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Bulletin No. 231

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1. Recent Corporate Law and Corporate Governance Developments

1.1 Board composition in the top 200 Australian listed companies: study

15 November 2016 - An influx of women directors who are younger than their male counterparts isn't stopping Australia's boards from getting older, according to the Australian Council of Superannuation Investors' latest research report Board Composition and Non-Executive Director Pay in the Top 200 Companies 2015.

Although women are increasingly bringing generational change to boardrooms, the average age of an ASX100 director has reached 61.9 - almost three years older than when the study began in 2001.

In 2015, 21% of ASX200 directorships were held by women. In 2016, it is almost 25%.

The study also highlights the prevalence of people with multiple directorships; 109 nonexecutive directors (NEDs) held 37% of all ASX100 board seats. Across the entire ASX200, 182 individuals (almost 20% of the director community) accounted for 418 seats - or 36% of all nonexecutive director positions.

1.2 APRA releases final revised standard on securitisation

10 November 2016 - The Australian Prudential Regulation Authority (APRA) has released the final revised *Prudential Standard APS 120 Securitisation* (APS 120) which is accompanied by the Response to Submissions Paper Revisions to the prudential framework for securitisation. APRA is also releasing a draft revised *Prudential Practice Guide APG 120 Securitisation* (APG 120).

In addition to strengthening banking sector resilience, APRA's main reform objectives for the securitisation framework are to facilitate a more robust securitisation market by providing:

- more flexibility for authorised deposit-taking institutions (ADIs) in their funding programs;
- a simpler set of operational requirements for the use of securitisation; and
- simpler and more transparent approaches to calculating regulatory capital requirements that appropriately reflect risk.

The final revised APS 120 also reflects APRA's implementation of the Basel III securitisation framework.

The final revised APS 120 will take effect from 1 January 2018. In the coming months, APRA will separately consult on revised reporting requirements for securitisation which would take effect at the same time as the revised prudential standard.

The response paper, final revised APS 120 and draft revised APG 120 can be found on APRA's website.

1.3 Protection for retail investors in over-the-counter derivatives products: proposed law reform

8 November 2016 - The Australian Government has announced it will proceed with reforms that will provide better protection for retail investors in over-the-counter derivatives products.

Australian financial service licence holders (Firms) can currently use money held on behalf of retail derivatives clients for a wide range of purposes, including for working capital. Use of client money for these purposes is either not permitted, or is more heavily regulated, in a number of other advanced G20 economies. Permitting the use of client money for these purposes therefore exposes Australian retail clients to a greater risk of loss in the event of the Firm's insolvency.

The new client money protection regime will remove the current exemption that permits a Firm's use of retail client money, paid to the Firm for derivatives transactions. Prohibiting a Firm's use of client money in this way will ensure that clients' money is held in trust, and will be repaid to clients in the event of the Firm's insolvency. The Bill will be introduced into Parliament at the earliest opportunity.

1.4 Consultation on ASIC industry funding

7 November 2016 - The Australian Government has opened public consultation on industry funding of the Australian Securities and Investments Commission (ASIC). The consultation process seeks stakeholder views on the proposed industry funding model to recover the regulatory costs of the ASIC though annual levies and fees-for-service. It provides an updated proposed model following extensive consultation in 2015.

There are two papers: a proposals paper and a supplementary technical paper.

The proposals paper provides a high-level overview of how the industry funding framework could be applied. It details the proposed implementation and legislative framework. It also details the engagement, transparency and accountability mechanisms built into the model to strengthen ASIC's accountability to consumers and its regulated entities.

The supplementary paper provides details of ASIC's costs of regulating each sector and the metrics for how the levies could be calculated for each sector.

Roundtables will be held during the consultation period to provide stakeholders with the opportunity to share their views collectively. Submissions on these proposals papers, together with feedback from roundtables, will assist the Government's final consideration of the model. The submission process will close on Friday, 16 December 2016.

View

- Proposals paper
- Supporting attachment

1.5 Survey on ESG reporting and engagement practices

4 November 2016 - Leading ASX companies risk becoming targets for hostile actions because they don't engage effectively with investors on environmental, social and governance (ESG) issues, a new survey has found.

The survey, conducted by the Australasian Investor Relations Association (AIRA), found that only 23.5% of respondents proactively engage with stockbroker and investor ESG analysts. 82.7% don't hold specific events for the investment community to explain their ESG practices. And just 51% speak to those people only when approached.

Key findings:

- 70.4% of respondents worked for a company that currently produces a Sustainability/ESG Report;
- The main targets for Sustainability/ESG Reports were shareholders 92.2%, potential investors 80.4%, government/regulators 52.9%, analysts 47.1% and marketing 13.7%;
- Just 23.5% of respondents said they actively seek to engage buy-side and sell-side ESG analysts. 51% said they only engaged when analysts requested a meeting, 17.7% said no they didn't and 7.8% said they didn't but the respondent believed they should;
- 82.7% of respondents said they didn't hold specific events that focus on ESG for the investment community. 7.7% conduct group briefings, 5.8% hold specialised events and 3.9% have ESG roadshows.65.4% participated in surveys or checked draft report requests from ESG research/index providers, including Regnan, Sustainalytics, MSCI and FTSE4GOOD;
- Of those that referred to or reported on external standards, 80% did for the Global Reporting Initiative, 77.1% for the Carbon Disclosure Project and 11.4% for Integrated Reporting. None referred or reported on the Sustainable Accounting Standards Board and 2.9% each did on the Sustainable Stock Exchanges Initiative and the International Corporate Governance Network;
- When asked who in the company was responsible for drafting and finalising the reports, 51% said the head of investor relations, 47.1% the head of sustainability and 27.5% the company secretary;
- Respondents to the survey came 34% from the ASX 1-50, 30.2% from the ASX 51-100, 22.6% from the ASX 101-150, 7.6% from the ASX 151-200 and 9.4% from the NZ50; and

- Respondents were from a broad spread of market sectors. 14.8% came from Industrials and Financial (excluding REITS), 11.1% from REITS, 9.3% from Consumer Staples, Financial and Materials and 7.4% from each of Utilities and Energy.

1.6 APRA releases enhanced governance requirements for superannuation trustees

3 November 2016 - APRA has released updated governance requirements for APRA-regulated superannuation trustees (RSE licensees) with a final revised prudential standard and prudential practice guide on governance.

This release follows APRA's letter of 18 December 2015, Governance arrangements for RSE licensees: Outcomes of consultation, which summarised the outcome of a consultation on proposed amendments to Prudential Standard SPS 510 Governance (SPS 510) and Prudential Practice Guide SPG 510 Governance (SPG 510).

The original SPS 510 and SPG 510 took effect in 2012 and 2013 respectively, and are being updated to further enhance governance practices across the superannuation industry.

The amendments to the prudential standard include requiring RSE licensees to have in place a governance framework which sets out policies and procedures to support effective governance practices, and requirements for these policies to address the nomination, appointment and removal of directors, board renewal, director tenure limits and board size.

The prudential practice guide has been updated to clarify APRA's expectations regarding key governance practices, to support the new requirements set out in the prudential standard. Final SPS 510 will take effect on 1 July 2017, but APRA expects RSE licensees to consider the guidance in SPG 510 immediately.

Further details of the requirements, including the final prudential standard and prudential practice guide can be found on the APRA website.

1.7 Investment Association statement on executive pay

31 October 2016 - The UK Investment Association, whose members manage over £5.7 trillion of assets, has written an open letter to all companies in the FTSE 350 setting out new shareholder expectations on executive pay.

The letter states that the Association has now rewritten its own Principles of Remuneration to pave way for simpler and more flexible remuneration structures. The Principles have been updated to ensure that they do not promote a single remuneration structure above others to enable companies to choose the appropriate structure for their business and strategy rather than automatically opting for the commonly used Long Term Incentive Plan (LTIP) structure.

The updated Principles also make it clear it is essential that company Boards provide investors with clear justification around their Executive's levels of pay. This should be both in terms of the maximum potential remuneration as set out in the Remuneration Policy, but also payments actually made to the Executive during the year in the context of the company's performance.

View

- Investment Association's open letter
- Principles of Remuneration
- Executive Remuneration Working Group's final report

1.8 IOSCO reports on implementation of G20/FSB recommendations to strengthen securities markets

28 October 2016 - The Board of the International Organization of Securities Commissions (IOSCO) has published a report on the implementation of the G20/FSB post crisis recommendations aimed at strengthening securities markets.

The Implementation Report: G20/FSB Recommendations related to Securities Markets was prepared by IOSCO's Assessment Committee, as part of its G20 Markets Reform Review Project. This effort involved working with the Financial Stability Board (FSB) on analysing the responses to the FSB's 2016 Implementation Monitoring Network (IMN) survey.

As the global standard setting body for securities regulation, IOSCO has worked closely with the FSB on previous IMN surveys. For the 2016 survey, IOSCO undertook the analysis for the following recommendations that relate to securities markets:

- Hedge funds;
- Structured products and securitisation;
- Oversight of credit rating agencies (CRAs);
- Measures to safeguard the efficiency and integrity of markets; and

- Supervision and regulation of commodity derivative markets.

IOSCO's Implementation Monitoring Report finds that most responding jurisdictions have taken steps to implement the G20/FSB recommendations and IOSCO guidance in each reform area. Implementation is most advanced in relation to hedge funds, structured products and securitisation, and the oversight of CRAs. Most jurisdictions had implemented these reforms by 2014, while implementation of G20/FSB recommendations in other areas continues to progress.

1.9 Guidelines on internal governance at European banks

28 October 2016 - The European Banking Authority (EBA) has launched a public consultation on its revised Guidelines on internal governance. These draft Guidelines aim at further harmonising institutions' internal governance arrangements, processes and mechanisms across the EU, in line with the new requirements in this area introduced in the Capital Requirements Directive (CRD) and also taking into account the proportionality principle.

These draft Guidelines put more emphasis on the duties and responsibilities of the management body in its supervisory function in risk oversight, including the role of committees. They aim at improving the status of the risk management function, enhancing the information flow between the risk management function and the management body and ensuring effective monitoring of risk governance by supervisors. In addition, the framework for business conduct has been further developed and more emphasis is given to the establishment of a risk culture, a code of conduct and the management of conflicts of interest.

Finally, more guidance is provided on the risk management framework, on how internal control functions are organised and how internal controls are implemented.

View Consultation Paper - Guidelines on internal governance

1.10 Consultation on making employee share schemes more user-friendly

26 October 2016 - The Australian Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, has released the National Innovation and Science Agenda - Employee Share Schemes paper for consultation.

The Government is taking steps to make it easier for employers to provide incentives to their employees through employee share schemes (ESS). In particular, the Government has committed to:

- Limit the requirement for disclosure documents given to employees under an eligible ESS, and lodged with the Australian Securities and Investments Commission (ASIC), to be made available to the public; and
- Consult on options to amend the disclosure requirements to make ESS more user-friendly.

The draft legislation will amend the Corporations Act 2001 No. 50 (Cth) to fulfil the first of these commitments. The draft legislation has been published on the Treasury website.

1.11 Global board culture report surveys the director behaviours that contribute to and create a high-performing culture and drive board effectiveness

26 October 2016 - Russell Reynolds has published Global Board Culture Survey Understanding the Behaviors that Drive Board Effectiveness that reports the results of a survey of 369 directors from 12 countries.

The survey showed that the attributes that define an effective director transcend cultural and national differences. Most important director behaviours, this study found, include possessing the courage to do the right thing for the right reasons; a willingness to constructively challenge management when appropriate; an ability to demonstrate sound business judgment; asking the right questions; and possessing independent perspective and avoiding "groupthink".

Although survey participants agreed on five key director behaviours, the survey also revealed that only the most effective and well-led boards are the ones that can incorporate the desired director behaviours into how the board actually operates. When Russell Reynolds' consultants observed behaviours of the most effective boards surveyed, they identified three characteristics that drive an effective culture built upon the most important behaviours: 1) a chair who is an effective facilitator; long-term horizon for strategic solutions; and 2) strong relationships with senior management.

1.12 SEC proposes amendments to require use of universal proxy cards

26 October 2016 - The US Securities and Exchange Commission has voted to propose amendments to the proxy rules to require parties in a contested election to use universal proxy cards that would include the names of all board of director nominees. The proposal gives shareholders the ability to vote by proxy for their preferred combination of board candidates, similar to voting in person.

The proposed rules would require proxy contestants to provide shareholders with a proxy card that includes the names of both management and dissident director nominees. The rules would apply to all non-exempt solicitations for contested elections other than those involving registered investment companies and business development companies. In addition, the proposed rules would require management and dissidents to provide each other with notice of the names of their nominees, establish a filing deadline and a minimum solicitation requirement for dissidents, and prescribe presentation and formatting requirements for universal proxy cards.

To further facilitate shareholder voting in director elections, the Commission also voted to propose amendments to the proxy rules to ensure that proxy cards specify the applicable shareholder voting options in all director elections and require that proxy statements disclose the effect of a shareholder's election to withhold its vote.

View SEC Fact Sheet

1.13 Differences between corporates and investors are creating gaps around ESG disclosures: study

25 October 2016 **-** Investors are increasingly interested in a company's non-financial disclosures - and while environmental, social and governance (ESG) reporting has become mainstream for companies, there is a disconnect between what companies are disclosing and what investors actually want to know, according to PwC's new report, Investors, corporations and ESG: bridging the gap.

The report, which is based on responses from both institutional investors and companies to gauge sentiment on ESG issues, uncovered key findings around the following themes:

- investors and corporates agree that ESG considerations are important, but the level of importance differs. Sixty-five percent of corporates said ESG considerations are "very important" to the company's core strategy, compared to 31% of investors who say considerations are "very important" in their equity investment decision making;
- current ESG information disclosures are not as valuable as they could be. More than nine out of ten investors (92%) said that companies are not disclosing ESG information in a way that allows easy comparisons, while 60% of corporates say the data disclosed is helpful. Instituting a commonly

recognized and widely understood standard was named a potential solution;

- several perception gaps are getting in the way of disclosure. Limited data and the perception that investors don't use the information provided were the two big areas getting in the way of disclosure, according to respondents. 29% of corporates said their companies only have limited data to share while 29% of investors say that companies think investors won't act on the information given to them, so disclosure isn't important. Additionally, there was a big difference in opinion on the quality of what is being reported. All of the corporations surveyed said they were confident in the data they were releasing, but less than 30% of investors felt that way; and
- standardizing and certifying ESG disclosures could help boost confidence in reporting. There is no common framework or set of standards for ESG disclosures: 80% of corporates currently report using GRI's standards, while 43% of investors would prefer them to follow SASB's standards, further contributing to the disconnect.

Investors also expressed an interest in improving the quality of ESG information. Having the information certified or audited by an independent third party is one way. 36% of investors said this would increase their confidence, compared to 43% of corporates. 36% of investors also noted that having information incorporated into SEC filings to signal higher quality would help the case.

1.14 FRC report on financial reporting quality

21 October 2016 - The UK Financial Reporting Council has released its Annual Review of Corporate Reporting 2015/2016.

The review found that most companies, particularly larger public companies, report in compliance with the accounting framework. The introduction of the strategic report has also improved the quality of narrative reporting according to the Financial Reporting Council's (FRC) *Annual Review of Corporate Reporting*. However, the report highlights calls for companies to be more balanced in their reporting of their performance. Failure to acknowledge when things have not gone so well, excessive use of underlying profit figures or inappropriate use of alternative performance measures (APMs) are found too often and erode trust and undermine the quality of corporate reporting.

The Annual Review of Corporate Reporting provides the regulator's assessment of the quality of corporate reporting in the UK based on its monitoring work for the year to 31 March 2016. Of the 192 companies whose reports were reviewed, the FRC raised queries with approximately one third. Most companies concerned have

agreed action to resolve the matters satisfactorily, primarily through their future reporting.

1.15 FSB publishes methodology for assessing the implementation of the key attributes of effective resolution regimes in the banking sector

19 October 2016 - The Financial Stability Board (FSB) has published a methodology for assessing the implementation of the Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes) in the banking sector. The Key Attributes Assessment Methodology for the Banking Sector sets out essential criteria to guide the assessment of the compliance of a jurisdiction's bank resolution frameworks with the FSB's Key Attributes. It is designed to promote consistent assessments across jurisdictions and provide guidance to jurisdictions when adopting or reforming bank resolution regimes to implement the Key Attributes.

1.16 Consultative report: harmonisation of critical OTC derivatives data elements

19 October 2016 - The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) has published for public comment a consultative report on Harmonisation of critical OTC derivatives data elements (other than UTI and UPI) - second batch.

The report responds to the G20's agreement in 2009 that all OTC derivatives contracts would be reported to trade repositories (TRs), as part of the G20's commitment to reforming OTC derivatives markets with the aim of improving transparency, mitigating systemic risk and preventing market abuse. Aggregation of the data reported across TRs will help ensure that authorities can obtain a comprehensive view of the OTC derivatives market and its activity.

The CPMI, IOSCO and the Financial Stability Board (FSB) have in recent years published reports that laid the foundation for the harmonisation work on key OTC derivatives data elements for meaningful aggregation on a global basis. That work includes the 2012 CPSS-IOSCO report on OTC derivatives data reporting and aggregation requirements, the 2013 CPSS-IOSCO report on Authorities' access to trade repository data and the 2014 FSB Feasibility study on approaches to aggregate OTC derivatives data.

Following the 2014 feasibility study, the FSB asked the CPMI and IOSCO to develop global guidance on the harmonisation of data elements reported to TRs

and important for the aggregation of data by authorities, including the Unique Transaction Identifier (UTI) and the Unique Product Identifier (UPI).

This consultative report is part of the Harmonisation Group's response to that mandate. It complements the consultative report on Harmonisation of key OTC derivatives data elements (other than UTI and UPI) - first batch as well as the consultative report on Harmonisation of the Unique Transaction Identifier and two consultative reports on Harmonisation of the Unique Product Identifier. The Harmonisation Group also plans to issue consultative reports on further batches of key data elements (other than UTI and UPI) in the coming months.

1.17 Progress report on adoption of Basel III standards published by the Basel Committee

19 October 2016 - The Basel Committee on Banking Supervision has issued the Eleventh progress report on adoption of the Basel regulatory framework.

This report sets out the adoption status of Basel III standards for each member jurisdiction of the Basel Committee as of end-September 2016. The Committee's latest report as of end-September 2016 shows that:

- all 27 member jurisdictions have final risk-based capital rules, liquidity coverage ratio regulations and capital conservation buffers in force;
- 26 member jurisdictions have issued final rules for the countercyclical capital buffers;
- 25 have issued final or draft rules for their domestic SIBs framework; and
- 18 have issued final or draft rules for margin requirements for non-centrally cleared derivatives.

With regard to the global SIBs framework, all members that are home jurisdictions to G-SIBs have the final framework in force. While members are now turning to the implementation of other Basel III standards, including the leverage ratio and the net stable funding ratio (NSFR), some member jurisdictions report challenges in meeting the agreed implementation deadlines for some standards. These include the revised Pillar 3 framework (by end-2016), the standardised approach for measuring counterparty credit risk (by January 2017), capital requirements for central counterparty (CCP) exposures (by January 2017) and capital requirements for equity investments in funds (by January 2017).

1.18 New sustainability reporting standards

19 October 2016 - GRI has launched the world's first global standards for sustainability reporting, giving companies a common language for disclosing non-financial information. The GRI Sustainability Reporting Standards will enable companies around the world to be more transparent about their impacts on the economy, the environment and society. They will also help organizations make better decisions and contribute to the United Nations Sustainable Development Goals (SDGs). The new GRI Standards replace the G4 Guidelines, which will be phased out by 1 July 2018.

The GRI Standards are a set of 36 modular Standards that facilitate corporate reporting on topics such as greenhouse gas emissions, energy and water use, and labour practices. The new format allows GRI to update individual topics based on market and sustainability needs, without requiring revisions to the entire set of GRI Standards. The GRI Standards are centred on materiality - focusing on the topics that represent the most significant impacts of the organization and are most important to organizations' stakeholders - which supports sustainability reporting that is tailored to each individual company. A company can prepare a sustainability report in accordance with the GRI Standards at Core or Comprehensive level, or disclose individual topics to meet specific reporting needs.

The GRI Standards are available for free download on the GRI Standards hub on the GRI website, along with detailed mapping documents that show all of the changes from G4 to GRI Standards.

1.19 ASIC enforcement review taskforce

19 October 2016 - The Australian Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, has released the terms of reference and membership for the ASIC Enforcement Review Taskforce.

The terms of reference allow for an examination of the adequacy of ASIC's enforcement regime, including in relation to industry Codes of Conduct, to deter misconduct and foster consumer confidence in the financial system.

The Taskforce will review the enforcement regime of ASIC, to assess the suitability of the existing regulatory tools available to it to perform its functions adequately.

According to the terms of reference, the review will include an examination of legislation dealing with corporations, financial services, credit and insurance as to:

- the adequacy of civil and criminal penalties for serious contraventions relating to the financial system (including corporate fraud);

- the need for alternative enforcement mechanisms, including the use of infringement notices in relation to less serious contraventions, and the possibility of utilising peer disciplinary review panels (akin to the existing Markets Disciplinary Panel) in relation to financial services and credit businesses generally;
- the adequacy of existing penalties for serious contraventions, including disgorgement of profits;
- the adequacy of enforcement related financial services and credit licensing powers;
- the adequacy of ASIC's power to ban offenders from occupying company offices following the commission of, or involvement in, serious contraventions where appropriate;
- the adequacy of ASIC's information gathering powers and whether there is a need to amend legislation to enable ASIC to utilise the fruits of telephone interception warrants or to grant the equivalent of *Federal Crimes Act* search warrant powers under ASIC's enabling legislation for market misconduct or other serious offences;
- the adequacy of ASIC's powers in respect of licensing of financial services and credit providers, including the threshold for granting or refusing to grant a license, the circumstances in which ASIC may vary, suspend, or cancel licenses, and its coercive powers (including whether there is a need for ASIC to have a power to direct licensees to take, or refrain from taking, particular action);
- the adequacy of the frameworks for notifying ASIC of breaches of law, including the triggers for the obligation to notify; the time in which notification is required to be made; and whether the obligation to notify breaches should be expanded to a general obligation (currently confined under the Corporations Act to auditors, liquidators, and licensees, and noting that obligations to report offences exist under other Federal or State statutes); and
- any other matters, which arise during the course of the Taskforce's review of the above, which appear necessary to address any deficiencies in ASIC's regulatory toolset.

Upon completion of the Review, the Taskforce will identify any gaps in ASIC's powers and make recommendations to the Government which it considers necessary to strengthen any of ASIC's regulatory tools and as to the policy options available.

1.20 APRA releases snapshot of industry practice in risk culture

18 October 2016 - APRA has released an information paper that provides a snapshot of current practice in risk culture in a range of banking, insurance and superannuation businesses.

The paper released by APRA notes that while there has clearly been a stronger focus on risk culture in recent years amongst APRA-regulated institutions, continued effort and ongoing attention is required by institutions to better understand and manage their risk cultures.

APRA began an information gathering exercise in relation to industry practices on risk culture in late 2015, and in the paper finds that:

- approaches to understand and manage risk culture are at a relatively early stage of development; and
- many institutions are grappling with how best to:
  - clearly articulate what type of risk culture they aspire to;
  - identify any specific weaknesses in their current risk culture; and
  - effectively address those weaknesses.

Underpinning much of this work has been APRA's *Prudential Standard CPS 220 Risk Management*, which came into effect on 1 January 2015. Amongst other things, CPS 220 requires each Board of an authorised deposit-taking institution (ADI) or insurer to form a view of the risk culture in their institution, identify any desirable changes to that risk culture, and ensure the institution takes steps to address those changes.

View the Information Paper on Risk Culture

1.21 FCA publishes the final report of its investment and corporate banking market study

18 October 2016 - The UK Financial Conduct Authority (FCA) has published the final findings of its investment and corporate banking market study and set out a targeted package of remedies to ensure effective competition in the market.

The final report confirms the findings of the interim report published in April 2016. It finds that whilst many clients feel well served by primary capital market services there were some areas where improvements could be made to encourage competition, particularly for smaller clients.

The FCA's final report outlines a targeted package of remedies, including:

- banning banks from using contractual clauses that seek to limit clients' choice on future transactions. The FCA has published a separate consultation paper alongside this final report setting out the proposals. Depending on the responses to the consultation paper, the FCA expects to publish the final rules in early 2017;
- ending league table misrepresentation in banks' pitches to clients: banks routinely present league tables to clients in a way that inflates their own

position. The FCA is working with the BBA and AFME so that they can develop and adopt industry guidelines to improve the way such information is presented;

- removing incentives for loss-making trades to climb league tables: league tables that rank investment banks can be misleading because some banks carry out loss-making transactions purely to generate a higher position in such tables. The FCA has asked league table providers to review their recognition criteria so as to reduce the incentives for banks to undertake such league table trades; and
- supervisory program for initial public offering (IPO) allocations: allocations of shares in IPOs are at times skewed towards buy-side investors from whom banks derive greater revenues from other business lines (for example, trading commission). In the run up to the implementation of MIFID II, the FCA will work with those firms where shortcomings in their allocation policies or practices have been identified.

1.22 Directors survey

11 October 2016 - Institutional investors and shareholder activists are gaining more access and exerting more influence on boards, according to PwC's 2016 Annual Corporate Directors Survey. The report is based on responses from 884 US public company directors to gauge sentiment on board governance.

PwC's survey uncovered the following key findings that are impacting how boards are performing:

- Directors continue to say someone on their board isn't measuring up. Thirty-five% of directors say someone on their board should be replaced - a sentiment directors have had since 2012. The most common reasons why: they're not prepared for meetings and they lack the right expertise
- How beneficial is diversity on the board? It depends on who you ask. Nearly all directors agree that diversity is important (96%). But how important it is and how much it helps depends on who you are talking to. Eighty-nine percent of female directors believe that board diversity leads to enhanced company performance, compared to just 24% of male directors. Ninety-two percent of female directors think board diversity leads to enhanced board effectiveness - only 38% of male directors agree;
- A gender imbalance on boards. In 2015, women made up 20% of S&P 500 boards, up only five percentage points in a decade. The majority of directors today say anywhere from one-fifth to one-half of the board should be female. But 10% of directors believe the optimal female board representation is 20% or less; 97% of those who believe this are male;
- Are activists good for business? Most directors actually say yes. Eighty percent of directors at least somewhat agree that shareholder activism has compelled them to more effectively evaluate their company's strategy,

execution, and capital allocation. A similar percentage at least somewhat agrees that shareholder activism has resulted in improved company operations and capital allocation;
- The search for new directors doesn't extend too far behind the boardroom. The most common source for new directors is fellow board member recommendations (87%). However, calls for increased board diversity have prompted some boards to use less traditional sources to find new directors;
- Investors flex their muscles about board composition. Many investors have become more vocal about who's sitting in the boardroom. Due to investor pressure, 61% of directors say their board added a director with a specific skillset, 46% say they added a diverse board member, and 34% say they added a younger board member;
- Some directors question whether dialogue with investors really matters. Direct engagement between boards and investors has become much more commonplace over the past few years. In fact, 54% of directors said their boards engage directly with their investors. However, not all directors think the engagement is useful - 21% of directors said they didn't receive any valuable insights from directly engaging with investors; and
- Companies respond to investor demands about capital allocation. Forty-eight percent of directors said their company increased share buybacks due to actual or potential investor demands; 38% said their companies initiated or increased dividends, and 27% said their companies decreased corporate investments.

1.23 Effect of shareholder activism on corporate strategy

October 2016 - Shareholder activist campaigns have increased significantly over the past few years. A survey of more than 300 directors of publicly traded US companies provides insights into the impact of shareholder activism.

Key findings:

- 84% of directors believe most activist shareholders do not represent the interests of all of a company's shareholders, with 85% saying they are simply too focused on short-term performance;
- Almost two-thirds (63%) of directors surveyed say activism has had no effect on public company boards' ability to attract quality members, and nearly half (47%) think directors who are nominated or placed on a board by an activist can remain independent;
- More than three-quarters (78%) of directors believe that activists who push for a change in strategy should be required to hold the company shares for one to three years subsequent to the implementation of that strategy;
- Almost all directors agree that if an activist places a director on a board, that director should never be allowed to take confidential information back

to the fund, and the fund should be subject to the same restrictions on pledging and hedging; and
- A majority (63%) of directors say it's a good idea to designate a committee or certain individuals to interact with large shareholders.

View full report

1.24 Regulators and government agencies annual reports

Several regulators and government agencies with responsibility for corporate law and corporate governance have recently released their annual reports for 2015-2016.

They include:

- Australian Accounting Standards Board (AASB) Annual Report 2015-16;
- Australian Auditing and Assurance Standards Board (AUASB) Annual Report 2015-16;
- Australian Financial Security Authority (AFSA) Annual Report 2015-16;
- Australian Office of Financial Management (AOFM) Annual Report 2015-16;
- Australian Prudential Regulation Authority (APRA) Annual Report 2015-16;
- Australian Securities and Investments Commission (ASIC) Annual Report 2015-16;
- Commonwealth Director of Public Prosecutions (CDPP) Annual Report 2015-16;
- Commonwealth Treasury Annual Report 2015-16;
- Companies Auditors and Liquidators Disciplinary Board (CALDB) annual report for 2015-16;
- Financial Reporting Council (FRC) Annual Report 2015-16; and
- Takeovers Panel Annual Report 2015-16.

2. Recent ASIC Developments

2.1 Consultation on 'sunsetting' class orders about internet offers, hawking and PDS obligations

10 November 2016 - ASIC has released a consultation paper proposing to remake two class orders on internet offers and hawking, and to repeal a class order on PDS obligations. All three class orders are due to expire ("sunset") on 1 April 2017.

The instruments that ASIC proposes to remake are:

- [CO 02/246] Offers of securities on the internet; and
- [CO 02/641] Hawking: Securities and managed investments.

Class order [CO 02/246] gives relief for foreign offerors of securities to persons outside Australia, where the offer or advertisement is accessible incidentally to Australians. *Class order [CO 02/641]* gives technical relief so that securities and interests in managed investment schemes are not subject to two differing hawking prohibitions.

ASIC has found these class orders are operating effectively and efficiently, and continue to form a necessary and useful part of the legislative framework. However, in remaking *[CO 02/246]*, ASIC is proposing to update and streamline the conditions.

ASIC also proposes to repeal [CO 02/286] Obligation to provide a PDS: s1012B(4), which was originally issued to correct possible oversights in instruments issued before March 2002. ASIC is unaware of any continuing instruments that rely on the relief provided by [CO 02/286], so that relief is now redundant.

Consultation Paper 271 Remaking and repealing ASIC class orders on internet offers, hawking and PDS obligations (CP 271) outlines ASIC's rationale for proposing to remake *[CO 02/246]* and *[CO 02/641]* and repeal *[CO 02/286]*.

2.2 Market integrity report

3 November 2016 - ASIC has released its twice-yearly report and video on market integrity. Report 501 Market Integrity Report: January to August 2016 is an overview of the work of ASIC's Market Integrity Group during this period. The Market Integrity Group is responsible for ensuring that Australia's licensed markets are fair and efficient. Regulatory activity focuses on deterrence, setting standards and education, and behavioural change.

The report covers ASIC's review of the "cleanliness" of the Australian listed equity market. The review found that information leakage and insider information ahead of material, price-sensitive announcements had declined over the past 10 years.

There were 15 enforcement outcomes during the six months to June 2016, including for insider trading - where criminal sentences demonstrated the seriousness of this crime.

ASIC also commenced civil penalty proceedings against Australia and New Zealand Banking Group Limited, Westpac Banking Corporation and National Australia Bank Limited alleging unconscionable conduct and market manipulation in setting the Bank Bill Swap Rate from 2010-12. These matters are currently before the courts.

In a review of the management of confidential information and conflicts of interests within investment banks and other market participants, ASIC identified a number of areas of concern. Firms have been asked to review their sell-side and corporate advisory practices to ensure they meet regulatory requirements.

Over the next 12 months, ASIC will focus on the regulation of Australia's financial markets include cyber resilience, handling of confidential information and conduct risk.

2.3 Updated guidance for historical financial information disclosure in prospectuses

3 November 2016 - ASIC has released updated regulatory guidance to assist companies and their advisers to improve the quality and quantity of historical financial information disclosure in prospectuses as part of their disclosure obligations.

ASIC's updated Regulatory Guide 228 Prospectuses: Effective disclosure for retail investors (RG 228) follows consultation launched in May 2016 (refer 16-137MR).

The updated guidance provides additional clarity on ASIC's disclosure expectations and describes:

- the level of disclosure expected for business acquisitions and asset acquisitions;
- the types of audit and review opinions that are generally considered appropriate;
- when historical financial information requires updating in a prospectus;
- when cash flow information should be included in prospectuses; and
- the circumstances where historical financial information disclosures may not be required.

For business acquisitions ASIC has introduced a "significance" threshold, similar to that found in a number of other major foreign jurisdictions. RG 228 now provides that where an acquisition is significant (25% of the company), issuers will generally need to disclose audited historical financial information on the acquired business. This provides greater certainty for companies that make acquisitions in contemplation of, or concurrently with, a fundraising offering.

View

- Regulatory Guide 228
- Report 502 Response to submissions on CP 257
- CP 257 and submissions

2.4 Report on the charging of advice fees without providing advice by major financial institutions

27 October 2016 - ASIC has released Report 499 Financial advice: Fees for no service (REP 499)

The report provides an update on ASIC's work to address financial institutions' and advisers' systemic failures, over a number of years, to provide ongoing advice services to customers who paid fees to receive those services. The report summarises ASIC's work to ensure customers are fairly compensated. The report is part of ASIC's Wealth Management Project which is focusing on the conduct of the largest financial advice firms, including the advice arms of AMP, ANZ, CBA, NAB and Westpac groups (refer: 15-081MR).

The failures set out in the report relate to instances where customers were charged a fee to receive an ongoing advice service, but had not been provided with this service because:

- the customer did not have an adviser allocated to them, but was charged a fee for ongoing advice - usually by deduction from the customer's investment products; or
- the adviser allocated to the customer failed to deliver on their obligation to provide the ongoing advice service and the licensee failed to ensure that the service was provided.

To date, approximately $23.7 million of fee refunds and compensation has been paid, or agreed to be paid, to over 27,000 customers of ANZ, NAB, CBA, Westpac and AMP under various Australian Financial Services (AFS) licensees that are owned by these businesses. Further reviews are being conducted by the licensees to determine the extent of their ongoing service fee failures. Refunds and compensation are expected to increase substantially as the licensees' investigations and reviews continue. Based on estimates provided by the licensees to ASIC, compensation may increase by approximately $154 million, plus interest, to over 175,000 further customers, meaning that total compensation for related failures could be over $178 million, plus interest.

ASIC has commenced several enforcement investigations in relation to this conduct.

Most of the failures outlined in this report occurred before the commencement of the Future of Financial Advice (FOFA) reforms. The changes made by those reforms were a significant factor in the identification of the failures, and also substantially reduce the likelihood that the type of systemic failures described in this report will occur in the future. In particular, the requirement to now provide an annual Fee Disclosure Statement to the client, and the requirement for the client to "opt-in" to the advice relationship every two years, will significantly reduce the risk of fees being charged without any advice service provided.

2.5 Clarification of record-keeping obligations for financial services licensees

27 October 2016 - ASIC has clarified financial advisers' record-keeping obligations by way of an amendment to *Class Order [CO 14/923]* Record-keeping obligations for Australian financial services licensees when giving personal advice.

The amendments to the record-keeping obligations:

- place beyond doubt that Australian financial services (AFS) licensees must have access to records for the period of time in which the records are required to be kept, even if a person other than the licensee holds the records; and
- make explicit that authorised representatives who are advisers must keep records, and give the records to their authorising licensee if the licensee requests the records for the purposes of complying with financial services laws.

View:

- ASIC Corporations (Amendment) Instrument 2016/1006
- Report 500 Response to submissions on CP 247 Client review and remediation programs and update to record-keeping requirements

3. Recent ASX Developments

3.1 ASX responds to regulatory expectations and updates its code of practice

ASX has updated its Cash Equities Clearing and Settlement Code of Practice to align with the set of Regulatory Expectations released by the Council of Financial Regulators. The Regulatory Expectations provide a framework for ASX's conduct in operating its cash equities clearing and settlement services while remaining the

sole provider of these services. The Regulatory Expectations relate to key governance, pricing and access matters.

The media release is available on the ASX website.

3.2 ASX's new admission requirements and response to consultation

On 2 November 2016, ASX released its new rules for admission to the ASX official list and its response to the consultation on the proposed requirements that began in May 2016.

The new rules address the need to maintain appropriate listing standards and investor confidence in the ASX market, while providing a pathway for companies to list and access capital across their lifecycle.

The media release is available on the ASX website.

3.3 Reports

On 3 November 2016 ASX released the ASX Monthly Activity Report for October 2016.

4. Recent Research Papers

4.1 Managing reputation: Evidence from biographies of corporate directors

The authors examine how corporate directors manage reputation through disclosure choices in biographies in proxy statements filed with the SEC. Directors are more likely to withhold information about directorships at firms that experienced adverse events. Withholding such information is associated with more favourable stock price reactions at appointment and loss of fewer subsequent directorships. Non-disclosure of directorships is significantly reduced following changes to SEC rules, with the greatest change being for adverse-event directorships. These findings suggest that reputation concerns of corporate directors lead to strategic disclosure choices that have real consequences in both capital and labour markets.

Managing Reputation: Evidence from Biographies of Corporate Directors

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4.2 Managers' cultural background and disclosure attributes

The authors examine how a manager's ethnic cultural background affects managers' communication with investors. Using a sample of earnings conference calls transcripts with 26,430 executives from 42 countries, they find that managers from ethnic groups that have a more individualistic culture (i) use a more optimistic tone, (ii) exhibit greater self-reference, and (iii) make fewer apologies in their disclosure narratives. Managers' ethnic culture has a lasting effect on their narratives-the effects persist even for executives who are later exposed to different ethnic cultures through work experience. The effect of ethnic heritage is observed in dialogues that reflect real time interactions (i.e., Q&As) and less pronounced in the scripted, less spontaneous portion of the calls (i.e., management discussion). The capital market responds positively to optimistic tone yet does not distinguish between the optimism in tone of managers from different ethnic backgrounds. The findings suggest that managers' ethnic backgrounds have a significant effect on how they communicate with the capital markets and how the markets respond to the disclosure event.

Managers' Cultural Background and Disclosure Attributes

4.3 Law and the shadow payment system

Banking, derivatives, and structured finance may attract the lion's share of accolades and approbation in global finance - but payment systems are where the money is. Historically, payment systems in most jurisdictions have been legally and operationally intertwined with the conventional banking system. The stability of these payment systems has thus benefited from the unique prudential regulatory strategies governing deposit-taking banks. These strategies include emergency liquidity assistance, deposit guarantee schemes, and special resolution regimes. Importantly, these strategies have the practical effect of relaxing the strict application of corporate insolvency law, thereby enabling banks - and the payment systems embedded within them - to continue to perform payment and other functions even under severe institutional stress.

Recent years have witnessed the emergence of a vibrant shadow payment system. This system includes peer-to-peer payment systems such as PayPal, mobile money platforms such as M-Pesa, and crypto-currency exchanges such as Mt. Gox. The defining feature of these shadow payment systems is that they perform many of the same payment functions as conventional banks, but without benefiting from

the prudential regulatory strategies that ensure that bank-based payment systems can continue to function during periods of institutional stress. This paper examines the potential risks to shadow payment system customers generated by this functional gap, along with the likely effectiveness of various strategies that these systems currently - or might in future - employ to address these risks.

Law and the Shadow Payment System

5. Recent Corporate Law Decisions

5.1 Setting aside a statutory demand on the basis of a genuine dispute

(By Samuel J. Hickey, LLB Candidate, University of Queensland)

Citation Resources Ltd v IBT Holdings Pty Ltd [2016] FCA 1265, Federal Court of Australia, McKerracher J, 27 October 2016

(a) Summary

In Citation Resources Ltd v IBT Holdings, the Federal Court of Australia set aside a statutory demand for the payment of a debt pursuant to s. 459G of the Corporations Act 2001 (Cth) (Act). The statutory demand had been set aside on the basis that there had been a genuine dispute between the parties.

It is likely that IBT Holdings Pty Ltd (IBT) could have successfully enforced the debt against Citation Resources Ltd (Citation) had it not brought the construction of the deed upon which the debt was founded into dispute by accepting a payment that was not contemplated by the deed. Additionally, IBT's failure to effectively terminate the deed prior to issuing the statutory demand also indicated the existence of a genuine dispute in regard to their right to seek payment of the debt.

The decision serves as an indication of when the issuance of a statutory demand will be premature, and also provides a provides a useful summary of the principles which dictate whether a court will set aside a statutory demand under Part 5.4 of the Act.

(b) Facts

In September 2015, Citation and IBT entered into an agreement entitled "Deed of Debt Conversion Repayment and Release" (the Deed). Cl. 2.1 of the Deed stipulated that an outstanding debt owed to IBT by Citation was to be converted into an adjusted settlement amount and repaid in cash and shares. Cl. 2.3 went on to provide that the payment was to occur "on, or as soon as reasonably practicable after, the Completion Date" of 1 December 2015.

In December 201, an email correspondence took place between the directors of Citation which alluded to a variation of the Deed, as it was indicated that the share entitlements due to IBT had been forgone, and that the debt would instead be repaid by the issue of 4 million share options. Accordingly, Citation issued 4 million options exercisable at $0.05 to IBT, which IBT accepted. However, there was no evidence relating to any variation of the Deed. Further, between the time of the issuance of the options and the time of these proceedings, Citation had experienced a change of control and there was friction between the old board of directors and the new. As a consequence of this friction, the new board did not have access to the correspondences of the old board, and it was thus impossible for Citation to prove that the Deed had been varied. IBT claimed that the payment of the options was done pursuant to a separate deal, and that they were still entitled to the money and shares that Citation had originally agreed to pay.

Citation did not pay IBT in accordance with the Deed, thereby breaching cl. 2.1, and in March 2016, IBT advised Citation via email that it was terminating the Deed. That email, written by a director of IBT, simply stated "I terminate the attached deed or agreement" because Citation had "breached its obligations". Shortly afterwards, IBT issued Citation with a statutory demand seeking approximately $650,000.

Citation argued that the statutory demand should be set aside under s. 459H of the Act due to the existence of a genuine dispute; namely, whether the issuance of the options constituted a reduction in the amount owing under the Deed. In riposte, IBT contended that there was no evidence of any such alteration, and that it had rightly exercised its common law right to terminate the Deed and was thus entitled to enforce its debt against Citation.

(c) Decision

(i) The existence of a "genuine dispute"

Following a review of relevant authority, the Court set out the following principles which dictate whether or not it will be appropriate to set aside a statutory demand on the basis of there being a genuine dispute between parties:

- there has to be a "plausible contention requiring investigation";
- a plausible contention will not exist if the applicant has made submissions that are so devoid of substance that no investigation is warranted;
- it is not for the Court to determine the merits of a dispute, resolve a dispute or determine the likely outcome of a dispute;
- the threshold for establishing a genuine dispute requires the existence of a genuine claim with merit; and
- a mere assertion of an oral agreement will not necessarily suffice.

Citation put forward two key arguments supporting their claim that a genuine dispute existed. First, it was said that IBT's acceptance of the options indicated that the Deed had been varied and that the amount Citation owed to IBT should be accordingly reduced. Second, Citation argued that IBT had not been entitled to

terminate the Deed when it had purported to have done so, on the ground that Citation had not been afforded the time it should have been afforded in order to meet its contractual obligations.

The Court was satisfied that both of these arguments indicated the existence of a genuine dispute. First, even though Citation could not prove that the Deed had been varied due to its old board members not cooperating with the new board, the fact that IBT had accepted the options could potentially give weight to Citation's claim that the Deed had been varied. In this regard, the Court was satisfied that further investigation was necessary in order to determine Citation's liability. This finding was justified on the basis that it would be "unsafe" to decide that there was no genuine dispute.

Second, the Court accepted that there was a genuine dispute as to whether IBT had even been entitled to terminate the Deed and progress with the statutory demand. IBT had not followed the procedure for termination specified by the Deed, and as such, they could have only terminated the Deed pursuant to the common law doctrine of termination. At common law, IBT would have only been entitled to terminate the Deed had Citation breached an essential term. IBT accordingly claimed that cl. 2.1 was an essential term. However, the Court paid attention to the fact that Citation's obligation to pay under cl. 2.1 were subject to the wording of cl. 2.3, which provided that Citation had to make the payment 'on, or as soon as reasonably practicable after, the Completion Date'. Given the generality of this phrasing, the Court was satisfied that this was not an essential term. The Court explained that the failure to specify that time was of the essence tended against the essentiality of the clause. As such, if the Deed had specified that time was of the essence IBT would have been entitled to exercise a right of termination when Citation had failed to pay the debt. In the absence of a clause specifying that time was of the essence, the principle to be applied was that Citation should have been provided a reasonable time to perform their obligations under cl. 2.1 before IBT could validly terminate the Deed.

The Court went on to explain that, where a promisor had breached a non-essential term and the promisee wished to exercise a right of termination, the promisee first had to issue a notice to the promisor which included the following: First, the promisor had to be informed of the obligations which were to be performed. Second, the promisee had to fix a reasonable time for the performance of those obligations. Third, the notice had to indicate that time was of the essence, or that the promisor's failure to meet their obligations would give the promisee a right to terminate. Naturally, the email IBT had sent to Citation did not satisfy these requirements, and so the Deed had not been validly terminated.

With the benefit of hindsight, it can be said that IBT should have done two things in order to have avoided the statutory demand being set aside. First, IBT should have correctly terminated the Deed prior to issuing the statutory demand by providing a more detailed termination notice. Second, and perhaps more importantly, IBT should not have taken action that was not contemplated by the Deed by accepting the options issued by Citation. As there was only one agreement in dispute, by acting outside the scope of that agreement, IBT had

effectively invited a dispute regarding the determination of each party's rights and duties pursuant to the agreement. Indeed, the Court indicated that Citation's strongest claim to there being a genuine dispute was that the issue of the options could constitute part performance of the Deed.

5.2 Federal Court steps in to regulate class action funding

(By John Pavlakis, Mark Bradley, Ian Bolster, Ashley Wharton and Andrew Robertson, Ashurst)

Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited [2016] FCAFC 148, Federal Court of Australia, Full Court, Murphy, Gleeson and Beach JJ, 26 October 2016

(a) Summary

A key issue in class action funding is whether the Court should make "common fund" orders, which require all members of an open class to pay a funder out of any settlement or judgment. In an open class action, all members benefit from any settlement or judgment, whether or not they have entered an agreement with the funder. Common fund orders prevent "free riders" taking the benefit of litigation funding without paying for it. Such orders have the potential to encourage more open class actions and for class actions to be commenced more quickly, without a traditional "book-build" process where class members are signed up to funding agreements.

In the 2015 Allco Class Action (*Blairgowrie Trading Ltd v Allco Finance Group Ltd (Receivers & Managers Appointed) (in liq)* [2015] FCA 811), the Federal Court rejected an application for a common fund order. In the present case, the Full Federal Court distinguished Allco and decided to make a common fund order, with important limitations to protect class members' interests. While the decision focuses on the particular case before the Court, the unanimous decision is authoritative and opens the door to common fund orders (supervised by the court) in future open class actions.

(b) Facts

The application arose in a shareholder class action against QBE Insurance Group alleging misleading or deceptive conduct and breaches of continuous disclosure requirements. The class action was commenced as an open class action, which meant that the class included everyone who purchased shares in QBE over the relevant period. International Litigation Funding Partners Pte Ltd (the Funder) had entered into funding agreements with 1,290 of those class members (funded class members) representing more than half of the relevant shares acquired. The funding agreements provided for the Funder to have legal costs reimbursed and then be

paid commission of either 32.5% or 35% on amounts received by the funded class members.

Shortly after the first case management conference, and before the notice to class members giving them the chance to opt out, the applicant made a common fund application which was referred directly to the Full Federal Court. The applicant sought approval for common funding terms including for commission to be paid by all class members at a rate of 30%, which was slightly less than in the Funding Agreements but could generate a substantially higher return given the size of the class.

(c) Decision

In a joint judgment, the Court unanimously rejected the applicant's proposed orders, which would potentially have generated a disproportionate return to the Funder. However, it was prepared to make a more limited common fund order, with additional protections for class members' interests. The order provided for commission to be paid from a common fund, but in an amount to be approved by the Court at the time of settlement or decision.

The Court also ordered that the class members could not be worse off as a result of the common fund orders being made. This means for example that class members who had not signed up with the Funder (unfunded class members) could not be liable to pay more by way of commission than they would have been liable to pay, had an equalisation order been made. (An equalisation order, which has been made in a number of previous class actions, is made at the time of resolution and involves deducting from the return to unfunded class members an amount equivalent to the Funder's commission and redistributing that amount across all class members. Under such an order, unfunded class members do not get a free ride, but the Funder only gets its commission from funded class members).

The Court clearly signalled its expectation that the commission ultimately awarded to the Funder upon resolution was unlikely to be as high as the 32.5% or 35% provided for in the Funding Agreements. It suggested (without deciding) that a return in excess of $100 million on a hypothetical $400 million settlement might well be regarded as excessive.

The Full Court's order will apply to all class members and will override the Funding Agreements with the funded class members. The Court gave the Funder the option of entering a common fund on these terms or continuing under the Funding Agreements. As a condition of the approval, the Court also required the Funder, solicitors and applicant to give undertakings binding them to the arrangements already in place under the Funding Agreements to protect the interests of class members.

The Court viewed this regime as more likely to be favourable to class members as a whole, because of the Court's discretion as to the total amount and the cap on total recoveries.

This is a significant decision which - assuming there is no appeal to the High Court - will impact on the market for litigation funding and therefore on the number and kind of class actions commenced in Australia. Common fund orders had only previously been made in two cases, at the point of settlement of a class action, and there was some doubt about the correctness of those decisions. However, it remains to be seen whether this kind of common fund will be attractive to funders. It creates the risk for them of a lower return than the funding agreements would provide, because of the court's supervision, but caps their return at the level set by the funding agreements. The decision may also spur further regulation of third party litigation funding arrangements.

5.3 The rights and entitlements of preference shareholders to share pari passu in any dividends

(By Katrina Sleiman and Lara Nurick, Corrs Chambers Westgarth)

In the matter of Alexandria Landfill Pty Limited [2016] NSWSC 1503, Supreme Court of New South Wales, Brereton J, 25 October 2016

(a) Summary

The case concerned the rights and entitlements of preference shareholders to share in any dividends with other types of shareholders. This arose because of a resolution by the sole director to declare, but not pay, an interim dividend exclusively to the ordinary shareholders. The plaintiff (BBRC) alleged that the conduct of the second defendant (Mr Malouf) as sole director of the first defendant, Alexandria Landfill Pty Limited (ALF), in making such a resolution favouring ordinary shareholders, of which he held 100% of the shares, went against the entitlements of preference shareholders to participate in any dividends pari passu. It was therefore inconsistent with, or oppressive to, the rights of the preference shareholders or alternatively was void as beyond the director's dividend power.

The case turned on Brereton J's construction of the instruments under which the shares were issued and their respective terms. Ultimately, Brereton J found the resolution was void and made a declaration to this effect.

(b) Facts

BBRC and Mr Malouf are shareholders in ALF, the holding company of a waste business. While BBRC holds 53.2% of the preference shares, Mr Malouf holds all of the ordinary shares and is ALF's sole director. The terms on which the preference shares were issued under a Deed Poll made on 5 January 2009 provided for pari passu distribution of dividends with all other shares. These terms were supplemented by a Shareholders Agreement and Mr Malouf's "impugned dividend

resolution" of 28 November 2014. Mr Malouf resolved that ALF "declare (but not pay) an interim dividend to the ordinary shareholder totaling $24,434,678" by no later than 30 June 2017 (Resolution).

The Resolution was relayed to preference shareholders by letter dated 3 December 2014. The letter explained ALF was financially unable to pay the dividend, and the future ability to pay it, and the nomination of 30 June 2017, was influenced by: (1) the compulsory acquisition of the landfill site for the Westconnex for which ALF would be compensated at an unknown future date; and (2) the continuing liability of accrual or payment under cl. 8.2(b) of the Shareholders' Agreement, which "at this level will be financially too much for the Company to bear".

BBRC argued the Resolution was void, oppressive to preference shareholders and contrary to ALF's interests. This was because: (1) ALF incurred an immediate liability it was unable to pay; and (2) preference shareholders' rights were not treated pari passu as Mr Malouf was the only beneficiary of the Resolution. In the alternative, if the Resolution was valid, the accrued 11% minimum cash distributions owed to preference shareholders under cl. 8.2 were immediately payable.

The defendants argued the Resolution did not give rise to an immediate liability and the preference shareholders were not entitled to pari passu distribution of any dividend. Even if they were, as the intention to pay the impugned dividend would arise concurrently with a dividend declared in favour of the preference shareholders in discharge of their accrued liabilities, this was not inconsistent with their rights. Regarding the alternative claim, the defendants argued the liabilities to preference shareholders were not immediately payable because they would be paid concurrently with the impugned dividend, which would only become payable when ALF was in a financial position to pay and payment was authorised.

(c) Decision

(i) The rights and entitlements of preference shareholders

BBRC argued preference shareholders' entitlements extended to participating pari passu in any dividend as well as receiving an 11% minimum cash distribution. The defendants contended that the preference shareholders pari passu entitlement arose only on winding up, while their minimum cash distribution rights were not additional, but rather limited to an 11% minimum cash distribution.

Brereton J examined the instruments setting out the terms of issue. While the Constitution gave the directors power to issue shares and make dividend decisions, these were subject to any other agreement connected to their issue. The central clauses in dispute were cl. 7.4 of the Deed Poll and cl. 8.2 of the Shareholders Agreement:

- cl. 7.4 provided "preference shares will rank in priority to all other shares on winding up, but will rank pari passu with all other shares for dividends and other entitlements"; and

- cl. 8.2 expressly stated preference shareholders are entitled to quarterly "payments" which must "at least equal" a return of 11% per annum on the convertible notes investment. Such payments may be by way of a loan pending ALF's accrual of income so that it can declare a dividend. If payment is by dividend, it "must be in addition to the 11% minimum cash distribution".

The defendants submitted cl. 7.4 should be read as one sentence concerned only with entitlements during winding up. Brereton J rejected this construction because it would considerably alter ALF's constitutional provisions. Since the first phrase of cl. 7.4 expressly dealt with the position during winding up, Brereton J considered the second phrase, notwithstanding its wording, should be construed as concerning the situation when the company is a going concern. Brereton J noted that a construction which denied preference shareholders the right to participate pari passu with other shareholders in any dividend could not be reconciled with cl. 8.2, as it would defeat the purpose of the convertible note structure which intended to add to the rights of repayment of preference shareholders.

The defendants' contention that the preference shareholders entitlements were limited to an 11% dividend was also rejected as overly simplistic because it failed to account for the loan mechanism in cl. 8.2. Brereton J drew a distinction between future entitlements and accrued liabilities, explaining that:

- preference shareholders' entitlement is to share pari passu with other shares in any dividend, and, to the extent that such dividend is insufficient to provide an 11% return, to have it topped up to 11%; and
- separately, until there are sufficient funds to pay a dividend, actual payment of the 11% minimum cash distribution is credited as a loan to each preference shareholder. The loan is additional to, and not extinguished by, any dividend. Amounts accrued on loans must first be repaid before dividends can be declared and paid.

(ii) The effect of the Resolution

BBRC contended the effect of the Resolution was to give rise to an immediately enforceable debt, whilst the defendants contended it was merely a statement of intent. If merely a statement of intent, BBRC argued it was a nullity. Brereton J saw its effect as depending on whether the Resolution was a "declaration" of a dividend within the meaning of s. 254V(2) of the Corporations Act 2001 (Cth), which would give rise to an enforceable debt. This depended on the terms of the resolution and the power to declare dividends granted by cl. 7.1(b) of the Constitution.

Brereton J found the language of cl. 7.1(b), "to declare and authorise payment of a dividend", indicated it did not meet the definition of "declare" within s. 254V(2) because authorisation was required to trigger the payment obligation and give rise to a debt. Similarly, the wording of the Resolution, to "declare (but not pay) an interim dividend" by no later than 30 June 2017, was clearly not intended to make the dividend immediately payable. The clauses did not give rise to a deferred

liability within the meaning of s. 254V(1) either, since the resolution did not fix a date for payment. It merely stated that payment will be made no later than the specified date, clearly contemplating a further decision to fix the date of payment. Accordingly, Brereton J found that the impugned resolution was a partial exercise of power under cl. 7.1(b) and therefore a nullity.

(iii) The Resolution and the preference shareholders' rights

The defendants argued the Resolution was not inconsistent with the preference shareholders' right to pari passu treatment because the method of calculation of dividend payments was no less favourable. Brereton J rejected this, finding that if it were not a nullity, the resolution would be inconsistent with, and oppressive to, the rights of preference shareholders. This is because, at least on its face, the resolution only benefits the ordinary shareholder, does not provide for participation by the preference shareholders and fails to account for the preference shareholders' right to repayment of their accrued loans before the declaration of any dividend.

(iv) In the alternative, if the Resolution were valid, would the loans accrued to preference shareholders become immediately payable?

If a valid decision were made to declare and pay a dividend, Brereton J held that ALF would not be entitled to accrue the minimum cash distributions by way of loan, and the outstanding loans accrued would become immediately payable.

5.4 ACCC granted leave to proceed against vocational training college for misleading or deceptive conduct and unconscionable conduct

(By Jason Xu and Rebecca Williams, King & Wood Mallesons)

Australian Competition and Consumer Commission v Phoenix Institute of Australia Pty Ltd (subject to deed of company arrangement) [2016] FCA 1246, Federal Court of Australia, Perry J, 21 October 2016

(a) Summary

The Australian Competition and Consumer Commission (ACCC) and the Commonwealth have taken another step in proceedings against vocational educational provider Phoenix Institute of Australia (Phoenix) and its related company Community Training Initiatives Pty Ltd (CTI) (together, the Companies), who are alleged to have engaged in misleading and deceptive conduct and unconscionable conduct when inducing students to sign up to vocational educational courses and the associated VET FEE-HELP loans provided to students by the Commonwealth.

Both Companies are subsidiaries of Australian Careers Network Limited (ACNL). Voluntary administrators were appointed to ACNL and its subsidiaries (ACNL Group) in March 2016. The administration ceased in May 2016 upon the execution of a deed of company arrangement (DOCA).

Perry J of the Federal Court concluded that both the ACCC and the Commonwealth were creditors of the Companies for the purposes of the Corporations Act 2001 (Cth) (the Act) at the time that the Companies entered voluntary administration, such that leave was required for the ACCC and the Commonwealth to continue proceedings. Her Honour granted that leave, on the basis of the significant public interest in permitting the ACCC to proceed against Phoenix to obtain non-party redress on behalf of students who may otherwise remain liable to the Commonwealth for VET FEE-HELP loans entered into in relation to vocational educational courses run by the Companies.

Leave was granted on the condition that the ACCC and the Commonwealth would not, without further leave, seek to enforce any pecuniary penalties, injunctive relief requiring moneys to be refunded to the Commonwealth, or any costs order. Rather, the ACCC will seek declarations that the Companies breached the *Australian Consumer Law* (ACL) and non-party redress, including the annulment of the students' liability to pay any tuition fees, annulment of the students' liability to repay any loan amounts to the Commonwealth, and annulment of the Commonwealth's liability to pay any amounts to the Companies in connection with the students' enrolment.

(b) Facts

Under the Higher Education Support Act 2003 (Cth), an eligible student who enrols in a course offered by an approved vocational educational provider, such as Phoenix, is not ordinarily required to pay his or her tuition fees upfront to that provider directly. Rather, the effect of the legislative scheme is that the student's tuition fees are paid by the Commonwealth directly to the educational provider, with the student entering into a loan agreement with the Commonwealth (a 'VET FEE-HELP' student loan) for an amount equal to approximately 120% of the course tuition fees. The student remains liable to repay that debt to the Commonwealth irrespective of whether he or she finishes the relevant unit. Phoenix received Commonwealth funding of approximately $106 million by way of advance payments, with a further $253 million remaining unpaid.

On 23 November 2015, the Commonwealth and the ACCC initiated proceedings against the Companies, alleging that they had engaged in misleading or deceptive conduct and unconscionable conduct under the ACL. It is alleged that the Companies targeted potential students in low socio-economic communities and made misrepresentations designed to induce potential students to sign up to courses, including that certain vocational training courses were "free", that the VET FEE-HELP loan would never have to be repaid, and that they would receive a "free" laptop upon enrolment.

Phoenix's registration as a registered training organisation was subsequently cancelled, and both Phoenix and CTI (which provided administrative services to Phoenix) ceased trading. On 21 March 2016, voluntary administrators were appointed to the ACNL Group, including the Companies. The administration subsequently ended on 24 May 2016 upon the execution of the DOCA.

The Companies claimed that both the Commonwealth and the ACCC were "creditors" for the purposes of the Act at the time that the Companies entered administration. If that were the case, both the ACCC and the Commonwealth were therefore bound by the DOCA, pursuant to ss. 44D and 44E of the Act, such that they could not commence or continue proceedings against the Companies except with the Court's leave.

While the Commonwealth accepted that it was a creditor, the ACCC claimed that it did not have a claim against the Companies at the relevant date and was therefore not subject to the statutory stay. In the alternative, both the Commonwealth and the ACCC argued that the Court should grant leave to proceed notwithstanding the DOCA.

(c) Decision

(i) Was the ACCC a creditor of Phoenix for the purposes of Pt 5.3A of the Act?

There is no definition of "creditor" in the Act. Rather, whether the ACCC was a creditor of Phoenix at the time that it entered administration turned on whether it had a "Deed Claim" as defined in the DOCA. This definition was consistent with s. 553 of the Act, which provides:

". all debts payable by, and all claims against, the company (present or future, certain or contingent, ascertained or sounding only in damages), being debts or claims the circumstances giving rise to which occurred before the relevant date, are admissible to proof against the company."

The ACCC had not submitted a proof of debt in the voluntary administration of Phoenix. Rather, the question before the Court was whether the relief sought by the ACCC constituted a contingent claim where the circumstances giving rise to it occurred before 21 March 2016, being the date when Phoenix was placed into voluntary administration.

As noted above, while the ACCC had applied to the Court for pecuniary penalties, it had also sought discretionary relief including the annulment of certain liabilities owed by the Commonwealth and by the students (including non-party redress); declaratory relief; and injunctive relief requiring Phoenix and CTI to refund certain amounts to the Commonwealth. The ACCC submitted that the discretionary nature of that relief meant that, as at 21 March 2016, the ACCC had no more than a right to apply to the Court for relief. Accordingly, it submitted, the ACCC did not have any contingent claim.

The Court referred to the approach to "contingent creditors" taken in *Community Development Pty Ltd v Engwirda Construction Company (1969) 120 CLR 455*, where the High Court held that the term denoted a person towards whom the company, under an existing obligation, may or will become subject to a present liability upon the happening of some future event or at some future date.

Her Honour further referred to the decision in *McClellan v Australian Stock Exchange Ltd (2005) 144 FCR 327*. In that case, Finkelstein J concluded that a fine imposed by the Australian Stock Exchange Ltd (ASX), relating to breaches of the operating rules which occurred before the company entered administration, was a contingent liability. In that case, there was an underlying legal liability arising out of the statutory contract between the ASX and the listed company.

By analogy, Perry J concluded that the ACCC's claim for relief amounted to a contingent claim. The source of the obligation to refund certain moneys (if triggered by an order of the Court) was to be found in the pre-existing obligation upon the Companies to comply with the relevant provisions of the ACL, which were breached by conduct occurring prior to 21 March 2016.

Perry J distinguished these circumstances from other cases where it had been held that a right to take proceedings did not constitute a contingent claim. Her Honour drew support for this broad reading from the High Court's decision in Sons of Gwalia. In that case, the circumstances said to constitute misleading and deceptive conduct occurred before the relevant date - even though the loss or damage was not then apparent to the person who suffered that damage - and the claim was therefore provable under the relevant DOCA.

Accordingly, the Court concluded that the ACCC was a creditor and was required to seek the Court's leave to proceed against Phoenix and CTI.

(iii) Should the ACCC and Commonwealth be granted leave to proceed against the Companies?

Perry J concluded that leave should be granted to the ACCC and Commonwealth to proceed against the Companies, on the condition that the applicants would not seek pecuniary penalties, refunds by Phoenix to the Commonwealth, or costs, without seeking further leave.

First, the Court noted that there was a strong public interest to be vindicated by proceeding against the Companies for unconscionable conduct. It is alleged that the Companies procured a substantial sum of up to $360 million from public revenue through misleading or deceptive conduct and unconscionable conduct towards highly vulnerable people. While the ACNL Group may be unlikely to resume trading as a vocational education provider, the Court emphasised the importance of general deterrence.

Further, the Court noted that until the proceedings are determined, the students would remain subject to contingent debts, which may significantly affect their

financial position. The prejudice to these students would be substantially increased by the delay to proceedings caused by the statutory stay.

The Companies argued that defending the proceedings would likely result in significant expenditure of the funds which could otherwise be available to creditors. The Companies also argued the legislative purpose of the statutory stay is that it is temporary in nature, whereas a grant of leave would be inconsistent with the nature of the administration.

The ACCC and the Commonwealth were willing to give an undertaking not to seek pecuniary penalties, any refund remedy or any costs without further leave of the Court, so as not to prejudice creditors. Accordingly, her Honour concluded that the (more limited) depletion of the funds available to creditors was not sufficient to outweigh the significant public interest consideration in favour of granting leave to proceed.

5.5 Financial mismanagement results in 10 year prohibition on carrying on financial products or services business and disqualification from managing corporations

(By Alex Moores, DLA Piper)

Australian Securities and Investments Commission v McIntyre [2016] FCA 1276, Federal Court of Australia, Bromwich J, 17 October 2016

(a) Summary

Between August 2014 and October 2015, Mr Jamie McIntyre and Mr Dennis McIntyre (McIntyres), either directly or by way of eight corporate entities over which the two individuals had control through their position as directors (collectively, the Defendants), operated five managed investment schemes collecting a total of $6,658,192 from investors. The managed investment schemes (Schemes) all operated as land banks, whereby money is collected from investors and pooled for the development of land, and the investors receive benefit once the land begins to generate profit. The Schemes were unregistered, which is a contravention of s. 601ED(5) of the Corporations Act 2001 (Cth) (Act).

The Federal Court of Australia (Court) held that, while there was no evidence of dishonesty in the operation of the Schemes, the incompetence and irresponsibility of the Defendants along with their disregard for legal obligations and substantial loss to 152 separate investors was sufficient to warrant a lengthy disqualification from managing companies and carrying on any business involved in financial products or services. Accordingly, the McIntyres were restrained for a period of

ten years, and the Courts ordered that the Schemes be wound up. The McIntyres were ordered to pay the costs of the proceeding in the amount of $50,000.00.

(b) Facts

On 6 August 2015, ASIC petitioned the Court for ex parte orders to dispense with service requirements so that proceedings in relation to the Defendants could be brought on immediately. Ancillary orders were also made for the surrender of the McIntyres' passports. The remaining eight corporate entities among the Defendants were identified as companies of which the McIntyres were appointed directors and shadow directors.

The Defendants operated, from August 2014 onwards, five managed investment schemes within the meaning given by the Act. The Schemes were designed to accumulate investors funds as consideration for the acquiring of rights over parcels of land within a property managed by the respective scheme. The parcels were purchased with reference to an unregistered subdivision plan, and the offer was structured as an option over the specified lots that investors could exercise once the plan was registered with the relevant councils. The investors did not have an active role in the development or management of the land, and it was the responsibility of the Schemes to arrange zoning and permits as required.

The material provided to investors outlined the benefits that would flow from the Schemes once developments on the land enabled the Schemes to generate profit. It was promoted through seminars and events, articles and web presence, as well as direct contact with potential investors. As part of this marketing effort, the Defendants and their agents made recommendations and expressed opinions that were intended, or could reasonably be regarded as intended, to influence investor decisions regarding the options, which were financial products.

Under the Act, all managed investment schemes that meet certain criteria must be registered with ASIC, and the Schemes met the criteria so as to require registration. The Defendants did not register any of the Schemes with ASIC, which constituted a breach of s. 601ED(5) of the Act. The projects encountered difficulties, attributed by the eventually appointed liquidators of the eight corporate Defendants to poor strategic management and failure to manage cash flow. The liquidators were ordered by the Court to wind up the companies on 10 March 2016.

(c) Decision

In reaching its decision to affirm the orders sought by ASIC, the Court looked at the fact that, in addition to mismanagement of the Schemes, Mr Jamie McIntyre had previously been director and secretary of five other companies that were forced to wind up due to poor financial controls, a lack of adequate record keeping, and failure of strategic management. In addition, he had been the subject of earlier proceedings in which Merkel J made declarations that he and another

company with which he was associated had contravened ss. 911A and 911B(1) relating to provision of financial advice without a financial services licence.

(i) The appropriateness of disqualification

Drawing on recent judicial decisions citing the same, the Court found the fifteen considerations outlined in *Australian Securities and Investments Commission v Adler* [2002] NSWSC 483 to be appropriate in determining whether to impose a banning order. The list that the court compiled to analyse trends in decisions relating to disqualification included one guiding principle on which the Court primarily relied in arriving at its decision. It stated that in cases where disqualification "ranged from 7 to 12 years, the factors included serious incompetence and irresponsibility, substantial loss, defendants had engaged in deliberate courses of conduct to enrich themselves at others' expense, but with lesser degrees of dishonesty, continued, knowing and wilful contraventions of the law [than longer disqualifications]".

Whereas the courts are historically more willing to grant longer disqualifications where there is evidence of dishonesty and lack of remorse, the Court held that ten years was appropriate given the quantum of funds lost and mismanagement by the Defendants. The past behaviour of the McIntyres in the financial sector was a factor in the overall decision, and also in relation to the length of the disqualification period.

(ii) Injunction prohibiting financial businesses

In addition to the disqualification from company management, the orders sought by ASIC included injunctions in relation to the financial sector specifically. The Court accepted that it is appropriate to restrain activity other than actual management of companies and therefore the McIntyres were more broadly restrained from:

- carrying on a business related to or concerning or directed to financial products or services within the meaning of s. 761A of the Act;
- providing financial product advice or dealing in financial products within the meaning of s. 761A of the Act; or
- in any way holding themselves out as doing either of those things.

This restraint was imposed for the same amount of time as the disqualification being a period of ten years.

(iii) Granting of declaratory relief

Finally, the orders sought by ASIC included various declarations in relation to the Schemes and services offered by the Defendants. The Court examined the use of declaratory relief, again with reference to recent precedential analysis, stating that "care needs to be taken in granting declaratory relief which affects other parties because it may be incorrectly taken to have been made following an adjudication by the court on the merits, rather than being as a result of agreed facts and

submissions, and consent orders and declarations". The historical position of the courts was that a declaration cannot be made in the absence of a contradictor, however, the recent case of *Australian Competition and Consumer Commission v MSY Technology Pty Ltd* [2012] FCAFC 56 (MSY) clarified this position finding that the requirement for a contradictor is met if there is a party who has an interest in opposing the declaratory relief sought, regardless of whether the choice is made to actually oppose it.

Once the requirement of a contradictor is met, the courts must then exercise discretion in whether or not to grant declaratory relief based on the circumstances. The Court held that because the disqualification and injunctions relate to two individuals and companies of which they were a controlling influence, the declarations perform a particularly useful function by identifying specifically what the corporate Defendants have done, and the involvement of the individuals in that activity. Therefore, there is a proper basis for granting the declaratory relief sought in this case.

(iv) Orders resulting from consent

Although the Court believed the disqualification, restraint period, and declaratory relief to be appropriate for the reasons discussed above, in this case the orders sought had been agreed prior to the proceedings and were presented to the Court by agreement of the parties. In addition to agreement on the orders, the proceeding itself was assisted by the use of a statement of agreed facts signed by both ASIC and the McIntyres, who also made joint submissions as the only written submissions in the matter. Due to the analysis of MSY and the appropriateness of the punitive measures sought, the Court did not find any problems with affirming the orders presented with the consent of all parties and specifically referred to sections of the Act, such as s. 1324(3), that allow the courts to act by consent of all the parties to the proceedings.

5.6 Liquidators directed to use trust funds to investigate claims brought against the trustee

(By Fred Chan and Louise Hang, Corrs Chambers Westgarth)

In the matter of PrimeSpace Property Investment Ltd (in liq) [2016] NSWSC 1450, Supreme Court of New South Wales, Black J, 13 October 2016

(a) Summary

The liquidators of PrimeSpace Property Investment Limited (in liq) (PPIL) obtained directions from the Court under s. 511 of the Corporations Act 2001 (Cth) (Corporations Act) to apply trust funds that PPIL held in its capacity as

trustee in the PrimeSpace Northbourne Trust (PSNT) for the liquidators' reasonable costs and expenses in:

- investigating claims made against PPIL as trustee for PSNT in proceedings brought by a third party, Canberra Finance Group Pty Ltd (CFG) (CFG Proceeding), including by conducting examinations and obtaining orders for the production of documents pursuant to Part 5.9 of the Corporations Act and obtaining counsel's opinion to determine whether PPIL could defend the proceedings and bring any cross-claim in the CFG Proceeding; and
- taking any necessary steps in the proceedings pending the carrying out of investigations and any steps or actions incidental to these matters.

The application was opposed by a creditor of PSNT, IQIT Nominees Pty Ltd (IQIT Nominees) as trustee of the IQ Investment Trust (IQIT), on the bases that it would delay its own claim to the trust funds and the only party to benefit a successful defence was the trust beneficiary, but if the defence was unsuccessful, lower ranking creditors including IQIT would be disadvantaged because the trust assets available to repay such creditors would be depleted in doing so.

Ultimately, the Court granted the directions sought by the liquidators on the basis that the liquidators faced a real controversy as to the steps that should be taken and that the directions sought raised an issue of propriety and reasonableness and was not merely a commercial decision.

(b) Facts

PPIL was a trustee company which acted as responsible entity and trustee of various funds and trusts within the Prime Access Group, a property investment and development funder. CFG and members of the Prime Access Group entered into a series of transaction documents to the effect that:

- PPIL in its capacity as trustee of PSNT would guarantee a $1.2 million loan made by CFG to PS Retail Pty Ltd (PS Retail) to fund a mixed use development in Orange; and
- CFG was entitled to exercise an option to purchase four apartments in another development and offset the purchase price of the apartments against the amount owed to it under the transaction documents.

Upon the appointment of voluntary administrators to PPIL, CFG purportedly sought to exercise the option and set-off rights described above and subsequently commenced the CFG Proceeding. However, the liquidators formed the view that:

- there was no recorded basis for PPIL as trustee of PSNT assuming liability under the transactions;
- in entering into the transactions, PPIL may have been in breach of its duties as trustee of PSNT;
- in entering the transactions, the directors of PPIL may have committed breaches of their directors' duties; and

- CFG may have been knowingly concerned in such breaches, depending upon the extent of its involvement and knowledge.

Accordingly, the liquidators filed an application under s. 511 of the Corporations Act seeking directions from the Court to use the trust funds of PSNT to conduct investigations and obtain counsel's opinion with respect to pursuing a defence in the CFG Proceeding. The application was opposed by a creditor of PSNT, IQIT Nominees.

(c) Decision

The Court granted the directions sought by the liquidators and held that the liquidators should be justified in using the trust funds held by PPIL on PSNT's behalf to conduct the relevant examinations and obtain the relevant opinion from counsel. Additionally, the Court held that the liquidators would be justified in taking such steps in the CFG Proceeding as were necessary pending the carrying out of the relevant investigations and taking such steps or action incidental to those matters.

(i) Whether a direction under s. 511 of the Corporations Act should be given

Section 511 of the Corporations Act provides the court with the power to determine any question arising in a voluntary winding up on a liquidator's application. In its application, the liquidators submitted they are properly in need of a direction to apply the trust funds in the manner proposed because PPIL had no substantive business activities outside its role as trustee and responsible entity of the several trusts and has no substantive assets in its own capacity. The liquidators also submitted it is often appropriate for liquidators to seek the court's direction as to whether a particular course that they propose to take is reasonable in advance of incurring disbursements and performing the relevant work in the context of a liquidation of a trustee company.

Black J considered that it was appropriate for the Court to exercise its powers in circumstances where it was just and equitable to do so and to assist in the proper performance and discharge of the liquidator's duties and functions. His Honour considered the principles in *Re Ansett Australia (No 3)* [2002] FCA 90; (2002) 115 FCR 409 and *Re MF Global Australia Ltd (in liq)* [2012] NSWSC 994; (2012) 267 FLR 27 and granted the directions sought by the liquidators on the basis that:

- the liquidators faced a real controversy and the advice sought raised an issue of propriety and reasonableness and was not merely a commercial decision;
- the direction provided clarity to the liquidators and would be of advantage to the liquidation of PPIL;
- the transactions between CFG and PPIL raised several questions which the liquidators may properly consider warrant further investigation; and
- the liquidators formed the view that creditors' interests would be served by conducting the examinations.

(ii) The competing arguments

The Court rejected the various arguments put forward by IQIT Nominees, the trustee of IQIT, opposing the liquidators' application.

First, IQIT Nominees submitted that the trust funds should not be applied in the defence of the CFG Proceeding because IQIT was likely to be repaid in the immediate future and therefore, only PSNT's beneficiary, Prime Office Property Fund (POPF) as the sole ordinary unitholder of PSNT, would benefit from the successful defence of the CFG Proceeding. Furthermore, it submitted that pursuing the defence would significantly delay the distribution of funds from PSNT to IQIT and other creditors.

Black J was not satisfied, on the evidence, that IQIT and other creditors of PSNT would be paid in full in the immediate future or that POPF would be the only party that benefits from the defence of the CFG Proceedings. Furthermore, while not pursuing a meritorious defence may be of commercial advantage to a creditor of PSNT, his Honour held that the liquidators are not entitled to disregard the interests of unitholders in making a relevant decision merely because trust creditors rank higher than unitholders in the distribution of trust assets.

IQIT Nominees also submitted that if IQIT's debt was subordinated to the debts of other creditors of PSNT (which was a possibility on one construction of the relevant documentation), it would, as a practical matter, be the only entity funding the liquidators and bear the costs arising from an unsuccessful defence of the CFG Proceedings. Although Black J acknowledged this possibility, his Honour noted that this is a situation that could commonly arise in respect of a liquidation where there are different ranking creditors, and rejected a general proposition that a liquidator must not conduct examinations, obtain counsel's advice or pursue a meritorious claim where the advantage would flow to both higher ranking or lower ranking creditors but the costs of doing so would be potentially borne by lower ranking creditors if those proceedings are unsuccessful.

Accordingly, his Honour held that the liquidators should properly be directed that they would be justified in utilising funds held by PPIL on PSNT's behalf to conduct the relevant examinations and obtain the relevant opinion from counsel, and made the directions sought by the liquidator.

5.7 Recognising foreign proceedings in Australia - considering a company's centre of main interests

(By Dea Fairbairn, MinterEllison)

Wood v Astra Resources Ltd [2016] FCA 1192, Federal Court of Australia, White J, 7 October 2016

(a) Summary

In this case, the Federal Court of Australia was asked to recognise foreign proceedings under the *United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency* (Model Law). The Court confirmed that displacing the presumption that a company's centre of main interests (COMI) is its registered office would be difficult, in the absence of clear factors that are both objective and ascertainable by third parties.

(b) Facts

On 2 November 2015, the High Court of Justice of England and Wales made an order winding up Astra Resources Plc (Astra), a UK company. The liquidators of Astra sought to have the winding up recognised in Australia and so made an application under the Model Law. As an alternative, the liquidators sought an order for the winding up of the company pursuant to s. 583(c) of the Corporations Act 2001 (Cth).

The Model Law is given effect in Australia under s. 6 of the Cross-Border Insolvency Act 2008 (Cth). Under the Model Law, in order for an Australian Court to recognise proceedings in a foreign jurisdiction, it must satisfy itself that the foreign proceedings are taking place in the same state as where the debtor has its COMI.

While the Model Law does not define "centre of main interests", it does provide that, in the absence of contrary evidence, the Court is entitled to presume that the debtor's registered office is its COMI.

The liquidators submitted, and White J agreed, that Australian courts have adopted the position taken by the European Court of Justice that the COMI should correspond to the place where the debtor conducts the administration of its interests on a regular basis and is therefore ascertainable by third parties.

The registered office of Astra has always been in the United Kingdom. The liquidators contended that a number of factors indicated that the presumption that the registered office of Astra was its COMI should not be displaced, including:

- Astra's corporate secretary was and is located in London;
- Astra had engaged solicitors in England in relation to the winding up proceedings;
- Astra had retained auditors in England; and
- Astra had, between December 2012 and June 2014, been listed on the GXG Market Exchange operating in London.

Despite this, the liquidators acknowledged that Astra is linked in various ways with Australia, insofar as:

- Astra was a resident in Australia for tax purposes;
- Astra distributed share application forms and made offer of shares to several people in Australia;
- Astra's information brochure provided contact details in Australia;
- a number of Astra's previous directors were located in Australia;
- Astra retained an Australian accountant;
- Astra retained Australian brokers;
- Astra had a business premises in South Australia; and
- Astra is related to a number of incorporated subsidiaries in Australia.

In addition to the above, the liquidators acknowledged that there were some factors that linked Astra with jurisdictions other that the United Kingdom and Australia, including the following:

- Astra engaged a share registry service provider in Canada;
- Astra's sole director's address is in Macedonia;
- evidence that Astra may have pursued some form of activity in 11 different countries; and
- the creditors known to the liquidators being located in various jurisdictions, with the largest known creditor being a company in the United States.

(c) Decision

White J held that Astra's COMI was its registered office in the UK and ordered that the UK proceedings be recognised as a foreign main proceeding in Australia.

In reaching his conclusion, White J held that the COMI must be identified by reference to criteria that are both objective and ascertainable by third parties. He considered that the presumption laid down by the European Court of Justice that the COMI is a company's registered office can only be rebutted if factors which are both objective and ascertainable by third parties displace that presumption.

White J held that the identities and location of shareholders are not necessarily irrelevant considerations in ascertaining a company's COMI. However, in the circumstances of the present case, it was held that it was not necessarily appropriate to attach much weight to the fact the majority of Astra's shareholders were located in Australia. On this point, White J concluded that the shareholders should not be considered "the alter ego" of the corporate entity where there was little to suggest they were more than passive investors.

The objective factors which might have pointed towards Astra's COMI being in the UK or Australia were largely historical and together with the fact it was hard to identify the company's COMI with reference to the activities the company engaged in, strengthened the importance of the presumption of the COMI being the company's registered office. Although there were factors to link Astra to

jurisdictions other than the UK or Australia, they were not sufficient to displace the presumption that its COMI was its registered office.

5.8 Liquidator negotiates orders with ASIC in proceedings involving civil penalty

(By Nicholas Josey, Clayton Utz)

Australian Securities and Investments Commission v McDermott (in the matter of Conalpin Pty Ltd (in liq)) [2016] FCA 1186, Federal Court of Australia, Moshinsky J, 4 October 2016

(a) Summary

The proceedings concerned the results of an inquiry conducted by the Australian Securities and Investments Commission (ASIC) under ss. 56 and 447E of the Corporations Act 2001 (Cth) (Act) into the activities of Mr Ross McDermott, who had been carrying on a practice as a liquidator and administrator.

The parties presented the Court with an agreed statement of facts and a set of proposed consent orders which primarily provided for penalties to be imposed on Mr McDermott. In making orders largely in line with those proposed by the parties, the Court:

- stressed the importance of insolvency practitioners adhering to all relevant professional codes of conduct;
- confirmed that the Act granted the Court a broad supervisory jurisdiction over people placed in positions of control over certain companies; and
- confirmed that defendants are able to negotiate consent orders with ASIC in civil penalty proceedings commenced by the regulator.

(b) Facts

Mr McDermott had been an insolvency practitioner for approximately 22 years as at the time of the judgment. In or about November 2012, ASIC commenced a compliance review into Mr McDermott's practice after becoming aware of certain irregularities and concerns regarding Mr McDermott's conduct through its ongoing surveillance activities. ASIC's concerns fell into four categories:

- Mr McDermott had failed to act independently, free of any actual or apparent conflict of interest, or with the appropriate degree of care and diligence required of a registered liquidator;
- Mr McDermott had accepted appointments in external administrations in circumstances where he was in a position of actual or potential conflict;

- Mr McDermott had failed to lodge with ASIC a report of suspected offences by officers/former officers of companies to which he had been appointed; and
- Mr McDermott had failed to properly inform creditors of the basis for remuneration that he was claiming, and drew upon that remuneration without appropriate creditor or Court approval.

It should be noted that, as liquidators are subject to the same standards imposed on officers of a corporation, Mr McDermott was subject to the statutory duty of care and diligence imposed by s. 180 of the Act, breach of which amounts to breach of a civil penalty provision.

The parties agreed to a Statement of Agreed Facts, which was annexed to the Court's reasons for judgment.

The parties agreed to resolve the matter by way of consent, and proposed *inter alia*, the following:

- that Mr McDermott be prohibited from acting as a liquidator, provisional liquidator, voluntary administrator or deed administrator for such period as the Court considered appropriate; and
- that Mr McDermott be removed as a liquidator and/or deed administrator for all companies listed in the schedules to the judgement, and (for the most part) either:
    - a different administrator or liquidator be appointed, being Mr John Potts; or
    - Mr McDermott be reappointed jointly and severally with Mr Potts.

Notably, ASIC did not seek to have Mr McDermott removed from the list of registered practitioners but rather proposed that he be suspended from accepting new appointments for 3 years, subject to him having completed a peer review of his practice, and the ARITA advanced certification course. ASIC was also content for him to accept future appointments in member's voluntary liquidations.

(c) Decision

Section 536 of the Act gives both the Court and ASIC the power to inquire into the conduct of a liquidator in connection with the performance of their duties, functions and powers, and to take such action "as it saw fit". Here, the Court noted that whilst the Act does suggest that the Court is able to "inquire" into such conduct, it is settled that it was more appropriate in such matters for ASIC to assist the court as its representative in presenting relevant and admissible evidence.

Section 447E of the Act provides similar powers to the Court in respect of administrators in that it may make any order "as it thinks just". However, s. 447E(3) provides that such orders may only be made on the application of ASIC or a creditor or member of the relevant company (rather than permitting an "inquiry"). Here, the Court referred to the findings of Justice Dodds-Streeton in *ASIC v Edge [2007] VSC 170*, in which it was held that the Court was able to

make inquiries into an administrator's conduct as an incident of an inquiry under s. 536 of the Act.

The Court also observed the broad discretion provided to it as to the types of orders that could be made in such matters, which included the power to, *inter alia*, cancel a liquidator's registration, and make orders in relation to particular companies subject to the liquidation or administration process under the Act.

Accordingly, the Court held that it was able to make the orders requested by ASIC and agreed with ASIC's recommendation as to the length of the suspension. The Court thus made orders substantially in line with those proposed. In so doing, the Court observed that whilst Mr McDermott had failed to carry out his duties as a liquidator properly, he had not been dishonest in the course of his conduct. It also noted that it had previously been recognised that withdrawing from the liquidator the entitlement to accept new appointments operated to both:

- protect the public from the work of that person; and
- deter other liquidators from acting in similarly dilatory fashion.

Although it did not comment expressly on the fact, by making the orders as proposed by the parties, the Court confirmed that a defendant was able to negotiate orders with ASIC despite the fact that the proceedings involved a contravention of a civil penalty provision of the Act.

The Court also agreed that Mr McDermott should pay ASIC's costs of the proceeding, fixed in the sum of $100,000.

5.9 Bringing derivative actions on behalf of a company in liquidation

(By Ann-Kathrin Goller, King & Wood Mallesons)

Hua and Song v Tuckerman [2016] NSWSC 1431, Supreme Court of New South Wales, Black J, 27 September 2016

(a) Summary

This matter involved an Amended Notice of Motion by the defendants/cross-claimants, Mr Tuckerman and Mr Devine, (Defendants). Most significantly, the Defendants brought an application for leave to bring derivative proceedings on behalf of MST Investment Corporation Limited (in liq) (MST) and several of MST's subsidiaries, for the purposes of cross-claiming against the plaintiffs, Ms Hua and Mr Song, (Plaintiffs) for delayed payments and a failure to contribute monies. It was common ground that MST and its subsidiaries were in liquidation

following a failed development project, in which the Plaintiff and the Defendant were participants.

The Plaintiffs sought indemnity costs and costs forthwith on the grounds of extensive delays and lack of solid grounds by the Defendants.

Black J dismissed the Defendants' application to represent MST and other entities. His Honour held that the derivative proceedings lacked merit and there were considerable difficulties in establishing causation. Further, Black J considered the negative impacts on the liquidator and assets of MST, and held that other practical considerations favoured dismissing the application. His Honour also denied the Plaintiffs' applications for costs, re-iterating the unique circumstances and gravity required to make out such an application, and emphasising that the Defendants were self-represented litigants.

(b) Facts

The underlying proceedings concern a failed development project in New South Wales which caused MST and its subsidiaries to fall into liquidation. The claims brought by the Plaintiffs are for the loss of monies invested in the project in the order of approximately $2 million. The Defendants sought to cross claim against the Plaintiffs in the order of approximately $4 million.

While the Defendants' Amended Notice of Motion sought several orders to amend their pleadings, the most substantive issue was whether the Defendants could bring cross claims against the Plaintiffs via derivative action on behalf of MST and its subsidiaries. The first cross claim related to the Plaintiffs' delayed payment under a joint venture agreement, whilst the second claim alleged that Ms Hua had obligations to contribute additional amounts to MST arising on the face of minutes of meetings between the parties. The Defendants argued that the Plaintiffs' actions brought about the failure of the development project and consequently a loss of profits for MST and its various subsidiaries in respect of aspects of the project.

The Plaintiffs sought orders for indemnity and forthwith costs, arguing that the 'ill-advised' orders sought by the Defendants, and the already lengthy two year proceedings, would largely impact the Plaintiff's position to recover costs.

(c) Decision

(i) The Defendants' claim

Black J held that the application to bring derivative proceedings on behalf of MST and its subsidiaries should not be granted and ordered that costs should follow the event. His Honour highlighted that, in circumstances where each of MST and its subsidiaries were in liquidation, ss. 236 and 237 of the Corporations Act 2001 (Cth), which provide for the bringing of a derivative proceeding on behalf of a solvent company, did not apply. Rather, the Court's inherent jurisdiction to decide

whether proceedings should be taken in the name of a company in liquidation had been enlivened.

His Honour considered the following factors to be relevant, albeit not exhaustive, to the exercise of the Court's inherent jurisdiction.

(ii) Merit of the proposed derivative proceedings

First, his Honour considered whether the Defendants' proposed cross claims would have some solid foundation. That is, whether they exhibit a degree of merit as to be neither vexatious nor oppressive, with reasonable prospects of success. Black J established that while the claim by the Defendants that the Plaintiffs has delayed payment would be somewhat arguable, the payment obligation arising out of the minutes of meeting relied upon hypotheticals and had formidable obstacles so far as causation was concerned.

(iii) Financial protection of the liquidator and the company's assets

Second, his Honour noted that a Court must be satisfied that the assets of the company in liquidation are not put at risk, and the liquidator is not exposed to personal liability. Black J relied on the liquidators' evidence who advised that they did not wish to bring the claims by reason of limited resources and a preliminary view that the claims did not have merit. His Honour therefore concluded that there could be a negative impact on the liquidator and creditors, and that the Defendants' ability to provide an indemnity to MST, including via the support of a litigation funder, in order to protect the interests of MST and its creditors, was remote. His Honour referred to relevant case law, such as *Scarel Pty Ltd v City Loan & Credit Corporation Pty Ltd (1988) 6 ACLC 213*, in recognising the importance of an adequate indemnity to protect the assets of a company in liquidation, where leave to bring a derivative action is sought.

(iv) Other practical considerations

Lastly, Black J considered practical considerations, such as the apparent lack of connection between the claims on behalf of MST, and therefore the introduction of significant new issues and additional evidence.

(v) Plaintiff's claim for costs

Black J also denied the Plaintiff's application for indemnity costs and forthwith costs. On indemnity costs, his Honour re-iterated the proposition that some special or unusual feature is required to depart from the rule of costs on an ordinary basis. Emphasising that the Defendants were self-represented litigants, his Honour held that if the Plaintiffs had wished to rely on indemnity costs, they should have warned the Defendants of their rights to preserve indemnity costs due to the practical difficulties of the claims.

Further, his Honour reiterated that forthwith costs should rarely be awarded as they have the ability to exhaust financial capacity. His Honour refused to grant

forthwith costs largely on the basis that the Plaintiffs had contributed to the lengthy proceedings in submitting pleadings that were overly complex and voluminous for a case of similar nature and size.

6. Contributions

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

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