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Bulletin No. 263

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 2019 Harold Ford Memorial Lecture

The 2019 Harold Ford Memorial Lecture will be presented by The Honourable Chief Justice James Allsop AO, Federal Court of Australia, on the topic *The Intersection of Companies and Trusts*.

The Harold Ford Memorial Lecture celebrates the many contributions of Professor Ford to Melbourne Law School, the legal profession, and to the development of corporate law and trusts law. The inaugural lecture was held in 2013 and hosted by the Centre for Corporate Law.

In 1981, Professor Harold Ford wrote an article on *Trading Trusts and Creditors' Rights*. In it, he described trading trusts, an intersection of companies and trusts that had emerged in the decade prior as an increasingly popular alternative to the proprietary company, as a "commercial monstrosity". It has been nearly 40 years since those comments yet there is still no coherent and unified approach by Australian courts as to their treatment under Australian company law, nor is there any clear treatment of them in the Corporations Act 2001 No. 50 (Cth).

On 5 February 2019, the High Court heard the appeal of what is commonly known as the *Amerind decision*. In the context of this appeal and other recent significant case law, this speech will examine the development of the law on trading trusts, specifically on the issue of trust property in an insolvency administration.

The lecture will be held at 6pm Thursday 26 September 2019 at the Melbourne Law School.

For more details and to register for a free ticket please visit the Melbourne Law School events website.

1.2 APRA proposes stronger requirements on remuneration to enhance conduct, risk management and accountability

23 July 2019 - The Australian Prudential Regulation Authority (APRA) has released a draft prudential standard aimed at clarifying and strengthening remuneration requirements in APRA-regulated entities.

In a discussion paper released for consultation, APRA has proposed creating a new prudential standard to better align remuneration frameworks with the long-term interests of entities and their stakeholders, including customers and shareholders.

The *Draft Prudential Standard CPS 511 Remuneration* (Draft Prudential Standard) introduces heightened requirements on entities' remuneration and accountability arrangements in response to evidence that existing arrangements have been a factor driving poor consumer outcomes.

The proposed reforms address recommendations 5.1 to 5.3 from the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, which were endorsed by the government in February.

The package of measures is materially more prescriptive than APRA's existing remuneration requirements and will place Australia in line with international remuneration practice.

Among the key reforms, APRA is proposing:

- to elevate the importance of managing non-financial risks, financial performance measures must not comprise more than 50% of performance criteria for variable remuneration outcomes;
- minimum deferral periods for variable remuneration of up to seven years for senior executives in larger, more complex entities. Boards will also have scope to recover remuneration for up to four years after it has vested; and
- boards must approve and actively oversee remuneration policies for all employees, and regularly confirm they are being applied in practice to ensure individual and collective accountability.

APRA flagged its intention to strengthen prudential requirements on remuneration in April last year following its review of *Remuneration practices at large financial institutions*. The need for a strengthened approach was further underlined by the findings of last year's *Prudential Inquiry* *into the Commonwealth Bank of Australia*, as well as the recent discussion paper on industry self-assessments examining issues on governance, accountability and culture.

A three month consultation period will close on 23 October 2019. APRA intends to release the final prudential standard before the end of 2019, with a view to it taking effect in 2021 following appropriate transitional arrangements.

Copies of the discussion paper and the Draft Prudential Standard are available on the APRA website: Consultation on remuneration requirements for all APRA-regulated entities.

1.3 Government and APRA response to the APRA Capability Review

17 July 2019 - The government has released the *Australian Prudential Regulation Authority (APRA) Capability Review* (the Capability Review), alongside the government and APRA's responses.

The government announced the establishment of the Capability Review on 11 February 2019 in response to the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* and a previous recommendation of the Productivity Commission.

The Panel made 24 recommendations, with 19 directed to APRA and the remaining five directed to the government. The Capability Review found that APRA is an "impressive and forceful" regulator in matters of traditional financial risk. However, the Compatibility Review has also identified important changes to ensure that APRA is well positioned to respond to an environment of growing complexity and emerging risks for APRA's regulated sectors.

Government response

The government has agreed to take action on all five of the recommendations directed to it. In response to the Compatibility Review, the government will:

- ensure that APRA has sufficient powers and flexibility to prevent inappropriate directors and senior executives from being appointed or re-appointed to regulated entities, as part of extending the Banking Executive Accountability Regime (the BEAR);
- consider changes to APRA's regulatory framework including a review of penalties, amending its private health insurance licensing powers and providing APRA with the power to appoint a person to undertake a review of a regulatory entity;
- in establishing the Financial Regulator Oversight Authority, streamline and improve the effectiveness of both APRA and the Australian Securities and Investments Commission's (ASIC) accountability arrangements;
- outline its expectations for APRA on superannuation in its next Statement of Expectations; and
- work with APRA and the Australian Public Service (APS) Commission to better understand and address any restrictions within the current APS Bargaining Framework in order to ensure APRA can attract and retain high skilled staff.

APRA response

APRA has also welcomed the Capability Review report and the opportunity it presents to better position APRA for the future. Of the 19 recommendations directed at APRA, APRA supports them all. The Capability Review concludes that APRA must expand its capabilities in a number of areas, while at the same time emphasising that this should be done without jeopardising its core capability in financial safety and financial stability.

In line with the recommendations and APRA's own plans for change, APRA is committed to:

- maintaining and building financial system resilience: APRA will retain its focus on financial safety and stability, while expanding its capability in other important areas;
- leadership and culture: APRA is continuing to strengthen its own leadership capabilities and culture, and will adjust its organisational structure to support flexible and effective modes of operating;
- strengthening capability: APRA is strengthening both its resourcing and supervisory approach to make issues of governance, culture, remuneration and accountability a much more prominent and central part of its supervisory framework;
- a strong outcomes focus in superannuation: Building on the recent legislative reforms, APRA will continue to embed its strengthened focus on member outcomes as the centrepiece of its supervisory approach in superannuation; and
- enhanced communications: APRA will better utilise strategic communications to deliver stronger prudential outcomes and enhance its own accountability.

APRA's response to the specific recommendations is set out in its media release.

1.4 Australian Financial Complaints Authority report on operations for first six months

15 July 2019 -The Australian Financial Complaints Authority's (AFCA) *Six Month Report* (the Report) reveals the complaints body has received over 35,000 complaints, far exceeding initial forecasts. The Report states that 60% of complaints have already been resolved, with 74% resolving in favour of the complainant or by agreement.

Banks received the most complaints of all financial institutions (12,305), followed by general insurers (6,839) and credit providers (5,447). The most complained about financial products were credit cards (5,191), followed by home loans (2,921) and personal loans (2,704).

Key statistics:

- 35,263 complaints received;
- 60% of complaints resolved;
- 74% of complaints were resolved by agreement or in favour of the complainant;
- 88% of financial firms did not have a single complaint lodged against them; and
- $83 million obtained in settlements. Note: This includes matters previously received by AFCA's predecessor, the Financial Ombudsman Service, and resolved by AFCA since 1 November 2018.

1.5 Global M&A review

6 July 2019 - The International Institute for the Study of Cross-Border Investment and M&A has published its data for the second quarter of 2019.

Key highlights include:

- in Q2 2019, global M&A volume reached US$1 trillion for the quarter and surpassed US$2 trillion for the year to date. Global M&A volume in 2019 is on pace to reach the US$4 trillion mark for the second consecutive year and only the third time in the last decade;
- the significant global deal volume in 2019 is a product of a surge in large deals in the United States (US). US M&A volume exceeded US$606 billion in Q2 2019, up from US$513 billion in Q1 2019, and almost double the average quarterly volume over the 12 prior second quarters (US$342 billion). In Q2 2019, US M&A represented 57% of global transaction volume;
- the volume of mega deals (transactions valued at US$5 billion or greater) was nearly US$1 trillion in the first half of 2019, accounting for almost 50% of global M&A volume (compared to 31% over the prior 12 years);
- cross-border M&A volume remained historically low through the second quarter of 2019, reaching only US$274 billion in Q2 2019 and US$507 billion for the first half of 2019. Cross-border M&A accounted for only 25% of global M&A volume in the first half of 2019, compared to an average of 36% over the prior 12 years; and
- several significant deals headlined Q2 2019, including United Technologies' US$90 billion combination with Raytheon, AbbVie's US$84 billion acquisition of Allergan and Occidental Petroleum's US$54 billion acquisition of Anadarko Petroleum.

The full report is available here.

1.6 APRA consults on its proposed approach to product responsibility under the Banking Executive Accountability Regime

28 June 2019 - APRA has outlined its proposed approach to implementing the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (the Final Report) recommendation on product responsibility for authorised deposit-taking institutions (ADIs) under the BEAR.

Recommendation 1.17 of the Final Report recommended that APRA determine an end-to-end product responsibility for each ADI subject to the BEAR with the aim of improving customer experience and outcomes.

In response, APRA has released a letter to ADIs detailing how it intends to achieve heightened and clarified product accountability among senior executives. Specifically, APRA proposes requiring ADIs to identify and register an accountable person to hold end-to-end product responsibility for each product the ADI offers to its customers, including retail, business and institutional customers.

The letter requests feedback on four key considerations relating to implementing the proposed product responsibility requirements:

- the scope of accountability;
- the product coverage;

- the structure of the legal mechanism; and
- the application of joint accountability within ADIs and ADI groups.

Although the requirements are directly applied to locally incorporated ADIs, APRA strongly encourages all ADIs to consider elements of strengthened product accountability as they relate to their accountable persons, and accountability statements and map.

APRA expects to implement the new requirements by 1 July 2020.

A copy of *The Banking Executive Accountability Regime - Consultation on product responsibility* consultation letter can be found on the APRA website here.

1.7 IMF policy paper - Fintech: the experience so far

27 June 2019 - The International Monetary Fund (IMF) has published a policy paper titled *Fintech: The Experience So Far* (the paper). The paper reviews country fintech experiences and identifies key fintech-related issues that merit further attention by IMF members international bodies.

The paper finds that while there are important regional and national differences, countries are broadly embracing the opportunities of fintech to boost economic growth and inclusion, while balancing risks to stability and integrity.

The paper finds:

- fintech is having global impact on the provision of financial services. Mobile payments have been a key early developer with broad implications for inclusion. New entrants are challenging incumbents who are responding. The evolving market structure could boost competition and efficiency, while raising new risks to financial stability and integrity. Balancing competing policy priorities is a key challenge;
- Africa has seen rapid growth in mobile money as a driver for greater financial inclusion; Asia has made advances in nearly every aspect of fintech; the European fintech market is growing rapidly but remains unevenly distributed; the Middle East, North Africa, Afghanistan and Pakistan, and Caucasus and Central Asia regions are seeing a gradual pick-up in activity, especially in some countries; and the Latin America region is taking off, albeit at an earlier stage than other regions;
- countries are seeking to provide an enabling environment, including open and affordable access to core digital services and infrastructures. But important infrastructural gaps and regulatory impediments remain. Significant gains are expected from fintech advances in payments, clearing, and settlement; and
- while concerns of increased risks posed by fintech arise, monitoring is still largely confined to activities and entities within the traditional regulatory perimeter. Gaps in the legal framework to address fintech issues are widely acknowledged, while there is a need to modernise data frameworks.

The paper identifies key areas for international cooperation - including roles for the IMF and World Bank - and in which further work is needed at the national level and by relevant international organisations and standard-setting bodies. In their responses to the survey, countries called for greater international cooperation in many areas, prioritising:

- cybersecurity;
- anti-money laundering and combating the financing of terrorism;
- development of legal, regulatory, and supervisory frameworks; and
- payment and securities settlement systems and cross-border payments.

They also saw these as areas for seeking technical support and policy advice from the IMF and World Bank staff. The paper suggests further work on international dimensions of data policy frameworks, while there is a clear demand also for considering new international standards by standard-setting bodies, including on crypto-assets, mobile money services, and peer-to-peer lending.

1.8 Consultation on risk guidance

26 June 2019 - The Risk Coalition, a United Kingdom (UK) group that aims to improve risk governance and risk management in the UK financial services sector, has published a consultation document titled *Principles and guidance for board risk committees and risk functions in the UK financial services sector* (the guidance).

This guidance sets out to:

- develop a common understanding of the purpose and remit of board risk committees and risk functions;
- raise expectations and promote good practice of risk oversight in UK financial services; and
- provide a benchmark against which board risk committees and risk functions can be objectively assessed.

Part A of the guidance focuses on what can reasonably be expected of a mature board risk committee through defining a number of key principles and supporting guidance. Part B of the guidance follows a similar format but focuses on the role and responsibilities of the chief risk officer.

1.9 APRA finalises updated guidance on information security

25 June 2019 - APRA has released updated prudential guidance to all APRA-regulated entities on managing information security risks, including cyber-crime.

Prudential Practice Guide CPG 234 Information Security replaces CPG 234 Management of Security Risk in Information and Information Technology. The updated guide will assist regulated entities to embed and comply with the requirements of APRA's new cross-industry prudential standard, Prudential Standard CPS 234 Information Security, which came into force on 1 July 2019.

APRA has also published a letter to industry responding to submissions on the draft CPG 234 released for consultation in March (the letter). In the letter, APRA re-emphasised the need to maintain appropriate oversight of all third parties that manage information security on an entity's behalf, including entities subject to existing regulatory oversight and service providers engaged by third party entities.

The new Prudential Standard CPG 234 Information Security and APRA's letter to industry are available on APRA's website here.

1.10 Big tech in finance: opportunities and risks

23 June 2019 - The entry of large technology firms (big techs) such as Alibaba, Amazon, Facebook, Google and Tencent, into financial services, including payments, savings and credit, could make the sector more efficient and increase access to these services, but also introduces new risks, the Bank for International Settlements (BIS) writes in its *Annual Economic Report*.

In a special chapter on *Big tech in finance: opportunities and risks*, BIS notes that these companies offer many potential benefits, including enhanced efficiency of financial services provision, facilitating financial inclusion and promoting associated gains in economic activity.

However, big techs' entry into finance introduces additional elements into the risk-benefit equation. Some are old issues of financial stability and consumer protection in new settings, but a new element is big techs' access to data from their existing platforms. This could spark rapid change in the financial system through the emergence of dominant players that could ultimately reduce competition.

The role of big techs in finance raises issues that go beyond traditional financial risks, according to BIS. Tackling these requires striking a balance between financial stability, competition and data protection. Regulators need to ensure a level playing field, taking into account big techs' wide customer bases and particular business models.

As big techs' move into financial services accelerates, expanding beyond regulatory perimeters and geographical borders, policymakers will need institutional mechanisms to help them work and learn together. Coordination among authorities - national and international - is crucial to sharpening and expanding their regulatory tools.

1.11 IOSCO examines liquidity in corporate bond markets under stressed conditions

21 June 2019 - The Board of the International Organization of Securities Commissions (IOSCO) has published a report that examines the factors affecting liquidity in secondary corporate bond markets under stressed conditions.

The *Final Report - Liquidity in Corporate Bond Markets Under Stressed Conditions* (the Final Report), prepared by IOSCO's Committee on Emerging Risks, examines how liquidity in secondary corporate bond markets tends to evolve when those markets experience stress. The Final Report seeks to increase understanding of how stressed conditions may affect both bond and other financial markets and the financial system more broadly.

The findings are drawn from a review of the literature on liquidity in corporate bond markets under normal and stressed conditions, an examination of past episodes of stress in corporate bond markets and discussions with a broad range of industry stakeholders.

The Final Report notes that changes in the structure of secondary corporate bond markets have altered the way that liquidity is provided in these markets. These changes result from such things as:

- post-crisis regulations that have reduced the capacity of intermediaries to provide liquidity in secondary corporate bond markets;
- greater risk aversion on the part of intermediaries;
- the gradual introduction of electronic trading; and
- significant growth in the size of these markets resulting from central banks' quantitative easing policies and low rates of return on other financial assets.

The Final Report's main findings include:

- the structure of corporate bond markets has evolved since the financial crisis, driven primarily by changes in the behaviour of market intermediaries and in the supply of and demand for corporate bonds;
- a reduction in the capacity and desire of dealers to participate in corporate bond markets as principals could mean that future movements in bond prices in times of stress will be more acute than before;
- several characteristics of corporate bond markets should reduce the risk that strong price movements in bond markets will generate broader economic stress. These include effective liquidity management by issuers of corporate debt, reduced leverage and fewer leveraged players in the market than before the financial crisis, and the low frequency with which many corporations enter primary bond markets for financing;
- the willingness, resources and ability of market participants to provide sufficient demand-side liquidity to help stabilise markets will be critical factors in determining how corporate bond markets operate under stress; and
- mutual funds are unlikely to be a source of either considerable selling or price volatility under stress, particularly those funds with managers who have instituted strong liquidity management processes, including plans for operating under stressed conditions.

1.12 Reserve Bank of Australia Quarterly Bulletin

20 June 2019 - The Reserve Bank of Australia (RBA) has published its quarterly Bulletin. Articles include:

- **A Decade of Post-crisis G20 Financial Sector Reforms**: The global financial crisis resulted in significant disruption to markets, financial systems and economies. It also led to comprehensive reform of the financial sector by the G20 group of countries. After a decade of policy design and implementation, standards in the global financial system and regulatory approaches in many countries have changed substantially to improve financial system resilience. Australia, as a G20 member, has been active in implementing these reforms. This article looks at the main financial sector reforms developed in the immediate post-crisis period, their implementation in Australia and the more recent shift in international bodies' focus to assessing whether these reforms have met their intended objectives;

- **The Australian Equity Market over the Past Century**: This article describes developments in the Australian equity market over the past century, drawing in part from a newly compiled historical dataset which begins in 1917. Over the past 100 years, the market has increased in size relative to the economy, while its composition by industry also changed substantially. The data also provides new evidence that historical returns on Australian equities - and therefore the equity risk premium - are lower than previously thought; and
- **Cryptocurrency: Ten Years On**: Ten years on from the creation of Bitcoin, the term "cryptocurrency" has entered the public consciousness. Despite achieving some name recognition, cryptocurrencies are not widely used for payments. This article examines why Bitcoin is unlikely to become a ubiquitous payment method in Australia, and summarises how subsequent cryptocurrencies have sought to address some of the shortcomings of Bitcoin - such as its volatility and scalability problems. It also examines the proliferation of new "coins" and concludes that, despite the developments in cryptocurrencies, none are currently functioning as money in the economy.

1.13 Sustainable finance: European Commission publishes guidelines to improve how firms report climate-related information

18 June 2019 - The European Commission (the Commission) has published new Guidelines on reporting corporate climate-related information, as part of its Sustainable Finance Action Plan. These guidelines will provide companies with practical recommendations on how to better report the impact that their activities are having on the climate as well as the impact of climate change on their business.

The Commission has also welcomed three reports published by the Technical Expert Group on Sustainable Finance:

- The first, Taxonomy Technical Report, is a classification system - or taxonomy - for environmentally-sustainable economic activities. This aims to provide practical guidance for policy makers, industry and investors on how best to support and invest in economic activities that contribute to achieving a climate neutral economy. The group has extensively screened activities across a wide range of sectors, including energy, transport, agriculture, manufacturing, information and communications technology and real estate. It has identified low carbon activities like zero emissions transport but also transition activities like manufacturing of iron and steel in order to compile the most comprehensive classification system for sustainable activities to date. This expert report is published as the Commission's proposal on taxonomy awaits agreement by the co-legislators;
- The second expert Report on EU Green Bond Standard recommends clear and comparable criteria for issuing green bonds. In particular, by linking it to taxonomy, it will determine which climate and environmentally friendly activities should be eligible for funding via a European Union (EU) green bond. The Commission expects this to boost the green bond market allowing investors to scale up sustainable and green investment; and
- Finally, a third expert Report on Benchmarks, EU climate benchmarks and benchmarks' environmental, social and governance (ESG) disclosures sets out the methodology and minimum technical requirements for indices that will enable investors to orient the choice of investors who wish to adopt a climate-conscious investment strategy, and address the risk of greenwashing. The report also sets out disclosure requirements by benchmark providers in relation to ESG factors and their alignment with the *Paris Agreement*. This

expert report relates to the Commission's proposal on low carbon benchmarks, which has recently been agreed by the co-legislators.

1.14 SEC seeks public comment on ways to harmonise private securities offering exemptions

18 June 2019 - The US Securities and Exchange Commission (SEC) has requested public comment on ways to simplify, harmonise, and improve the exempt offering framework to expand investment opportunities while maintaining appropriate investor protections and to promote capital formation.

The concept release seeks input on whether changes should be made to improve the consistency, accessibility, and effectiveness of the SEC's exemptions for both companies and investors, including identifying potential overlap or gaps within the framework. It also considers, among other things, whether:

- the limitations on who can invest in certain exempt offerings, or the amount they can invest, provide an appropriate level of investor protection or pose an undue obstacle to capital formation or investor access to investment opportunities;
- the SEC should take steps to facilitate a company's ability to transition from one offering to another or to a registered offering;
- the SEC should expand companies' ability to raise capital through pooled investment funds;
- retail investors should be allowed greater exposure to growth-stage companies through pooled investment funds such as interval funds and other closed-end funds; and
- the SEC should revise its exemptions governing the secondary trading of securities initially issued in exempt offerings.

The SEC also released a staff report on the impact of *Regulation Crowdfunding* on capital formation and investor protection, which was required to be provided to the Commission no later than three years following the effective date of the crowdfunding rules. The relevant findings of the report are discussed in the concept release.

Further details are available in the SEC Fact Sheet - Concept Release on Harmonization of Securities Offering Exemptions.

1.15 IOSCO report on cyber risk

18 June 2019 - The Board of the IOSCO has issued a Final Report on Cyber Task Force (the Final Report) that provides an overview of three internationally recognised cyber standards and frameworks used by IOSCO members. It also identifies potential gaps in the application of these standards and seeks to promote sound cyber practices across the IOSCO membership.

The Final Report is intended to serve as a resource for financial market regulators and firms, raise awareness of existing international cyber standards and frameworks and encourage the adoption of good practices to protect against cyber risk - an important threat to financial markets.

The Final Report examines how IOSCO member jurisdictions apply three internationally recognised cyber standards which are termed the Core Standards in the Final Report. These standards consist of:

- the Committee on Payments and Market Infrastructures and IOSCO *Guidance on cyber resilience for financial market infrastructures*;
- the National Institute of Standards and Technology *Framework for Improving Critical Infrastructure Cybersecurity*; and
- the International Organization for Standardization 27000 series standards.

The Final Report does not propose new cyber standards or guidance.

By highlighting the application of the Core Standards by some IOSCO members, the Cyber Task Force hopes more members will review their own cyber standards against the practices of the Core Standards and, where relevant, use the Core Standards as a model to further enhance their cyber regimes.

Finally, the Final Report sets out a series of questions that firms and regulators may use to promote awareness of cyber good practices or to guide them as they review their own practices.

1.16 FSB publishes remuneration progress report

17 June 2019 - The Financial Stability Board (FSB) has published a progress report, *Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards* (the report), on the implementation of its Principles and Standards for sound remuneration practices in financial institutions. The report assesses how remuneration practices have evolved since the Principles and Standards were published in 2009.

The report confirms the finding of the previous progress report in June 2017 that all FSB jurisdictions have implemented the Principles and Standards for sound remuneration for all banks considered significant for the purposes of the Principles and Standards. While most banks have put in place practices and procedures which reduce the potential for inappropriate risk taking, their effectiveness is still being tested. At most banks, further work is required to validate that practices and procedures operate effectively and cover all remuneration related risks. International supervisory dialogue has facilitated increased attention to remuneration design and implementation, contributing to better practice. Authorities remain focused on remuneration practices, with many now incorporating assessment of remuneration practice as part of ongoing supervisory review processes.

The report highlights that for significant banks a number of changes have taken place, including:

- boards appear more active and engaged and remuneration processes are now conducted with greater oversight;
- remuneration arrangements now have longer time horizons, include mechanisms that better align them with effective risk management practices and include a wider range of financial and non-financial risk assessment criteria;

- in recent years, there has been an increased focus on remuneration as a tool to address conduct risk and there is now greater emphasis on how results are achieved; and
- the challenge now is developing frameworks for assessing the effectiveness of remuneration policies and practices in balancing risk and reward. Remuneration systems should be monitored and reviewed to ensure that they operate as intended.

The Principles and Standards are intended to apply to financial institutions that are significant for the purposes of remuneration standards, including banks, insurers and asset managers. In most jurisdictions, identified institutions are mainly in the banking sector. Fewer jurisdictions have implemented the requirements for the insurance and asset management sectors.

1.17 Report on US securities class action lawsuits

11 June 2019 - Chubb has released a new report on the rising volume of securities class action lawsuits in the US, which have more than doubled in the last four years. The report, *From Nuisance to Menace: The Rising Tide of Securities Class Action Litigation*, examines the origin, scope and cost of securities class actions, as well as proposals for reform.

In 2017 and 2018, the number of securities class actions filed in the Federal Court broke new records each year, and the volume has doubled since 2014, according to National Economic Research Associates Economic Consulting. Last year, Cornerstone Research found that an average of one in 12 public companies was the target of a securities class action. Among S&P 500 companies, the likelihood was one in 10.

Chubb's analysis of merger-objection lawsuits, which are brought when two companies enter into a merger or acquisition, found that 61% of the total costs of the litigation flowed to lawyers. Shareholders received the smaller portion 39%. In 2018, 85% of merger and acquisition transactions were challenged with a merger-objection lawsuit.

1.18 Expert panel discussion of *ASIC v Kobelt*

On 17 July 2019, Melbourne Law School hosted an expert panel discussion on the recent High Court decision *Australian Securities and Investments Commission v Kobelt* [2019] HCA 18 (*ASIC v Kobelt*).

The High Court held that an informal, expensive and largely undocumented credit scheme known as "book-up" provided by Mr Kobelt to the Indigenous residents of the remote South Australian Anangu Pitjantjatjara Yankunytjatjara Lands, the Anangu people, was not unconscionable under the Australian Securities and Investments Commission Act 2001 No. 51 (Cth).

An expert panel of speakers considered the decision and its legal and policy consequences, including:

- Nathan Boyle, Senior Analyst, ASIC Indigenous Outreach Program;
- Gerard Brody, Chief Executive Officer, Consumer Action Law Centre;
- Professor Jeannie Marie Paterson, Melbourne Law School;

- Professor Ian Ramsay, Melbourne Law School (Chair); and
- Dr Michelle Sharpe, Barrister, Castan Chambers.

An audio recording of the discussion is available on the Melbourne Law School website. A summary of the High Court decision in *ASIC v Kobelt* can be read in Item 6.8 of this Bulletin.

2. Recent ASIC Developments

2.1 Proposal to ban unsolicited telephone sales of life insurance and consumer credit insurance

18 July 2019 - ASIC is inviting feedback on its proposal to ban unsolicited telephone sales of direct life insurance and consumer credit insurance (CCI). Such a ban would prevent the sale of complex insurance products which consumers do not need, want or understand.

Before it makes a final decision, ASIC has issued a consultation paper seeking views on the proposed ban, *CP 317 Unsolicited telephone sales of direct life insurance and consumer credit insurance*.

On 11 July 2019, ASIC published *REP 622 Consumer credit insurance: Poor value products and harmful sales practices* (REP 622) which identified unfair sales practices that were consistently failing consumers, and recommended a ban on unsolicited telephone sales of CCI. See Item 2.2 of this Bulletin.

This follows ASIC's announcement in August 2018 that ASIC would restrict unsolicited sales of direct life insurance after it found a link between outbound sales calls and sales conduct issues, including pressure selling (see: *REP 587 The sale of direct life insurance*).

The *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* recommended that the law should be changed to clearly prohibit unsolicited sales of superannuation and insurance products. The government has committed to implement this recommendation - in the meantime, ASIC's ban will protect consumers where ASIC has identified ongoing sales issues and have evidence of consumer harm.

This work forms part of ASIC's broader priority to address harms in insurance - once the ban is implemented, ASIC will monitor compliance and take enforcement action as necessary if insurers or distributors do not comply. ASIC also intends to review its guidance in *RG 38 The hawking provisions* later this year.

2.2 ASIC finds unacceptable sales practices, poor product design and significant remediation costs in CCI sold by major banks and lenders

11 July 2019 - ASIC's review of the sale of CCI by 11 major banks and other lenders has found that the design and sale of CCI has consistently failed consumers.

ASIC's report, *REP 622*, highlights the very low value of CCI products and the unfair way they are promoted and sold to consumers. This work forms part of ASIC's broader priority to address fairness to consumers and, in particular, harms in insurance.

ASIC's review found that:

- CCI is extremely poor value for money - for CCI sold with credit cards, consumers received only 11 cents in claims for every dollar paid in premiums. Across all CCI products sold by lenders, only 19 cents was recovered in claims for every premium dollar which consumers paid;
- CCI sales practices caused consumers harm:
    - consumers were sold CCI despite the fact they were ineligible to claim under their policy;
    - telephone sales staff used high-pressure selling and other unfair sales practices when selling CCI; and
    - consumers were given non-compliant personal advice to buy unsuitable policies;
- Consumers were incorrectly charged for CCI, including being charged ongoing CCI premiums even though they no longer had a loan; and
- Many lenders did not have consumer-focused processes to help consumers in hardship make a claim under their CCI policy.

The problems identified in the review are being addressed by ASIC in the following ways:

- ASIC is undertaking investigations into the suspected misconduct of several entities involved in the CCI product market, with a view to enforcement action. The defendants to ASIC's future action will be publicly identified at the time proceedings commence;
- due to the consumer harms ASIC has seen with the unsolicited outbound sale of CCI by telephone, it is consulting with all interested participants and consumers with a view to ASIC completely banning this practice - see Item 2.1 of this Bulletin;
- ASIC's work has led to a significant remediation program expected to exceed $100 million paid to over 300,000 consumers. To date, over $51 million has been paid to over 186,000 consumers. ASIC's work to secure further compensation will continue;
- ASIC expects all CCI lenders to incorporate a four day deferred sales model for all CCI products across all channels, not just those entities that subscribe to the *Banking Code of Practice*.

ASIC expects lenders and insurers to design and offer products with significantly higher claims ratios and will continue to collect and publish data to measure improvements.

ASIC's report also sets out important design and distribution standards for CCI sold by lenders. Lenders and insurers are expected to meet these standards or entirely cease selling CCI until they do. Several lenders have already ceased selling CCI.

Further, ASIC requires attestations from accountable senior executives that:

- the recommendations to address mis-selling have been implemented and are working effectively;
- the minimum standards in ASIC's report are being met; and
- the remediation programs are thorough and robust.

2.3 Consultation on proposal to intervene to stop consumer harm in short term credit

9 July 2019 - ASIC has released a consultation paper*, CP 316 Using the product intervention power: Short term credit*, on the first proposed use of its new product intervention power. On this inaugural occasion, ASIC is looking to address significant consumer detriment in the short term credit industry.

The product intervention power allows ASIC to intervene where financial and credit products have resulted in or are likely to result in, significant consumer detriment. The new product intervention power is an important addition to ASIC's regulatory toolkit. It reinforces ASIC's ability to directly confront, and respond to, harms in the financial sector.

ASIC considers that significant consumer detriment may arise in relation to a particular model designed to provide short term credit at high cost to vulnerable consumers. These consumers include those on low incomes or in financial difficulty.

In its first proposed deployment of this power, ASIC is targeting a model involving a short term credit provider and its associate who charge fees under separate contracts. When combined, these fees can add up to around 990% of the loan amount.

While ASIC is presently aware of two firms currently using this model - Cigno Pty Ltd and Gold-Silver Standard Finance Pty Ltd - the proposed product intervention order would apply to any firm using this type of business model.

ASIC anticipates making a decision on whether to make a product intervention order in relation to short term credit during the course of August 2019.

All intervention orders subsequently made must be published on ASIC's website, and a public notice issued in relation to the intervention.

View:

- *CP 316 Using the product intervention power: Short term credit*; and
- *CP 316 Draft instrument ASIC Corporations (Product Intervention Order - Short Term Credit) Instrument 2019/XX*.

2.4 ASIC provides new guidance for certain AFS licence applications

5 July 2019 - ASIC has released *Information Sheet 240 AFS licensing - Requirements for certain applicants to provide further information* to provide guidance to applicants on recent changes to ASIC's Australian financial services (AFS) licensing assessment procedures. These changes apply to:

- applicants that are a body corporate;
- applicants that are APRA-regulated bodies;
- applicants that are proposing to offer certain financial services or to operate in specific circumstances; and

are required to provide additional information to ASIC.

This will enable ASIC to ascertain whether it has reason to believe an applicant is likely to contravene its legislative obligations, including to deliver financial services "efficiently, honestly and fairly" and to ensure that the responsible officers of a body corporate applicant are of good fame or character.

2.5 Consultation on relief for foreign providers of funds management services to Australian professional investors

3 July 2019 - ASIC has released a consultation paper proposing to provide licensing relief for foreign financial services providers of funds management services in Australia to professional investors.

CP 315 Foreign financial services providers: Further consultation (CP 315) sets out ASIC's proposal to:

- provide funds management relief - foreign providers will be exempt from the requirement to hold an AFS licence to provide services to professional investors in Australia. ASIC proposes a cap on the scale of activities that may be undertaken in Australia; and
- repeal the licensing relief known as "limited connection" relief as previously proposed in *Consultation Paper 301 Foreign financial services providers* (CP 301). Foreign financial services providers may still access the proposed new funds management relief and the licensing exemptions in the Corporations Act 2001 No. 50 (Cth) and Corporations Regulations 2001 No. 193 (Cth).

ASIC decided against giving relief for the situation where an Australian professional client initiates an inquiry or request to a foreign service provider operating outside Australia (reverse solicitation). ASIC is not currently minded to provide this relief due to the lack of information from industry about how it would be used and concerns about monitoring compliance with its conditions. CP 315 seeks further information on this.

ASIC's proposals reflect earlier feedback from industry that there is a need for Australian professional investors to access funds management financial services providers outside Australia. This proposal aims to strike an appropriate balance between facilitating cross-border investment as well as maintaining Australian market integrity and investor protection.

Extension of limited connection relief while ASIC consults

The current "limited connection" relief is due to expire on 30 September 2019. ASIC will extend the relief for a further six months until 31 March 2020 while it consults with stakeholders on the funds management relief and repeal of the "limited connection" relief. ASIC proposes a transition period of six months to 30 September 2020 should it proceed with the repeal of the "limited connection" relief, enabling foreign providers to seek an AFS licence if applicable.

Implementation of foreign AFS licence and extension of sufficient equivalence relief

ASIC will be implementing the foreign AFS licensing regime for foreign financial services providers relying on the licensing relief known as "sufficient equivalence" relief. ASIC proposed this relief in CP 301. The *Draft updated RG 176 - Foreign financial services providers* attached to CP 315 provides guidance on how foreign providers may apply for the foreign AFS licence.

ASIC will extend the sufficient equivalence relief for a further six months until 31 March 2020 to allow foreign providers to engage with the details of the guidance. The new foreign AFS licensing regime will commence on 1 April 2020. Foreign providers currently relying on the sufficient equivalence relief will have a transition period of 24 months from 1 April 2020 to comply with the new regime, including for example to submit an application for a foreign AFS licence and have the application assessed by ASIC.

View:

- *ASIC Corporations (Repeal and Transitional) Instrument 2016/396*; and
- *ASIC Corporations (Foreign Financial Services Providers - Limited Connection) Instrument 2017/182*.

2.6 New regime for corporate whistleblower protections commences

1 July 2019 - Whistleblowers who report misconduct about companies and company officers can access stronger rights and protections in the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).

The Corporations Act now better protects corporate whistleblowers with requirements to maintain their confidentiality and prevent them from suffering or being threatened with detriment. Whistleblowers can also seek compensation if they suffer loss, damage, or injury for making their disclosure. These protections are important to ensure and encourage whistleblowers to come forward to the company or to ASIC to raise their concerns.

To provide guidance to whistleblowers on their rights and protections and how ASIC handles their reports, ASIC has updated information on its website and issued two new information sheets:

- *Information Sheet 238 Whistleblower rights and protections*; and
- *Information Sheet 239 How ASIC handles whistleblower reports*.

The protections now apply to a larger group of people who may observe or be affected by corporate misconduct and face reprisals for reporting it. They cover both current and former company employees, officers, and contractors, as well as their spouses and dependants, even where these people wish to remain anonymous.

The protections will apply to whistleblower reports covering misconduct or an improper state of affairs or circumstances, not just breaches of the law.

Whistleblowers can lodge a report with ASIC through the online misconduct reporting form.

The changes to the whistleblower protections will also require public companies, large proprietary companies, and corporate trustees of registrable superannuation entities, to have a whistleblower policy from 1 January 2020. ASIC will consult on regulatory guidance on the requirement for a whistleblower policy in due course.

2.7 ASIC approves an updated Banking Code of Practice

28 June 2019 - ASIC has approved an updated version of the Australian Banking Association's (ABA) new *Banking Code of Practice* (the Code).

Since ASIC approved the Code in August 2018 (see *18-223MR ASIC approves the Banking Code of Practice*), the ABA applied to ASIC for approval of a number of changes to the Code. ASIC is assessing those changes in two stages - ASIC has approved the first stage of changes and is yet to decide on the second stage of changes.

First stage of changes to the Code

The first stage of changes, now approved by ASIC, includes:

- new provisions that put beyond doubt that a bank will not charge fees for services to deceased customers, where services are no longer being provided to that customer's estate;
- changes to the commitments around provision of valuations to small business customers;
- changes to reflect ASIC's implementation of law reforms to credit card responsible lending (see *18-257MR ASIC prescribes three-year period for credit card responsible lending assessments*); and
- minor and technical corrections throughout the Code.

ASIC approved the above changes on 25 June 2019 by issuing an approval of a new Code. The ABA published the new Code on its website on 24 June 2019. The approval is contained in *ASIC Corporations (Approval of Banking Code of Practice) Instrument 2019/663*.

ASIC has now revoked its previous approval of the August 2018 approval by issuing *ASIC Corporations (Banking Code of Practice - Revocation of 2018 Approval) Instrument 2019/662*.

The new Code, incorporating the above changes, commenced on 1 July 2019.

All ABA member banks will be required to subscribe to the Code as a condition of their ABA membership and the relevant protections in the Code will form part of the banks' contractual relationships with their banking customers.

Second stage of changes to the Code

The second stage of changes are designed to:

- address recommendations of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (including improvements to the provisions dealing with accessibility to banking products and services for vulnerable customers and commitments regarding the charging of default interest on agricultural loans in the event of natural disasters; and
- address stakeholder feedback relating to various small business protections.

The ABA proposes that these changes will commence from 1 March 2020.

ASIC aims to decide on these proposed changes later in 2019. ASIC's decision will follow engagement with key stakeholders to ensure that the revised Code provides an appropriate level of commitment by banks to consumer and small business protections.

Background

ASIC approved the Code in August 2018. In approving the Code, ASIC considered that:

- the rules in the Code are binding on the ABA's members and form part of the contracts between banks and their customers;
- the Code was developed and reviewed in a transparent way, which involved significant consultation with relevant stakeholders including consumer and small business groups; and
- the Code is supported by effective administration and compliance mechanisms. The Banking Code Compliance Committee will have oversight of banks' Code compliance, tools to require banks' cooperation with their monitoring and investigations, and a range of sanctions for non-compliance with Code provisions.

2.8 Consultation on proposed market integrity rules for technological and operational resilience

27 June 2019 - ASIC has released a consultation paper proposing new market integrity rules for securities and futures market operators and participants that promote technological and operational resilience of their critical systems.

CP 314 Market integrity rules for technological and operational resilience seeks feedback on proposals to address the increasingly automated and interconnected nature of markets. The proposals apply to:

- futures and securities market operators of the Australian Securities Exchange (ASX), ASX 24, Chi-X, the National Stock Exchange of Australia and the Sydney Stock Exchange; and
- participants of those markets.

The proposals address the following areas of critical systems arrangements:

- change management in relation to critical systems;
- outsourcing of critical systems;
- risk management, and data and cyber security;
- incident management and business continuity planning;
- governance and resourcing; and
- fair access to markets and trading controls.

The proposals are consistent with international standards and clarify and strengthen existing obligations for market operators and market participants.

2.9 Consultation on new product intervention power use

26 June 2019 - ASIC has initiated consultation on the proposed administration of its new product intervention power.

The product intervention power allows ASIC to intervene and take temporary action where financial and credit products have resulted in or are likely to result in, significant consumer detriment.

The regulatory guide sets out the scope of the power, when and how ASIC expects to use the power and how a product intervention order is made.

ASIC's principles-based approach to the regulatory guidance, outlined in *CP 313 Product intervention power*, reflects the product intervention power being a broad and flexible tool for ASIC to use. ASIC can take a range of temporary actions including banning a product or product feature, imposing sale restrictions, amending product information or choice architecture.

To assist consultation, the paper provides case studies of past products and practices to illustrate the circumstances in which ASIC may have contemplated using the product intervention power (had it been available) to address consumer detriment identified at the time.

The power is unique in its focus on reducing significant detriment to consumers, rather than stepping in only after a breach of the law. ASIC can also use the power on a market-wide basis to address industry-wide problems. ASIC is required to consult before making a product intervention order.

The product intervention power was enacted in April 2019 with new design and distribution obligations. The product intervention power is available for ASIC to use now. The design and distribution obligations do not apply to industry until April 2021.

ASIC aims to release its final regulatory guide in September 2019. A further, separate ASIC consultation on its proposed guidance on the design and distribution obligations will commence later this year.

2.10 Industry funding: Cost Recovery Implementation Statement and estimated 2018-2019 levies

26 June 2019 - Estimated industry sector levies for 2018-2019, as well as details on how ASIC allocated its regulatory costs in 2017-2018, are available in ASIC's *Cost Recovery Implementation Statement: ASIC industry funding model (2018-19)* (the CRIS).

The CRIS is a key disclosure and accountability measure incorporated into the Industry Funding Model. The final CRIS released includes detail on some of the key issues that arose out of the submissions received during consultation in March 2019.

The indicative levies published in the final CRIS aim to help industry better plan for the actual levy which will not be billed until January 2020. The indicative levies are a guide and the amounts are likely to change when ASIC's actual regulatory costs are known and published in December 2019 and the actual business activity metrics for each subsector are provided by regulated entities.

View the CRIS.

Background

The CRIS provides transparency of ASIC's costs and explains how ASIC's regulatory activities will be cost recovered from each subsector it regulates, as well as how ASIC will recover its user-initiated costs via fees for service in 2018-2019.

The CRIS includes:

- a forecast of ASIC's regulatory costs and indicative levies for each subsector in 2018-2019;
- the work undertaken by ASIC for each subsector in 2018-2019;
- an explanation of the cost recovery model, including the business process, outputs and how ASIC allocates costs to calculate the levies and fees for service;
- the actual expenses ASIC incurred in 2017-2018 for each subsector and the variance between actual expenses and the estimated costs in last year's CRIS. Where there is a material variance, the CRIS explains the variance;
- an explanation of the amendments to the levies and fees for service models since the release of last year's CRIS; and
- an assessment of the risks associated with the industry funding model and how those risks have been managed.

2.11 ASIC amends fees and cost disclosure to align with Protecting Your Super Package laws

21 June 2019 - ASIC has amended *ASIC Class Order [CO 14/1252]* (CO 14/1252) to ensure it is consistent with the Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019 No. 16 (Cth) and Treasury Laws Amendment (Protecting Your Superannuation Package) Regulations 2019 (Cth) (the PYSP), which ban exit fees from 1 July 2019.

CO 14/1252 modifies the Corporations Act 2001 No 50 (Cth) and Corporations Regulations 2001 No. 193 (Cth) to set out requirements for the disclosure of fees and costs in Product Disclosure Statements (PDSs) for superannuation and managed investment products.

The amendment made is technical only and applies to disclosure concerning superannuation products. It reflects the PYSP ban on exit fees for these products by eliminating the line allowing for disclosure of exit fees. The amendment does not otherwise make any change to the requirements set out in CO 14/1252.

ASIC is reminding product issuers that as part of their implementation of PYSP, they need to take care that, from 1 July 2019, PDSs do not suggest that exit fees will be charged on superannuation products. They should also implement any changes necessary to ensure that no exit fees are charged in practice. ASIC understands that some issuers may have difficulty implementing changes to delete the line about exit fees from their template by 1 July (although it will be blank) and encourage them to make this change as soon as possible.

ASIC's broader review of the fees and costs disclosure regime for superannuation and managed investment schemes (see *CP 308 Review of RG97: Disclosing fees and costs in PDSs and* *periodic statements*) (CP 308) is continuing and will not affect the requirement to comply with the PYSP amendments and CO 14/1252.

Following the end of the consultation period in April, ASIC has been considering the submissions on CP 308 and its response. A number of submissions raised the need to consider PYSP changes to the law. ASIC will take PYSP into account in the finalisation of its response to proposals outlined in CP 308.

ASIC expects to provide a report addressing its final position on the consultation proposals in the second half of 2019.

2.12 ASIC reports on decisions to cut red tape - October 2018 to March 2019

21 June 2019 - ASIC's latest report, REP 620 Overview of decisions on relief applications (October 2018 to March 2019) (REP 620), outlines decisions on relief. During the period, ASIC granted relief from provisions of the Corporations Act 2001 No 50 (Cth) (the Corporations Act) or the National Consumer Credit Protection Act 2009 No. 134 (Cth) (the National Credit Act) in relation to 709 applications.

The granting of relief, which has a net regulatory benefit, or which facilitates business or cuts red tape is an important part of ASIC's regulatory function. The reporting of ASIC's decisions on relief applications aims to provide transparency about ASIC decision making and to better inform businesses about the circumstances in which ASIC will grant relief.

REP 620 lists publications released by ASIC during the period that may be relevant to prospective applicants for relief.

The report also provides examples where ASIC has exercised, or refused to exercise, its exemption and modification powers under the Corporations Act and the licensing and responsible lending provisions of the National Credit Act.

3. Recent ASX Developments

3.1 Amendments to the ASX Operating Rule Schedule 10A (the AQUA Rules)

The ASX is introducing the first tranche of changes to *ASX Operating Rule* Schedule 10A, known as the AQUA Rules, to address regulatory commentary and guidance under ASIC *Information Sheet 230 Exchange traded products: Admission guidelines* and ASIC *REP 583 Review of exchange traded products*. The amendments to the AQUA Rules provide further clarity in relation to an AQUA product issuer's obligations to disclose certain matters to the ASX via an ASX market announcement and the timeframe to do so. The introduction of formal procedures will enhance the transparency of the admission requirements of AQUA Products for issuers and investors.

The amendments, which are effective as of 1 July 2019, make changes to:

- Schedules 10 and 10A; and
- *ASX Operating Rules* Procedures 10 and 10A.

The notice is available on the ASX website.

3.2 Monthly Activity Reports

On 4 July 2019, the ASX released the ASX Monthly Activity Report for June 2019.

4. Recent Takeovers Panel Developments

4.1 GBST Holdings Limited - Panel declines to conduct proceedings

16 July 2019 - The Takeovers Panel (the Panel) has declined to conduct proceedings on an application dated 8 July 2019 from Kiwi Holdco CayCo, Ltd, as the group holding company of the FNZ Group (FNZ), in relation to the affairs of GBST Holdings Limited (GBST).

The application concerned (among other things) the process adopted by GBST which led to entry into a process and exclusivity deed (as amended, the Deed) with SS&C Technologies (SS&C) in relation to a non-binding indicative proposal from SS&C to acquire GBST at $3.25 per share via a scheme of arrangement. The SS&C proposal was received in response to an invitation from GBST to a number of interested parties (including FNZ) to submit non-binding indicative proposals as part of a confidential tender process that would grant exclusive due diligence access to the successful party.

After announcing the SS&C proposal, GBST received a revised non-binding indicative proposal at $3.50 per share from FNZ and a draft of a process and exclusivity deed with a three week exclusivity period. On 3 July 2019, GBST announced that SS&C had increased its non-binding indicative proposal to $3.60 per share and the Deed had been amended by reducing the exclusivity period from four weeks to three weeks.

On 5 July 2019, FNZ submitted a further revised non-binding indicative proposal at $3.65 per share. On 8 July 2019, GBST announced that the GBST board, after considering FNZ's further revised proposal, had resolved not to proceed with FNZ on that proposal, stating that it "remains of the view that it is in the best interests of GBST and its shareholders to continue to facilitate the receipt of a binding offer from SS&C reflecting the terms of its last proposal and which is capable of being put to shareholders".

While in the Panel's experience the process adopted by GBST was not conventional, it did not consider the process unacceptable. To date, that process had led to significantly increased indicative offer prices to the benefit of GBST's shareholders. The Panel considered that there was nothing that prompted it to second guess the GBST board's decisions. It noted that there was nothing to prevent third parties submitting a superior proposal to GBST to trigger the fiduciary out.

The Panel accepted an undertaking on behalf of GBST to disclose a copy of the Deed with limited redactions. It considered that the disclosure of the exclusivity arrangements in this case should assist FNZ and other potential bidders when assessing whether to make a competing offer and lead to a better informed market generally.

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

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

4.2 Aurora Absolute Return Fund - Panel declines to make declaration

12 July 2019 - The Panel has declined to make a declaration of unacceptable circumstances in response to an application dated 18 June 2019 from Aurora Funds Management Limited (Aurora) in relation to the affairs of the Aurora Absolute Return Fund (ABW).

The application concerned (among other things) allegations that a number of persons were associated by reasons of entering into relevant agreements in relation to the acquisition of units in ABW and a proposal to replace Aurora as responsible entity of ABW.

The Panel conducted proceedings but decided not to make a declaration of unacceptable circumstances. The Panel did not consider that there was sufficient material to establish that the alleged associations had been formed or that it was in the public interest to make a declaration of unacceptable circumstances.

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

The reasons for the decision are available on the Takeovers Panel website.

5. Recent Research Papers

5.1 Sustainability, FinTech and financial inclusion

The authors argue that sustainable balanced development is preconditioned on financial inclusion, and that FinTech is the key driver for financial inclusion. In turn, the full potential of FinTech to support the Sustainable Development Goals will only be realised with a progressive approach to developing infrastructure to support digital financial transformation.

The authors' research suggests the best way to think about such a strategy is to focus on four primary pillars:

- the first pillar requires the building of digital identity and simplified account opening and e-KYC systems;
- this is supported by the second pillar of open interoperable electronic payments systems;

- the third pillar involves using the infrastructure of the first and second to underpin electronic provision of government services and payments; and
- the fourth pillar - digital financial markets and systems - supports broader access to finance and investment.

Implementing the four pillars is a major journey, but one with tremendous potential to transform financial inclusion and sustainable growth.

View *Sustainability, FinTech and Financial Inclusion*.

5.2 Underwriting in the Australian IPO markets: Determinants and pricing

The authors examine the factors that explain the underwriting decision and underwriting fees for a sample of Australian Initial Public Offerings (IPOs), spanning the period 1999-2016. This includes young and often unprofitable IPOs that list as Commitments Test Entities (CTEs).

They find:

- CTE IPOs are more likely to be underwritten than non-CTE IPOs;
- IPOs that allow oversubscription of the shares and/or are issued by way of a bookbuild are less likely to be underwritten; and
- for underwritten offers, greater initial returns and wealth loss to pre-existing shareholders for bookbuild IPOs and lower initial returns (wealth loss) in IPOs that allow oversubscription of the shares.

View *Underwriting in the Australian IPO Markets: Determinants and Pricing*.

5.3 The specter of the Giant Three

This article examines the large, steady, and continuing growth of the Big Three index fund managers - BlackRock, Vanguard, and State Street Global Advisors. The authors show that there is a real prospect that index funds will continue to grow, and that voting in most significant public companies will come to be dominated by the future "Giant Three."

The authors begin by analysing the drivers of the rise of the Big Three, including the structural factors that are leading to the heavy concentration of the index funds sector. They then provide empirical evidence about the past growth and current status of the Big Three, and their likely growth into the "Giant Three". Among other things, they document that the Big Three:

- have almost quadrupled their collective ownership stake in S&P 500 companies over the past two decades;
- have captured the overwhelming majority of the inflows into the asset management industry over the past decade;
- now manage 5% or more of the shares in a vast number of public companies; and
- collectively cast an average of about 25% of the votes at S&P 500 companies.

The authors then extrapolate from past trends to estimate the future growth of the Big Three. They estimate that the Big Three could well cast as much as 40% of the votes in S&P 500 companies within two decades. Policymakers and others must recognise - and must take seriously - the prospect of a "Giant Three" scenario. The plausibility of this scenario exacerbates concerns about the problems with index fund incentives that the authors identify and document in other work.

View *The Specter of the Giant Three*.

5.4 Ownership concentration and institutional investors' governance through voice and exit

Drawing on data collected in interviews with investors and corporates in the US and Europe, this paper sheds light on the motives behind shareholder engagement. It explains why index funds engage in corporate governance, despite their apparent lack of financial incentive to do so.

Applying Hirschman's concepts of exit and loyalty to the investment management industry, this paper suggests that for many institutional shareholders today, voice is more feasible than exit. For the largest index investors, the cost of engagement has fallen to a level where it is today negligible. The immense concentration amongst index funds, with the three largest fund managers controlling over 90% of assets, ensures sufficient return on their governance investments. Furthermore, interviews with activist investors suggest that they have learned to work with index investors and that index funds do not present barriers to successful campaigns.

This paper therefore advocates against restricting index funds' voting rights. Doing so would muzzle those shareholders with the deepest pockets and the greatest potential for corporate oversight. Instead what is needed is regulation to ensure greater disclosure of engagement efforts by the largest fund companies enabling greater academic and public oversight of asset managers' engagement activities.

View *Ownership Concentration and Institutional Investors' Governance Through Voice and Exit*.

5.5 An overview of market manipulation

In this publication the author describes the various forms of market manipulation, ranging from classical pump and dump schemes, bear raids, and painting the tape, through to recent forms of manipulation such as spoofing, layering, pinging, and quote stuffing. The author discusses the defining elements of market manipulation, including recent legislative changes that seek to keep pace with the changing nature of market manipulation.

Finally, the author:

- reviews what is and is not known on the topic of market manipulation based on academic studies;
- discusses the challenges of analysing market manipulation; and
- suggests future research directions.

View *An Overview of Market Manipulation*.

5.6 Financial crises and international law

Ten years after the global financial crisis (GFC) that started in 2007, the time has come to take stock of the international regulation of finance.

This report assesses the causes and consequences of the GFC and the broader context of the changes in the international financial system since the collapse of the Bretton Woods system of fixed exchange rates and turns to the status and evolution of international financial law. It contends that the growth of international financial markets has outpaced the development of international financial law.

The paper concludes with a brief comparison between the first golden age of capital in the late 19th century and the contemporary second age of global capital - both characterised by recurrent financial crises, rising inequality within countries and backlashes against globalisation.

View *Financial Crises and International Law*.

6. Recent Corporate Law Decisions

6.1 Court rejects application to limit the court's discretionary powers under the Corporations Act

(By Deniz Ektem, King & Wood Mallesons)

Lees v Connective Services Pty Ltd [2019] VSCA 143 (21 June 2019) Supreme Court of Victoria, Court of Appeal, Whelan and McLeish JJA

(a) Summary

The Victorian Court of Appeal (the Court) has refused an application for leave to appeal an order granting leave to amend a statement of claim in certain derivative proceedings. In doing so, the Court noted that discretionary powers of a court should not be limited in the absence of express provision in the text of the legislation.

The power to grant leave to amend a statement of claim under s. 241 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) did not require the granting of fresh leave, nor satisfaction of criteria under s. 237 of the Corporations Act, which allows a person referred to in s. 236 of the Corporations Act to apply for leave to bring proceedings. The Court noted by way of *obiter*, however, that in circumstances where an entirely new and unrelated cause of action was sought to be introduced, the Court would have to consider the requirements of s. 237 of the Corporations Act.

(b) Facts

(i) Background

The first respondent, Connective Services Pty Ltd, and the second respondent, Connective Services OSN Pty Ltd (the Connective companies) were incorporated in 2003 to conduct a mortgage aggregation business established by the sole shareholder of the tenth respondent, Slea Pty Ltd (Slea), the first applicant, Glenn Andrew Lees, and Mr Lees' brother.

In 2011, Slea commenced a proceeding (the oppression proceeding) alleging oppressive conduct of the Connective companies' affairs under s. 232 of the Corporations Act.

In 2012 and 2013, the three directors of the Connective companies (Mr Lees, Mr Haron and Mr Maloney) undertook a corporate restructure (the restructure), which involved establishing a number of subsidiary companies, including Connective Group Pty Ltd (Connective Group), the fourth respondent. After the restructure, the Connective companies fully owned Connective Group, which held all of the shares in the established subsidiaries. The mortgage business operated by the Connective companies was transferred to Connective Group. Later in 2013, 25% of the shares in Connective Group were sold to the third respondent, Macquarie Bank Limited (the sale).

After the restructure and the sale, Slea applied for leave under s. 237 of the Corporations Act to bring a proceeding on behalf of the Connective companies against the three directors, Macquarie Bank Limited and others (the derivative proceeding). The Connective companies alleged that a substantial purpose of the restructure and the sale was to circumvent pre-emptive rights that Slea had under the constitutions of the Connective companies, and to reduce Slea's interest in the mortgage business. The relief sought included rescission and "unwinding" of the restructure and the sale. Leave was granted.

(ii) Present proceedings

In 2018, a process referred to by the parties as the "sale process" was undertaken. This led to an application by Slea in the oppression proceeding and by the Connective companies in the derivative proceeding to amend their respective claims to allege that the sale process was undertaken by the three directors for the improper purpose of preventing the court from ordering the "unwinding" of the restructure and the sale, and limiting the relief Slea might obtain to monetary compensation. The proposed amendments also sought to introduce a claim for final injunctive relief, restraining the three directors from approving or authorising the sale process.

In April 2019, the Victorian Supreme Court ordered that leave be granted under s. 241 of the Corporations Act to amend the respective statements of claim to include these new allegations. The three directors applied for leave to appeal this order in relation to the derivative proceeding, arguing that the order granting leave to amend could not be made without a fresh grant of leave under s. 237 of the Corporations Act, or unless the criteria for leave under s. 237 of the Corporations Act had been satisfied.

(iii) Relevant provisions of the Corporations Act

Section 241 of the Corporations Act provides (among other things) that "the Court may make any orders, and give any directions, that it considers appropriate in relation to proceedings brought or intervened in with leave .".

Section 237 of the Corporations Act provides that "a person referred to in s. 236 may apply to the Court for leave to bring ... proceedings". It provides further (among other things) that:

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

(c) Decision

The Court refused the directors' application for leave to appeal, for the following reasons:

- the trial judge's conclusion that the new claim has a "real prospect" of success, and the introduction of the new claim into the oppression proceeding, were unchallenged by the parties;
- the derivative proceeding and the oppression proceeding are fixed to be heard at trial together on 19 August 2019. The new claim would be fully litigated in the joint trial regardless of the outcome of this proposed appeal;
- the three directors are parties to the derivative proceeding and will therefore very likely give evidence in the joint trial;
- the trial judge's order permitting the amendment in the derivative proceeding is valid unless and until it is set aside. The absence of leave (even if subsequently decided that leave should have been obtained) will not render the judgment a nullity;
- if it were to become clear in the joint trial that there is substance in the new claim, and assuming fresh leave under s. 237 of the Corporations Act were necessary, it is "close to inevitable" that leave under s. 237 of the Corporations Act would be ordered retrospectively; and
- the only likely practical effect of requiring Slea to seek leave under s. 237 of the Corporations Act would be substantial additional costs and delay, and the possibility of postponing the trial date.

While rejecting the application for leave, the Court nevertheless addressed the arguments advanced, noting that the matters were currently unresolved by authority.

The Court stated that the trial judge was correct that the power contained in s. 241 of the Corporations Act permitted the Court to grant leave to amend without requiring a fresh application for leave under s. 237 of the Corporations Act, or requiring that the criteria in s. 237(2) of the Corporations Act be satisfied. The Court stated that while ss. 236 and 237 of the Corporations Act regulate commencing a proceeding, s. 241 of the Corporations Act regulates its management once commenced.

The Court stated that s. 241 of the Corporations Act is a legislative provision which confers power on a court, and that such provisions should not be interpreted as subject to limitations which are not expressly provided in the text of the legislation.

The Court also stated that where an entirely new and unrelated cause of action was sought to be introduced, the Court would have to consider whether the amendment should be refused unless the criteria in s. 237 of the Corporations Act were satisfied, or until a fresh application under s. 237 of the Corporations Act was made.

6.2 A creditor's right to secured property when it has been invalidly transferred to a third party

(By Freeman Chen, Herbert Smith Freehills)

Bendigo and Adelaide Bank Ltd v Boothbuck International Pty Ltd [2019] QSC 153 (21 June 2019) Supreme Court of Queensland, Flanagan J

(a) Summary

The Supreme Court of Queensland (the Court) has outlined the steps to determine the validity of a purported transfer of land, while also highlighting a creditor's ability to enforce its rights when secured property has been invalidly transferred to a third party.

The Court held that where the transferor is a company, and the company is insolvent, s. 198G of the Corporations Act 2001 No 50 (Cth) (the Corporations Act) affects the validity of the transfer.

Where a transfer of secured property has been executed invalidly and registration of interest has transferred, the Court does not have power under the Land Title Act 1994 No. 11 (Qld) (the LTA) to amend the land registration itself, but the Court may declare the transfer invalidly executed, which should have the effect of encouraging the Registrar of Titles (the Registrar) to amend the registry with its powers. In this way, the creditor will be able to claim the property against the debtor.

(b) Facts

(i) The loan and the related parties

In 2015, Mr Buckby and Ms Booth obtained a $920,000 loan from Bendigo and Adelaide Bank Ltd (the Bank). Irongrow Corporation Pty Ltd (Irongrow), in its own right and as trustee of the "Soul Mates Trust", guaranteed the liability of Mr Buckby and Ms Booth under the loan.

Ms Booth, as appointor of the trust, signed a deed of covenant, under which she agreed to not remove Irongrow as trustee, appoint any other trustee, or appoint another appointor without the Bank's consent. Irongrow subsequently executed a mortgage in favour of the Bank over a property at Lot 21 of Registered Plan 71363. This mortgage was registered in December 2015.

(ii) Insolvency and the dispute

In 2018, Irongrow became insolvent and a liquidator was appointed. This constituted an event of default under the loan. Mr Buckby sent a document to the Bank purporting to replace Irongrow as the trustee of the trust with Boothbuck International Pty Ltd and a transfer of the fee simple interest in the property from Irongrow to Boothbuck was registered in September 2018. The Bank argued that the transfer was invalid, citing the deed of covenant executed by Ms Booth, and demanded possession of the property.

(iii) The proceedings

The Bank brought two separate proceedings, which were heard concurrently.

- first, the Bank sought declaratory relief against Boothbuck and Irongrow asserting that the transfer was executed invalidly. The purpose of seeking a declaration was to help inform the Registrar in exercising its discretion under s. 15(1) of the LTA to correct the land register; and
- secondly, the Bank sought default judgment for the recovery of possession of land against Irongrow under r. 286 of the Uniform Civil Procedure Rules 1999 No. 111 (Qld) (the UCPR). Mr Buckby and Ms Booth filed a defence to the Bank's claim pursuant to r. 143 of the UCPR as persons in possession of the property. The Bank sought summary judgment in response to this defence.

(c) Decision

(i) The declaration proceedings

The Court addressed three main questions:

1. Was the transfer executed invalidly by Irongrow?

The Court acknowledged that ordinarily, Mr Buckby could execute the transfer document in his capacity as sole director/secretary of Irongrow. However, s. 198G(1) of the Corporations Act provides that a company officer "must not perform" the powers of that office while the company is under external administration. In addition, s. 198G(2) of the Corporations Act provides that an officer who purports to do so in such circumstances commits an offence. Flanagan J held that, upon its proper construction, s. 198G of the Corporations Act deprives officers of their functions while the company enters external administration. In addition, Mr. Buckby himself had admitted that he was not authorised to sign the transfer because Irongrow was insolvent at the time.

Flanagan J declared that the transfer was not executed validly by Irongrow because:

- Irongrow was already in liquidation when Mr Buckby purported to sign the transfer; and
- Mr Buckby did not obtain approval from the Supreme Court or the liquidator, nor was he empowered under the Corporations Act.

2. Was the transfer void and of no effect?

The Court referred to s. 61(1)(a) of the LTA, which states that an instrument for a transfer of a lot must be validly executed.

Section 161(1) of the LTA states that, for a corporation, an instrument is validly executed if:

- it is executed in a way permitted by law; or
- the instrument is sealed with the corporation's seal in accordance with s. 46 of the Property Law Act 1974 No. 76 (Qld).

Flanagan J declared, with reference to the findings in the first question, that:

- the transfer was not executed in a way permitted by the law;
- the purported transfer was void and of no effect; and
- as a result, the freehold land register was incorrect.

3. Did Boothbuck know of the circumstances behind the purported transfer, and would it suffer prejudice if the land register was corrected?

The Court considered s. 15(1) of the LTA, which allows the Registrar to correct the register if satisfied that:

- the register is incorrect (which was established); and
- the correction will not prejudice the rights of the holder of an interest recorded in the register.

Section 15(8) of the LTA provides that a correction will not prejudice the rights of the holder of an interest if the holder acquired or has dealt with the interest with actual or constructive knowledge that the register was incorrect and how it was incorrect. In this case, the issue turned on a factual inquiry as to whether Boothbuck acquired the interest with actual or constructive knowledge that Mr Buckby did not have authority to execute the transfer on behalf of Irongrow.

It was also emphasised that only the Registrar, and not the court, is entitled to exercise the power to change the registry - the Court referred to *Medical Benefits Fund of Australia Ltd v Fisher* [1984] 1 Qd R 606 at 611-612.

Based on the evidence, Flanagan J found that Boothbuck had actual knowledge that:

- Irongrow was in liquidation;
- the transfer was not executed by Irongrow; and
- the transfer was invalid.

Notably, the Court found that:

- Mr. Buckby executed the transfer on 25 September 2018 on behalf of Irongrow and he had been a director of Boothbuck with his wife until 26 August 2018; and
- at the time the transfer was signed, both Mr Buckby and Ms Booth knew that Irongrow was in liquidation.

Flanagan J rejected the notion that Boothbuck would be protected from actual knowledge simply because Mr. Buckby had resigned as director prior to his purported execution of the transfer. With reference to *Fightvision Pty Ltd v Onisforou* (1999) 47 NSWLR 473 at 527, the Court emphasised that "a corporation cannot cause itself to shed knowledge by shedding people".

(ii) Recovery of possession of land proceedings

In the second proceeding, Irongrow did not file a defence, and its liquidator consented to judgment. Pursuant to s. 286 of the UCPR, the Bank was entitled to recover possession of the land against Irongrow.

Mr Buckby and Ms Booth, having possession of the property, raised several arguments to oppose this. These included that the Bank had denied them "the ordinary and legal courtesies afforded to customers in genuine hardship", which had been caused by serious medical conditions suffered by Mr. Buckby. It was noted that many of these arguments were raised as borrowers, rather than in protection of their rights as occupiers. Flanagan J cited *National Australia Bank Ltd v Nikolaidis* (2011) NSW Conv R 56-284 at [13], where McCallum J stated that the right of an occupier in this context does not place the occupier in the shoes of the mortgagor. Flanagan J concluded that summary judgment should be granted to the Bank.

The Court acknowledged that enforcement of this order hinges upon the Registrar's exercise of discretion to correct the land register to reflect Irongrow's status as the registered proprietor of the fee simple interest in the property.

6.3 Has the door opened to contingency fees in class actions, and the last word on competing class actions?

(By Ian Bolster, John Pavlakis, and Matthew Youssef, Ashurst)

Klemweb Nominees Pty Ltd (as trustee for the Klemweb Superannuation Fund) v BHP Group Ltd [2019] FCAFC 107 (21 June 2019) Federal Court of Australia, Full Court, Middleton, Beach and Lee JJ

(a) Summary

The Full Federal Court (the Court) has left open the possibility of approving a common fund order incorporating a contingency payment for plaintiff law firms in class actions. But will they really be ordered while the legislative ban on contingency fees in costs agreements remains?

The Court also gave some further guidance on selecting from competing class actions before making it clear it has limited interest in allowing further appeals on competing class actions given the principles are now clear.

The prospect of contingency fees as part of a common fund order may encourage more class action activity. The reduction in appeals (for competing class actions) should speed up dealing with multiple claims.

(b) Facts

Contingency fees allow law firms to share in a percentage of a judgment or settlement. All states and territories have laws prohibiting solicitors from entering cost agreements with them, although the Australian Law Reform Commission has recommended that contingency fees be allowed in class actions.

In this case, one applicant proposed a funding arrangement to be the subject of a common fund order involving the payment of a contingency fee. The idea was that the solicitors not enter into a cost agreement for a contingency fee - but the Court be asked to order one.

The primary judge considered that even if that structure would mean there was no contravention of the prohibition on contingency fees in cost agreements, there was a clear legislative policy against such payments and it was unlikely a court would make a common fund order incorporating a contingency fee.

(c) Decision

The Court considered whether a common fund order involving the payment of a contingency fee could be made: the legislative prohibition was on costs agreements rather than payments, and its exercise of federal power could not be circumscribed. In particular:

- Middleton and Beach JJ accepted there was a reasonable implication that legislative policy was against such payments being paid and this was not irrelevant. However they said that the primary judge's comments were a statement of opinion only and other judges may hold different views. They did not themselves express any opinion on the subject; and
- Lee J stated that it was not apparent to him why a common fund order involving a contingency payment could not in some cases be appropriate to ensure justice. His Honour went on to say that he did not consider it unlikely that a common fund order incorporating a contingency payment could be made. His Honour's main issue in this case was that the order proposed by the applicant was not properly framed.

While the door may have been opened, it is hard to see many cases where a contingency fee would be ordered (as part of a common fund order) while they are banned in costs agreements.

For example: If a law firm has agreed to act without a contingency fee, why would a court consider it in the interest of justice to give them an extra payment (at the expense of group members)?

While it is conceivable that a contingency fee payment could be seen as more attractive for group members than the standard solicitor's costs plus funders commission model for class actions (e.g. if the contingency is less than the funder's commission), they are also likely to be coming up against "no-win no-fee" models as well as being compared against an hourly rate model likely to result in smaller payment to the lawyers (as well as facing the other issues surrounding contingency fees).

If the court waited until the end of proceedings before considering a contingency fee payment as part of a common fund order, would it also compare the contingency with an hourly fee rate alternative?

We also note that the question of validity of common fund orders is currently before the High Court on 13 and 14 August 2019 in the Westpac and BMW Australia appeals. The High Court's determination may impact on the possibility of any contingency fee payment via a common fund order.

(i) Key factors in play when choosing among the competing class actions

This is the second Full Federal Court decision on competing class actions and adds to the growing authorities setting out the applicable principles. The Court's further guidance on choosing among competing class actions in this decision included:

No win/no pay is not the benchmark for success - Middleton and Beach JJ endorsed the observations made by the Supreme Court of NSW in *Wigmans v AMP Ltd* [2019] NSWSC 603 in relation to the potential benefits of a no win/no fee model. However, they also confirmed that a no win/no fee model, "like other funding models, is to be considered on its merits and has no necessary privileged status over other funding models".

Accordingly, the Court held that although the nature of a funding model is relevant, the fact that a no win/no fee model was not preferred by a competing firm was not and each model proposed had to be considered on its own merits.

Equal fighting power between the parties - At first instance the trial judge considered whether the action that would proceed was "properly resourced" so that there was a "level playing field".

Lee J accepted that resourcing was a relevant consideration, and it was impliedly accepted by Middleton and Beach JJ.

Different pleadings will be relevant but not determinative - The Court said that whilst the fact that one class action had broader or different allegations would be a relevant factor, it would not be determinative. Significant emphasis was placed on the professional obligations of plaintiff lawyers to consider amending pleadings as necessary. Lee J explained: "If upon reflection it is thought a claim exists that should be advanced, then applicants are rarely shrinking violets paralysed by indecision".

The Court's comments also reflected its concern that placing too much emphasis on different pleadings may result in perverse incentives in the form of encouraging competing class actions to file claims for longer periods to try and seek an advantage.

(ii) The Court will be more strict in considering future applications for leave to appeal

A consistent theme was that applications for leave to appeal would be treated more strictly in the future. The Court emphasised that a decision as to which competing class action would proceed was a discretionary judgment forming part of the case management of cases.

Lee J referred to the test as follows:

"an applicant for leave must usually show that: first, in all the circumstances, the decision to be appealed is attended with sufficient doubt to warrant its reconsideration on appeal; and secondly, supposing the decision to be wrong, 'substantial injustice' would result if leave was refused".

Lee J also emphasised that even with the Court's protective role in relation to group members "it must be borne in mind that the potential injustice to be identified on a leave application must be substantial". His Honour concluded this part of his judgment with the stark warning that: "In my view, in light of this guidance [from two Full Court decisions], and the flexibility given to docket judges, absent recognisable legal error, considerable hurdles confront those seeking leave to appeal in similar circumstances in the future".

His Honour also warned that in future parties should not expect that applications for leave to appeal would be heard at the same time as the appeal.

6.4 In Amerind we (mostly) trust: navigating the statutory priority regime when winding up an insolvent corporate trustee

(By Jonathon McRostie and Amorkor Amartey, Clayton Utz)

Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth of Australia [2019] HCA 20 (19 June 2019) High Court of Australia, Kiefel CJ, Bell, Gageler, Keane, Nettle, Gordon and Edelman JJ

(a) Summary

While the High Court has provided some clarity on the operation of the statutory priority regime, insolvency practitioners will still need to tread carefully when dealing with corporate trustees.

For insolvency practitioners who need clarity on how receivers and/or liquidators should pay, out of trust assets, priority employee claims arising from trust liabilities, the High Court's decision in *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth of Australia* [2019] HCA 20 (the *Amerind decision*) is a welcome result.

Despite the greater clarity about when the statutory priority regime outlined in ss. 433, 556 and 561 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) will apply in the winding up of a corporate trustee, the *Amerind decision* will not be the last word. Insolvency practitioners will still need to take care when applying ss. 433, 556 and 561 of the Corporations Act, particularly where the company operated as trustee for multiple trusts and/or in a non-trust capacity.

While the High Court delivered three separate judgments, each characterising and approaching the resolution of the issues in a different way, all judgments reached the same unanimous conclusion on the primary issues for determination:

- a corporate trustee has a proprietary interest in the trust assets, which is created by the trustee's right of indemnity. The proprietary interest falls within the broad definition of property of the company and is, therefore, "property of the company" for the purposes of s. 433 of the Corporations Act;
- section 433(3) of the Corporations Act requires receivers to pay the debts of the corporate trustee in accordance with the statutory priorities in a winding up. The order of priorities in s. 556 of the Corporations Act is to be similarly followed in the distribution of the proceeds of the trustee's rights of indemnity among trust creditors; and
- the proceeds from an exercise of the trustee's right of exoneration may be applied only in satisfaction of trust liabilities to which the right relates, following *In Re Suco Gold Pty Ltd (In Liq)* (1983) 33 SASR 99 (*Re Suco*).

(b) Facts

Amerind Pty Ltd (Amerind) was a trustee of a trading trust and for that purpose obtained bank credit facilities. Amerind failed to comply with those facilities and receivers were appointed under the general security deed. Amerind was then wound up in insolvency. The receivers realised Amerind's assets, satisfied its obligations to the Bendigo and Adelaide Bank (the Bank) and a surplus of $1,619,108 was made available for distribution to creditors. The Commonwealth under the Fair Entitlements Guarantee Scheme had advanced employee entitlements totalling $3.8 million. On this basis, the Commonwealth claimed to be entitled to payment out of the surplus in priority to other creditors, including the appellant, Carter Holt, pursuant to ss. 433(3), 556(1)(e) and 560 of the Corporations Act.

In the first instance decision by a single judge in the Victorian Supreme Court, Robson J held that, amongst other matters, the Commonwealth was not entitled to be paid out as a priority creditor as the statutory priority regime did not apply to distribution of trust assets by a receiver. On appeal, the Court of Appeal of the Supreme Court of Victoria unanimously overturned that aspect of the decision of Robson J. Carter Holt subsequently appealed the decision of the Court of the Appeal to the High Court of Australia.

(c) Decision

(i) Are the right of exoneration and the surplus held by the receivers, "property of the company" within the meaning of s. 433 of the Corporations Act?

The trustee's right of exoneration - the right to discharge trust liabilities directly from the assets of the trust - and the trustee's proprietary interest in the trust fund are inextricably linked. The proprietary interest generated by the trustee's right of exoneration is not the right of exoneration itself. The right of exoneration generates a proprietary interest in the trust assets, which takes priority over competing interests of beneficiaries. The trustee's interest in the trust fund rises and falls as debts are incurred on behalf of the trust, and satisfied out of the fund.

(ii) Is an insolvent corporate trustee's right of indemnity property comprised in or subject to a "circulating security interest" within the meaning of s. 433 of the Corporations Act?

For the purposes of s. 433 of the Corporations Act, the right of indemnity itself does not constitute property subject to a circulating security interest, and is not itself a circulating asset. The inventory, and later the surplus proceeds held by the receivers, was the circulating asset subject to a circulating security interest, pursuant to which the receivers were appointed. It was those assets that attracted the operation of s. 433 of the Corporations Act.

Similarly, in the event of a winding up, where the liabilities identified in s. 556(1)(e) of the Corporations Act are trust liabilities, the priority regime of ss. 556 and 561 of the Corporations Act is to be applied from trust assets.

(iii) Trust property to non-trust creditors: *Re Suco* v *Re Enhill*

A flow-on effect from the High Court's decision is that the existing tension between the Full Court of the South Australian Supreme Court's decision in *Re Suco* and the Victorian Supreme Court's decision in *Re Enhill Pty Ltd* [1983] 1 VR 561 (*Re Enhill*) appears to have been resolved.

In effect, in *Re Suco* the Supreme Court held that despite the right of indemnity forming property of the company for the purposes of the corporations legislation, that did not authorise a division of the trust property amongst the trustee's non-trust creditors. In *Re Enhill*, the Supreme Court held to the contrary, that the trust assets were available for creditors generally and not limited to only trust creditors. The High Court agreed with Robson J at first instance in connection with *Re Suco*, to the effect that:

- proceeds from an exercise of a corporate trustee's right of exoneration in respect of trust liabilities may be applied only in satisfaction of the trust liabilities to which that right relates; and
- unlike in *Re Enhill*, the power of exoneration does not apply unconditionally in payment of trust and non-trust creditors alike.

(iv) Practical implications for insolvency practitioners dealing with multiple trusts or non-trust operations

The High Court acknowledged that complications will arise if the company conducts business as trustee for multiple trusts and/or in a non-trust capacity.

The High Court's approach is that a receiver or liquidator should create multiple funds, referrable to the assets of each separate trust. Sections 433 or 561 of the Corporations Act, as the case may be, would then apply to each fund separately, to the extent that each fund comprises circulating assets. In relation to costs of an administration given priority under s. 556(1)(a) of the Corporations Act, the High Court considered that such costs should be regarded as debts of the corporate trustee and those debts have priority under s. 556(1)(a) of the Corporations Act.

It may not always be possible to readily attribute a particular asset to a particular trust. The High Court confirmed it is open to a receiver to apply pursuant to s. 424 of the Corporations Act, or a liquidator pursuant to s. 90-15 of Schedule 2 to the Corporations Act, for directions from the

Court as to how to allocate the assets or liabilities between the trusts, or to apportion the expenses across the multiple trusts.

The High Court did not specifically address whether assets of a trust can be applied to a liquidator's remuneration. However, Gordon J stated that the approach of King CJ in *Re Suco* should be adopted - a liquidator is entitled to have recourse to the property of the trustee to meet costs and expenses of the winding up and the liquidator's remuneration, so far as they are incurred in relation to each trust.

It remains to be seen how these practical issues are addressed on a case by case basis. Insolvency practitioners and lawyers alike should continue to approach the application of ss. 433, 556 and 561 of the Corporations Act with care.

6.5 Dividends not "financial assistance" if commercially independent of a scheme of arrangement

(By Katrina Sleiman, Corrs Chambers Westgarth)

In the matter of DuluxGroup Ltd [2019] FCA 961 (14 June 2019) Federal Court of Australia, O'Bryan J

(a) Summary

The Federal Court (the Court) made orders for a meeting of members of DuluxGroup Ltd (Dulux) for the purposes of members considering a proposed scheme of arrangement which provided for the transfer to Nippon Paint Holdings Co., Ltd (Nippon) of the ordinary shares of Dulux (the Scheme).

The Court was required to consider whether dividends which had been previously declared by Dulux, and which were to be subtracted from the Scheme payments made to members, constituted financial assistance for the purposes of the prohibition in s. 260A(1) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). In previous cases, courts had not considered that threshold question, but had instead considered whether the dividends would materially prejudice the company for the purposes of s. 260A(1)(a) of the Corporations Act. In this case, the Court held that the dividends did not constitute financial assistance as they were commercially independent from the Scheme.

(b) Facts

Nippon and Dulux entered into a Scheme Implementation Deed (SID) pursuant to which Dulux agreed to propose and implement the Scheme. In consideration for the transfer, Dulux shareholders receive a cash payment of $9.80 per Dulux share less the amount of the dividends discussed below (Scheme Consideration).

On 15 May 2019, Dulux declared an interim dividend of 15 cents per share and a special dividend of 28 cents per share (Permitted Dividends). While the Permitted Dividends were contemplated by the SID, they are not conditional on the Scheme and will be paid on 28 June 2019, prior to the proposed Scheme meeting on 31 July 2019. The Scheme Consideration payable for each Dulux share is calculated as $9.80 less the amount of the Permitted Dividends, being an amount of $9.37.

Under the SID, a break fee of approximately $38 million is payable by Dulux to Nippon in certain specified circumstances (Break Fee) and a "reverse break fee" in the same amount is also payable by Nippon to Dulux in certain circumstances. The Break Fee represents approximately 1% of the total equity value of Dulux based on a value of $9.80 per Dulux share. The SID also contains a number of exclusivity provisions which apply during the exclusivity period, being five months from the date of the SID, unless terminated earlier (Exclusivity Provisions).

Dulux operates a number of incentive schemes pursuant to which Dulux shares can be issued to executives and employees (Incentive Plans). Under the SID, Dulux and Nippon agreed that all outstanding rights to be issued shares in Dulux will be exercised or deemed to be exercised so as to be able to be voted and participate in the Scheme, and the Dulux directors will exercise their discretions under the Incentive Plans such that, subject to the Scheme becoming effective, shares subject to the plans will vest in the holders and be able to participate in the Scheme. One of the Incentive Plans is the Long Term Executive Incentive Plan (LTEIP), under which the directors may invite eligible employees to acquire Dulux shares and receive a loan to finance the acquisition. If a transaction is proposed that may result in a change in control of Dulux, the directors may decide to forgive an amount or percentage of the loan. Under the SID, and exercising its discretion under the LTEIP rules, Dulux will forgive 30% of each LTEIP loan, subject to the Scheme becoming effective. The value of the loan forgiveness represents about $1.60 per LTEIP share.

An Independent Expert's Report was obtained from Grant Samuel & Associates Pty Limited (Expert), which stated that it was the Expert's opinion that the Scheme is fair and reasonable and in the best interests of Dulux members.

(c) Decision

The Court noted that before making orders for the convening of a meeting of members to consider a proposed scheme of arrangement under s. 411 of the Corporations Act, the Court must be satisfied that the scheme is fit for consideration by the proposed meeting. That is, it is of such a nature and cast in such terms that, if it achieves the statutory majority at the meeting the Court would be likely to approve it on the hearing of an unopposed petition. For the reasons set out below, the Court was so satisfied and made orders for the convening of the Scheme meeting.

The Court stated that the question whether or not to accept particular consideration for shares is quintessentially a commercial matter for the members of Dulux to assess. In this case, the Scheme Booklet informed members of the directors' recommendation that members vote in favour of the Scheme and the directors' intention to vote their shares in favour of the Scheme and contained the Expert's opinion that the Scheme is fair and reasonable and in the best interests of Dulux members.

The Court then considered each of the specific matters drawn to the attention of the Court by Dulux, including the Permitted Dividends, the Break Fee, the Exclusivity Provisions and the Incentive Plans.

The Court considered whether financial assistance is being given by Dulux to Nippon to acquire the Dulux shares because of Dulux's payment of the Permitted Dividends. Section 260A(1) of the Corporations Act provides that a company may financially assist a person to acquire shares in the company only if:

- giving the assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors;
- the assistance is approved by shareholders under s. 260B of the Corporations Act; or
- the assistance is exempt under s. 260C of the Corporations Act.

While a number of decisions concerning proposed schemes of arrangement have considered whether the payment of a special dividend by the target company - in addition to the payment of the Scheme consideration by the bidder - infringes the implied prohibition in s. 260A of the Corporations Act, these cases considered the "material prejudice" exception in s. 260A(1)(a) of the Corporations Act, without deciding the threshold question as to whether payment of the special dividend amounts to "financial assistance".

The Court stated that the payment by Dulux of the Permitted Dividends does not constitute financial assistance to acquire the Dulux shares. While the SID anticipates the payment of the Permitted Dividends, the payment of the dividends is commercially independent of the Scheme: the Scheme does not require the dividends to be paid and the payment of the dividends is not conditional on the Scheme being implemented. The proper characterisation of the arrangements is that the consideration for the acquisition of Dulux shares is adjusted in a commercial manner by the payment of the dividends and the resulting reduction in Dulux's cash reserves, which was anticipated by the parties.

The Court was satisfied that the terms of the Break Fee payable to Nippon are not such as to render the Scheme unfair to members. The Court was also satisfied that the Exclusivity Provisions are reasonable and adequately disclosed in the Scheme Booklet and accordingly do not prevent the Court from making an order to convene a meeting of members to vote on the Scheme.

The Court then considered whether there is a need for those members who will receive shares and associated benefits under the Incentive Plans to form a separate class at the Scheme meeting, in order to consider and vote on the proposed Scheme in accordance with the requirements of s. 411 of the Corporations Act. The Court did not consider that a separate class was necessary, as the shares to which the Incentive Plan members are or will become entitled are not of a different type than those of other members and they will receive a common benefit from the Scheme. While it might be argued that certain benefits under the Incentive Plans will be accelerated if the Scheme is approved, the Court did not consider that this outcome is of itself sufficient to place the recipients into a different class, when the Incentive Plans pre-dated the Scheme and were part of the agreed executive and employee remuneration.

One way of viewing the LTEIP arrangements is that, if the Scheme becomes effective, the holders of the LTEIP shares will receive the Scheme Consideration ($9.37 per share) plus the loan forgiveness of $1.63 per share. A question then arises whether that additional benefit requires those members to be placed into a different class. The relevant question is whether the legal rights and obligations of members are so dissimilar as to prevent them consulting together with a view to a common interest. Divergent commercial interests extrinsic to share membership do not warrant separate class meetings. The Court concluded that additional benefits to be received by executives of Dulux if the Scheme is approved are not sufficient to require a separate class. In forming that view, the Court took into account that: the LTEIP pre-dated the Scheme and is an ordinary part of the remuneration arrangements for eligible executives; under the LTEIP rules, the directors had a pre-existing discretion to forgive a percentage of the loans and on a number of previous occasions had forgiven up to 30% of the loans; the LTEIP rules also anticipated the directors may exercise their discretion if there was a change in control of the company; the loan shares constitute a relatively small proportion of Dulux's issued share capital;

while the additional benefit that will accrue to holders of the LTEIP shares is not immaterial, it is a modest amount in comparison to the Scheme Consideration.

6.6 Court orders relief in accordance with s. 1322 of the Corporations Act

(By Eloise Culic, DLA Piper)

Re Animoca Brands Corporation Ltd; Ex Parte Animoca Brands Corporation Ltd [2019] WASC 225 (14 June 2019) Supreme Court of Western Australia, Hill J

(a) Summary

The plaintiff (the company) by originating motion sought relief under s. 1322(4) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) for alleged contravention under Part 6D.2 of the Corporations Act. Part 6D.2 of the Corporations Act, imposes disclosure obligations, known as "cleansing notices" in relation to the issue and sale of shares. A cleansing notice exception can be relied upon where trading was not suspended for more than a total of five days during the shorter of the period during which the class of securities were quoted, and the period of 12 months before the day on which the relevant securities were issued. The alleged contraventions concern five separate instances of shares being issued. In four of the instances, a cleansing notice was issued at the time of share issues. In the fifth instance, no cleansing notice was lodged. Later, the company discovered these notices may not be valid due to suspension of the company as determined by the ASX for more than five days in the preceding 12 month period. However, Hill J was satisfied the failures were caused by an incorrect assessment of the legal position rather than deliberate disregard of obligations.

(b) Facts

On 16 April 2019, the company issued 32,553,202 shares (April share issue). Prior to the April share issue, trading was suspended between 3 April 2019 and 4 April 2019. The company's shares were suspended from trading for the following periods:

- from 11:02am on 24 January 2018 to 10:14am on 25 January 2018;
- from 9:24am on 11 July 2018 to 9:49am on 12 July 2018; and
- from 9:46am on 10 August 2018 to 10:20am on 15 August 2018.

On 15 May 2019, the company received an email from the ASX querying why it had not issued a cleansing notice in respect of the April share issue. One day later, the company notified the ASX it intended to issue a cleansing notice after it had made an announcement. The ASX brought to the company's attention it may not be able to issue a cleansing notice as it may have been suspended for more than five days in the 12 months prior to the April share issue.

The company issued cleansing notices on four occasions (7 September 2018, 16 November 2018, 13 December 2018 and 25 January 2019) when the company may not have been eligible to issue a cleansing notice due to suspension from trading.

April Share issue:

The shares issued in April fell into three categories:

- 14,353,202 shares issued to Mr Fredrik Wahrman and Mr Niklas Wahrman;
- 200,00 shares issued pursuant to an exercise of share options; and
- 18,000,000 shares issued to investors under a placement announced on 4 April 2019, five of whom were clients of Taylor Collinson (the company's corporate advisors).

In an email to the company, in which Mr Niklas Wahrman was copied, Mr Fredrik Wahrman set out his understanding that without a cleansing notice, the Wahrmans were not able to sell or transfer their shares. The shares issued to investors were governed by an agreement between Taylor Collison and its clients. Nothing in the agreement imposed any disclosure obligations on Taylor Collison or its clients.

(c) Decision

Hill J found that the conduct of the company was not in deliberate disregard of its obligations under the Corporations Act. As such, in these circumstances, relief should be granted.

(i) Construction of "day" for the purposes of s. 708A(5)(b) of the Corporations Act

On the facts before Hill J, the shares of the plaintiff were suspended:

- in January 2018, for less than 24 hours across two trading days;
- in July 2018, for more than 24 hours but only involving one trading day;
- in August 2018, for more than 72 hours across four trading days; and
- in April 2019, for more than 24 hours across two trading days.

Consequently, the plaintiff's shares had been suspended from trading for more than five days.

(ii) Power under s. 1322 of the Corporations Act to grant relief sought

Section 1322(6) of the Corporations Act states that the court must not make an order if a person concerned in or party to the contravention failed to act honestly. According to Hill J, in relation to share issues on 7 September 2018, 16 November 2018 and 13 December 2019, although the company issued cleansing notices when it was not entitled to, the actions of the company were honest. Regarding the share issue on 25 January 2019, the actions of the company in failing to consider whether the company had been suspended from trading for more than five days was inadvertent and there was no failure to act honestly. Similarly, regarding the April share issue, the company failed to consider whether a cleansing notice was required. This was due to inadvertence on the part of the company and no failure of the company to act honestly

(iii) Relief from civil liability (s. 1322(4)(c) of the Corporations Act)

A person must have acted honestly to be relieved from civil liability. In *Re Poseidon Nickel Ltd* [2018] FCA 1063*,* Colvin J noted three aspects of the relief being sought:

- first, orders are sought to remove uncertainty of title to shares thereby ensuring they are offered for further sale;
- second, orders are sought that prior dealings with the shares are not invalidated by reason of any contravention of Part 6D.2 of the Corporations Act; and
- finally, orders are sought to relieve parties from civil liability in respect of any contravention or failure to meet disclosure requirements in relation to the offering and selling of shares the subject of the impugned share issues.

According to Hill J in this case, the court will readily infer, on the basis that shareholders have access to the relevant Appendix 3Bs of the *ASX Listing Rules* which contain warranties that disclosure obligations have been addressed, that the shareholders to whom the shares are issued have acted honestly in on-selling the shares. This inference cannot be drawn where there is evidence that a shareholder had actual knowledge of the non-disclosure.

Applying these principles, the holders of shares issued on 7 September 2018, 16 November 2018, 13 December 2018 and 25 January 2019 have acted honestly. In relation to the April share issue, the current holders of the shares issued acted honestly with the exception of Mr Fredrik and Mr Niklas Wahrman. In their case, based on evidence, they had actual knowledge of the company's obligation to issue a cleansing notice and this had not occurred. Therefore, an order reliving them of civil liability without further evidence should not be made. In relation to the clients of Taylor Collison, agreements were in place that govern the issue of shares to them. Under the terms of the agreement, they cannot be said to have knowledge of the relevant disclosure requirements under Part 6D.2 of the Corporations Act.

(iv) Order

Hill J ordered relief to be granted. The plaintiff acted diligently after discovering the irregularity of the April share issue on Tuesday 14 May 2019. It would be just and equitable to grant relief to protect the interests of current shareholders and to ensure the integrity of future trading in the plaintiff's shares. Refusal to grant relief was not warranted given there was no evidence of substantial misconduct, serious wrongdoing or flagrant disregard of the law or the company's constitution or minority shareholder oppression.

6.7 Trigger of insolvency exclusions in D&O insurance policies

(By Jordan Osrin, King & Wood Mallesons)

AIG Australia Ltd v Kaboko Mining Ltd [2019] FCAFC 96 (14 June 2019) Federal Court of Australia, Full Court, Allsop CJ, Derrington and Colvin JJ

(a) Summary

In this decision, the Full Federal Court (the Court) upheld the primary judgment and found that a directors and officers (D&O) insurance policy could cover claims brought against former directors of a company under external administration.

The Court's reasoning relied primarily on a close consideration of the policy's wording rather than the commercial considerations considered at first instance. The Court held that for the purposes of the insolvency exclusion in the relevant policy, a claim does not arise out of, is not based upon and is not attributable to insolvency unless the subject matter of the claim has that character.

(b) Facts

In July 2012, Kaboko Mining Limited (Kaboko) entered into several agreements with Noble Resources Limited (Noble), under which Noble advanced Kaboko approximately US$6 million as prepayment for manganese ore.

In July 2014, Noble issued a default notice to the directors of Kaboko alleging that Kaboko had breached several terms of the prepayment agreements. In August 2014, Noble's solicitors issued a statutory demand for the amount of the prepayments, which was then set aside by the Supreme Court of Western Australia. In November 2014, Noble sent letters to Kaboko's former directors, putting them on notice of insolvent trading claims against each of them personally. In March 2015, after Kaboko defaulted under the prepayment agreement and Noble appointed receivers to Kaboko, Kaboko's directors appointed administrators to Kaboko.

In September 2016, Kaboko commenced proceedings against four former directors for allowing Kaboko to breach the prepayment agreement with Noble. The proceedings alleged breaches of ss.180 and s.181 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) and a breach of the general law duty to act in good faith in the best interests of Kaboko and for a proper purpose (Kaboko's Claims). Kaboko claimed the former directors breached these duties by:

- failing to maintain proper financial records;
- failing to use the prepayments as permitted;
- failing to ensure that Kaboko was the holder of all relevant mining interests;
- allowing Kaboko to sell the manganese ore to third parties without Noble's consent; and
- causing the loss of opportunity to profitably exploit Kaboko's mining interests in Zambia.

The four former directors sought indemnity against the Koboko Claims under their D&O insurance policy with AIG Australia Limited (the Insurer). The Insurer declined their request, arguing the insolvency exclusion clause in the D&O insurance policy applied as the former directors' alleged breaches led to Kaboko's insolvency.

The relevant exclusion provided that "the Insurer shall not be liable under any Cover or Extension for any Loss in connection with any Claim arising out of, based upon or attributable to the actual or alleged insolvency of the Company or any actual or alleged liability of the Company to pay any or all of its debts as and when they fall due."

At first instance, McKerracher J found the insolvency exclusion did not apply to preclude indemnity under the D&O insurance policy, on the basis of subjective commercial considerations in determining the extent of cover provided. The Insurer appealed this decision to the Court.

The Insurer submitted that the insolvency exclusion applied if there was the requisite insolvency connection with either the bringing of a Koboko Claim or the nature of the loss for which the indemnity was sought. Therefore, the Insurer argued, the exclusion applied irrespective of whether the liability for the loss was itself caused by insolvency or was established by reference to a cause of action that depended upon demonstrating insolvency. The Insurer submitted that if Kaboko had been solvent and repaid the prepayments to Noble when they were due there would have been no proceedings against the former directors. Therefore, the bringing of the proceedings arose out of, was based upon or was attributable to the insolvency or Kaboko or its inability to pay its debts.

Conversely, Kaboko submitted that the insolvency exclusion only applied if insolvency was one of the underlying facts that, if established, would justify the claim or the loss claimed. Accordingly, for the insolvency exclusion to apply, the claim itself or the cause of the loss claimed in the proceeding must be shown to depend upon demonstrating Kaboko's insolvency.

(c) Decision

The Court unanimously upheld the primary judgment and declined to apply the insolvency exclusion to Kaboko's Claims. In interpreting the meaning of the insolvency exclusion, in particular the use of the words "in connection with any Claim", the Court noted that the same principles for construing definitional provisions of statutes apply to the construction of commercial instruments.

The Court held that for the purposes of this insolvency exclusion, a claim does not arise out of, is not based upon and is not attributable to insolvency unless the claim itself or the cause of the loss claimed depended upon Kaboko's insolvency.

The Court found that (subject to one exception) the subject matter of Kaboko's Claims was not founded upon any allegation of insolvency. Rather, as these were not claims that were based upon insolvent trading nor claims of breaches of directors' duties that could only arise in a context where the company is insolvent, the claims could have been made irrespective of whether Kaboko was insolvent or under administration. Accordingly, as it was not relevant why the claims were brought, the insolvency exclusion did not apply to preclude indemnity.

The exception to this determination was Kaboko's Claim for the costs of the receivers, managers and administrator. The Court considered that these costs were losses which would not have occurred had Kaboko not been insolvent. Therefore, the Court held that the insolvency exclusion would apply to this aspect of the claim because the subject matter of these claims was founded upon allegations of insolvency.

6.8 Statutory unconscionability in the provision of financial services

(By Andrew Carter and Matthew Youssef, Ashurst)

Australian Securities and Investments Commission v Kobelt [2019] HCA 18 (*ASIC v Kobelt*) (12 June 2019) High Court of Australia, Kiefel CJ, Bell, Gageler, Keane, Nettle, Gordon and Edelman JJ

(a) Summary

In *ASIC v Kobelt*, ASIC unsuccessfully sought civil penalties against an individual on the basis of unconscionable conduct.

The High Court (the Court) by majority rejected ASIC's approach to the broad unconscionable conduct provision in s. 12CB of the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) (the ASIC Act), in relation to informal credit arrangements provided to residents of indigenous communities. This provision is often relied on in financial services regulatory and consumer litigation, and its scope has long been uncertain. Section 12CB(1) of the ASIC Act, which is a civil penalty provision, relevantly provides that a person must not in trade or commerce, in connection with the supply or possible supply of financial services to a person, engage in conduct that is in all the circumstances unconscionable.

Whilst the facts are relatively specific, the decision is nevertheless an important guide as to:

- the application of statutory unconscionability, and in particular, whether it is wider in scope than equitable unconscionability and whether special disadvantage is still a requirement;
- the elements to be met to run a "systems or pattern" case pursuant to s. 12CB(4)(b) of the ASIC Act; and

- how a court may approach a case concerning financial services provided to remote indigenous communities (which is particularly important in light of the attention given to the topic during the recent *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*).

Key Points:

- statutory unconscionability pursuant to s. 12CB of the ASIC Act goes further than equitable unconscionability. The extent of that expansion, and in particular whether it always requires taking unconscientious advantage of a person's special disadvantage, is not clear. Three justices said it was still a requirement. Two justices said that it was not. The remaining two justices appeared to accept that it was no longer a requirement, but nevertheless applied it to resolve the case;
- where a case involves a group of people with its own norms, culture and circumstances that will need to be taken into account. Conduct which may be unconscionable to mainstream society may not be unconscionable when those differences are taken into account;
- the voluntary choice by a recipient to enter into an arrangement will be relevant, although how that choice came to be made will be important;
- whereas in equity undue influence (focusing on the person who suffered loss) is separate and distinct from unconscionability (focusing on the defendant's conduct), it is a relevant factor for statutory unconscionability and a lack of undue influence supports a finding that that conduct was not unconscionable; and
- whilst conduct that gives rise to potential exploitation or abuse by a financier may be a relevant factor, if that potential is not realised then that may be sufficient to find that conduct was not unconscionable.

(b) Facts

The key facts were as follows:

- Mr Kobelt ran a store in which he sold, among other things, groceries and used vehicles;
- Mr Kobelt provided credit to residents of remote communities in the Anangu Pitjantjatjara Yankunytjatjara Lands through a "book-up" system. The Anangu customers lacked financial literacy;
- under the "book-up" system, Mr Kobelt would defer payment of goods if the customer provided a keycard and PIN to him until the debt was repaid. Mr Kobelt would apply income received into the bank account to repayment of the debt and leave a limited amount (often half) for basic living expenses. No accounts or records were given to customers;
- much of the debt under the "book-up" system was from the sale of used vehicles. A vehicle sold to an Anangu customer through "book-up" cost about $1,000 more than the cash price. That credit charge was held to be high;
- Mr Kobelt's Anangu customers could effectively cancel participation in the book up system by, for example, stopping using the particular account or keycard. Some customers did so; and
- anthropological evidence adduced by ASIC suggested that the Anangu people preferred and may have benefited from the use of the book up system.

(c) Decision

The Court found against ASIC (in a 4:3 majority), holding that Mr Kobelt had not engaged in unconscionable conduct in his dealings with the Anangu people.

(i) The scope of statutory unconscionability as against equitable unconscionability

Section 12CB(4)(a) of the ASIC Act states: "It is the intention of Parliament that: (a) this section is not limited by the unwritten law of the States and Territories relating to unconscionable conduct".

A key issue considered by the Court (to varying degrees in the different judgments given) was whether that section had the effect of expanding the scope of statutory unconscionability beyond unconscionability involving a special disadvantage being exploited unfairly.

Whilst there is no clear unifying principle addressing the issue, a majority of the High Court seemed to accept that statutory unconscionability is broader in some way than the equitable concept, although the extent to which this is the case remains unclear. The Court concluded:

- Gageler J (majority) held that s. 12CB of the ASIC Act operated independently of equity to prescribe a normative standard of conduct which the Court must administer in the totality of the circumstances. However he found that Parliament's appropriation of the term "unconscionability" served "to signify the gravity of the conduct necessary to be found by a court in order to be satisfied of a breach of that standard". He also said that exploitation of a special disadvantage was not a requirement under the section;
- Keane J (majority) said that whilst the section was "not limited to conduct that has been held to be "unconscionable" under the general law, . it does not operate to give the term "unconscionable" a meaning different from its ordinary meaning". This included the exploitation or unconscientious taking advantage of a special disadvantage;
- Nettle and Gordon JJ (minority) held that the non-exhaustive list of factors in s. 12CC of the ASIC Act "necessarily implies that the statutory conception of unconscionability is more broad-ranging than that of the unwritten law" but that nevertheless the "unwritten law has a significant part to play in ascribing meaning to the term 'unconscionable'". Later in their judgment they appear to dismiss the concept of ascribing fixed elements or rules to unconscionability. Nevertheless, their subsequent analysis of the case appears to have been conducted through the prism of the Anangu people suffering a special disadvantage; and
- Edelman J (minority) held that there was "a clear legislative intention that the bar over which conduct will be unconscionable must be lower than that developed in equity even if the bar might not have been lowered to the "unreasonableness" and "unfairness" assessments in the various categories in nineteenth century equity". In particular, he held that statutory unconscionability permits consideration of, but no longer requires, a special disadvantage or the taking advantage of that special disadvantage.

Kiefel CJ and Bell J (majority) did not address in detail the scope of statutory unconscionability as it was not an issue that was squarely raised and argued in the appeal, although they did emphasise that Parliament had adopted the term "unconscionability" and the relevance of certainty in the conduct of commercial transactions. They expressly noted there was scope for the concept, and in particular, a "lowering the bar", to be considered further. However the ultimate effect of their judgment seems to be that until that time arrives, special disadvantage is still a requirement.

Overall, the outcome shows that in an appropriate case the High Court may be inclined to reconsider and potentially expand the content of the concept of unconscionability in s. 12CB of the ASIC Act, which may dispense with a requirement that there be some special disadvantage. Until that time we are left in a situation where three justices required special disadvantage, two didn't and two appeared to accept in theory that it was not required but nevertheless analysed the facts through that prism.

(ii) Proof required in a "systems" or "pattern" case

The case run by ASIC in the High Court relied on s. 12CB(4)(b) of the ASIC Act which states: "It is the intention of Parliament that: . (b) this section is capable of applying to a system of conduct or pattern of behaviour, whether or not a particular individual is identified as having been disadvantaged by the conduct or behaviour".

Kiefel CJ and Bell J (majority) described a system case as: "a system or pattern of conduct by a trader could constitute unconscionable conduct without the necessity to identify the circumstances of, or the effect upon, any particular consumer". Nettle and Gordon JJ (minority) provided guidance as to the meaning of "system" and "pattern", describing the former as "an internal method of working" and the latter as "the external observation of events".

There was a divide between Keane J (majority) on the one hand, and Nettle and Gordon JJ (minority) on the other as to the role of special disadvantage in a "system" or "pattern" case. Keane J held that a party must prove "a calculated taking advantage of a weakness or vulnerability on the part of victims of the conduct in order to obtain for the stronger party a benefit not otherwise obtainable" but that the extent of the disadvantage did not need to be proven. Nettle and Gordon JJ held that it was not necessary to identify that an individual had a special disadvantage.

(iii) Unconscionability in financial services to remote indigenous communities

Any assessment of whether particular conduct is unconscionable will be heavily dependent on the specific facts of the case. Although the Court's judgment leaves many questions about the general concept unanswered, it is useful to consider how the Court approached the following key topics:

- differing cultures, norms and circumstances than mainstream society may lead to different outcomes: In considering the particular cultures, norms and circumstances of the Anangu people, the majority adopted a neutral approach to consider these matters as part of "all of the circumstances" (Kiefel CJ and Bell J) or as an implicit acceptance of a separate community entitled to due respect for their own choices and their ability to make them (Gageler J). However, the minority considered the Anangu people's differences led to their vulnerability and special disadvantages which emphasised rather than excused the alleged unconscionability;
- a recipient's choice to voluntarily enter into an arrangement will be relevant: Both the majority and the minority considered this a relevant factor, and for the majority it appears to have been a key factor. The issue for the minority was "how that willingness or intention was produced". In that regard, the minority appeared to form the view (contrary to the majority) that the Anangu people's choice was tainted by vulnerability and special disadvantage such that it was given little to no weight;
- the lack of any undue influence, undue pressure or unfair tactics will favour a finding of no unconscionability: Both the majority and the minority acknowledged that in equity undue influence differed from unconscionability, the former being "concerned with the quality of consent of the weaker party" whereas the latter was "concerned with the conduct of the stronger party in taking advantage of the vulnerability of the weaker party". However, in considering statutory unconscionability, by virtue of s. 12CC(1)(d) of the ASIC Act the Court is invited to consider whether there was any undue influence, undue pressure or unfair tactics; and
- the mere potential for exploitation and abuse may not be sufficient to find unconscionability: The majority and the minority equally recognised that Mr Kobelt's credit arrangements had the potential to be exploited or abused by him to the disadvantage of his customers, and this was a matter that could support a finding of unconscionability. The minority found there was exploitation, and there are some indications that the

possibility of exploitation or abuse was in and of itself sufficient. However, the majority's view was that whilst there was potential, Mr Kobelt did not in fact exploit or abuse the arrangement (except on one particular occasion), and that customers were able to, and did, extricate themselves from the arrangement with relative ease. Those factors appear to have been sufficient for the majority to find that there was no unconscionability.

6.9 Where a breakdown of business relationship led to a company winding up on the just and equitable ground

(By Isaac Buckland, MinterEllison)

In the matter of TM Fresh Pty Ltd [2019] VSC 383 (6 June 2019) Supreme Court of Victoria, Hetyey JR

(a) Summary

This case concerned the winding up of TM Fresh Pty Ltd (the Company) by an order pursuant to s. 461(1)(k) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) due to the irretrievable breakdown of the relationship between Francesco Tripodi and Michael Margheriti and the lack of confidence in the conduct and management of the affairs of the company. The Supreme Court (the Court) found there was no other appropriate remedy other than a winding up, but delayed the winding up order to allow parties further opportunity to resolve the dispute.

(b) Facts

The Company was established on 16 June 2017 to purchase and operate a produce stall at the Dandenong Market. Mr Tripodi and Mr Margheriti were both directors of the Company and each held 50% of its shares. Both Mr Tripodi and Mr Margheriti agreed they would both be involved in the Company's day-to-day operation and management. The relationship between them, through the Company, was a quasi-partnership.

In August 2017, the Company entered into a contract to purchase a business trading at certain stalls at the Dandenong Market, while also entering into a licensing arrangement with Dandenong Market Pty Ltd and another entity. Settlement of the sale occurred on or about 31 August 2017 and the Company commenced operation. After trading for a few months, the relationship between Mr Tripodi and Mr Margheriti deteriorated.

Mr Tripodi filed an originating process on 13 July 2018, with primary relief sought being that the Company be wound up pursuant to ss. 233 (shareholder oppression) or s. 461(1)(k) (the just and equitable ground) of the Corporations Act. In the alternative, orders were sought that Mr Margheriti acquire Mr Tripodi's shares in the Company at a price to be determined by the court. On 30 July 2018, Sifris J referred the proceeding for management under the *Court's Oppression proceeding Program*. The initial conference failed.

The matter was referred to judicial mediation, which was subsequently vacated as Mr Margheriti was not prepared to engage a lawyer. The matter was then referred to private mediation, which was unsuccessful. At a directions hearing on 30 January 2019, the parties wished to continue without prejudice discussions. The matter was stood down and the parties informed the Court they had reached a settlement in principle. When the matter returned to Court on 20 February 2019, the settlement had collapsed and no further agreement was reached. Orders were made which appointed a joint expert to provide an opinion on the market value of the Company and required both parties to provide the expert with documentation to allow the expert to undertake the valuation. Neither party complied with the Court's orders, and therefore no evidence was available for the value of the Company's shares.

On 7 May 2019, proposed orders were presented to the parties. Mr Tripodi consented to the proposed orders and pressed for just and equitable winding up. Mr Margheriti did not comment on the form of the proposed orders, but instead in an email dated 8 May 2019 indicated that he did not consent to the winding up of the Company. On 30 May 2019, Sifris J referred the proceeding to a Judicial Registrar for hearing and determination.

Hetyey JR cited the case of *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (*Ebrahimi)* as the leading case for just and equitable grounds of winding up, in which the House of Lords held that the jurisdiction to wind up a company on this ground arise where one of the following are present:

- an association formed or continued on the basis of a personal relationship, involving mutual confidence.;
- an agreement, or understanding, that all, or some . of the shareholders shall participate in the conduct of the business; and
- the restriction upon the transfer of the member's interest in the company - so that if confidence is lost, or one member is removed from management, they cannot take out his stake and go elsewhere.

When determining whether a just and equitable winding up order should be made, Hetyey JR noted that a number of matters need to be considered, including:

- a failure of the main object of the company's formation;
- a deadlock in the management of the company;
- a breakdown in the relationship between the shareholders;
- a lack of confidence in the conduct and management of the affairs of the company;
- where there has been fraud, misconduct or oppression in relation to the affairs of the company;
- serious concerns about the company's compliance with its statutory obligations, including the filing tax returns; and
- a risk to the public interest that warrants protection.

Further, while a court may find circumstances where a winding up on the just and equitable ground is satisfied, s. 467(4) of the Corporations Act states that the court must consider whether an alternative and less dramatic form of relief is available.

(c) Decision

Hetyey JR found that one or more circumstances in *Ebrahimi* were present, the Court's jurisdiction to wind up the Company under s. 461(1)(k) of the Corporations Act was enlivened, and held that it was clear that a winding up order should be made for a number of reasons.

(i) Reasons for Decision

First, Hetyey JR found that the management of the Company was deadlocked, with both directors being unable to agree on how the Company ought to be managed. Due to the deadlock, there was an inability for the Company to reach agreements for the licence renewal with Dandenong Markets. While a month-to-month agreement existed, it was uncertain whether it was possible for the Company to conduct its business in the future if the directors could not enter into the agreement jointly, or if Mr Tripodi did not resign.

Second, the relationship between the shareholders of the Company had broken down within three months of the commencement of business, and it appeared that the relationship was irretrievable. The conflict between Mr Tripodi and Mr Margheriti had resulted in litigation which, despite numerous attempts, the parties could not resolve.

Third, both parties began their business relationship with the objective that they would each be involved in the management and the day-to-day operations of the business, which had obviously failed. Of note, Mr Tripodi deposed that he had been excluded from management of the Company since 12 December 2017.

Fourth, both Mr Tripodi and Mr Margheriti expressed a lack of confidence in the management of the affairs of the Company. Each party made allegations about the others' dealings with the Company finances, revealing the extent to which confidence has been lost in each other. The allegations also displayed the degree of mistrust and disharmony between the shareholders. Hetyey JR suggested that if any allegations had substance, they may warrant further investigation by an independent liquidator.

Fifth, Hetyey JR found that there were real concerns about the Company's historical compliance with tax returns. Mr Margheriti was in possession of the books and records of the Company, but had previously stated that he was unable to lodge tax returns due to Mr Tripodi withholding documents. However, Mr Tripodi submitted that he was only involved with the Company for a short period of time, and had already provided Mr Margheriti with all necessary records. Whatever the position, any non-compliance with the Company's tax obligations exposed both directors and the Company to adverse consequences capable of being imposed by the Australian Taxation Office.

(ii) Outcome

Hetyey JR found that even if a company is solvent or flourishing, that should not be a basis for a winding up order to be declined. There was no less drastic remedy or order that was available or appropriate to assist the parties. There was no possibility for Mr Margheriti to buy Mr Tripodi's shares in the Company because the Court could not assess their value. Nor was it appropriate for the Court to adjourn or dismiss the proceedings for further negotiation due to the history of failed settlement attempts, and it was inappropriate to allow the Company to continue in a state of limbo.

While Hetyey JR noted that it would be unnecessary to consider the application of ss. 232 and 233 of the Corporations Act or other sections of legislation the parties were invited to address, if required, Hetyey JR would likely have found that the Court's jurisdiction under the oppression provisions had been engaged, and that it would have been open on the evidence to make a winding up order pursuant to ss. 233(1)(a) or 461(1)(f) of the Corporations Act.

Hetyey JR refrained from immediately pronouncing an order for the Company to be wound up, instead adjourning until 10 July 2019 to allow for the parties to provide consent orders for the dismissal of proceedings if they resolved the dispute. A liquidator was subsequently appointed on 10 July 2019, and notice of winding up and appointment of liquidator was given on 12 July 2019.
