtained. The magnitude of the 35% interest rate and the circumstances under which it was payable amounted to a "naked no vote" break fee, which was likely to coerce Billabong shareholders to approve the issue of a controlling interest in the company; and
- the long term financing required the loan to be repaid in the event of a change of a control of Billabong, plus payment of a "make-whole" premium should the loan be repaid in the first two years. The make-whole premium was 10% of the principal plus interest that would have been payable during that two years. This premium, and the circumstances under which it was payable, had the capacity to deter rival proposals.

After being informed that the Panel intended to make a declaration of unacceptable circumstances, the Altamont Consortium and Billabong advised that they would re-negotiate their agreements. On 21 August 2013, Billabong announced revised agreements with the Altamont Consortium that did not include the terms of the original agreements that the Panel considered unacceptable.

On the basis of the above, the Panel decided not to make a declaration of unacceptable circumstances.

The reasons for the Panel's decision will be published in due course on the Takeovers Panel website.

4.2 Coppermoly Limited - Declaration of unacceptable circumstances and orders

On 20 August 2013, the Takeovers Panel (the Panel) announced that it has made a declaration of unacceptable circumstances and final orders in relation to an application dated 26 July 2013 by Yeaman Nominees Pty Limited as trustee for the Yeaman Super Fund in relation to the affairs of

Coppermoly Limited.

(a) Background

The application concerned a one for four non-renounceable entitlement offer at a price of $0.045 per share to raise up to approximately $1.95 million, fully underwritten by Jelsh Holdings Pty Ltd.

After entering into the underwriting arrangement, a related entity of Jelsh entered into an agreement to acquire 16,290,333 Coppermoly shares. As a result of this acquisition, and additional on-market acquisitions, Jelsh's voting power in Coppermoly increased to 12.06%.

The entitlement offer closed on 30 July 2013. Based on the participation of shareholders and Jelsh's obligations as underwriter, Jelsh's voting power in Coppermoly will increase to approximately 26.76%.

(b) Declaration

The Panel considered that:

- the acquisition of shares by a related entity of Jelsh, after Jelsh became the underwriter to Coppermoly's proposed entitlement offer, put Jelsh in a position where it would be likely to increase its voting power in Coppermoly to more than 20%;
- all reasonable steps to minimise the potential control impact of the entitlement offer on Coppermoly were not taken; and
- there are material deficiencies in Coppermoly's disclosure, including in relation to the identity of Jelsh and its intentions for Coppermoly and the changed intentions of directors in respect of taking up their entitlements.

(c) Orders

The Panel has made orders, including orders to the effect that:

- Coppermoly and Jelsh comply with their obligations under the underwriting arrangement;
- Jelsh not rely on any right it may have to terminate the underwriting arrangement as a consequence of the application to the Panel, the declaration or the orders;
- Jelsh is obliged to divest shares it receives as underwriter of the entitlement offer so that shareholders who were originally entitled to participate in the entitlement offer are offered as many shares as is necessary for them to take up what was their full original entitlement in the entitlement offer; and shares in excess of their entitlement;
- Jelsh and its associates are restricted from: voting any shares held in excess of 20% voting power (subject to such voting rights being restored at a rate of 3% every six months), and participating in any future rights issue in respect of shares subject to the voting restriction above; and
- the letter of offer to shareholders in respect of shares to be divested by Jelsh be in a form approved by the Panel.

The determination of these proceedings brings to an end the interim orders dated 29 July 2013.

The reasons for the Panel's decision will be published in due course on the Takeovers Panel website.

4.3 ASIC regulations amended to improve Panel process

On 26 July 2013, amendments to the Australian Securities and Investments Commission Regulations 2001 (Cth) took effect that improve the Takeovers Panel's (the Panel) processes - see

Corporations and Australian Securities and Investments Commission Amendment Regulation 2013 (No. 1) 2013 (Cth).

These amendments:

- remove the requirement for the Panel to provide reasons at the time of notifying persons that the Panel has decided not to conduct proceedings. This will enable the Panel to communicate decisions not to conduct proceedings to the parties and the market faster. Reasons for these decisions will be provided later to the parties and the market;
- remove the requirement for the Panel to make and retain a transcript of the proceedings of a conference; and
- facilitate the use of Panel conferences by specifically allowing electronic conferencing to be used and ensuring that a person is able to attend a conference without being physically present at the nominated location of the conference.

The Panel has determined nearly 400 applications since it was revitalised on 13 March 2001. These amendments will assist the Panel in making commercial, consistent and timely decisions.

5. Recent Research Papers

5.1 Say on pay laws, executive compensation, CEO pay slice, and firm value around the world

This paper examines the effects of say on pay (SoP) laws on CEO compensation, the portion of top management pay captured by CEOs, and firm valuation.

Using a large cross-country sample of about 103,000 firm-year observations from 39 countries, the authors document that compared to their control group of firms, SoP laws are associated with:

1. a lower level of CEO compensation, which partly results from lower CEO compensation growth rates and is related to CEO power;
2. a higher pay for performance sensitivity suggesting that SoP laws have the greatest effects on firms with poor performance;
3. a lower portion of total top management pay awarded to CEOs indicating lower pay inequality among top managers; and
4. a higher firm value, which is related to whether the CEO's share of total top management pay was relatively high before the laws are passed.

Further, while both mandatory and advisory SoP laws are associated with lower CEO pay levels, only advisory SoP laws tighten the sensitivity of executive pay to firm performance. Collectively, the results document significant changes in executive compensation policies and firm valuation following the passage of SoP laws around the world.

The paper is available on the SSRN website.

5.2 Independent directors and risk taking: Evidence from listed US insurance companies

This study examines the relation of independent directors and their gender diversity, busyness, and experience with risk taking for 112 listed US insurance companies over 2003 - 2010. Using OLS, system GMM and 3SLS, the authors find that board independence, females amongst independent directors and busy boards are positively related to risk taking. While board tenure is not related to risk taking, experienced boards are found to be positively related to risk taking. The study extends the board structure literature to show that the composition of independent board members matters for monitoring. Female independent directors, rather than simply female directors, improve board monitoring but that more than two does not. A higher percentage of non-busy directors may also mitigate the adverse effect of busy directors. Furthermore, experience gained through serving on the board improves monitoring.

The paper is available on the SSRN website.

5.3 Long run trends in Australian executive remuneration: BHP 1887 - 2012

Outside the US, little is known of long-run trends in executive compensation. The authors fill this gap by studying BHP, a resources giant that has long been one of the largest companies on the Australian stock market. From 1887 to 2013, trends in CEO and director remuneration (relative to average earnings) follow a U-shape. This matches the pattern for US executive compensation, Australian top incomes, and (for the past two decades) average trends in executive compensation in top Australian firms. Like the US, Australia experienced a post-war "great compression" prior to the recent "great divergence".

The paper is available on the SSRN website.

5.4 Accountability of independent directors - Evidence from firms subject to securities litigation

The authors examine which independent directors are held accountable when investors sue firms for financial and disclosure related fraud. Investors can name independent directors as defendants in lawsuits, and they can vote against their re-election to express displeasure over the directors' ineffectiveness at monitoring managers. In a sample of securities class-action lawsuits from 1996 to 2010, about 11% of independent directors are named as defendants. The likelihood of being named is greater for audit committee members and directors who sell stock during the class period. Named directors receive more negative recommendations from Institutional Shareholder Services (ISS), a proxy advisory firm, and significantly more negative votes from shareholders than directors in a benchmark sample. They are also more likely than other independent directors to leave sued firms. Overall, shareholders use litigation, along with director elections and director retention, to hold some independent directors more accountable than others when firms experience financial fraud.

The paper is available on the SSRN website.

5.5 Professional expertise and board diversity

The authors examine the diversity of professional expertise on corporate boards and implications for shareholder value using a hand-collected dataset of directors categorised by 11 types of professional expertise. They find the most common types of professional expertise are executives, accountants, bankers, scientists, lawyers and engineers. The primary determinants of professional expertise diversity are board size, industry and location, with certain types of professional expertise (academics, bankers, doctors, engineers and scientists) clustered in specific industries. Overall, the authors find no relationship between professional expertise diversity and firm value, but they find evidence that shareholders react positively to directors that bring certain types of new expertise to the board (accountants, bankers, lawyers and other CEOs) and negatively to directors with other types of new expertise. In general, the analysis indicates that firms are following a constrained approach to professional expertise diversity.

The paper is available on the SSRN website.

5.6 Rethinking "one share, one vote"

"'One-share, one-vote", a bedrock principle of Anglo-Saxon corporate governance, is back in the spotlight. Except this time, the aim is to diminish its application rather than to extend its global footprint. Hoping to stem the tide of short-termism in the financial markets, prominent commentators have advocated bolstering the voting rights of long-term shareholders or, conversely, withholding them from short-term investors. Significantly, it was recently reported that the European Commission was preparing a proposal to give "loyal" shareholders extra voting influence. This commentary discusses the case for departing from the one-share, one-vote standard and the issues to consider to ensure that the intended benefits are realised without accompanying adverse or other unintended outcomes.

The paper is available on the SSRN website.

6. Recent Corporate Law Decisions

6.1 Defaulting directors cannot attribute their unlawful acts to the company to defeat the company's action against them

(By Olivia Cameron, Herbert Smith Freehills)

Jetivia S.A. v Bilta (UK) Ltd (in liquidation) [2013] EWCA Civ 968, England and Wales Court of Appeal (Civil Division), Dyson LJ, Rimer LJ and Patten LJ, 31 July 2013

The full text of this judgment is available at:

http://www.bailii.org/ew/cases/EWCA/Civ/2013/968.html

(a) Summary

In this appeal case, the Court of Appeal of England and Wales upheld the order of the Chancellor of the High Court dismissing the appellants' applications for the summary dismissal or striking out of the claims against them in the action.

The claimants in the action are Bilta (UK) Ltd (Bilta), which is now in liquidation, together with the joint liquidators of the company. Bilta seeks damages and equitable compensation from the appellants and the other defendants for conspiracy and dishonest assistance. The liquidators have separate claims for fraudulent trading under s. 213 of the *Insolvency Act 1986* (UK) (the Insolvency Act).

This was an appeal by the sixth and seventh defendants, Jetivia S.A. (Jetivia) and Mr Urs Brunschweiler (Mr Brunschweiler) (the appellants). They argued that Bilta's claim should be dismissed on the ground of public policy based on the ex turpi causa non oritur action principle ("from a dishonourable cause an action does not arise"). This was rejected by Patten LJ who held that the appellants could not rely upon the process of attribution to claim that Bilta was personally responsible for the conspiracy carried out by Bilta's directors and therefore the ex turpi causa principle did not apply.

The appellants' challenge to the s. 213 claim on the basis that the Court had no jurisdiction over the appellants in respect of the claim was also rejected because the legislation uses unqualified language ("any person") which does not impose any territorial limit on the scope of the section.

(b) Facts

Bilta is an English company which traded in European Emissions Trading Scheme Allowances (EUAs) which are treated as taxable supplies under the *VAT Act 1994* (UK).

Bilta bought EUAs from traders carrying on business outside the UK such as the Swiss company Jetivia. Supplies from foreign traders were zero-rated so no VAT liability was incurred on the supply. The EUAs were then on-sold to UK-based traders (the First Line Buffers) who were registered for VAT. These were taxable supplies at the standard rate (which was 15% at the time) and Bilta thereby incurred a liability of £38,733,444 for VAT.

The amount which Bilta charged for the EUAs (inclusive of VAT) was less than the amount which Bilta paid for them which enabled the First Line Buffers to make a small profit when they on-sold the EUAs. Bilta's directors (who are the first and second defendants) instructed the First Line Buffers to pay the gross purchase price (including VAT) to Jetivia or some other third party located outside the UK. This meant that Bilta made no profit on the transactions and was unable to pay the VAT which it owed because it never received or retained the proceeds of sale.

On 29 September 2009, liquidators were appointed, and later commenced Bilta's claim against the appellants and the other defendants.

The parties dispute the nature of the pleaded conspiracy:

- Bilta's pleaded case is that the object of the alleged conspiracy was to defraud and injure the company by depriving it of the money necessary to meet its VAT liabilities; and
- the appellants claim that Bilta was used by its directors and their associates to carry out a carousel fraud, the intended victim of which was not Bilta but HM Revenue and Customs (HMRC) who were deprived of the VAT which was due to them.

(c) Decision

(i) *Ex turpi causa*

Patten LJ accepted the reliance test for whether the *ex turpi causa* rule was engaged as used by the House of Lords in *Stone Rolls Ltd v Moore Stephens* [2009] 1 AC 1391 (Stone Rolls). Accordingly, it was held that a claimant cannot rely on an illegal act as the basis of a cause of action.

In order to engage the *ex turpi causa* rule, the appellants had to establish that the law attributed to Bilta the unlawful conduct of its directors and sole shareholder so that its actions against them and the appellants should be treated as an action between co-conspirators.

(ii) The principles of attribution

The appellants argued that the fraud was conducted by Bilta's two directors who were its directing mind and will. They argued that the process of attribution fixed the company with the knowledge and criminal intent of its directors. This arguably meant that the directors' use of Bilta as part of the fraudulent transactions became a conscious act of wrongdoing for which Bilta was personally responsible.

Patten LJ explained that, while the acts and intentions of the directors or other senior representatives will usually be attributed to the company for the purpose of establishing personal liability for the conduct, the process of attribution is not automatic.

Attribution cannot be avoided merely by demonstrating the harsh consequences to the company of attributing to it the conduct of its managers or directors. However, where the company seeks to recover from its directors the loss which it has suffered through their breach of fiduciary duties, the position of the company as victim ought to be paramount and attribution will not apply.

In refusing to attribute the directors' unlawful conduct to Bilta, Patten LJ held:

[t]o allow the defendant to defeat that claim by seeking to attribute to the company the unlawful conduct for which he is responsible so as to make it the company's own conduct as well would be to allow the defaulting director to rely on his own breach of duty to defeat the operation of ss. 172 and 239 of the [the *Companies Act 2006* (UK)] whose very purpose is to protect the company against unlawful breaches of duty of this kind: at 35.

In this case, the duty of the directors to consider the interests of creditors was engaged from the time when the trading commenced. This was because the effect of the conspiracy was that Bilta was insolvent from the moment it began trading because it never even received the purchase price for the EUAs which it on-sold. Bilta never had any substantial assets of its own and depended upon receiving the proceeds of sale from the EUAs in order to meet its VAT liabilities.

Further points on the operation of the principles of attribution in the context of a claim by the company to recover for losses caused to it by breaches of duty by its directors were:

- where an officer is guilty of fraud, their knowledge of the fraud cannot be attributed to the company (the Hampshire Land principle);
- the rationale of the Hampshire Land principle is based on the inherent unlikelihood of directors disclosing their own fraud to the object of the directors' deceit which also applies where the intended victim was not the company of which they were directors but was a third party;
- it does not matter whether the object of the alleged conspiracy was a VAT fraud on HMRC or was limited to depriving Bilta of the proceeds of sale from the EUAs. In both cases, the directors and other defendants will have committed or aided a breach of fiduciary duty and other wrongs against the company for which Bilta can sue. In neither case would it be open to the directors and their associates to rely upon a process of attribution to defeat the claim;
- in the context of a claim by the company against its fraudulent directors, the sole actor exception which was relied on in Stone Rolls has no place in English law and would directly contradict the protection given to creditors under ss. 172 and 239 of the *Companies Act 2006* (UK); and
- the decision in Stone Rolls was distinguished and in Patten LJ's view should be confined to the claim and the facts in that case.

(iii) Section 213

Section 213 of the Insolvency Act provides that, if in the course of winding up a company it appears that the company has attempted to defraud its creditors or has carried out any other fraudulent business, the liquidator may apply to the Court for a declaration that "any persons" who were knowingly parties to the fraud are liable to make proper contributions to the company's assets.

The issue was whether the appellants are "any persons" within the meaning of s. 213(2). Patten LJ accepted the Chancellor's application of the reasoning in *Re Paramount Airways Ltd* [1993] Ch 223 which concerned the scope of s. 238 of the Insolvency Act. It was found that the expression "any person" is unqualified language which does not place any limitation on the scope of the section. Parliament intended both ss. 213 and 238 to have extra-territorial effect.

6.2 *Pari passu* payment of local tax debts that are otherwise not recoverable in a recognised foreign insolvency proceeding

(By Elanor Morrison and David Barton, Ashurst)

Ackers (as joint foreign representative) v Saad Investments Company Limited; In the matter of Saad Investments Company Limited (in official liquidation) [2013] FCA 738, Federal Court of Australia, Rares J, 30 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/738.html

(a) Summary

Rares J reasoned that his orders of 22 October 2010 (the 2010 orders), which recognised proceedings in the Grand Court of the Cayman Islands, should be modified to permit the Commissioner of Taxation (the Commissioner) to exercise his right to recover up to the *pari passu* amount that he would be entitled to receive as a dividend, were the Commissioner entitled to prove for tax debts as an unsecured creditor in the Cayman Island proceedings.

His Honour held that the interests of the Commissioner, as an unsecured creditor of Saad Investments, were not adequately protected under the 2010 orders.

Further, his Honour reasoned that other unsecured creditors stood to receive a windfall gain to the extent that the Commissioner's bona fide claim was irrecoverable outside Australia. Rares J held that that result would be contrary to the fair or efficient administration of Saad Investments' insolvency.

(b) Facts

The Grand Court of the Cayman Islands ordered that Saad Investments be wound up on 18 September 2009. The Commissioner asserted a claim for tax debts and penalties of A$83,271,545.70.

The Cayman Island liquidators commenced proceedings before the Federal Court to have the foreign proceedings recognised as "a foreign main proceeding", on the basis that Saad Investments had its centre of main interests in the Cayman Islands.

The 2010 orders recognised the Cayman Islands proceedings as the "foreign main proceedings", and provided that, pursuant to Article 21 of the Model Law on Cross-Border Insolvency as implemented in Australia by the Cross-Border Insolvency Act 2008 (Cth) (the Model Law), no legal or administrative proceedings could be taken against Saad Investments or its assets except with leave of the Court or the written consent of the foreign representatives.

Rares J noted that the 2010 orders were made on the basis of cross undertakings by the Commissioner and the Cayman Islands liquidators. The Commissioner undertook not to issue further notices under Division 260 of Schedule 1 of the Taxation Administration Act 1953 (Cth) without giving 14 days' notice. The Cayman Islands liquidators undertook not to remit outside of Australia the proceeds of any realisation or sale of Saad Investments' assets located in Australia without giving the Commissioner 14 days' written notice.

The liquidators obtained orders and subsequently gave the Commissioner notice of their intention to remit the proceeds of the realisations of Australian assets out of Australia. The Commissioner brought an interlocutory application to prevent the liquidators from doing so.

The Commissioner's application was brought under Article 22 of the Model Law on the basis that the Commissioner's interests as a creditor of Saad Investments were "not adequately protected" by the 2010 Orders.

The Commissioner submitted that he was entitled to receive a distribution from the proceeds of the realisations of the Australian assets of no more than he would be entitled to receive as a *pari passu* payment under Australian law.

(c) Decision

Rares J reasoned that Article 22(1) of the Model Law gives the Court of the forum jurisdiction to make orders enabling the payment of taxation and penalty liabilities to be made from debtor's assets held by it or a foreign representative appointed under Article 19 or 21 of the Model Law before those assets are removed from the local forum and sent to the debtor's centre of main interests or elsewhere at the direction of the foreign representative.

His Honour held that the 2010 orders should be modified to permit the Commissioner to exercise his rights to recover an amount as an unsecured creditor for the following reasons.

(i) The principle of modified universalism revisited

The principle of modified universalism is that local Courts should co-operate with the Courts of the country of the principal liquidation so as to ensure that all the insolvent company's assets are distributed to its creditors under a single distribution system.

The purpose lying behind this principle is the achievement of a proper and fair distribution to creditors of a cross border insolvent company.

Rares J held that:

a. the public policy of Australia in relation to debts for taxation in insolvency is that such debts should be placed in the same position as unsecured debts of the company or individual;
b. the Model Law is silent on how domestic taxation legislation may operate to diminish the debtor's estate that will become available for remission to the foreign country;
c. it would not be fair to a domestic sovereign, its taxpayers or others doing business in its territory, or to the international body of the debtor's creditors, for a debtor's estate to be freed of any taxation obligation except in the debtor's centre of main interests, nor is there any reason in principle to exempt a debtor in a cross-border insolvency from all taxation liability in every jurisdiction other than that of its centre of main interests;
d. one of the objectives of the Model Law is the "fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor", and this objective is given effect partly by Article 22(1);
e. the Commissioner's interests were not adequately protected as he was unable to prove in the Cayman Islands for any distribution from the estate, and the effect of the unmodified 2010 Orders meant that the Commissioner could not or may not be able to avail himself of any other statutory remedies. Further, if the moneys were remitted to the Cayman Islands without the Commissioner being allowed to recover his *pari passu* entitlement, the other unsecured creditors would receive a windfall, and Saad Investments would effectively benefit from its insolvency since it would cease to be subject to the incidents of Australian taxation and insolvency laws in respect of taxable capital gains and penalties imposed in respect of its profit making activities in Australia; and
f. there was jurisdiction under Article 22 to make orders enabling the payment of taxation and penalties to be paid from the debtor's estate held by it or a foreign representative appointed under Articles 19 or 21 before those assets are removed from the local forum and sent to the debtor's centre of main interests or elsewhere at the direction of the foreign representative.

(ii) Public policy

Rares J noted that it was not necessary for the Court to consider whether it would be manifestly contrary to public policy, within the meaning of Article 6 of the Model Law, to permit the 2010 Orders to operate without modification or termination.

His Honour did, however, comment that it is fundamental to any society that its government be able to require its citizens and others who operate a business or reside within that society to pay taxation so as to maintain the state, and that without deciding the issue, there was considerable force in the Commissioner's reliance on Article 6 of the Model Law.

(iii) Election

Rares J rejected the liquidators' argument that by lodging a proof of debt the Commissioner had submitted or elected to submit to the jurisdiction of the Grand Court of the Cayman Islands, because:

a. in the period relied upon by the liquidators, the Grand Court of the Cayman Islands had not exercised jurisdiction over the Commissioner, nor did the Commissioner make any application to that Court, nor was he a party to any application to that Court;
b. the only benefit the Commissioner received from lodging the proof was access to information that he would have been entitled to receive were he treated as a creditor under the Corporations Act 2001 (Cth). However, as the Commissioner subsequently learned, he was not a creditor with any claim under the law of the Cayman Islands; and
c. there was no evidence that the Commissioner had, in the period relied upon by the liquidators, the necessary information for him to make an effective choice between pursuing his rights in the Cayman Islands or in Australia.

6.3 UK insolvency law: End to super priority payment ranking for pension claims

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

In the matter of the Nortel Companies; in the matter of the Lehman Companies; in the matter of the Lehman Companies (No 2) [2013] UKSC 52, United Kingdom Supreme Court, 24 July 2013

The full text of this judgment is available at:

http://www.bailii.org/uk/cases/UKSC/2013/52.html

(a) Summary

This case considers how administrators of a company should treat the company's potential liability under a financial support direction (FSD) regime, when the FSD is not issued until after the company has gone into administration.

If a UK company runs an occupational pension scheme for its employees, and the company experiences an "insolvency event" under the *Pensions Act 2004* (UK) (the Pensions Act), then the Pensions Regulator may issue a FSD requiring third parties (including other companies in the same group) to provide financial support covering the deficit in a company's pension scheme.

The Lehman Brothers and Nortel Networks corporate groups both had a member company that managed a UK pension scheme, and both pension schemes were in deficit following their respective collapses. Other Lehman Brothers and Nortel group companies (the Targets) were issued an FSD to provide financial support for the pension scheme associated with their group. These companies all received the FSD after entering administration, and the administrators sought directions from the Court about how this liability should be ranked in the order of priority of payment under the *Insolvency Act* 1986 (UK) (the Insolvency Act) and the *Insolvency Rules* 1986 (UK) (the Insolvency Rules). The Pensions Regulator's proceedings to enforce the FSD were in effect stayed until the Court made its decision.

The UK Supreme Court allowed the appeal against the Court of Appeal's decision to the extent of declaring that a Target's potential FSD liability, arising under an FSD issued after the Target had gone into administration, was a provable debt ranking equally with other unsecured creditors and not an "expense of the administration" which ranked ahead of unsecured creditors, creditors with floating charges and other expenses. The Supreme Court overruled previous cases that the Court of Appeal had applied.

(b) Facts

The appellants in the Supreme Court were the administrators of the Target companies that had received an FSD to support the deficit in UK pension schemes operated by other group entities.

Lehman Brothers collapsed on 15 September 2008, and its London-based group companies were placed under administration. The principal UK employer company went into administration with a crystallised debt of £120 million in relation to the group's pension scheme under s. 75 of the Pensions Act. In September 2010, the Pensions Regulator's Determination Panel decided that the employer company was a "service company" for the purposes of the Pensions Act 2004, because it had employed staff and seconded them to other Lehman Brothers companies. The Panel therefore issued an FSD against six other Lehman Brothers group companies, to require that they provide financial support to the employer company's underfunded pension scheme.

Nortel Networks collapsed in January 2009, and its subsidiary Nortel Networks UK Limited crystallised debt in relation to the group's pension scheme was £2.1 billion. After entering administration, the Pensions Regulator's Determination Panel decided that Nortel Networks UK Limited was "insufficiently resourced" for the purposes of the Pensions Act, and issued an FSD against other Nortel group companies.

In the case of both Lehman Brothers and Nortel, the effect of the FSD was that the Target companies would be required to provide reasonable financial support to the pension schemes in deficit. The Targets all received the FSD after they themselves had entered administration. The administrators applied to Court for a decision on how the Targets' potential liability under an FSD (issued after the Targets had entered administration) should be treated and given priority as compared to other liabilities under the Insolvency Act and the Insolvency Rules.

At first instance, the Court of Appeal found that the Pensions Regulator's issuance of an FSD did not create a legal obligation on the Targets before they entered administration, and was not a provable debt ranking *pari passu* with other unsecured debts under the Insolvency Act and Insolvency Rules. The Court of Appeal found instead that the FSD was an "expense of the administration" that ranked behind only fixed charge creditors, and before past wages and ordinary unsecured creditors. The administrators appealed to the Supreme Court.

(c) Decision

(i) FSD liabilities rank as provable debts

The Supreme Court overturned the decision of the Court of Appeal and unanimously decided that a company's liability under a FSD that is issued after the company entered administration is a provable debt ranking alongside other unsecured debts, and not an expense of the administration to be given higher priority payment ranking.

The Supreme Court overruled earlier decisions that the Court of Appeal had considered itself bound by. These earlier decisions, regarding individual bankruptcy, held that a person's liability for costs did not arise from an obligation existing before the bankruptcy proceedings, and therefore was not a provable debt. Lord Neuberger (who wrote the lead judgment) found these decisions "very short of any reasoning", and noted that the legislature had progressively widened the definition of provable debts over time.

The Supreme Court held that a Target's liability under an FSD was a liability to which it "may become subject" at the time of entering administration. A Target incurred an obligation giving rise to this liability because:

- it was part of a group of companies, and this relationship created legal rights and obligations; and
- it was vulnerable to a specific liability under a FSD if the group's pension scheme was in deficit, with a real prospect of this liability being incurred.

Because these two requirements were met, the Court also found it relevant to consider whether concluding that the Target had an obligation was consistent with the Pension Act's FSD regime. However, Lord Neuberger stated that these two requirements were not a "universally applicable formula" to determine whether a company had incurred an obligation for the purpose of the Insolvency Rules.

The Lehman Brothers and Nortel groups both had a specific member company that employed staff and managed the UK pension scheme, and these arrangements had existed for more than two years. The Target companies were precisely the type of entities who were intended to be subject to the FSD regime, because the Pensions Act 2004 requires financial support from companies connected with the employer company that has a pension scheme in deficit.

(ii) FSD liabilities not an expense of the administration

The parties agreed in the Supreme Court that if the Targets' potential FSD liability was a provable debt, it could not also be an expense of the administration. However, in *obiter* comments, Lord Neuberger discussed why, even if the FSD liability was not a provable debt, it would not be an expense of the administration. Under the Pensions Act, an expense of the administration includes "any necessary disbursements by the administration in the course of the administration". The Targets' potential FSD liability arose out of events which occurred before the Targets entered administration, and if the Targets' obligations under the FSD became payable, this debt would not be "part of" the administration nor one of the "natural incidents connected with" the administration. Alternatively, the FSD liability could only be an expense of the administration if the legislation had reasonably intended that a liability of that nature should rank ahead of provable debts, but no such intention was established.

(iii) Ability of Courts to override priority

Lord Neuberger dismissed an additional argument that, if the Targets' liability had lower priority than provable debt, the Court had the power to override the statutory rankings of debts and give higher priority to the FSD debt. Lord Neuberger considered that such a power would be especially inappropriate if the Court's decision to re-prioritise a particular debt would cause significant prejudice to others.

6.4 Advisor's duty to take reasonable care in giving accurate advice and not exposing a client to a risk of avoidable financial loss

(By Lucy Witheriff, Minter Ellison)

Swan & Baker Pty Ltd v Marando [2013] NSWCA 233, New South Wales Court of Appeal, McColl JA, Leeming JA, Sackville AJA, 24 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWCA/2013/233.html

(a) Summary

The New South Wales Court of Appeal (NSWCA) upheld the decision of the New South Wales District Court (NSWDC) in finding that accounting firm Swan & Baker was in breach of its duty of care when it advised clients to invest in a fund and failed to inform the clients of their right to withdraw their investment within a cooling off period.

(b) Facts

From about 1987 until 2008, the respondents, Mr and Mrs Marando, used Swan & Baker as their accountants and Mr Legat, a director of the firm, was their advisor. In January 2008, the respondents met with Mr Legat to discuss, among other things, the possibility of investing in the City Pacific First Mortgage Fund (the Fund).

In February 2008, the respondents attended another meeting with Mr Legat. At this meeting the respondents made it clear that they wished to invest funds for only 90 days, as they wanted to purchase an investment property. At the meeting, the respondents were given a copy of the Fund's Product Disclosure Statement (PDS). The PDS provided for a 14 day cooling off period for new investments starting from the end of the fifth day after the units were issued. Mr Legat did not point this out to the respondents at that time. Mr Legat did however mention that Mr Swan, a fellow director of Swan & Baker, was a director of the fund.

At a meeting with Mr Legat on 20 February 2008, the respondents decided to invest $500,000 in the Fund for a term of 90 days and Mr Legat took care of the application on behalf of the respondents. Soon after this meeting, the respondents went away on holiday. Mr Legat was aware of this and retained their mobile phone number to contact them.

On 27 February 2008 and 4 March 2008, Fairfax media outlets published articles which suggested that City Pacific Ltd (CPL) was in need of funds and that CPL was veering towards collapse. Over the weekend of 1-2 March 2008 investors in the Fund lodged withdrawal requests totalling $10 million, which was four to five times the usual number of withdrawal requests. The next day, CPL announced that the redemption period for investment in the Fund had been extended from 90 days to 180 days. On 14 March 2008, the audited accounts of the Fund for the six months ending 31 December 2007 were released and the accounts revealed no asset impairments.

In late March 2008, the respondents returned from holidays and became aware of a letter addressed to them from CPL dated 3 March 2008. The letter stated that due to the large volume of redemption requests, the redemption period for investment in the Fund had been extended to 180 days. The letter also reminded recent investors that a 14 day cooling off period applied to all new investments. Immediately after reading this letter, the respondents contacted Mr Legat to explain that they had made it clear from the outset that they only wished to invest funds for a 90 day term.

However, Mr Legat informed them that nothing could be done. Despite this, the respondents lodged a redemption request for all their units in the fund. This request was eventually extinguished by CPL.

The matter was first heard in the NSWDC and the respondents were successful on the ground that Mr Legat breached a duty of care owed to the respondents and that Swan & Baker were vicariously liable for his negligence. The primary judge awarded damages of $377,390 to the respondents. Swan & Barker then appealed the decision.

(c) Decision

McColl JA and Leeming JA both agreed with the reasons and orders proposed by Sackville AJA.

On appeal, the appellants accepted that in some circumstances a professional person's duty of care to a client may extend to taking positive steps to avoid foreseeable economic loss being sustained by the client. However, they argued that an 'extended duty' did not arise in this case. The counsel for the appellants submitted that if the Court upheld the primary Judge's finding that the appellants breached their duty of care by failing to advise the respondents, after they had already made their investment in the Fund, that they were entitled to withdraw that investment, the consequences would be extensive. They argued that the burden on an advisor would be substantial. The appellants' counsel also submitted that on the primary Judge's findings, Mr Legat had no reason to doubt that the Fund was in a sound financial position. On those findings, there was no basis to establish that the appellants breached their duty of care by failing to advise the respondents that they were entitled to withdraw their investments within the cooling off period.

(i) Duty of care

It was not disputed that the appellants owed the respondents a duty of care when advising them to invest in the Fund. This duty required them to take reasonable care that the advice given was accurate and that it did not expose the respondents to an avoidable risk of financial loss. The issue in contention was whether Mr Legat owed a duty of care to the respondents to take positive steps to warn and advise them during the cooling off period of their entitlement under the PDS to withdraw their money from the Fund.

Sackville AJA noted that the primary Judge was correct to conclude that the applicant's duty to the respondents did not end once they had made their investment in the Fund. The freeze on redemptions from the Fund significantly increased the risk of financial loss to the respondents. Mr Legat should have known that the respondents were entitled to withdraw their investment during the cooling off period. Sackville AJA found that the appellants continued after the freeze to owe the respondents a duty to take reasonable care not to expose, or continue to expose, them to an avoidable risk of financial loss by reason of their investment in the Fund. Sackville AJA also noted that the primary Judge was correct in finding that the appellants' duty to exercise reasonable care to avoid the risk of financial loss to the respondents could extend to requiring the appellants to take affirmative action to eliminate the additional risk the respondents faced after the announcement of the freeze.

(ii) Breach of duty

Sackville AJA noted that the primary Judge was correct in finding that the appellants breached the duty of care they owed to the respondents. The primary Judge found that Mr Legat breached his duty when he failed to inform the respondents, after they had made their investment in the Fund, that they had the right to withdraw their investment within the cooling off period. Mr Legat was aware that the respondents were away at the time the letter was sent and it was unlikely that they would receive the letter before the expiry of the cooling off period. Mr Legat failed to contact the respondents to advise them of the recent developments.

(iii) Damages

The appellants argued that the primary Judge had erred in the approach he adopted in assessing and awarding damages. They said that because there was no evidence before the Court of the present value of the units, the respondents had not discharged the onus of proving that they had sustained a loss. However, Sackville AJA found that there was evidence to support the primary Judge's finding that the value of the units at the date of the hearing was no greater than 40 per cent of their face value.

The damages awarded by the primary Judge were upheld. The primary judge awarded the respondents $628,982.77. However, the damages were reduced by 40% to take account of the failure by the respondents to mitigate their loss by refusing an offer to purchase their units and also to take account of the present valuation of the respondents' holding in the Fund. The final award of damages was $377,390.

Ultimately, the appeal was dismissed and the appellants were ordered to pay the respondents' costs.

6.5 Disputing the existence of a dispute: The meaning of 'genuine dispute' under the Corporations Act

(By Rohan Phelps, DLA Piper Australia)

Welldog Pty Ltd v World Oil Tools Inc [2013] QSC 180, Supreme Court of Queensland, Daubney J, 22 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/qld/QSC/2013/180.html

(a) Summary

The Supreme Court of Queensland allowed an application under s 459G of the Corporations Act 2001 (Cth) (the Act) to set aside a statutory demand where the applicant submitted that the debt was subject to a genuine dispute.

The applicant argued that the debt claimed in the statutory demand was one and the same as that which was part of a negotiated compromise agreement which the respondent had subsequently repudiated. The applicant contended that the debt was in genuine dispute on the basis of that repudiation.

Daubney J, in allowing the application, considered what was meant by the phrase "genuine dispute" under s. 459H of the Act. He held, in line with previous authorities, that a Court is not required to assess the merits of a dispute. Its function under the Act is to simply identify the genuine level of a claim, not the result of it.

In this instance, the facts supported a clear finding that the parties were in a genuine dispute over the debt owed.

(b) Facts

The applicant was in the business of coal seam gas testing. In 2011, it entered into a contract with the respondent for the supply of certain permeability testing equipment (the tools). Shortly after delivery in September 2011, the applicant discovered that the tools were defective.

As a result of the defective tools, the applicant lost a major testing contract with AGL Energy Ltd (AGL). The applicant also incurred significant additional expense in attempting to rectify the defects.

The applicant subsequently wrote an email to the respondent which outlined their concerns with the tools and comprehensively detailed the costs incurred through the loss of the AGL contract and in attempting to make the tools serviceable. In an effort to maintain a good working relationship, the parties met to negotiate a compromise agreement.

In June 2012 it was agreed that:

- the sums which had been invoiced to the applicant for the tools would be payable by instalments over a period of 12 months; and

- any further spare or replacement parts related to the tools and which were required by the applicant to operate the tools would be added to the current balance of the invoices and incorporated into the extended payment arrangement.

By the end of July 2012, however, the respondent had failed to supply the spare parts which had been urgently requested by the applicant in June 2012. On 3 August 2012, the respondent wrote to the applicant stating that whilst the outstanding invoices for the tools would continue to be subject to the payment plan, the invoices for the spare parts would need to be paid in full before they would be shipped.

The applicant wrote back claiming this was a repudiation of the contract. No further response was received until November 2012 when the respondent issued the applicant a statutory demand for all of the unpaid invoices.

(c) Decision

Section 459H(1) of the Act states that an application to set aside a statutory demand under s. 459G will be allowed when the Court is satisfied of either or both of the following:

- that there is a genuine dispute between the company and the respondent about the existence or amount of a debt to which the demand relates; and
- that the company has an offsetting claim.

Daubney J considered what the applicant was required to prove to obtain relief under this section. Daubney J cited with approval the judgment of Dodds-Streeton JA in *TR Administration Pty Ltd v Frank Marchetti & Sons Pty Ltd* (2008) 68 ACSR 67, which held at 79:

As the terms of s. 459H of the [Corporations Act] and the authorities make clear, the company is required, in this context, only to establish a genuine dispute or off-setting claim. It is required to evidence the assertions relevant to the alleged dispute or off-setting claim only to the extent necessary for that primary task. The dispute or off-setting claim should have a sufficient objective existence and *prima facie* plausibility to distinguish it from a merely spurious claim, bluster or assertion, and sufficient factual particularity to exclude the merely fanciful or futile.

In applying the authority to the facts in this case, Daubney J concluded that the applicant had succeeded in establishing a genuine dispute under s. 459H(1)(a) on two grounds. Firstly, it was clear that the debt claimed in the statutory demand was the same as that in the June 2012 compromise agreement. As the conditions and enforceability of the agreement were being challenged by the respondent (through their repudiation), there was clearly a dispute about the amount of the debt owed by the applicant.

Secondly, even if this agreement was, per Daubney J, "airbrushed out of existence", the respondent's failure to supply spare parts in accordance with its original agreement demonstrated there was a dispute as to the applicant's indebtedness to the respondent. The applicant seemingly had a claim against the respondent for the damages suffered as a consequence of the respondent's breach of the supply agreement. The fact that the parties then entered into extended settlement negotiations in June 2012 led Daubney J to the conclusion that the existence of a genuine dispute was "undoubted".

As the applicant had established grounds under s. 459H(1)(a), Daubney J declined to consider the applicant's offsetting claim in great detail. By way of reference, for an offsetting claim to be successful, an applicant would need to prove that the amount of debt owed was offset by way of counterclaim to the extent that the debt could be reduced to below $2,000.

Nonetheless, Daubney J made some observations in relation to the sufficiency of the applicant's evidence supporting its offsetting claim. Consistent with the earlier authorities, Daubney J concluded that the requirements under the Act were that evidence needed to be put which enabled the Court to make a determination of the offsetting total. That is, that some evidence of quantum must be contained in the supporting affidavit to enable the Court to take that course.

In this case, the applicant had adduced as evidence the correspondence from the applicant to the respondent, discussed above, that outlined its concerns with the tools and the total extra costs incurred in using them. This was considered by Daubney J as sufficient under the Act to enable a Court to make an estimate of the amount of an offsetting claim.

While such comments are obiter, they may be useful for future applicants that seek to rely on offsetting claims to set aside statutory demands.

6.6 The power of the Court under s. 1319 of the Corporations Act to convene a ratification meeting of members

(By Masatoshi Suzuki, Clayton Utz)

PR Finance Group Limited, in the matter of PR Finance Group Limited (No 3) [2013] FCA 704, Federal Court of Australia, Farrell J, 19 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/704.html

(a) Summary

Section 1319 of the Corporations Act 2001 (Cth) (the Act) provides:

Where, under this Act, the Court orders a meeting to be convened, the Court may, subject to this Act, give such directions with respect to the convening, holding or conduct of the meeting, and such ancillary or consequential directions in relation to the meeting, as it thinks fit.

This section gives the Court power to make directions with respect to Court-ordered meetings, which include meetings ordered by the Court under s. 411(1) of the Act. Courts had previously held that this power extends to the making of orders adjourning a meeting convened under s. 411(1) to a later date on the basis that the adjournment order is both "consequential" in relation to the meeting and with respect to "holding" of the meeting (*Re Lend Lease Primelife Ltd* [2009] NSWSC 1340 per Austin J at [16] and *Re Cellestis Limited (No 2)* [2011] VSC 329).

In the present case, the Court extended this power further and held that the Court has the power under s. 1319 to make orders for convening a meeting at which the resolution passed in the preceding meeting convened under s. 411(1) will be considered and, if thought fit, ratified on the basis that such order convening such ratification meeting is "ancillary" and "consequential" to the preceding meeting and the exercise of this power is akin to the exercise of the power making orders for adjourning a meeting convened under s. 411(1).

(b) Facts

On 13 May 2013, the Court made orders convening a meeting of members of the plaintiff company, PR Finance Group Limited (PRF), under s. 411(1) of the Act for the purpose of considering a scheme of arrangement proposed between PRF and its members under which the whole of the issued capital of PRF was to be acquired by Keybridge Capital Limited (Scheme) (Scheme Meeting).

Shortly before the Scheme Meeting, the Australian Securities and Investments Commission (ASIC) wrote to PRF indicating that ASIC intended to withhold the usual "no objection" statement under s. 411(17)(b). ASIC considered that PRF had failed to disclose material information to members because the audited accounts of PRF for the 2012 financial year (FY 2012 Accounts) had not been provided to ASIC at least 10 days before the Scheme Meeting in accordance with the provisions of the scheme booklet. The FY 2012 Accounts were not available to members at the time of the Scheme Meeting.

Notwithstanding this, the Scheme Meeting was held on 14 June 2013 and the Scheme was approved by the requisite majority referred to in s. 411(4) (Scheme Approval Resolution).

ASIC appeared at the second Court hearing on 20 and 21 June 2013 to oppose the Court making orders approving the Scheme under s. 411(4)(b).

On 25 June 2013, the Court declined to approve the Scheme at that stage and adjourned the application to a date to be fixed in August 2013. The Court indicated that in the absence of any additional material facts which emerge prior to the adjourned date, the Court would be prepared to approve the Scheme provided that by that date:

- a further meeting of members is duly convened and held at which the Scheme Approval Resolution is ratified (the Ratification Meeting);
- the Ratification Meeting is held at a time when the FY 2012 Accounts are available;
- the FY 2012 Accounts have been lodged with ASIC not less than ten days before the Ratification Meeting;
- any material matters in the FY 2012 Accounts to which attention should be drawn should be provided by way of a supplementary scheme booklet;
- the resolution ratifying the Scheme Approval Resolution is passed by the majority stated in s, 411(4)(a)(ii) of the Act; and
- the Ratification Meeting is held no later than 15 August 2013, or such later date as the Court may approve.

At the hearing on 11 July 2013, PRF sought directions under s. 1319 in relation to convening the Ratification Meeting and the conduct of that meeting to implement the process indicated by the Court.

(c) Decision

The Court held that making orders for convening such a Ratification Meeting would be "ancillary" and "consequential" to its orders made on 13 May 2013 convening the Scheme Meeting and to the Scheme Meeting held on 14 June 2013. Therefore, the Court made the orders for convening a Ratification Meeting on 12 August 2013 based on its power under s. 1319.

In order to draw this conclusion, the Court made the following findings:

- it would serve no useful purpose to require PRF, a company in perilous financial circumstances, to go through the whole members approval process again by making new orders under s. 411(1) to convene a new Scheme Meeting;
- the Ratification Meeting is necessary for the efficacy of the Scheme Approval Resolution and to carry its purpose through to making of orders under s. 411(4)(b);
- the exercise of the power making orders for convening a Ratification Meeting is akin to the exercise of the power making orders for adjourning a meeting convened under s. 411(1);
- the power of the Court under s. 1319 is not exhausted because the Scheme Meeting convened under s. 411(1) has already occurred and the Scheme Approval Resolution has already been passed; and
- it is desirable, in the context of the regime which applies to members schemes under the Act, for the Court to have supervision of members approval process rather than the meeting being convened by PRF.

6.7 Principles applicable to the making of costs orders and suppression orders in relation to disciplinary proceedings

(By Katrina Sleiman, Corrs Chambers Westgarth)

Levi v Australian Securities and Investments Commission (No 2) [2013] NSWSC 932, Supreme Court of New South Wales, Rothman J, 16 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/932.html

(a) Summary

This case concerned applications by the plaintiff (Levi) and the defendant (ASIC) in relation to proceedings before the Companies Auditors and Liquidators Disciplinary Board (Board). On Levi's application, the Court was required to determine whether the usual rule that costs follow the event should apply to an application for a stay of disciplinary proceedings. On ASIC's application, the Court considered the principles applicable to the setting aside of a suppression order.

Rothman J rejected Levi's application for a different costs order and granted ASIC's application for a vacation of a suppression order.

(b) Facts

On 3 April 2013, Rothman J made orders (the First Judgment), the effects of which were to dismiss the proceedings and order that Levi pay the costs of ASIC. The substantive proceedings sought a stay of proceedings before the Board brought by ASIC.

On Levi's application at the time of the First Judgment, an order was made preventing the publication of the name of Levi or any information that would identify him, from anything done or arising from the proceedings. The order was made without the benefit of any considered submission from ASIC because of the lack of notice.

Liberty was granted to each of the parties to agitate for any special or different order for costs and in relation to the suppression order. The First Judgment was the subject of appeal proceedings and a motion for an interim stay of the disciplinary proceedings commenced by ASIC. A judgment on that motion was handed down on 2 May 2013 (the Appeal Judgment), which dismissed the application for a stay.

Levi sought a different order as to costs and ASIC sought to have the suppression order vacated.

(c) Decision

(i) Costs

Levi relied on two grounds. First, the jurisdiction of the Court to make the orders sought was raised by ASIC and the Court in the First Judgment determined the matter favourably to Levi. Second, the proceedings are analogous to proceedings for a stay of criminal proceedings, for which a costs order would not ordinarily be made.

With respect to the first ground, Levi's submission implicitly accepted that ordinarily costs follow the event, but argued that there were two events, the jurisdictional issue and the merits issue, which were determined differently. Rothman J accepted that ASIC relied on two bases to convince the Court that the orders sought ought not be made, but that does not detract from the proposition that ASIC was successful. The "event" was the dismissal of the proceedings; the dismissal of the only relief claimed.

His Honour considered that nothing in the manner in which ASIC conducted the proceeding should deprive it of the ordinary entitlement to be compensated for its taxable costs in successfully defending the action.

Rothman J also rejected the second ground on the basis that the proceeding before the Board is not a criminal proceeding. There is no general or ordinary rule that costs are not awarded in disciplinary proceedings, which are civil proceedings. His Honour considered that the rule applying to costs in civil proceedings should apply.

His Honour held that the order for costs would remain unaltered from that which formed part of the First Judgment and also held that those costs would include the costs of the suppression order and the subsequent proceedings.

(ii) Suppression order

ASIC relied on jurisdictional and discretionary grounds in seeking the setting aside of the suppression order.

On the issue of jurisdiction, Basten JA in the Appeal Judgment reiterated that a State Court has no power to exercise federal jurisdiction unless conferred by a valid law of the Commonwealth. Rothman J accepted that the Supreme Court of New South Wales (NSWSC) cannot exercise federal jurisdiction without a basis for such exercise in Commonwealth law. His Honour preferred not to express the view by reference to the power of the Court, rather, by reference to jurisdiction.

It is not the exercise of federal jurisdiction for the NSWSC to punish for or restrain contempt, even if the proceedings to which the contempt relates were federal. The jurisdiction to deal with such matters is conferred by a combination of provisions, being ss. 38 and 39 of the Judiciary Act 1903 (Cth) (the Judiciary Act), together with the provision granting original jurisdiction and s. 79 of the Judiciary Act.

The jurisdiction conferred on the NSWSC by s. 39 of the Judiciary Act is subject to the limitations in s. 9 of the Administrative Decisions (Judicial Review) Act 1977 (Cth) (the ADJR Act). This is consistent with the approach of Basten JA in the Appeal Judgment. However, his Honour's analysis then went on to depart from that of Basten JA in the Appeal Judgment. Rothman J noted that the definition of "review" in the ADJR Act does not include "injunction"; it includes "a review by way of ... injunction". It is only where the injunction is being used as a remedy to effect a review that s. 9 of the ADJR Act applies to deny jurisdiction to the NSWSC.

His Honour sought to explain in the First Judgment that the summons did not seek a review. The cause of action upon which it depended ran independently of any decision of any officer of the Commonwealth.

ASIC did not provide any basis for suggesting that a valid Commonwealth law required the publication of material from the proceedings and his Honour considered that there is no jurisdictional limitation on the capacity of the NSWSC to restrain publication (or republication) of its judgment or any part of its contents. Further, there is no limitation on the power of the NSWSC to restrain publication of material or evidence in the Court of a particular kind.

On the merits, his Honour noted that the Court did not intend to stop the Board from publishing its decision, as and when it thought appropriate. The suppression order was intended to be interim, until such time as ASIC could consider its position.

An order under the Court Suppression and Non-publication Orders Act 2010 (NSW) can be made where it is "necessary to prevent prejudice to the proper administration of justice" or "it is otherwise necessary in the public interest ... [where] that public interest significantly outweighs the public interest in open justice". Rothman J considered that in order to "prejudice ... the proper administration of justice" the material must significantly affect the fairness of a subsequent trial in a manner that cannot be negated by appropriate orders in the trial, or, at least, carry a substantial risk of being unable to be overcome so that a fair trial is at some significant risk.

Rothman J considered that "necessary" should be construed in the same way as one uses that term when determining the implied powers of a lower Court or orders made under s. 23 of the Supreme Court Act 1970 (NSW), which are orders "necessary for the administration of justice". In relation to the implied powers in the District Court, the High Court said that the term "necessary" does not have the meaning of "essential"; rather it is to be "subjected to the touchstone of reasonableness": *Pelechowski v Registrar, Court of Appeal (NSW)* (1999) 198 CLR 435 at 50-51.

Rothman J considered that the primary consideration in the proper administration of justice must be the public interest in open justice. Any orders qualifying that public scrutiny should be as limited as possible, while achieving the intended purpose.

The suppression order was sought in order to ensure a fair criminal trial, if and when one commences. The fact that the criminal trial has not commenced is a factor to be taken into account. His Honour considered a criminal prosecution likely. However, orders are not made to ensure a fair trial; they are made to prevent a significant risk of an unfair trial. The risk of unfairness is the publication of the decision of the Board on the internet and any other mass circulation publicity that may be given to it. That publication or publicity may, in turn, become known to a jury, or members of it.

His Honour warned that ASIC must understand that if, as a result of the Board decision and any publicity given to it, a fair trial in a subsequent prosecution were at risk, in the discretion of the Court, any prosecution may be stayed, either permanently or for some time. His Honour noted that

ASIC is entitled to take that risk.

His Honour ordered that the suppression order be vacated.

6.8 Common interest legal privilege - not so common for directors

(By Lidia Vicca, Clayton Utz)

Bradley Phillip Ingram v Y Twelve Pty Limited [2013] NSWSC 928, Supreme Court of New South Wales, Hammerschlag J, 12 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/928.html

(a) Summary

This case involved the use of "common interest legal privilege" by two individuals attempting to resist production of documents under a subpoena. Hammerschlag J considered whether directors of companies that are parties to a proceeding have a common interest with the companies in the legal advice given to the companies.

(b) Facts

HM&O Investments Pty Limited (HM&O) and Teach & Play Investments Pty Limited (Teach & Play) (collectively "the Companies") sued Bradley and Glenda Ingram (the Ingrams) for damages resulting from misleading and deceptive conduct in connection with the sale by the Ingrams to the Companies of a business which designed and manufactured playground equipment (the initial proceedings).

The directors of the Companies were Mr Salmon and Mr Rufford. HM&O was the trustee for family trusts associated with Mr Salmon, Mr Rufford and a Mr O'Shea. Owen Hodge Lawyers were the solicitors on record in the initial proceedings.

The initial proceedings were heard by McDougall J during 2011 and 2012. On 29 August 2012, McDougall J's associate notified the parties' solicitors that his Honour would give judgment on 31 August 2012. On 30 August 2012, HM&O transferred assets to the first defendant, Y Twelve Pty Limited (Y Twelve). Y Twelve had only been incorporated on 23 August 2012. Both Mr Salmon and Mr Rufford were associated with Y Twelve. His Honour gave judgment on 31 August 2012, awarding the Companies $10,000 in damages for two misleading and deceptive comments made by the Ingrams. His Honour, however, expressed the view that the Companies had otherwise failed in their action and ordered costs be awarded to the Ingrams.

On 26 September 2012, his Honour made costs orders resulting in the Companies incurring a substantial liability. On 29 October 2012, Teach & Play was placed into liquidation and on 30 October 2012 HM&O followed suit.

These proceedings were issued by the Ingrams on 21 December 2012. The Ingrams sought declarations that the transfer of assets by HM&O was an alienation of property with intent to defraud the creditors within the meaning of s. 37A of the Conveyancing Act 1919 (NSW) and, therefore, void *ab initio*.

On 17 April 2013, the Ingrams issued a subpoena to Owen Hodge Lawyers seeking:

- documents concerning the transfer or any proposal to transfer assets from HM&O to Y Twelve;
- documents and communications recording, referring to, or concerning, the risks of adverse costs orders in the proceedings; and
- documents recording or concerning advice provided to any or all of HM&O, Teach & Play,

Y Twelve, Mr Salmon, Mr Rufford and Mr O'Shea in relation to any of those matters.

The liquidators of the Companies had formally waived any privilege in respect of the documents held by Owen Hodge Lawyers.

Owen Hodge Lawyers produced the documents to the Court. However, access to ten of the 12 documents returned under the subpoena was resisted by Mr Salmon and Mr Rufford on the basis of common interest legal privilege. They submitted that "the directors hold the ultimate shareholding and the ultimate beneficial interest in the company, and therefore in the proceedings". Accordingly, if advice was given to the Companies in relation to the proceeding, then there must be a "common interest" with the directors in the Companies.

The plaintiffs subsequently by way of motion in the proceedings sought access to these ten documents.

(c) Decision

Hammerschlag J briefly reviewed the common law principles associated with common interest privilege. His Honour looked at whether a sufficient common interest exists in light of the nature of the relationship between a company and its director, stating:

a director's knowledge of a decision by a company to obtain advice, and knowledge of that advice on his or her part, is not treated as a disclosure to a party separate from the company itself. Directors act as the mind and directing will of a company.

Hammerschlag J also distinguished the facts in this case from *Farrow Mortgage Services (in liq) v Webb* [1995] NSWSC 187 (Farrow Mortgage) (subsequently upheld in *Farrow Mortgage Services Pty Ltd (in liq) v Webb* (1996) 39 NSWLR 601) which Mr Salmon and Mr Rufford sought to rely on. The difference in Farrow Mortgage was that the relevant company and the directors separately were each given advice, as opposed to the directors receiving the advice as the controllers of the company. This gave rise to a joint interest as opposed to common interest privilege.

When reaching his conclusion his Honour held that:

- the documents were effectively communication between the lawyers and the Companies themselves;
- the directors were no more than the guiding mind, will and embodiment of the Companies; and
- there was only a single interest, that of the Companies. No question of common interest or waiver properly arose.

In light of this, his Honour ordered that the plaintiffs have access to the documents as the Companies had effectively waived their privilege.

6.9 Insolvency under s. 459A and the "relation-back day"

(By Mimosa Rizzo and Adam Purton of Corrs Chambers Westgarth)

CBA Corporate Services (NSW) Pty Limited v Walker and Moloney, in the matter of ZYX Learning Centres Limited (receivers and managers appointed) (in liq) [2013] FCAFC 74, Federal Court of Australia, Full Court, Foster, Barker and Griffiths JJ, 12 July 2013

The full text of this judgment is available at:
http://www.austlii.edu.au/au/cases/cth/FCAFC/2013/74.html

(a) Summary

This case arose from the collapse of ZYX Learning Centres Limited (formerly ABC Learning Centres Limited) and its related companies (the ABC Group), previously the largest operator of childcare centres in Australia.

In this proceeding, the Full Court of the Federal Court of Australia rejected an argument that, in addition to proving insolvency at the date of filing the application and the date of the hearing, the applicant for an order for a company to be wound up in insolvency under s. 459A of the Corporations Act 2001 (Cth) (the Act) must also prove that the company was insolvent at the "relation-back day" where the company is already subject to a voluntary winding up.

Pursuant to Part 5.7B of the Act, liquidators have a number of special powers to bring recovery proceedings for the benefit of creditors. Most recovery proceedings are available to voluntary liquidators and to Court appointed liquidators. However, an application under s. 588FJ of the Act is only available to a Court appointed liquidator. Section 588FJ provides that a circulating security interest (formerly known as a "floating charge") created during the six months ending on the "relation-back day" will be void as against a company's liquidator in certain circumstances.

Section 459A of the Act provides that, on an application under s. 459P, the Court may order that an insolvent company be wound up in insolvency. The Court's power to wind up a company in insolvency under s. 459A is a discretionary power. Save for the fact that the company must be insolvent at the time of the application, the Act does not contain explicit criteria which control the exercise of that discretion.

In this case, the appellant argued that s. 459A also requires the applicant to prove insolvency at the "relation-back day". The "relation-back day" is the date by reference to which various provisions in Part 5.7B of the Act (including s. 588FJ) operate to make voidable transactions entered into by a company during the pre-liquidation period. The determination of the "relation-back day" depends on the manner in which the company went into liquidation, and is set out in s. 9 of the Act.

(b) Facts

The appellants were a syndicate of eight banks and their agent, CBA Corporate Services (NSW) Pty Ltd (the Banks). The Banks held circulating security interests granted by the ABC Group between 25 June 2008 and 27 October 2008.

On 6 November 2008, the ABC Group went into voluntary administration. Mr Peter Walker and Mr Gregory Moloney were appointed voluntary administrators. The Banks appointed receivers and managers on the same day.

On 2 June 2010, the ABC Group's creditors resolved that each of the companies in the ABC Group be wound up voluntarily and that the voluntary administrators be appointed liquidators of the ABC Group.

On 5 September 2011, the liquidators made their first application for orders under s. 459A.

On 2 April 2012, the liquidators commenced further proceedings in the Federal Court seeking to have all the companies in the ABC Group wound up in insolvency pursuant to s. 459A.

The liquidators sought the order under s. 459A to enable them to pursue claims against the Banks under s. 588FJ of the Act in relation to various transactions which resulted in a significant proportion of the amounts owing to the Banks being repaid in the six months prior to the commencement of the voluntary administration.

As noted above, s. 588FJ renders any circulating security interest created during the six months ending on the "relation-back day" void as against a company's liquidator (subject to certain exceptions). However, s. 588FJ only applies in respect of a company that is being wound up in insolvency. An order under s. 459A would therefore allow the liquidators to commence proceedings to recover assets realised pursuant to the Banks' circulating security interests for the benefit of the unsecured creditors, who were together owed many hundreds of millions of dollars.

It was accepted by all parties that, for an order under s. 459A to be made, it was necessary for the liquidators to prove that each company within the ABC Group was insolvent at the date the application was filed and the date of the hearing. However, the Banks argued that the liquidators should also be required to prove that the companies were insolvent at the "relation-back day" (which the parties agreed was 6 November 2008, by virtue of ss. 9, 513A, 513B and 513C of the Act).

The liquidators gave evidence that the companies were insolvent on 2 June 2010 (the commencement of the creditors' voluntary liquidation) and at 5 September 2011 (the date the winding up application was first filed), which the Banks did not contest. Neither party adduced evidence regarding solvency as at the "relation-back day".

In the first instance, Nicholas J granted the application. He was satisfied that the companies were insolvent at the date the application was filed and the date of the hearing, and held that there was nothing in the relevant provisions of the Act that expressly or impliedly required the liquidators to establish that the companies were insolvent at the "relation-back day".

The Banks appealed to the Full Federal Court. They argued that the liquidators had failed to establish that the ABC Group was insolvent at the "relation-back day" and that this was an essential and material consideration that the primary judge ought to have taken into account when exercising his discretion as to whether to make the winding up order.

(c) Decision

The Full Federal Court dismissed the Banks' appeal and confirmed that, on an application for an order that a company be wound up in insolvency, it is not mandatory to prove insolvency at the "relation-back day". The Full Court held that neither the wording of s. 459A, its legislative history, nor the authorities on which the Banks relied, supported the imposition of such a requirement.

However, the Full Court clarified that there may be circumstances where the solvency or insolvency of a company at the "relation-back day" will be a relevant consideration when a Court exercises its discretion whether or not to grant a winding up order. For example, noting that a holder of a circulating security interest can defend a liquidators' claim under s. 588FJ by demonstrating that the company was solvent immediately after it granted the circulating security interest, the Full Court held that a company's solvency at the "relation-back day" would be relevant if the only reason for ordering the winding up of a company in insolvency was to allow a liquidator to initiate proceedings under s. 588FJ, where those proceedings were bound to fail.

Two other arguments advanced by the Banks were also rejected. First, the Banks argued that the Court must be satisfied that a winding up order was being made "for good reason" and that, as the liquidators had not yet decided whether or not to proceed with a claim under s. 588FJ against the Banks, this criteria was not satisfied. The Full Court disagreed with this argument and held that s. 459A does not impose a standard of probability or certainty of proceedings being brought by a liquidator under s. 588FJ before the order can be made, and that the Court must look to all the relevant circumstances prior to exercising its discretion to grant the order. The Full Court expressed concern that the phrase "for good reason" could displace or distort the otherwise broad discretion conferred by s. 459A, and emphasised that the primary judge had given considerable weight to the interests of the unsecured creditors in deciding to grant the order.

Secondly, the Banks complained that the primary judge had failed to take into account the liquidators' delay in making the application for the winding up order. The Full Court rejected this argument, holding that the primary judge had considered this and that it was not necessary for him to articulate his acceptance of the liquidators' explanation for the delay in his judgment.

6.10 Charge on insurance moneys does not extend to defence costs paid pre-judgment

(By Nicola Giarratana, Ashurst)

Chubb Insurance Company of Australia Limited v Moore [2013] NSWCA 212, New South Wales Court of Appeal, Bathurst CJ, Beazley P, Macfarlan and Emmett JJA and Ball J, 11 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWCA/2013/212.html

(a) Summary

The Full Bench of the New South Wales Court of Appeal has held that to the extent that s. 6 of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW) (the LRA) imposes a charge on insurance moneys that are or may become payable under Director and Officer insurance policies to satisfy the insured's liability, the charge only extends to moneys payable to meet this liability, leaving the insured to access moneys under the policy for defence costs incurred prior to judgment or settlement. As a result of the decision, insureds and insurers now have more certainty in knowing that insureds will be able to access costs inclusive insurance limits to fund defence and investigation costs, pending a judgment or settlement.

(b) Facts

This decision arose in the context of two class actions currently on foot (the Great Southern Proceedings) in response to the collapse of Great Southern Limited and its subsidiaries (the Great Southern Group). The Great Southern Group collapsed in 2009 and triggered class actions by investors seeking damages against various former directors and executives of the Great Southern Group and Great Southern Managers Limited (a member of the Great Southern Group) for breaches of the Corporations Act 2001 (Cth) and consumer protection legislation.

The defendant directors and executives held Director and Officer insurance policies, with costs inclusive limits, which responded to the liability claims in the Great Southern Proceedings. The policies also included a term whereby the insurers were liable to advance defence costs and legal representation costs incurred by the insured directors and executives in defending those proceedings.

The issue before the Court of Appeal was whether the statutory charge contained in s. 6 of the LRA prevented the insurers from advancing defence costs to the insured directors and executives. Section 6 of the LRA, in summary, states that the amount of a person's liability shall on the happening of an event triggering the claim for damages, be a charge on all insurance moneys that are or may become payable under the policy.

The High Court of New Zealand in the decision of *Steigrad v BFSL 2007 Ltd* [2011] NZHC 1037, Steigrad v Bridgecorp (Bridgecorp) had dealt with this issue earlier. The Court in Bridgecorp held that a statutory charge (which was substantially on the same terms as s. 6 of the LRA) precluded the insurer of Bridgecorp's insurance policy from advancing defence costs to certain former directors of the collapsed Bridgecorp group of companies. The New Zealand Court of Appeal overturned this decision on 20 December 2012 in *Steigrad v BFSL 2007 Ltd* [2012] NZCA 604, however some uncertainty remained as to how Australian Courts might approach this issue as neither decision is binding on a Court in Australia.

The plaintiffs in the Great Southern Proceedings asserted that due to the operation of s. 6 of the LRA, charges existed over the moneys to be advanced under the insurance policies. The relevant insurers then applied for various declarations, including:

- that on its proper construction, there can be no charge under s. 6 of the LRA in respect of any insurance moneys that are or may become payable by any of the insurers; and
- to the extent that s. 6 does impose a charge on the insurance moneys that are or may become payable by any of the insurers, those insurance moneys subject to the charge do not include defence costs payable by the insurers in accordance with the terms of those policies before any insurance moneys become payable to the plaintiffs in the Great Southern Proceedings.

(c) Decision

The section is intended to ensure that the plaintiff will be able to recover directly from the insurer those insurance moneys (that would otherwise be payable to the defendant) in respect of their claim. Similar provisions exist in the Australian Capital Territory and the Northern Territory. Section 6 of the LRA was originally enacted to ameliorate the potential unfairness to plaintiffs in civil proceedings who were unable to recover judgment against an insured insolvent defendant.

The Court of Appeal took the view that s. 6 "should be repealed altogether or completely redrafted in an intelligible form, so as to achieve the object for which it was enacted." The purpose behind the section is to ensure that plaintiffs will be able to recover directly from the insurer in respect of their claim, who would otherwise be advancing money to the defendant.

In a unanimous decision, the Court of Appeal declared several principles. Section 6 only applies to claims brought in a Court of New South Wales. As none of the Great Southern Proceedings had been brought in a New South Wales Court s. 6 had no application to those claims.

To the extent that s. 6 does impose a charge on insurance moneys that are or may become payable under the insurance policies to meet the insured's liability, those moneys are limited to moneys payable to meet that liability (whether pursuant to a judgment or settlement) and do not include defence costs payable by the insurers in accordance with the terms of the policies before judgment is entered or a settlement reached. If this was not the case, the third party claimant would have greater rights against the insurer than the insured himself or herself. Section 6 was not intended to alter the contractual rights of the parties to the contract of insurance.

Further, the payment by the insurers under the policies, by way of an indemnity for an insured's liability to pay damages or compensation to any of the claimants in the Great Southern Proceedings, would be a valid discharge to the insurers if it was made before judgment or settlement.

To the extent that s. 6 did impose a charge, the insurers were on actual notice of the existence of the charge by reason of certain letters written by the claimants in the Great Southern Proceedings.

Also, s. 6 applies to insurance policies written on a claims-made basis and on an occurrence basis. The section is not capable of applying to insurance moneys that are (or may become) payable under policies in respect of a claim where the alleged conduct giving rise to the claim happened before the policies were entered into as the charge created by s. 6 could not come into existence at a time when there was no policy to which it could attach.

6.11 Ambiguity and rectification in commercial contracts

(By Marissa Bendyk and Victoria Lanyon, King & Wood Mallesons)

Westpac Banking Corporation v Newey [2013] NSWSC 847, New South Wales Supreme Court, Pembroke J, 5 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/847.html

(a) Summary

This case considered principles of construction and rectification of a deed. The Court found that where no ambiguity exists, the words of the deed will be paramount and interpreted literally.

However, where ambiguity can be demonstrated through another clause, or upon "a general intent to be gathered from the whole of the instrument", the general principle of construction will not always apply.

In terms of assessing ambiguity, details of prior negotiations may not be used as evidence. They are not relevant to issues of construction. The "actual intentions and expectations" of the parties "are superseded by, and merged in, the contract itself". Where ambiguity is established however, the prior negotiations may be used as evidence in a claim for rectification.

(b) Facts

Westpac Banking Corporation (Westpac) acquired St George Bank Limited (St George) in 2008. Following its acquisition, St George was initially operated as a wholly owned subsidiary of Westpac. Subsequently, the St George business was subsumed into Westpac, with integration effective as at 1 March 2010.

A number of St George employees had their employment terminated over this time. Most of these employees were terminated by St George during the time it was a wholly owned subsidiary of Westpac. The others were terminated directly by Westpac after the St George business had been integrated into Westpac.

Several of the aggrieved former St George employees engaged law firm Gillis Delaney to pursue their claim against Westpac. There were also former employees whom Gillis Delaney could have acted for in the future.

The facts were such that Gillis Delaney entered into a deed with Westpac whereby the firm agreed that other than the Applicants (those former employees for whom it was acting) and Prospective Applicants (being those employees that had instructed Gillis Delaney to act but not yet commenced proceedings), it would not bring a claim against Westpac or any of its related bodies corporate for termination of former St George employees.

However, the terms of the deed defined "Westpac" as "Westpac Banking Corporation" and did not contain any interpretation provisions to capture any of Westpac's related bodies corporate.

Therefore, when the restraint clause referred to the termination of employees by Westpac, it did not, on its strict face, capture those employees terminated by St George (i.e. while it was a wholly owned subsidiary of Westpac).

Gillis Delaney argued that the clause was unambiguous and should be given its literal interpretation.

Westpac argued that it should be given a broader interpretation and that "Westpac" should be interpreted to include its related bodies corporate.

(c) Decision

(i) General principle

The Court reiterated that the general principle in respect of the construction of commercial documents is that the instrument must be given a "business-like interpretation". Ultimately however, the Courts' ability to do so is constrained by the actual language used by the parties which is "paramount, especially where those words have been selected by sophisticated and well-resourced commercial parties". This will be the case even if it is "guessed or suspected that the parties intended something different" (*Australian Broadcasting Commission v Australasian Performing Right Association Ltd* [1973] HCA 36; (1973 129 CLR 99 at 109)).

The Court must treat the words as paramount unless there is some ambiguity or it is clear that something has gone wrong with the language or the language gives rise to an absurd operation.

(ii) Ambiguity

To depart from the general principle outlined above it is necessary to show ambiguity on the face of the deed.

In this case, if the words of the deed were taken to be unambiguous and read literally, the result would be that "Westpac" be read as "Westpac Banking Corporation" only and not as including its related bodies corporate. The deed would therefore not capture those former employees whose employment was terminated by St George while it was a wholly owned subsidiary of Westpac.

Westpac was able to show ambiguity as the deed was specified not to apply to the "Applicants" or "Prospective Applicants". One of the Prospective Applicants had his employment terminated by St George while it was a wholly owned subsidiary of Westpac. Westpac argued that unless "Westpac" was interpreted broadly (i.e. to include related body corporate) then there was no need to include this former employee as a Prospective Applicant. The judge found that this undisputed fact, that the employee was terminated by St George, struck a "jarring note" and showed that an anomaly did exist in the drafting.

The judge found that only by construing "Westpac" to mean "Westpac Banking Group" could "the whole of Clause 1 operate harmoniously, giving full effect to each of its components, including the exclusions embodied in the words "Applicants" and 'Prospective Applicants'".

(iii) Rectification

Westpac brought a claim for rectification in the alternate. The resolution of a rectification suit "involves finding corresponding contractual intention on each side" (*Australasian Performing Right Association Ltd v Austarama Television Pty Ltd* [1972] 2 NSWLR 468 at 473). In assessing this claim, the judge looked to the prior negotiations between the parties.

When negotiations for the contractual restraint commenced, Westpac had sent a letter to Gillis Delaney. The purpose of the letter was to propose the restraint, which was ultimately contained in the deed, that prevented Gillis Delaney from bringing any further action against Westpac on behalf of former St George employees whose employment was terminated. Importantly, in this letter "Westpac" was defined to mean "the Westpac Group" which comprised Westpac and its related bodies corporate.

Throughout these negotiations, Westpac contended, and the judge found, that the understanding of the parties was that Westpac comprised Westpac and its related bodies corporate. The judge found that the correspondence between Gillis Delaney and Westpac made it clear that the restraint would prevent Gillis Delaney from representing any former St George employee whose employment had been terminated by either St George or Westpac in a claim against Westpac. In negotiating and accepting the agreement prior to the execution of the deeds, the evidence showed that parties anticipated an alternate commercial position to that exhibited in the literal meaning of the words in the deed.

Despite the written prior negotiations of the parties, representatives of Gillis Delaney argued in oral evidence that they believed the firm to only be restrained against terminations made by Westpac. His Honour chose not to accept the oral evidence to this effect as his Honour found it incompatible with the contemporaneous written evidence.

The judge held that the letters that constituted the negotiation of the agreement resulting in the deeds "explicitly spelled out that Westpac meant the Westpac Group" (i.e. Westpac and its related bodies corporate). In assessing the corresponding contractual intention the judge found that "contemporaneous evidence of the antecedent consensus is the most reliable touchstone of the true position". While his Honour found that the construction claim was sufficient and there was no need to make a finding on the rectification claim, the judge specifically stated that if required, the document would be rectified to include the words "or any of its related bodies corporate" after the word Westpac.

6.12 Liquidators appointing partners as administrators

(By Steven Grant, Minter Ellison)

Kukulovski in his capacity as liquidator of Corrimal Leagues Club Ltd (in liquidation) [2013] FCA 697, Federal Court of Australia, Farrell J, 3 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/697.html

(a) Summary

This case demonstrates the factors which a Court may consider when determining whether to grant leave to a liquidator to appoint a business partner of a liquidator as an administrator.

(b) Facts

The plaintiff, Mr Trajan John Kukulovski (Mr John Kukulovski), in his capacity as liquidator of Corrimal Leagues Club Limited (in liquidation) ACN 001 035 267 (the Company) sought an order pursuant to s. 436B(2) of the Corporations Act 2001 (Cth) (the Act) that Roderick Mackay Sutherland (Mr Sutherland) be appointed as administrator of the Company. Mr Kukulovski and Mr Sutherland were both partners in the firm Jirsch Sutherland. Mr Kukulovski also sought an order pursuant to s. 447A of the Act that the first meeting of creditors, required to be held pursuant to s. 436E of the Act, be dispensed with. Section 436B(2) provides that a liquidator of a company must not appoint certain persons as an administrator including:

- himself or herself; and

- if he or she is a partner of a partnership - a partner or employee of the partnership

unless:

- at a meeting of the company's creditors, the company's creditors pass a resolution approving the appointment; or
- the appointment is made with the leave of the Court.

Section 447A provides the Court with the general power to make orders and s. 436E sets out the timing and procedure for calling the first meeting of creditors.

Mr Kukulovski was appointed voluntary administrator of the Company together with two of his former partners. Later the Company entered into a deed of company arrangement and Mr Kukulovski became the deed administrator. When the deed of company arrangement was terminated Mr Kukulovski was appointed as liquidator. From the time of his appointment as liquidator, Mr Kukulovski and his staff conducted investigations in relation to the Company's business, property, affairs and financial circumstances. The Company operated as Corrimal Leagues Club in Corrimal, New South Wales (the Club). The Company was insolvent. Mr Kukulovski continued the trading operations of the Club with a view to either offering the assets of the Club for sale or amalgamating the Club with another registered club. However, the Club had traded at minimal to no profit and its operations had been break-even at best, before accounting for the costs and expenses of the liquidation.

In the absence of arrangements for amalgamation with another registered club, the Company was to cease trading in a few weeks following the hearing of this matter. Mr Kukulovksi advertised for expressions of interest from other registered clubs in the area. Mr Kukulovski received an expression of interest from a registered club (the Amalgamation Partner) to amalgamate the Company pursuant to the provisions of the Registered Clubs Act 1976 (NSW).

Based on Mr Kukulovski's discussions with the Amalgamation Partner and the board of directors of the Company, a deed of company arrangement could be proposed for consideration by the creditors (the Proposal). If the Proposal proceeded, Mr Kukulovski would recommend it to the Company's creditors because it would allow the Company and its creditors the greatest opportunity to continue the business of the Club and provide a better return to the Company's creditors, who would have the opportunity to continue trading with the amalgamated businesses in the future, than would result from winding up the Company. It would also be in the interest of the Club's members who will lose the benefit of their membership if the Club closes. If the Company's assets were sold, instead of completing the Proposal, the creditors might have received approximately the same amount or perhaps slightly more than under the Proposal. However, the creditors would not have the benefit of continuing to trade with the Company and the Amalgamation Partner and the Company's employees would not have continued employment.

(c) Decision

Farrell J noted that the main question in this type of application is whether the liquidator (subject to being appropriately qualified) is an appropriate person to act as the company's administrator. Although the Court is not unduly constrained in the way it exercises the discretion under s. 436B(2), the most important consideration of the Court is to ensure that there is no conflict of duty or interest if the liquidator is appointed as administrator. If, for any reason, it is preferable for a completely independent person to be appointed instead, then the application must be refused.

Farrell J further observed that leave was required under s. 448C for Mr Sutherland to consent to act as administrator. That section relevantly provides that a person must not, except with the leave of the Court, seek or consent to be appointed as, or act as, administrator of a company or of a deed of company arrangement if the person is a partner, employer or employee of an officer of the company. Mr Kukulovski was an officer of the Company as its liquidator and leave was required under s. 448C(1) for Mr Sutherland as his partner to consent to be appointed as administrator of the Company and to act as administrator of a deed of company arrangement. The focus in considering such an application is the issue of conflict of interest, in this instance, incompatible allegiances or interests.

Farrell J was satisfied that leave should be granted to Mr Sutherland's appointment as an administrator and to his administering the deed of company arrangement (should the deed of company arrangement be proposed and agreed to by creditors) after considering the following factors:

- Mr Kukulovski and his partners and the staff of his firm had been involved in the external administration of the Company for over four years and possessed a substantial body of knowledge regarding the Company's affairs;
- prior to Mr Kukulovski's first appointment as voluntary administrator in 2009, neither he, any of his partners, nor his firm were engaged by the Company to provide any accounting advice or services to it;
- Jirsch Sutherland had no relationships with the possible Amalgamation Partner or any of the other possible purchasers of the assets of the Company which were known to them at the time;
- Mr Kukulovski was pursuing both the Proposal and expressions of interest in the Company's assets (particularly the poker machine entitlements) from a number of parties and both the Proposal and the sale of the assets would be provided to creditors in the alternative at the meeting of creditors under s. 439A (which would be convened to consider whether to enter into a deed of company arrangement);
- the familiarity of Mr Sutherland and the staff at Jirsch Sutherland with the Company's affairs would avoid duplication of work which would be occasioned by the appointment of an administrator independent of that firm. Thus the appointment would save both time and expense of the administration;
- the Australian Securities and Investments Commission had been advised of the application. It notified the solicitors for Mr Kukulovski that it considered this matter properly left to the determination of the Court and confirmed that it did not propose to intervene in the proceedings or seek leave to appear at the hearing; and
- Mr Kukulovski tendered a copy of a written consent by Mr Sutherland to act as administrator and he is a registered liquidator.

In respect of the application to dispense with the requirement for the administrator to call a first meeting of creditors pursuant to s. 436E of the Act, Farrell J noted that Mr Kukulovski sought relief because the costs of such a meeting would exceed $20,000, being a significant amount to the Company which was barely breaking even. Farrell J also acknowledged that as Mr Sutherland was to be appointed as the administrator, not Mr Kukulovski, the creditors would have the opportunity to consider any change to the administrator at the meeting of creditors to be convened pursuant to s. 439A of the Act.

Accordingly, Farrell J was satisfied to make the order would advance the purposes of Part 5.3A of the Act. However, Farrell J also ordered that notwithstanding s. 439A(2) of the Act, the meeting of creditors required under s 439A(1) may be held at any time during or within five business days after the end of the convening period, subject to compliance with s. 439A(3). Farrell J also ordered that Mr Kukulovski give notice of these orders to creditors of the Company within seven days by a circular to creditors and by notice placed on the website of his firm.

6.13 The constraints on the discretion of a decision-making body - relevant considerations in regards to the power to exclude an inappropriate dispute

(By Jane Xu, DLA Piper Australia)

Cromwell Property Securities Ltd v Financial Ombudsman Service Ltd, Peter Radford and Robyn Radford [2013] VSC 333, Supreme Court of Victoria, Digby J,1 July 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/vic/VSC/2013/333.html

(a) Summary

The case concerned whether the Financial Ombudsman Service Ltd (the Financial Ombudsman) was in breach of contract due to its failure to exercise its power under the Terms of Reference of its Constitution.

(b) Facts

The plaintiff (Cromwell) is a financial services provider and is responsible for the Cromwell Property Fund (Fund). Pursuant to s. 912A of the Corporations Act 2001 (Cth) (the Corporations Act), Cromwell was obliged to be a member of an "external dispute resolution scheme". As a result of this requirement, Cromwell became a participating member of a dispute resolution regime operated by the Financial Ombudsman.

The current constitution of the Financial Ombudsman establishes Terms of Reference (TOR) which regulate the dispute resolution processes undertaken by it.

Under paragraph 5.2 of the TOR, the Financial Ombudsman has the power to refuse to consider a referred dispute if the Financial Ombudsman considers this course of action appropriate.

Paragraph 5.2 of the TOR provides that:

[the Financial Ombudsman] may refuse to consider, or continue to consider, a Dispute, if [the Financial Ombudsman] considers this course of action appropriate, for example, because:

a. there is a more appropriate place to deal with the Dispute, such as a Court, tribunal or another dispute resolution scheme or the Privacy Commissioner;
b. the Applicant is not a retail client as defined in the Act;
c. the Dispute relates to a Financial Service Provider's practice or policy and does not involve any allegation of either Maladministration or inappropriate application of the practice or policy;
d. the Dispute being made is frivolous or vexatious or lacking in substance; or
e. after the Dispute is lodged with [the Financial Ombudsman], the Applicant commences legal proceedings against the Financial Services Provider that are related to the Dispute.

The second and third Defendants (the Radfords) had a dispute with Cromwell who was their financial services provider and sought to refer the dispute to the Financial Ombudsman.

Cromwell sought to have the Financial Ombudsman invoke its power under paragraph 5.2 of the TOR to refuse to consider the dispute between the Radfords and Cromwell.

The Financial Ombudsman decided that it would not refuse to consider the dispute between the Radfords and Cromwell.

Cromwell sought a declaration that the Financial Ombudsman's decision not to invoke its power to refuse to consider the dispute was in breach of the contract between Cromwell and the Financial Ombudsman.

Further, Cromwell sought an injunction restraining the Financial Ombudsman from hearing and determining the dispute between Cromwell and the Radfords.

(c) Decision

It was held that:

- the Financial Ombudsman's decision to not exercise its power under the TOR was not a breach of contract; and
- Cromwell was not entitled to seek an injunction restraining the Financial Ombudsman from hearing and determining the dispute between Cromwell and the Radfords.

(i) Considerations which the Financial Ombudsman must make when deciding whether to exercise its power

Justice Digby stated that:

I conclude that in deciding whether to exercise the power to exclude [under paragraph 5.2 of the TOR], the Financial Ombudsman was required to:

1. decide reasonably in the "Wednesbury sense".
2. consider proper submissions put to it by a party as to whether it is appropriate to exclude the Dispute.
3. consider whether the Financial Ombudsman process or a Court process was more appropriate for the determination of the Dispute.
4. correctly decide any question of law in relation to the meaning of a law which it is the function of the Financial Ombudsmen to interpret, were that to arise.

(ii) The Financial Ombudsmen's decision only needs to not be unreasonable in the 'Wednesbury sense'

Cromwell contended that the Financial Ombudsmen was subject to a more onerous reasonableness requirement than Wednesbury reasonableness. Cromwell submitted that the Financial Ombudsman's decision must be positively reasonable as distinct from being merely not "Wednesbury unreasonable".
Justice Digby rejected Cromwell's arguments and found that the Financial Ombudsman's decision not to exclude itself as mediator of the dispute only had to be not unreasonable in the "Wednesbury sense".

(iii) The Financial Ombudsman must exercise its power to exclude taking into account considerations relevant to its exercise

It was held that an extension of the requirement that the Financial Ombudsman must decide reasonably in the "Wednesbury sense", meant that the Financial Ombudsman must also take into account relevant considerations when deciding whether or not to use its discretion.

It would generally be unreasonable in the "Wednesbury sense" for a domestic tribunal not to consider proper submissions made to it by a party in accordance with the proper procedure applicable to the tribunal.

(iii) The Financial Ombudsman is required to correctly decide questions of law

Justice Digby held that "in deciding whether to exercise the power to exclude a dispute, were there to be a question of law, the meaning of which it is the function of the Financial Ombudsman to interpret, the Financial Ombudsman would be required to correctly decide such a question."

However, Digby J held that on the facts of the case there was no relevant question of law for the Financial Ombudsmen to correctly decide.