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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 JPMorgan Chase Bank fined US$920 million by four regulators

On 19 September 2013, the UK Financial Conduct Authority (FCA), the United States Securities and Exchange Commission (SEC), the US Federal Reserve and the US Office of the Comptroller of Currency announced that JPMorgan Chase Bank NA (JPMorgan) had been fined US$920 million for serious failings related to its Chief Investment Office (CIO). According to the FCA 'JPMorgan's conduct demonstrated flaws permeating all levels of the firm: from portfolio level right up to senior management, resulting in breaches of Principles 2, 3, 5 and 11 of the FCA's Principles for Businesses - the fundamental obligations firms have under the regulatory system'.

The FCA imposed a fine of £137,610,000, the SEC imposed a financial penalty of US$200 million and required the firm to admit wrongdoing, the Office of the Comptroller of the Currency imposed a financial penalty of US$300 million, and the US Federal Reserve imposed a financial penalty of US$200 million.

The breaches occurred in connection with the US$6.2 billion trading losses sustained by the CIO in 2012. According to the FCA, these losses arose as a result of what became known as the 'London Whale' trades, and were caused by a high risk trading strategy, weak management of that trading and an inadequate response to important information which should have notified the firm of the huge risks present in the CIO's Synthetic Credit Portfolio (SCP).

The trading strategy for the SCP in 2012 caused the size of its positions to grow so large that it was at risk of substantial losses from even a small adverse market move. However the firm's response to breaches of relevant risk limits was to assume the numbers indicating a breach were unreliable or to doubt the accuracy of the methodology for risk measurement, and to approve temporary limit increases without adequate analysis of the root cause of the breaches.

When significant losses began to mount during 2012, JPMorgan's traders sought to conceal them by mismarking positions and through misconduct in the market in which the losses were occurring. Mismarking went undetected in 2012 owing to flaws in valuation controls, some of which had existed since 2007.

According to the FCA, JPMorgan's failings extend to its senior management's response to the problems with the SCP in the second quarter of 2012. In preparation for a regulatory filing (of JP Morgan Chase & Co (the Group)'s first quarter net income) on 10 May 2012, the firm's senior management had commissioned a review of the SCP's valuations. However the review failed to uncover the extent of the valuation problems present in the SCP. The firm's senior management gave insufficient weight to inconsistencies raised in the information in its possession, especially in light of the context provided by the scale of the losses in the SCP. Firm senior management did not take sufficient steps to ensure that all crucial information reached the appropriate decision makers; findings made by Internal Audit were not escalated to senior management and therefore not considered as part of the review. In addition, the firm's senior management did not involve key parts of the firm's overall control framework in the review.

The Group filed a statement of its earnings in the US on 10 May 2012 which over-valued the SCP's positions. It subsequently filed a restatement on 13 July 2012. More effective analysis of the information available as at 10 May 2012 may have prevented the need for this restatement.

JPMorgan also failed to meet its obligations in respect of its relationship with the FCA. During the first half of 2012, JPMorgan failed to be open and co-operative with the FCA in that it concealed the extent of the losses as well as numerous serious and significant issues regarding the situation in the SCP. In addition, the FCA states that JPMorgan's failings were extremely serious and undermined trust and confidence in UK financial markets.

Further information is available on the websites of the SEC, the Federal Reserve, the Office of the Comptroller of Currency, and the Financial Conduct Authority.

1.2 European Commission announces draft regulation to reform LIBOR and EURIBOR benchmarks

On 18 September 2013, the European Commission proposed a draft regulation to help restore confidence in the integrity of benchmarks. A benchmark is an index (statistical measure), calculated from a representative set of underlying data, that is used as a reference price for a financial instrument or financial contract or to measure the performance of an investment fund. The new rules will enhance the robustness and reliability of benchmarks, facilitate the prevention and detection of their manipulation and clarify responsibility for and the supervision of benchmarks by the authorities. They complement the Commission's proposals, agreed by the European Parliament and Council in June 2013, to make the manipulation of benchmarks a market abuse offence subject to strict administrative fines (see MEMO/13/774).

The manipulation of the London Interbank Offered Rate (LIBOR) and the Euro Interbank Offered Rate (EURIBOR) has resulted in multi-million euro fines on several banks in Europe and the US, and allegations of manipulation of commodity (e.g. oil, gas and biofuel) and exchange-rate benchmarks are also under investigation. The prices of financial instruments worth trillions of euro depend on benchmarks, and millions of residential mortgages are also linked to them. As a result, benchmark manipulation can cause significant losses to consumers and investors, distort the real economy, and undermine market confidence.

The proposal is in line with the principles recently agreed at international level by the International Organization for Securities Commissions (IOSCO) and covers a broad variety of benchmarks, not just interest rate benchmarks such as LIBOR, but also commodity benchmarks for example. It covers all benchmarks that are used to reference financial instruments admitted to trading or traded on a regulated venue, such as energy and currency derivatives, those that are used in financial contracts, such as mortgages and those that are used to measure the performance of investment funds.

The draft regulation is available on the European Commission website.

1.3 SEC proposes rules for pay ratio disclosure

On 18 September 2013, the US Securities and Exchange Commission voted 3-2 to propose a new rule that would require public companies to disclose the ratio of the compensation of its chief executive officer (CEO) to the median compensation of its employees.

The new rule, required under the Dodd-Frank Act, would not prescribe a specific methodology for companies to use in calculating a "pay ratio." Instead, companies would have the flexibility to determine the median annual total compensation of its employees in a way that best suits its particular circumstances.

A copy of the proposed rules is available on the SEC website.

1.4 Bank for International Settlements quarterly review

On 15 September 2013, the Bank for International Settlements (BIS) released its quarterly review. The review highlighted the following:

- higher yields in advanced economies generated serious tremors in emerging markets;
- cross-border claims of BIS reporting banks were broadly stable in the first quarter of 2013. Banks redirected lending from the advanced economies to emerging markets; especially to China, Brazil and Russia;
- Japanese banks returned as the world's largest providers of cross-border credit, a position they had lost in the aftermath of the crisis in the 1990s;
- corporations from emerging markets have overtaken firms from the advanced economies as the largest group of issuers of corporate debt securities in offshore financial centres;
- large banks raised their capital ratios mainly by increasing retained earnings rather than by reducing their assets or loan books;
- an analysis of the structure of contingent convertible capital instruments (CoCos) and the evolution of the market shows that the bulk of CoCos have come from small investors rather than institutional investors;
- in many countries the difference between lending and policy rates remains well above its pre-crisis level;

- there is no aggregate collateral shortage, although collateral may be distributed unevenly; and
- a database on monetary and prudential measures aimed at moderating housing booms and busts, which collates data from 60 economies over the period 1990-2012, has been created the BIS.

The full report is available on the BIS website.

1.5 Crowd sourced equity funding: discussion paper

On 10 September 2013, the Corporations and Markets Advisory Committee (CAMAC) released a discussion paper on crowd sourced equity funding (CSEF).

CSEF refers to arrangements through which a business (the issuer) seeks to raise capital, particularly early-stage funding, by offering small debt or equity interests in the issuer to large numbers of investors through a crowd funding online platform, which serves as an intermediary between the issuer and the investors.

Internationally, CSEF is receiving increasing attention as an alternative form of corporate fundraising for start-up or other small to medium companies. To date, some jurisdictions, notably the United States, Italy and New Zealand, have enacted legislation dealing with CSEF (though the US and New Zealand legislation on general CSEF is not yet in force), while some other jurisdictions, such as Canada, France and the United Kingdom, are giving consideration to this form of fundraising.

The CAMAC discussion paper notes that CSEF is already theoretically available in Australia, but subject to compliance by the issuer and the online intermediary with fundraising, licensing and other requirements under the Corporations Act. The paper examines the nature of those requirements and raises for consideration, taking into account approaches in other jurisdictions, whether the Australian provisions should be adjusted in some manner for CSEF.

In considering possible approaches to CSEF in Australia, CAMAC notes that this form of fundraising carries a series of risks for persons providing funds through this medium. While risks may be present in any capital raising process, the central role of the internet means that the number of persons potentially affected can be significantly greater than for more traditional means of fundraising. There is also the question of the degree of scrutiny of these offerings, and the information to be provided to investors, compared with traditional prospectus or other disclosure requirements.

Another issue concerns the obligations that should rest on the online intermediaries.

The CAMAC discussion paper seeks views on these matters, including:

- whether CSEF should be regulated in a different manner than other forms of corporate fundraising;
- whether any form of regulatory accommodation for CSEF should be limited to specific situations, such as offers to sophisticated investors, falling well short of general public offers open to all investors; or
- whether the Australian legislation should 'cherry pick' CSEF approaches in some other jurisdictions but within the context of otherwise maintaining the existing regulatory structure; or
- whether the Australian legislation should regulate the process of CSEF in the same self-contained manner as, say, under the *Jumpstart Our Business Startups Act* in the US, which is intended to exhaustively regulate this form of fundraising in that jurisdiction.

The discussion paper is available on the CAMAC website.

1.6 The financial crisis five years later: response, reform and progress - US Treasury paper

On 9 September 2013, the United States Department of the Treasury released a note on the global financial crisis and reforms that have occurred in the regulation of markets in the US in response.

The note is available on the Department of the Treasury website.

1.7 G20 endorses OECD principles on long-term investment financing

On 6 September 2013, G20 Leaders endorsed an OECD initiative to encourage the flow of institutional investment towards longer-term assets, such as infrastructure and renewable energy projects, in order to strengthen the global economy.

Currently, pension funds, insurers, mutual funds and sovereign wealth funds hold more than USD 80 trillion in assets. Pension funds alone managed over USD 20 trillion in assets as of the end of 2012, with a net annual inflow of savings of over $1 trillion. But only 1% of those assets were invested in infrastructure projects, with an even smaller fraction in clean energy projects.

The "*High-Level Principles of Long-Term Investment Financing by Institutional Investors*", prepared by an OECD Taskforce working together with G20 members, establish a framework for encouraging institutional investment in long-term assets. They set out the preconditions to long-term investment, such as the need for stable macroeconomic conditions, a clear and transparent government plan for projects, as well as opportunities for private sector involvement via public procurement and public-private partnerships investment. The principles also address specific policies, including:

- improving incentives to mobilise higher levels of long-term savings;
- strengthening the governance of institutional investors to provide the right incentives for the adoption of a long-term perspectives and the management of often illiquid assets;
- ensuring the tax and regulatory framework reflects the particular risk characteristics of the investments, promotes long-term strategies and lowers barriers; and
- informing and educating consumers about the virtues of long-term saving.

As part of its work for the G20, the OECD will also be intensifying monitoring of institutional investors and carrying out in-depth analysis of a variety of policy and market-based incentives to facilitate long-term investment, including in clean energy.

The High Level Principles are available on the OECD website.

1.8 FSB report to G20 leaders on financial regulatory reform progress

On 5 September 2013, the Financial Stability Board (FSB) published the following documents, which were delivered to G20 Leaders:

- a letter from the FSB Chair, Mark Carney, to the G20 Leaders, taking stock of the financial reforms since the global financial crisis and the major outstanding issues which call for the attention of Leaders;
- a narrative progress report, setting out in summary, non-technical language the framework

of financial reforms that the FSB is coordinating at the request of G20 Leaders and the remaining steps that need to be taken to complete the reforms;

- a more detailed and comprehensive overview report on progress in the implementation of the financial reforms in order to strengthen financial stability; and
- a "scoreboard" status report prepared by the FSB Secretariat, in consultation with FSB members, that assesses the current state of progress made in global policy development and implementation of financial regulatory reforms.

1.9 Enhanced statement of principles for hedge funds

On 5 September 2013, the Alternative Investment Management Association (AIMA), the global hedge fund industry association, published an enhanced statement of policy principles. The principles are set out in a new AIMA paper, "Regulating Capital Markets: AIMA's Policy Principles".

The paper builds on the AIMA Policy Platform, the 2009 document in which AIMA offered its support for improved transparency, unified global standards, manager authorisation and supervision, aggregated short position disclosure to regulators and new policies to reduce settlement failure.

AIMA's principles for improving investor protection include rules around the segregation and protection of investor assets and collateral and a call for regulation that reflects the differentiation between retail and professional investors.

The AIMA paper also sets out a number of methods for improving market integrity, including clearly-defined and internationally-harmonised market abuse rules and effective market abuse sanctions.

The principles are available on the AIMA website.

1.10 APRA releases final guidance on managing data risk

On 2 September 2013, the Australian Prudential Regulation Authority (APRA) released in final form its prudential practice guide on the management of data risk for all APRA-regulated institutions.

"Prudential Practice Guide CPG 235 Managing Data Risk" (CPG 235) is a cross-industry guide applicable to all authorised deposit-taking institutions (ADIs), general and life insurance companies and superannuation funds regulated by APRA. The guide is designed to assist these institutions in appropriately managing their data risk and is targeted at those areas where APRA has identified weaknesses through its supervisory activities.

The management of data risk is crucial for APRA-regulated institutions because it can affect their ability to meet financial and other obligations to beneficiaries. The risks associated with the use of data, including data application, retention, storage and security, have become more significant with increasing automation and the criticality of data to decision-making.

CPG 235 provides guidance on each of these areas as part of an overall framework for managing data risk. The guidance is intended to be used by Boards and senior management of APRA-regulated institutions, as well as risk and technical specialists and others with an interest in this topic.

CPG 235 and other guidance material are available on the APRA website.

1.11 Report on implementation of OTC derivatives market reforms

On 2 September 2013, the Financial Stability Board (FSB) published a report by the FSB Chairman to the G20 Leaders summarising progress in over-the-counter (OTC) derivatives reforms, together with the sixth of the FSB's semi-annual comprehensive progress reports on implementation of OTC derivatives market reforms.

G20 Leaders agreed in 2009 to a comprehensive reform agenda to improve transparency in these markets, mitigate systemic risk, and protect against market abuse.

To achieve these objectives, the G20 agreed that by the end of 2012:

- all OTC derivatives contracts should be reported to trade repositories (TRs);
- all standardised contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs); and
- non-centrally cleared contracts should be subject to higher capital requirements and minimum margining requirements should be developed.

These reports find that substantial progress has been made in standard-setting bodies, national and regional authorities and market participants toward meeting the G20 commitments, through international policy development, adoption of legislation and regulation, and expansion of infrastructure.

The reports also discuss areas where further work is needed to complete the reforms and achieve the G20 objectives, including:

- increased use of central clearing, and a renewed focus on the commitment to increase the use of exchanges and electronic trading platforms;
- continued work by regulators to cooperate in the application of regulations in cross-border contexts, to enable them to defer to each other's rules where these achieve similar outcomes; and
- greater clarity from regulators regarding the detailed rules on the treatment of cross-border transactions and the timetables for implementation.

1.12 Margin requirements for non-centrally cleared derivatives

On 2 September 2013, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO) released the final framework for margin requirements for non-centrally cleared derivatives.

Under the globally agreed standards, all financial firms and systemically important non-financial entities that engage in non-centrally cleared derivatives will have to exchange initial and variation margin commensurate with the counterparty risks arising from such transactions. The framework has been designed to reduce systemic risks related to over-the-counter (OTC) derivatives markets, as well as to provide firms with appropriate incentives for central clearing while managing the overall liquidity impact of the requirements.

The framework is available on the websites of the Bank for International Settlements and IOSCO.

1.13 OTC derivatives regulators issue report to the G20

On 30 August 2013, authorities with responsibility for the regulation of over-the-counter (OTC) derivatives markets in Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Quebec, Singapore, Switzerland and the United States issued a report regarding common understandings to improve the cross-border implementation of OTC derivatives reforms. This report responds to an April 2013 request by the G20 Finance Ministers and Central Bank Governors, urging key OTC regulators to intensify their efforts to address and resolve remaining cross-border conflicts, inconsistencies, gaps and duplicative requirements.

The report reflects a number of substantive understandings to improve the cross-border implementation of OTC derivatives reforms.

The report is available on the US Commodity Futures Trading Commission website.

1.14 Policy recommendations to strengthen oversight and regulation of shadow banking

On 29 August 2013, the Financial Stability Board (FSB) published policy recommendations to strengthen the oversight and regulation of the shadow banking system.

The FSB has focused on five specific areas in which policies are needed to mitigate the potential systemic risks associated with shadow banking:

- mitigation of the spill-over effect between the regular banking system and the shadow banking system;
- reduction of the susceptibility of money market funds (MMFs) to "runs";
- assessment and alignment of the incentives associated with securitisation;
- dampening of risks and pro-cyclical incentives associated with securities financing transactions such as repos and securities lending that may exacerbate funding strains in times of market stress; and
- assessment and mitigation of systemic risks posed by other shadow banking entities and activities.

The documents published comprise:

- a report entitled "An Overview of Policy Recommendations" that sets out the FSB's overall approach to addressing financial stability concerns associated with shadow banking, actions taken to date, and next steps;
- a report entitled "Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos" that sets out recommendations for addressing financial stability risks in this area, including enhanced transparency, regulation of securities financing, and improvements to market structure (refer to the fourth risk element above). It also includes consultative proposals on minimum standards for methodologies to calculate haircuts on non-centrally cleared securities financing transactions and a framework of numerical haircut floors; and
- a report entitled "Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities" that sets out the high-level policy framework to assess and address risks posed by shadow banking entities other than MMFs (refer to the fourth risk element outlined above).

1.15 Progress report and interim peer review report on credit rating agency ratings

On 29 August 2013, the Financial Stability Board (FSB) published a progress report on reducing reliance on, and strengthening the oversight of, credit rating agencies (CRAs). The progress report is accompanied by the interim peer review report on national implementation of the FSB "Principles for Reducing Reliance on Credit Rating Agency (CRA) Ratings".

The progress report includes a summary of the main findings and recommendations of the peer review, describes ongoing work by standard-setting bodies to reduce references to CRA ratings in international standards, and provides an update on work by the International Organisation of Securities Commissions (IOSCO) to improve transparency and competition among CRAs.

The main points of the progress report are as follows:

- authorities need to accelerate work to end the mechanistic reliance of regulatory regimes and of market participants on external ratings, which can lead to herd behaviour and cliff effects in market prices when downgrades occur;
- the FSB is taking forward its roadmap to reduce reliance on CRA ratings through a peer review of national authorities' actions to reduce reliance. The review aims to accelerate progress and assist national authorities in fulfilling their commitments under the roadmap;
- the interim peer review notes that jurisdictions have faced different starting positions from which to make reforms. The US has moved the furthest in removing hard-wiring of ratings, and the EU has also made significant progress. Progress in most other jurisdictions has been slower;
- among existing international standards, the greatest use of CRA ratings is in the Basel framework. The Basel Committee for Banking Supervision has made proposals to reduce reliance in its securitisation framework and by mid-2014 will make proposals on reducing reliance within its standardised approach for capital requirements. The challenge is to identify credible alternative standards of creditworthiness;
- market participants need to improve their own capacity to make their own credit assessments in order that they can safely reduce their reliance on CRA ratings. This too presents challenges and will take time;
- FSB members should disclose action plans, as agreed under the roadmap, that identify and prioritise further areas for changes in laws and regulations. These action plans will be used in the second stage of the peer review to share lessons on the steps that can be taken by authorities to reduce references to CRA ratings in legislation and regulation and to promote strengthened credit assessment capabilities; and
- IOSCO sees enhanced transparency as playing an important role in market competition and may enhance its transparency standards for CRAs as part of its ongoing revision of its CRA Code of Conduct. The FSB will continue to monitor whether further work is needed in this area beyond the revision of the Code.

While recognising the progress made in implementing the Principles, the peer review has identified several areas where accelerated progress is needed, including that FSB jurisdictions should:

- provide incentives to financial institutions to develop their own independent credit assessment processes;
- encourage or continue to enhance disclosures on financial institutions' internal credit risk assessment practices (drawing on guidance from standard-setting bodies where available).

The peer review has also identified a number of challenges that need to be addressed in order to make further progress in implementing the Principles. These include reducing undue reliance on CRA ratings in international standards as well as in private contracts or private sector investment decisions, identifying suitable alternative standards of creditworthiness, and addressing constraints in the development of internal risk assessment systems, particularly for smaller firms. The second stage of the peer review will analyse these challenges in more detail. The FSB intends to issue the final peer review report in early 2014.

1.16 New Zealand Financial Markets Conduct Bill enacted

On 28 August 2013, the Financial Markets Conduct Bill passed its third reading. This major law reform is aimed at improving financial market conduct in New Zealand's financial markets.

The Bill rewrites many of the rules for how financial products and financial services are offered to the public and how they are governed and operated. It replaces several Acts, including the Securities Act 1978, the Securities Markets Act, the Unit Trusts Act, the Superannuation Schemes Act, and the non-tax parts of the KiwiSaver Act.

Key changes in the Bill include:

- a new requirement for issuers to prepare a single product disclosure statement tailored to retail investors;
- two new online public registers that will make offer documents and information much more accessible to investors, their advisers, market analysts, and commentators;
- a new system of escalating penalties: from infringement notices for minor breaches through to penalties of up to $1 million for individuals, $5 million for companies and criminal penalties of up to 10 years' prison for the worst conduct;
- new licensing regimes for specific financial services providers including fund managers, independent trustees of workplace superannuation schemes, discretionary investment management services and derivatives issuers;
- new forms of capital-raising, such as peer-to-peer lending and crowd-funding;
- new duties on fund managers and supervisors and stronger governance requirements; and
- a new system to regulate securities exchanges such as the stock market, including allowing for new low cost exchanges to make capital-raising easier and cheaper.

An exposure draft of regulations to support the Bill will be released for consultation in October. The implementation dates for the changes will be phased as follows:

- phase 1 on 1 April 2014 comprising general fair dealing obligations, key growth-focussed initiatives including employee share schemes and enabling financial market participants to become licensed, including for crowd-funding; and
- phase 2 on 1 December 2014 comprising the new disclosure requirements, go-live of the online registers, licensing obligations and the remainder of the Bill.

Starting from December 2014, continuous issuers such as managed funds and non-bank deposit takers will have a two-year transition period in which they can continue to comply with the Securities Act 1978. Other issuers will be able to comply with the old law for one year from December 2014.

The Financial Markets Authority (FMA) will be responsible for implementing the changes and the FMA will consult on new licensing frameworks and other key operational changes in October.

Further information is available on the FMA website.

1.17 Assessment methodology for the key attributes of effective resolution regimes for financial institutions

On 28 August 2013, the Financial Stability Board (FSB) released a consultative document regarding the "too big to fail" problem.

Solving the "too big to fail" problem requires effective and credible resolution regimes. The Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes), which were endorsed by the G20 in November 2011, set out the responsibilities, instruments and powers that resolution regimes should have for all parts of the financial sector that could cause systemic problems. As an international standard, G20 jurisdictions have publicly committed to implement them.

Jurisdictions need to have resolution regimes in place that are capable of managing the failure in all parts of the financial sector that could cause systemic problems. The methodology has been developed as a single comprehensive document with assessment criteria for all sectors, including financial market infrastructure, as well as sector-specific criteria. It also guides assessors to take into account the structure and complexity, and the overall level of development of a jurisdiction's financial system.

The Consultative Document is available on the FSB website.

1.18 FSB peer review of the United States

On 27 August 2013, the Financial Stability Board (FSB) published its peer review of the United States.

The report examines the progress made in the US on three topics that are important for financial stability and relevant for the broader FSB membership: systemic risk oversight arrangements, supervision and oversight of financial market infrastructures (FMIs), and insurance supervision. To a large extent, the reforms analysed in this review focus on the need to ensure effective and efficient coordination and information sharing arrangements and to address any overlaps or gaps in the roles and responsibilities of the relevant US agencies, given the complex and fragmented US regulatory and supervisory structure.

The report is available on the FSB website.

1.19 Implementation of Basel III regulatory reforms issued by the Basel Committee

On 27 August 2013, the Basel Committee on Banking Supervision published its fourth Report to G20 Leaders on progress made in the implementation of Basel III regulatory reforms.

Full, timely and consistent implementation of Basel III has been accorded high priority by the G20 Leaders. This latest report notes substantial progress with respect to:

- the adoption of the Basel standards by Basel Committee member jurisdictions;
- the harmonisation of capital regulations across member jurisdictions; and
- the finalisation of remaining post-crisis reforms that form part of the Basel regulatory framework.

The report can be accessed on the Bank for International Settlements website.

1.20 Progress report on remuneration practices

On 26 August 2013, the Financial Stability Board (FSB) published the second progress report on the implementation of the FSB "Principles for Sound Compensation Practices and their Implementation Standards" (the Principles and Standards) by FSB jurisdictions.

The report finds that, while good progress continues to be made, more work needs to be done by national authorities and firms to ensure that implementation of the Principles and Standards is effectively leading to more prudent risk-taking behaviour. The report describes some of the key challenges and evolving practices in the areas of ex ante risk adjustment, alignment of remuneration with performance (including maluses and claw-back mechanisms), and the identification of material risk-takers.

All FSB member jurisdictions except two have now completed the implementation of the Principles and Standards in national regulation or supervisory guidance. The focus of national authorities is now on effective supervision and oversight of implementation by relevant firms.

Reported trends suggest that most remuneration structures are being revised in the direction indicated by the Principles and Standards. Further work is needed on the identification criteria for material risk-takers given the existing differences in approach and points of view by FSB jurisdictions.

The disclosure of remuneration practices has also improved, although it is still generally difficult for policymakers and the public to reliably access easy to understand and consistent data on remuneration structures for significant firms across jurisdictions.

The report notes that certain regulatory initiatives currently being implemented could materially change remuneration structures in some FSB member jurisdictions.

1.21 Impact assessment of OTC derivative regulatory reforms

On 26 August 2013, the Macroeconomic Assessment Group on Derivatives (MAGD) published a report on the "Macroeconomic Effects of OTC Derivatives Regulatory Reforms".

In this report, the MAGD focuses on the effects of:

a. mandatory central clearing of standardised OTC derivatives;
b. margin requirements for non-centrally cleared OTC derivatives and;
c. bank capital requirements for derivatives-related exposures.

In its preferred scenario, the Group found economic benefits worth 0.16% of GDP per year from avoiding financial crises. It also found economic costs of 0.04% of GDP per year from institutions passing on the expense of holding more capital and collateral to the broader economy. This results in net benefits of 0.12% of GDP per year. These are estimates of the long-run consequences of the reforms, which are expected to apply once they have been fully implemented and had their full economic effects.

The report is available on the Bank for International Settlements website.

1.22 Canadian Securities Administrators release review of proxy voting infrastructure

On 15 August 2013, the Canadian Securities Administrators (CSA) published a consultation paper to outline and seek feedback from issuers, investors and other stakeholders on a proposed approach to address concerns regarding the integrity and reliability of the proxy voting infrastructure. Two issues were identified for further examination because the CSA believes that they have the most potential to impact the ability of the proxy voting infrastructure to function accurately and reliably.

These issues are:

- whether or not accurate vote reconciliation occurs within the proxy voting infrastructure; and
- the type of end-to-end vote confirmation system that should be added to the proxy voting

infrastructure.

The Consultation Paper is available on the British Columbia Securities Commission website.

1.23 Supreme Court of Victoria Commercial Law Conference 2013 - papers available

The Supreme Court of Victoria Commercial Law Conference was held on Monday, 9 September 2013 in the Banco Court, Supreme Court of Victoria. The annual conference is a joint initiative of the Supreme Court of Victoria and the Centre for Corporate Law and Securities Regulation, Melbourne Law School.

Leading speakers addressed important commercial law topics including fiduciary breaches, commercial litigation and the adversarial system and, developments in legal professional privilege with regards to the Evidence Act 2008 (Vic). Some of the speakers and commentators have made their papers or other relevant materials available. If you did not attend the conference but are interested in viewing the papers, they can be purchased on the Centre for Corporate Law and Securities Regulation pay system for $110.00 (including GST).

Further information regarding the Conference can be found on the Centre for Corporate Law and Securities Regulation website.

1.24 New Centre for Corporate Law and Securities Regulation Research Papers

The Centre for Corporate Law and Securities Regulation at Melbourne Law School has published four new research papers.

They are:

- "Improving Auditor Independence in Australia: Is 'Mandatory Audit Firm Rotation' the Best Option?" by Joanne Ottaway;
- "Gender Diversity on Australian Boards of Directors (With Reference to Approaches in Europe and India)" by Meenal Kashyap;
- "Governance and Regulation of Bribery of Foreign Public Officials" by Andrew Blunt; and
- "Regulating the Rating Agencies" by Daphne Tan.

The research papers are available on the Centre for Corporate Law and Securities Regulation website.

2. Recent ASIC Developments

2.1 Consultation on the quality of SMSF advice

On 16 September 2013, ASIC released proposed guidance to improve the quality of advice given to investors as part of its continuing focus on the self-managed superannuation fund (SMSF) sector.

ASIC's recent review of the sector found there was significant room for improvement in the quality of advice received by clients. In particular, ASIC found that there is a need to improve the disclosure of information that may influence a decision to establish or switch to an SMSF.

Consultation Paper 216 "Advice on self-managed superannuation funds: Specific disclosure requirements and SMSF costs" contains ASIC's proposals to impose specific disclosure obligations on advisers.

They include the need to:

- warn clients that SMSFs do not have access to the compensation arrangements under the Superannuation Industry (Supervision) Act 1993 (Cth) in the event of theft or fraud; and
- explain other matters that may influence the client's decision to set up an SMSF.

Consultation Paper 216 also looks at the appropriate level of resources consumers should have before setting up an SMSF.

ASIC commissioned Rice Warner to examine the minimum cost-effective balance for SMSFs when compared with super funds regulated by the Australian Prudential Regulation Authority (APRA). Consultation Paper 216 includes Rice Warner's report: "Costs of Operating SMSFs". ASIC is seeking feedback on Rice Warner's findings and on the costs associated with setting up, running and winding up an SMSF.

ASIC established an SMSF taskforce in September 2012 to focus on risks in this sector, including potentially inappropriate geared investment strategies, increasingly aggressive advertising and investment fraud.

This is the second major project of the taskforce, the overarching aim of which is to ensure that:

- only those investors for whom an SMSF is suitable are advised to establish an SMSF; and
- investors receive good quality advice and services from gatekeepers such as accountants and financial advisers.

The Consultation Paper is available on the ASIC website.

2.2 Stakeholder survey

On 11 September 2013, ASIC released the findings of the ASIC stakeholder survey 2013.

The survey measured stakeholders' perceptions of the environment in which ASIC operates and ASIC's performance against its three strategic priorities:

- confident and informed investors and financial consumers;
- fair and efficient markets; and
- efficient registration and licensing.

Overall, stakeholders were positive about ASIC's current performance and most considered that ASIC was performing better than, or the same as, two years ago. Particular strengths included:

- ASIC's market supervision, including ASIC's work in keeping markets free from insider trading, and ensuring that companies provide reliable and timely information to the market;
- ASIC acting professionally, promoting confidence in Australia's financial system, and understanding the industries and markets it regulates; and
- ASIC's registration and licensing being easy, efficient, timely and cost-effective.

A copy of the ASIC stakeholder survey 2013 is available on the ASIC website.

2.3 Report finds hedge funds no systemic risk to financial system

On 10 September 2013, an ASIC report was released which found that Australian hedge funds do not currently pose a systemic risk to the Australian financial system.

Report 370 "The Australian hedge funds sector and systemic risk" found that:

- hedge funds ASIC identified manage only a small share of Australia's $2.1 trillion managed funds industry with more than half of these holding less than $50 million each;
- the survey indicates that Australian hedge funds do not currently appear to pose a systemic risk to the Australian financial system; and
- listed equities represent surveyed hedge fund managers' greatest asset exposure, with 32% of this being in Australian-listed shares.

Surveyed qualifying hedge funds also use low leverage and appear to have adequate liquidity to meet obligations.

The survey was representative of the state of the Australian hedge fund industry as a whole, with the assets of the 12 surveyed qualifying hedge funds representing approximately 42% of the assets held by single-strategy hedge funds in Australia.

Australian wholesale investors are the main investors in the surveyed funds. Their hedge-fund investment relative to their total investments is minimal, which tends to reduce systemic impact of any problems in the sector.

By asset class, listed equities (over US$19 billion) are the surveyed fund managers' greatest gross exposures, with almost one-third of this being Australian equities. Equity derivatives and G10 sovereign bonds are the next two most significant asset classes, with exposures of US$8.2 billion and US$6.9 billion respectively.

Hedge fund redemptions exceeded applications in 2012, compared with the substantial inflows in 2010. However, the 2012 redemptions are unlikely to result in liquidity pressures because the average redemption size is relatively small as a percentage of funds' net asset value.

The average time in which surveyed funds can liquidate 92% of their portfolio is less than 30 days. However, creditors can demand 99% of fund liabilities in less than 30 days. If the Australian market were subject to significant stress, the sector may struggle to meet redemption requests. However, this risk is offset by all the surveyed funds being able to suspend redemptions, if required.

Surveyed funds use relatively low levels of leverage, with synthetic leverage being the largest source in 2012. Average leverage, by gross market value as a multiple of net asset value, increased from 1.25 times assets in 2010 to 1.51 times assets in 2012.

Hedge funds' investments have in the past adversely affected the financial system by disrupting liquidity and pricing in markets (market channel risk) or by causing creditors to lose money (credit channel risk). The potential for systemic risk depends on the size, significance and interconnectedness of hedge funds.

In 2010 and 2012, the International Organization of Securities Commissions (IOSCO) called on members to survey their jurisdictions' largest hedge fund managers to better understand the systemic risk these funds posed. In late 2012, ASIC surveyed hedge fund managers operating in Australia with more than US$500 million under management.

Report 370 is available on the ASIC website.

2.4 ASIC surveillance targets illegal phoenix activity

On 9 September 2013, ASIC advised that it will be targeting company directors with a history of failed companies as part of a surveillance program to combat illegal phoenix activity.

Phoenix activity is the fraudulent act of transferring the assets of an indebted company into a new company to avoid paying creditors, tax or employee entitlements. The new company, usually operated by the same director, continues the business under a new structure to avoid their responsibilities to their creditors.

Figures put the cost of this activity to the Australian economy at more than $3 billion annually.

ASIC action to combat phoenix activities to date includes removing directors who have been involved in two or more failed companies from the industry.

As part of the surveillance program, ASIC will focus on the building and construction, labour hire, transport, and security and cleaning industries.

2.5 Report on emerging market issuers

On 27 August 2013, ASIC released Report 368 "Emerging market issuers".

Following the high profile collapse of some emerging market issuers overseas ASIC has undertaken a review of these types of entities in Australia. The review has not identified at this time any areas of systemic concern, however ASIC does consider that there are some specific challenges that retail investors should be aware of before making the decision to invest in an emerging market issuer.

Report 368 states that:

- ASIC identified challenges emerging market issuers may be more likely to encounter than entities operating wholly in Australia;
- ASIC is urging emerging market issuers and their advisers to focus on their corporate governance and the disclosure they provide to Australian investors regarding these challenges;
- investors should consider the risks before investing in an emerging market issuer; and
- investors need to know that they may not have the same protections when investing in an emerging market issuer that is listed in Australia but incorporated abroad.

As described in Report 368, ASIC found that there are a number of challenges faced by entities that are operating in, or have significant exposure to, emerging markets. Common challenges include implementing good corporate governance and management systems, operating through complex ownership or contractual arrangements, risks associated with relying on one or two key individuals located outside Australia, and the difficulty in accessing or verifying reliable information about an entity's operation and performance.

The report recommends emerging market issuers respond to these challenges by implementing effective internal controls and risk management systems. It is important that entities focus on making appropriate disclosure to investors consistent with an exchange's listing rules and ASIC's regulatory guidance.

ASIC will continue to monitor emerging market issuers in the coming year by including a number of these entities in its financial reporting surveillance programs and through reviewing selected disclosure documents lodged with it.

The report is available on the ASIC website.

3. Recent ASX Developments

3.1 Rule amendments - admission of licensed banks as Participants

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

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

3.2 ASX Limited Annual Report

On 22 August 2013, ASX released its full-year result for the year ending 30 June 2013.

The report and related documents are available on the ASX website:

- Media Release;
- ASX Limited Annual Report;
- transcript of the Media Briefing; and
- transcript of the Analyst Briefing;

along with the Final Dividend Announcement and Appendix 4E Preliminary Final Report.

3.3 ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service: consultation paper

On 28 August 2013, ASX released the first of two Consultation Papers in which it seeks stakeholder input on the draft Operating Rules for its Client Clearing Service for ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives. The Consultation Paper focuses on the client account segregation and portability features of the service. The second Consultation Paper, to be released in October 2013, will cover default management procedures.

ASX's Client Clearing Service will make available to Clearing Participants a client account structure that will enable participants to offer their Clients, in addition to net omnibus client segregation, an option that allows for separate identification and protection of individual Clients' positions and associated initial margin.

ASX is introducing its Client Clearing Service in response to:

- market demand for client account segregation options, in respect of both ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives, that offer Clients the choice of enhanced protection in the event of Clearing Participant default; and
- market demand for a domestic client clearing service for OTC Interest Rate Derivatives; and
  changes to regulatory standards in Australia.

The Consultation Paper is available on the ASXGroup website.

3.4 Reports

On 5 September 2013 ASX released:

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

for August 2013.

4. Recent Research Papers

4.1 The international scope of say on pay

Shareholders have long complained that top executives are overpaid by corporate directors irrespective of their performance. Largely powerless to stop these practices, in 2002, they prevailed upon the UK Parliament to adopt legislation requiring public companies to permit their shareholders to have a mandatory, non-binding vote on the compensation of their top executives (Say on Pay). Since that time, there has been a wave of such legislation enacted in countries around the world, including the US, Australia, Belgium, the Netherlands, and Sweden, while Switzerland, Germany and France appear to be moving rapidly in the same direction. In this article, the authors ask what is the justification for adopting these rules?

For countries where most corporations have dispersed ownership structures, like the US, the UK and Australia, proponents claimed that these votes would allow shareholders to more stringently monitor management and thereby reduce the agency costs of the separation of ownership and control in public companies. In concentrated ownership countries, such as the Netherlands, Germany, Sweden, France and Belgium, the existence of controlling shareholders at most companies in these countries means that there already is close supervision of pay levels by a concentrated owner with strong incentives not to overpay executives. However, the authors argue that there are other compelling reasons why Say on Pay has been enacted in these nations.

The authors find several other reasons for these changes:

- movements at larger public companies toward increased dispersion of ownership in several of these countries that are opening up a need for an alternative monitor of executive pay;
- strong support of such legislation by foreign institutional investors whose ownership interests in firms from these countries has increased dramatically in recent years;
- social pressures in many of these countries against rising levels of income inequality;
- political responses by left-leaning parties to these social pressures by introduction of Say on Pay legislation;
- and the presence of important state-owned enterprises in some of these countries that allows the state to play an important role in the regulation of executive pay using different techniques, including Say on Pay.

On balance, these arguments have carried, or seem likely to carry, the day in each of the countries the authors examine.

The authors conclude by examining existing evidence on the effects of Say on Pay votes and how it is likely to evolve over time.

The paper is available on the SSRN website.

4.2 Who chooses board members?

The authors exploit a recent regulation passed by the US Securities and Exchange Commission (SEC) to explore the nomination of board members to US publicly traded firms. In particular, they focus on companies' use of executive search firms versus simply giving choice rights to internal members (oftentimes simply the CEO), in nominating the new directors to serve on the board of directors. The authors show that companies that use search firms to find their board members pay their CEOs significantly higher salaries and significantly higher total compensations. Further, companies with search firm directors are significantly less likely to fire their CEOs following negative performance. In addition, they find that companies with search firm directors are significantly more likely to engage in mergers and acquisitions, and see abnormally low returns from this M&A activity (CEO compensation and monitoring along with acquisition strategy being perhaps the most attributable to board decision-making).

The paper is available on the SSRN website.

4.3 The long-term effects of hedge fund activism

The authors test the empirical validity of a claim that has been playing a central role in debates on corporate governance - the claim that interventions by activist shareholders, and in particular activist hedge funds, have an adverse effect on the long-term interests of companies and their shareholders. While this "myopic activists" claim has been regularly invoked and has had considerable influence, its supporters have thus far failed to back it up with evidence. This paper presents a comprehensive empirical investigation of this claim and finds that it is not supported by the data.

The authors study the universe of about 2,000 interventions by activist hedge funds during the period 1994 - 2007, examining a long time window of five years following the intervention. They find no evidence that interventions are followed by declines in operating performance in the long term; to the contrary, activist interventions are followed by improved operating performance during the five-year period following these interventions. These improvements in long-term performance are present also when focusing on the two subsets of activist interventions that are most resisted and criticised - first, interventions that lower or constrain long-term investments by enhancing leverage, beefing up shareholder payouts, or reducing investments and, second, adversarial interventions employing hostile tactics.

The paper is available on the SSRN website.

4.4 Following the rules? Corporate tax reporting by CEOs with military experience

The authors predict that CEOs who have greater respect for rules will avoid less tax. Based on new data, they find that firms avoid less tax when their CEOs have military service experience. Firms whose CEOs have military experience have higher cash and GAAP effective tax rates by 1-2%, controlling for a battery of firm-level characteristics. Military CEOs are less likely to be sued in class action lawsuits, restate financial statements, backdate options, engage in earnings management, and use tax havens, further validating the authors' use of military experience as a proxy for respect for rules, authority, and societal values.

The paper is available on the SSRN website.

5. Recent Corporate Law Decisions

5.1 The role of causation in cases concerning breach of fiduciary duty by directors of companies leading to loss of opportunity

(By Jane Xu, DLA Piper Australia)

BigTinCan Pty Ltd v Ramsay [2013] NSWSC 1248, New South Wales Supreme Court, Ball J, 4 September 2014

The full text of this judgment is available here.

(a) Summary

In this case where there were breaches of fiduciary duty by the defendant director, because the plaintiff company could prove there was a loss of opportunity, this was sufficient causation. Furthermore, because damages were difficult to assess because of the defendant's conduct, proof of the "loss of opportunity" could be inferred in the absence of evidence showing otherwise.

(b) Facts

The plaintiff, BigTinCan Ltd (BTC), was incorporated on 28 October 2008 by Mr David Keane, who had substantial experience in the information technology and telecommunications industries. BTC was established to develop and to exploit a smartphone application (app) and associated services which permitted subscribers to obtain access from their smartphones to telephony services offered by BTC at reduced rates using wholesale capacity acquired by BTC from a telecommunications carrier. The app in effect automated the functions of a traditional telephone calling card. The service, which was originally known as BigTinCan and which became known as BigTinCan Connect, required considerable capital investment not only to develop its functionality but also to acquire sufficient wholesale capacity from a telecommunications carrier at a price which would permit BTC both to offer a discount to its subscribers and to earn a profit on the services it provided.

The shareholding in BTC changed over time. However, throughout the period BTC traded, Mr Keane held a controlling interest in it.

On 9 January 2009, the second defendant, Mr David Ramsay, was appointed a director of BTC and he and his wife were issued with 1,225,000 shares each in the company which, at the time of the events giving rise to this proceeding, together constituted approximately 20.4% of the company's shares. Mr Ramsay had extensive experience in raising capital for start-up information technology companies and his principal task as a director of BTC was to assist the company to raise additional capital so that it could continue to develop the BigTinCan Connect service.

The first version of BigTinCan Connect was developed by BTC using several contractors. The technology it developed was known as Webcan 1. By the middle of 2009, BTC had a small number of subscribers to its BigTinCan Connect service.

Mr Keane was not entirely happy with the contractors who worked on Webcan 1. He was introduced to the third defendant, Mr Roel Pollers, as a technical person who could assist in developing an enhanced version of Webcan 1. Mr Pollers, who worked full time for Telstra, agreed to do work for BTC. By December 2009, Webcan 2 was largely complete and was made available to subscribers at about that time. On 8 February 2010, Mr Pollers entered into a consulting agreement with BTC. In addition, he was issued with 1,550,000 shares in the company which, at the time they were issued, constituted approximately 12.9% of the capital of the company.

(i) Breach of fiduciary duties owed by the director (Mr Ramsay) to the company

BTC claimed that Mr Ramsay breached his fiduciary duties as a director of BTC and the duties he owed under ss. 181-183 of the Corporations Act 2001 (Cth) (the Act), by formulating a plan to set up a new company, referred to as "NewCo", to acquire all or some of the business of BTC or to compete with BTC and for that purpose sought to raise capital for NewCo instead of raising capital for BTC.

(ii) Mr Poller's knowing assistance in a dishonest and fraudulent breach of fiduciary duty

BTC also alleged that Mr Pollers was knowingly concerned in Mr Ramsay's breaches of duty.

(iii) Cross-claim by the defendants

Mr Ramsay and Mr Pollers represented themselves. Both sought to defend the claim on the basis that BTC had failed to prove the essential facts which formed the basis of its claim. Both filed cross-claims in the proceeding.

Those cross-claims raised a number of issues. However, the only one that was mentioned during the course of the hearing (and then only during final submissions) was a claim that BTC acted oppressively by making a rights issue of its shares to existing shareholders which had the effect of diluting Mr Ramsay and his wife's interest in the company to 2.6% and Mr Pollers' interest in the company to 1.6%.

(c) Decision

Ball J held that:

- Mr Ramsay breached his duties as a director of BTC. He breached s. 181 of the Act and his fiduciary duties as a director;
- Mr Poller had knowingly assisted Mr Ramsay in his dishonest and fraudulent breach of duty; and
- there was no merit in Mr Ramsay's and Mr Pollers's cross-claims. There was no evidence to suggest that the rights issue were made for an improper purpose.

(i) Proof of loss of opportunity is sufficient causation

Ball J focused on the fact that there was a difference between causation for the purposes of breach of fiduciary duty and causation for the purposes of breach of contract.

His Honour held that it was not necessary for BTC to prove that, but for Mr Ramsay's breach, BTC would have raised additional capital. It was sufficient that it prove that it lost an opportunity to do so.

(ii) The difficulty in assessing the value of a "lost opportunity" will not bar recovery for "lost opportunities"

His Honour held that it was no bar to recovery that it is difficult to assess the value of the lost opportunity:

Where it is not possible to assess the loss that the plaintiff has suffered because the assessment involves speculation about what might have happened, the [C]ourt must do the best that it can using common sense: see *McCrohon v Harith* [2010] NSWCA 67 at [118]ff per McColl JA with whom Campbell JA and Handley AJA agreed; see also *Barescape Pty Ltd v Bacchus Holdings Pty Ltd (No 9)* [2012] NSWSC 984 at [269] per Black J; *Sydney Attractions Group Pty Ltd v Frederick Schulman (No 2)* [2013] NSWSC 1153 at [49]ff per Sackar J.

(iii) Proof of loss can be inferred in the absence of other evidence showing otherwise

Ball J thought that was not open in the circumstances of the case for Mr Ramsay to say that his conduct did not cause BTC to lose the opportunity to raise capital. He was the director responsible for the capital raising. He put himself in a position where in breach of his duties he had an interest in seeing that capital raising fail. BTC failed to raise any capital. The likelihood is that BTC's prospects of raising capital would have been better if Mr Ramsay had not put himself in the position he did. BTC was entitled to be compensated for that fact.

His Honour stated:

Where damages are difficult to assess because of the defendant's conduct, it may be appropriate to draw inferences in the plaintiff's favour concerning the assessment of that loss: *New South Wales v Burton* [2008] NSWCA 319 at [107]-[108] per Basten JA with whom Allsop P and Handley AJA agreed.
In my opinion, for the reasons I have given in the absence of any other evidence it is appropriate to infer that Mr Ramsay's conduct caused BTC to lose an opportunity to raise finance.

5.2 Liability for breach of contract for failure to provide redemption to underwriter of units in managed investment scheme

(By Jasper Kjar-Cruttenden, Herbert Smith Freehills)

TFML Ltd v MacarthurCook Fund Management Ltd [2013] NSWCA 291, New South Wales Court of Appeal, McColl, Macfarlan and Meagher JJA, 3 September 2013

The full text of this judgment is available here.

(a) Summary

In *MacarthurCook Fund Management Ltd v Zhaofeng Funds Ltd* [2012] NSWSC 911, the trial Judge found that TFML Ltd (TFML) was liable as the new responsible entity in the Reed Property trust (RP Trust) for breaches of contract between Zhaofeng Funds Management Ltd (RFML), as the previous responsible entity, and MacarthurCook Fund Management Ltd (MacarthurCook) as underwriter of units in the RP Trust.

In September 2013, the New South Wales Court of Appeal (COA) unanimously overturned the decision of the trial Judge and allowed TFML's appeal. The appeal was allowed on the basis that TFML was not liable as the new responsible entity of the RP Trust as RFML was not in breach of contract in its capacity as responsible entity when the alleged breaches occurred.

(b) Facts

The RP Trust was an unlisted registered managed investment scheme that primarily invested in property assets such as shopping centres. RFML was trustee and the responsible entity of the RP Trust during all relevant periods. RFML sought to raise funds by publicly offering ordinary units in the scheme at $1 per unit and issued product disclosure statements in October 2006 and December 2007. MacarthurCook agreed to underwrite the issue of units through five separate facility agreements (the Facility Agreements). MacarthurCook initially subscribed for two tranches of 5 million units in November 2006. RFML was subsequently released from their obligation to redeem the units when they were converted to ordinary units.

MacarthurCook subscribed for a further three tranches of 5 million units in November - December 2007. Under the Facility Agreements, the units held by MacarthurCook were to be redeemed by RFML with funds received from the public offer by the end of the relevant 12 month subscription periods (the Subscription Periods) (the Redemption Obligations). RFML also guaranteed to purchase any remaining units held by MacarthurCook at the end of the Subscription Periods (the Guarantee Obligations). The Redemption Obligations in the Facility Agreements were expressed to be in RFML's capacity as responsible entity of the RP Trust and the Guarantee Obligations were held in RFML's personal capacity. During the Subscription Periods the RP Trust received $12,347,079 from accepted applications from the public offer of units.

In September 2008 RFML suspended withdrawals due to the economic turmoil associated with the global financial crisis. As a result, RFML did not fulfil the Redemption Obligations or Guarantee Obligations. RFML also failed to pay MacarthurCook accrued fee instalments due under the first tranche of units (the Fee Instalments). In May 2012 RFML was replaced as responsible entity of the RP Trust by TFML.

MacArthurCook and Sandhurst Trustees Ltd, as custodian and agent of MacarthurCook, claimed damages from TFML for RFML's alleged breach of contract for the Redemption Obligations, the Guarantee Obligations and for RFML's failure to pay the Fee Instalments.

The trial Judge held on 17 August 2012 that RFML was contractually obliged to:

- redeem MacarthurCook units for $12,347,079 from accepted applications for units in order to fulfil the Redemption Obligations;
- fulfil its Guarantee Obligations and pay MacarthurCook for the 15 million units it purchased; and
- pay to MacarthurCook the Fee Instalments of $131,250;

and by virtue of s. 601FS(1) of the Corporations Act 2001 (Cth) (the Act) these obligations were conferred on TFML as the new responsible entity of the RP Trust.

(c) Decision

TFML appealed the decision on 32 grounds. The COA allowed the appeal. The reasons are summarised as follows:

(i) Redemption Obligations

MacarthurCook claimed damages for breach of contract for RFML's failure to redeem its units from funds received from the public offer. The parties agreed that RFML's liability would be transferred to TFML pursuant to s. 601FS(1) of the Act as the obligations were undertaken in its capacity as responsible entity of the RP Trust. The COA had to address a number of issues in relation to the Redemption Obligations.

The COA had to determine whether Part 5C.6 of the Act applied to the Redemption Obligations. The Facility Agreements expressly stated that the Redemption Obligations were subject to the Act and the RP Trust's constitution (Constitution). The COA agreed with the trial Judge's determination that Part 5C.6 of the Act applied. Section 601KA(3) of the Act requires that a responsible entity not allow a member to make a withdrawal unless in compliance with the scheme's constitution and ss. 601KB to 601KE of the Act. Section 601KB(2) of the Act and the Constitution both require that a withdrawal offer be made to the responsible entity before a unit holder is entitled to redeem its units. Section 601KB(1) of the Act provides that an opportunity to withdraw from a scheme may only be offered when there are units available to be converted to money.

Having held that Part 5C.6 of the Act and the Constitution applied to the Redemption Obligations, the COA had to determine whether the Facility Agreements satisfied the relevant requirements in Part 5C.6 of the Act. The trial Judge held that the requirements in Part 5C.6 of the Act were substantially complied with by virtue of the Redemption Obligations in the Facility Agreements. On appeal the COA held that execution of the Facility Agreements, requiring redemption of units to MacarthurCook, was not sufficient to comply with the Act and the Constitution. In their judgment the COA stated that no offer of withdrawal from the scheme, required under s. 601KB(2) and the Constitution, was made. Additionally, when MacarthurCook alleged the withdrawal offers were made the scheme did not have assets that were available to meet the purported withdrawal requests as required in s. 601KB(1) of the Act. As a result RFML was not required to fulfil the Redemption Obligations at the time of the alleged breach and was not in breach of the Facility Agreements by failing to do so.

The COA also had to determine whether RFML had provided an express or implied undertaking to redeem the units and whether it had made withdrawal offers that would be accepted by MacarthurCook. RFML suspended withdrawals from the scheme in the best interests of unit holders, pursuant to s. 601FC(1) of the Act, before the expiry of the Subscription Periods. The Redemption Obligations in the Facility Agreements provided that redemptions could not commence in the first six months of the Subscription Period.

The trial Judge held that after the initial six month period RFML's obligation to make withdrawals raised through the public offer accrued when the funds were received. The COA overturned this and held that the Facility Agreements did not create an obligation on RFML to make withdrawals in favour of MacarthurCook as and when funds were received. Instead the Redemption Obligations could be satisfied at any time after the initial six months until the conclusion of the Subscription Period at RFML's discretion. The COA noted that it was impractical, and therefore unlikely to have been intended, that RFML make a withdrawal offer every time it received funds from the public offer. Section 601KC of the Act prohibits multiple withdrawal offers being simultaneously available. If MacarthurCook's argument, that RFML had an obligation to withdraw as and when funds were received, was accepted RFML would have been required to make separate offers every time funds were received which would have inevitably breached s. 601KC of the Act. The obligation to make withdrawals did not fall as and when funds were received but instead crystallised at the end of the Subscription Periods. The suspension of withdrawals from the RP Trust required under s. 601FC(1) of the Act occurred before the end of the Subscription Periods. As the Redemption Obligations were subject to the Act, RFML was not in breach of the Facility Agreements as it had suspended withdrawals in the best interest of unit holders pursuant to the Act.

(ii) Guarantee Obligations and Fee Instalments

Under the Facility Agreements, RFML guaranteed the purchase of units held by MacarthurCook at the end of the Subscription Periods. RFML also had an outstanding obligation to pay the Fee

Instalments. The parties agreed that RFML was in breach of these obligations. MacarthurCook argued TFML was liable for these obligations pursuant to s. 601FS(1) of the Act which provides that the rights, obligations and liabilities of a former responsible entity are transferred to a new responsible entity if they are "in relation to the scheme".

The trial Judge adopted a broad interpretation of s. 601FS(1) of the Act and held that the liabilities of RFML were in relation to the scheme and undertaken in RFML's capacity as responsible entity of the RP Trust. The COA adopted a more restrictive interpretation as the Facility Agreements expressly provided that the Guarantee Obligations were undertaken by RFML "in its personal capacity". Furthermore, the obligations of RFML to MacarthurCook to buy back units and provide guaranteed income were over and above the obligations to ordinary members of the scheme which were indicative of an undertaking by RFML in its personal capacity. As a result RFML would not have been indemnified out of the RP Trust property if it remained the responsible entity and by virtue of s. 601FS(2)(d) of the Act the Guarantee Obligations and Fee Instalments were not transferred to TFML as the new responsible entity.

5.3 Contractual restrictions on lodging proofs of debt in the administration of a company

(By David Barton, Ashurst)

Strawbridge, in the matter of Retail Adventures Pty Ltd (administrators appointed) v Retail Adventures Pty Ltd (administrators appointed) [2013] FCA 891, Federal Court of Australia, Jacobson J, 2 September 2013

The full text of this judgment is available here.

(a) Summary

The administrators of Retail Adventures Pty Ltd (Administrators Appointed) (RAPL) and Retail Adventures Holdings Pty Ltd (Administrators Appointed) (RAHPL) (together, the Companies) rejected proofs of debt submitted by RAHPL for the amounts of $80,491,785 and $68,000,000.

RAHPL and RAPL were companies within a corporate structure within which the ultimate holding company was Bicheno Investments Pty Ltd (Bicheno). RAHPL's only role was as a vehicle to move funds between Bicheno and RAPL. RAHPL received these funds from RAHPL's holding company, DSG Holdings Australia Pty Ltd (DSG).

RAHPL was RAPL's immediate holding company and largest creditor. If permitted to vote, RAHPL's vote would be determinative of any resolution at any meeting of creditors on the basis of the value of votes cast. RAHPL had also acted as a guarantor for RAPL's leases, including several with Sypkes Security Pty Ltd (Sypkes), which was a substantial landlord creditor of RAPL. Clause 23.8 of those leases restricted RAHPL's ability (as RAPL's guarantor) to make claims or enforce rights against RAPL or to "prove in competition with" Sypkes in respect of RAPL's debts.

The Court held that the administrators were justified in rejecting these proofs of debt, at least until RAPL's debts to Sypkes were paid in full. RAHPL's lodgement of the proofs of debt amounted to proving in competition with Sypkes, even though the effect at the relevant time would only have been to allow RAHPL to vote at a meeting of creditors. The Court exercised its powers under s. 447A of the Corporations Act 2001 (Cth) (the Act) to declare that the administrators could withdraw the proofs of debt submitted by RAHPL to the extent necessary

(b) Facts

(i) Debts and contractual obligations

Both Companies were under administration at the time of the hearing. Shortly before entering external administration, RAHPL lodged two informal proofs of debt with the administrators of RAPL. RAHPL's proofs of debt in RAPL comprised $36 million in secured debt and $68 million in subordinated convertible notes. These debts would make RAHPL the largest creditor of RAPL, and would allow RAHPL's vote to determine the outcomes of any resolutions put to a meeting of RAPL's creditors.

According to the Companies' books and records, RAHPL was a secured creditor of RAPL in the amount of $77.5 million. In turn, DSG was a secured creditor of RAHPL in the amount of $77.5 million.

RAHPL's only other material creditors were the landlords under various leases for which RAPL was the tenant and for which RAHPL had agreed to act as guarantor for RAPL. Clause 28.3 of the leases for which Sypkes was the landlord included restrictions on RAHPL recovering debts from RAPL while any amounts payable to Sypkes remained outstanding.

Specifically, clause 23.8 precluded RAHPL from:

- making a claim or enforcing a right against RAPL or its property; or
- proving in competition with Sypkes if a liquidator, receiver or receiver were appointed to RAPL or if RAPL was otherwise unable to pay its debts.

It was common ground that RAPL had not paid Sypkes all money payable to Sypkes under the relevant leases.

Under a contract for the sale of RAPL entered into between DSG and the administrators, DSG paid the purchase price of the contract ($58.9 million) by reducing the amount of its secured debt in RAHPL. DSG agreed to pay any shortfall between the adjusted purchase price ($41.5 million) and the amount of DSG's secured debt in RAHPL if any part of the RAHPL security in RAPL was subsequently held to be void against a liquidator.

The administrators' investigations indicated that the security in respect of $49.77 million of the $77.5 million of loans made to RAPL by RAHPL would be unenforceable against a liquidator.

The administrators estimated the amount of any potential shortfall at $13 million. Consequently, as a term of the sale agreement, the administrators obtained a first-ranking security over the assets of DSG to secure DSG's obligation to pay any shortfall.

(ii) The proposed actions at the second meeting of creditors

Bicheno proposed a deed of company arrangement (DOCA) that would constitute a single deed fund for creditors of both Companies. The proposed DOCA would free RAPL and RAHPL from all creditors, return control of RAPL to RAPL's director, and would result in a return of approximately 6.46 cents in the dollar to unsecured creditors. By contrast, unsecured creditors were expected to receive between 20 and 45 cents in the dollar if RAPL was wound up.

The administrators considered that the proposed DOCA also had several inherent risks, including failures to identify the sources of the contributions to the deed fund, a lack of assurances from Bicheno that the contributions would be made, and the unusual absence of any enforceable obligations for the contributors under the DOCA to pay the contributions.

If the DOCA had been implemented, RAPL's director would also have been able to release the security provided to RAPL by DGL. This would have resulted in the value of the security, estimated at $13 million, being unavailable to a liquidator if the contributions were not made and RAPL was subsequently wound up.

The administrators expressly recommended against implementing the DOCA and applied for orders declaring that the administrators were justified in withdrawing RAHPL's informal proofs of debt.

(c) Decision

(i) The guarantee clause restrictions on proving in competition

Jacobson J considered that allowing RAHPL to lodge a proof of debt in order to be able to vote at a meeting of creditors would create the very outcome which the guarantee clause 23.8 was intended to prevent. Clause 23.8 was drafted to restrict RAHPL in circumstances other than a liquidation. Clause 23.8(d) expressly restricted RAHPL's ability to prove in competition with Sypkes where an administrator had been appointed for RAPL until all money payable to Sypkes had been paid.

The extension of the prohibition to all of the circumstances listed in cl. 23.8(d) of the leases led

Jacobson J to interpret the phrase "prove in competition with" to have a wider meaning than it would have in the context of a winding up. Jacobson J considered that the objective purpose of cl. 23.8 as a whole was to prevent RAHPL from asserting a claim or right over money owed to it by RAPL which may have the effect of competing with Sypkes's right to recover monies owed to it by RAPL, as long as any such money is payable to Sypkes in relation to RAPL's tenancy under the leases. Jacobson J held that "[a] proof of claim for the purpose of voting at a meeting of creditors to consider the future of RAPL is the assertion of such a right".

As such, RAHPL was not entitled to prove in RAPL's debts and the administrators were justified in withdrawing the informal proof of debt submitted by RAHPL.

(ii) The terms of issue of the subordinated notes and restrictions on proving in competition

Clause 4.3(b) of the terms of issue for the subordinated notes precluded a noteholder from proving in competition with holders of senior indebtedness, except with the prior written consent of the holders of the senior indebtedness. In this instance, "senior indebtedness" meant all creditors of RAPL other than RAHPL.

Jacobson J considered that the limitation on the noteholder proving in the debts of RAPL was narrower than the limitations under cl. 23.8 of the leases, and only applied where the proof or claim by the noteholder would diminish any distribution, dividend or payment which would otherwise be received by the holders of senior indebtedness.

However, Jacobson J held that it was not necessary to consider the effect of the restrictions imposed by cl. 4.3(b) of the terms of issue of the subordinated notes. Clause 23.8 of the leases prevented RAHPL from voting at a meeting of creditors on the basis of its subordinate debt in RAPL, as this would still be "proving in competition with" Sypkes.

5.4 Counterclaims and creditors - when a company may be declared insolvent

(By Helen Miller, Minter Ellison)

Bluestone Property Services Pty Ltd (in liq) v First Equilibrium Pty Ltd [2013] FCA 876, Federal Court of Australia, Jacobson J, 2 September 2013

The full text of this judgment is available here.

(a) Summary

This case demonstrates the factors the Court will consider when determining:

- the impact of offsetting claims on a creditors standing to bring an application for winding up on grounds of insolvency; and
- whether a company is insolvent.

(b) Facts

In April 2009 in the Supreme Court of New South Wales, Bluestone Property Services Pty Ltd (in liq) (the Plaintiff), acquired judgment against First Equilibrium Pty Ltd (the Defendant) for $600,000 exclusive of interests and costs.

In response to three separate statutory demands made by the Plaintiff, the Defendant initiated proceedings to have the statutory demands set aside on the grounds that it has an offsetting claim equal to or greater that the amount of the judgment debt.

Ball J in *Abadeen Group Pty Ltd v Bluestone Property Services* [2011] NSWSC 137 (*Abadeen v Bluestone*) dismissed the Defendant's application to set aside the Plaintiff's first statutory demand on the grounds that s. 459H did not apply as the offsetting claims asserted by the Defendant were not genuine.

Under s. 459H if the Court is satisfied that there is:

- a genuine dispute as to the existence or amount of a debt the subject of a statutory demand; or
- the company has a genuine claim against the party making the statutory demand by way of counterclaim, set-off or cross demand

it may make an order varying the amount claimed in the statutory demand to the "substantiated debt" (i.e. the amount not in dispute or offset).

In response to the Defendant's application to set aside the Plaintiff's second statutory demand (served on 18 September 2012), Breton J (see *In the matter of First Equilibrium Pty Ltd* [2012] NSWSC 1625) held that under s. 459H there was a substantiated debt due of at least $294,689.67 and that it was not possible that the offsetting claims were greater than the amount of the demand. In accordance with s. 459H, the amount of the statutory demand was varied (without prejudicing the balance of the debt) and on 17 January 2013 the Defendant paid the Plaintiff approximately $294,000.

On 21 January 2013, the Plaintiff served a third statutory demand on the Defendant for the remainder of the debt (approximately $588,000). This statutory demand was set aside by consent on 14 March 2013.

The Plaintiff then commenced these proceedings to have the Defendant wound up because it was insolvent; not because the Defendant had failed to comply with a statutory demand.

(c) Decision

Jacobson J ordered that the defendant be wound up on grounds of insolvency and appointed liquidators.

In reaching this conclusion, Jacobson J considered the following two issues:

- whether the plaintiff was a "creditor" within the meaning of s. 459P(1)(b) and had standing to bring an application under s. 459A to have the defendant wound-up on grounds of insolvency; and
- whether the defendant was, in fact, insolvent.

(i) Standing

Under s. 459(P)(1) a creditor (amongst others) may apply to the Court for a company to be wound up because it is insolvent. However, there is also a general principal that a company may not be wound up on application of a creditor if the debt is in dispute until the dispute regarding the debt is resolved (see *Tokich Holdings Pty Ltd v Sheraton Constructions Pty Ltd (in liq)* [2004] NSWSC 527). The Defendant argued that as it had a counterclaim based on genuine grounds for an amount equal to or exceeding the debt the Defendant owed the Plaintiff, the debt was in dispute and the Defendant could not be wound up until the dispute was resolved.

In the earlier proceedings of *Abadeen v Bluestone* the Defendant asserted that it had two offsetting claims. The first arose from the assignment of certain rights under an agreement for sale of units in a unit trust. Under the agreement between Sharlotte Pty Ltd (Sharlotte) and the Plaintiff, Sharlotte agreed to sell the Plaintiff its units in the unit trust for $450,000. Prior to the Plaintiff paying Sharlotte $450,000, Sharlotte assigned to the Defendant its right, title and interest in the debt due by the Plaintiff. The Defendant asserted that the Plaintiff was in breach of its obligation to pay the $450,000. However, Ball J held that this did not amount to a genuine offsetting claim as the obligation was dependant on Sharlotte's agreement to transfer the units free of encumbrance and there was no evidence that Sharlotte could transfer the units free of encumbrances. Additionally, Bell J held there was no evidence that Sharlotte had signed the purported assignment.

The second offsetting claim asserted by the Defendant in *Abadeen v Bluestone* related to an assignment by Babcock and Brown Real Estate Finance Pty Ltd (Babcock) to the Defendant of their rights against the Plaintiff as guarantor of a loan facility agreement. Ball J held that this alleged assignment did not give rise to a genuine offsetting claim.

The Defendant asserted the same two offsetting claims in this proceeding. Jacobson J held that the Defendant had not introduced sufficient new evidence for him to reach a finding regarding the offsetting claims that differed from Ball J's finding in *Abadeen v Bluestone*. It was held that the Defendant did not have genuine offsetting claims against the Plaintiff.

As a result of this finding, there was no argument against the Plaintiff's characterisation as a creditor and Jacobson J was not required to determine whether if the offsetting claims were genuine and, therefore, whether they would defeat the Plaintiff's standing as a creditor. However, Jacobson J did comment that while the general principle was that a company may not be wound up on application of a creditor if the debt is in dispute until the dispute regarding the debt is resolved, this was a different situation. The debt dispute in this case had been resolved by prior litigation whereas it was the asserted offsetting claims that had not been finally decided in litigation. The more appropriate view is that the correct principle (as stated in *The Law of Set-off* (3rd ed) (R Derham, Oxford University Press, 2003) at 2.73 and Gibbs CJ, *Philipson v Cadwell* (1815) 6 taunt 176; 128 ER 1001) is "... a judgment debtor cannot extinguish or reduce the amount of the judgment by setting off an unlitigated simple contract debt owing to him by the judgement creditor".

(ii) Solvency

The effect of the authorities regarding the principles surrounding the test of solvency is that solvency is a question of fact to be determined from a consideration of the company's financial position as a whole (see *Australian Securities and Investments Commission v Plymin* (2003) 46 ACSR 126). In *Southern Cross Interiors Pty Ltd (in liq) v Deputy Federal Commissioner of Taxation* (2001) 53 NSWLR 213 it was held that when considering the Defendant's position as a whole, the Court must consider the commercial realities (i.e. the resources available to meet liabilities of the company as and when they fall due and the nature of those resources).

In considering the Defendant's commercial realities, Jacobson J held that the Defendant was insolvent because:

- the Defendant failed to pay a judgment debt incurred four years ago;
- the Defendant had not provided any evidence that it had the resources to pay the debt aside from unlitigated offset claims; and
- the Defendant's balance sheet for the year end 30 June 2011 supported the claim that the Defendant was insolvent once readjusted to remove the unlitigated offsets from the assets and to record the judgment debt as a liability.

5.5 Winding up managed investment schemes on just and equitable grounds

(By Erica Rathbone Bales and Ike Kutlaca, King & Wood Mallesons)

Re Banksia Mortgages Ltd [2013] VSC 451, Supreme Court of Victoria, Sifris J, 30 August 2013

The full text of this judgment is available here.

(a) Summary

This case involved an application by the responsible entity (RE) of a registered managed investment scheme to wind up that scheme and amend its constitution.

The winding up application was made under the "just and equitable" ground of s. 601ND(1)(a) of the Corporations Act 2001 (Cth) (the Act).

In this case, Sifris J held that it would be "just and equitable" for the RE to wind up the scheme because its intended purpose (to provide investment opportunities to members) could no longer be achieved.

Section 601GC(1)(b) of the Act provides that a scheme's constitution can be amended if the RE reasonably considers that the change will not adversely affect members' rights. The RE sought judicial advice (under rule 54.02 of the Supreme Court (General Civil Procedure) Rules 2005 (Vic) (the Rules)) to confirm that it was justified in amending the constitution of the scheme so that the RE was able (but not compelled) to wind up the scheme by way of an asset sale.

The board of the RE concluded that the amendment would give the RE another avenue by which to realise value in a winding up, and so members' rights would not be adversely impacted. Sifris J held that it was "reasonably open" to the directors to reach this finding, and as such, judicially advised that the RE was justified in making the amendments.

(b) Facts

This case involved an application by Banksia Mortgages Limited, the responsible entity of the Banksia Mortgage Fund (BMF) managed investment scheme, to wind up that scheme and amend its constitution.

As part of the well-publicised collapse of the Banksia Group:

- a related entity upon which the RE depended for funding and administrative support, Banksia Securities Ltd (BSL), entered into receivership;
- BMF was unable to take on new investments or "roll over" existing investments, so the RE suffered dwindling management fees;
- the RE was unable to find a replacement for itself (despite engaging consultants and establishing a competitive bid process, and asking for ASIC's assistance in finding a replacement); and
- ultimately BMF could not continue and must be wound up.

BMF's constitution mirrored ss. 601NB, 601NC and 601ND by providing that winding up could be instituted at the direction of members, by the RE after calling a meeting of members or by Court order. This case concerns an application by the RE for a Court order directing it to wind up BMF on just and equitable grounds pursuant to s. 601ND(1)(a) of the Act.

BMF's constitution also provided that winding up could only occur over the long-term, as investments matured or expired. BSL's receivers, however, were unwilling to indefinitely provide the support upon which the RE relied. If the support of BSL was withdrawn, the RE faced appointing external administrators whose costs would be borne by BMF's investors. As such, the board of the RE sought to amend BMF's constitution to permit winding up by way of an asset sale.

(c) Decision

(**i) Winding up**

In reviewing previous authority, Sifris J confirmed that the concept of winding up of managed schemes on just and equitable grounds is originally derived from the common law. As such, case law relating to winding up corporations on just and equitable grounds can inform the application of s. 601ND(1)(a) of the Act.

Sifris J confirmed that s. 601ND(1)(a) of the Act confers a "very wide discretionary power" that may be applied in both established and novel contexts.

Drawing on *Sergio Capelli v Craig Peter Shepard and Mark Xavier Mentha* (2010) 29 VR 242, *Trio Capital (Admin app) v ACT Superannuation Management Pty Ltd* (2010) [2010] NSWSC 286 and *In Re PWL Ltd* [2008] WASC 232, Sifris J held that one established category where a winding up order will be made under just and equitable grounds is where the "purpose of the scheme can no longer be accomplished" or the "original arrangement as set out in the prospectus of the scheme has broken down".

On the facts before him, Sifris J found that the purpose of BMF (being to provide members with investment opportunities in accordance with its prospectus) could no longer be fulfilled. As a result, it was "appropriate" that the Court exercise its discretion to direct the RE to wind up BMF on just and equitable grounds.

(ii) Constitutional amendments

Under rule 54.02 of the Rules, proceedings can be brought to determine any question which could otherwise be determined in a proceeding relating to the execution of a trust. This is known as judicial advice.

The RE (in its capacity of trustee for "scheme property" held on behalf of each investor) was therefore entitled to seek judicial advice from the Court on proposals to amend the constitution of BMF. Sifris J noted that responsible entities "often" seek such advice, and doing so was "prudent and reasonable" in this case.

The proposed amendments to the BMF constitution would permit the RE to wind up BMF by selling its assets. This would only occur if the RE decided this method of winding up was in the best interests of BMF members (under the RE's general obligation to act in the best interests of members under s. 601FC(1)(c)). Additionally, the proposed amendments required the RE to obtain further judicial advice before commencing any asset sale.

Section 601GC(1)(b) of the Act provides that a registered scheme's constitution may be modified by the RE (without member approval) if it reasonably considers that the change will not adversely affect members' rights. This provision was mirrored in the BMF constitution.

Sifris J endorsed Robson J's review of authorities in *Elders Forestry Management Ltd v Seels* [2012] VSC 287, which necessitated that the RE take a "three step" test (as first articulated by Barrett J in *ING Funds Management Ltd v ANZ Nominees Ltd* (2009) 228 FLR 444). This requires the RE to ask what the members' rights are prior to the amendment, what the members' rights will be after the amendment and finally, if the rights after the amendment are different, whether those differences are unfavourable from a members' perspective.

In this case, the board determined that the amendments would affect members' rights as they would permit the RE to accelerate the winding up of BMF. However, the proposed amendments would not give the RE a unilateral power to compel an asset sale (but rather the option to wind up via an asset sale).

As the only available alternative in the circumstances would be the appointment of a voluntary administrator to BMF (which would involve a smaller return for members), Sifris J held that it was "reasonably open to the directors [of the RE] to reach the conclusion that members' rights would not be adversely affected by the proposed constitutional amendment, in accordance with s 601GC(1)(b)" of the Act.

As a result, the Court directed the RE to wind up BMF and confirmed that the RE was justified in amending the BMF constitution.

5.6 Relationship between the oppression remedy and the statutory derivative action

(By Aman Gaur, Herbert Smith Freehills)

LPD Holdings (Aust) Pty Ltd v Phillips, Hickey and Toigo [2013] QSC 225, Supreme Court of Queensland, McMurdo J, 28 August 2013

The full text of this judgment is available here.

(a) Summary

This case considered a shareholder oppression claim against a company and its directors under s. 233 of the Corporations Act 2001 (Cth) (the Act). Justice McMurdo held that a plaintiff can obtain compensation from the directors of a company under this provision because its powers are not qualified by the existence of s. 236.

(b) Facts

LPD Holdings (Aust) Pty Ltd, a shareholder in Macarthur Minerals Limited (the company), sought relief pursuant to s. 233 of the Act against the company and three of its directors (director defendants).

Section 232 of the Act states:

Grounds for Court order

The Court may make an order under s. 233 if:

a. the conduct of a company's affairs; or
b. an actual or proposed act or omission by or on behalf of a company; or
c. a resolution, or a proposed resolution, of members or a class of members of a company; is either:
d. contrary to the interests of the members as a whole; or
e. oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity.

For the purposes of this Part, a person to whom a share in the company has been transmitted by will or by operation of law is taken to be a member of the company.

Section 233 of the Act states:

Orders the Court can make

(1) The Court can make any order under this s. that it considers appropriate in relation to the company, including an order:

a. that the company be wound up;
b. that the company's existing constitution be modified or repealed;
c. regulating the conduct of the company's affairs in the future;
d. for the purchase of any shares by any member or person to whom a share in the company has been transmitted by will or by operation of law;
e. for the purchase of shares with an appropriate reduction of the company's share capital;
f. for the company to institute, prosecute, defend or discontinue specified proceedings;
g. authorising a member, or a person to whom a share in the company has been transmitted by will or by operation of law, to institute, prosecute, defend or discontinue specified proceedings in the name and on behalf of the company;
h. appointing a receiver or a receiver and manager of any or all of the company's property;
i. restraining a person from engaging in specified conduct or from doing a specified act;
j. requiring a person to do a specified act.

The plaintiff argued that the conduct of the company and the board was oppressive to, unfairly prejudicial to, or unfairly discriminatory against, the plaintiff within s. 232 of the Act and that the directors breached general law directors' duties.

The director defendants argued that the claim should be struck out as, under s. 233, the proper complainant about the directors' misconduct is only the company itself. They argued this claim could only proceed under s. 236 following the granting of leave under s. 237 (i.e. it could only proceed as a derivative action). In consequence, it was argued that the broad powers of s. 233 must be qualified by excluding a power to grant relief for acts/omission for which the company would have a cause of action under s. 236. No authority was offered for this construction.

(c) Decision

Justice McMurdo held that s. 233 has the dual character of being actionable by both the company and a shareholder, as demonstrated by s. 233(1)(g) under which a Court can give orders allowing members to institute proceedings in the name and on behalf of the company.

Although this will give rise to the potential operation of both s. 233 and s. 236, these are not mutually exclusive. Justice McMurdo held that "because there will be many cases where the relevant conduct is both oppressive or unfairly prejudicial and actionable by the company" the defendants submissions would "significantly confine the beneficial operation of s. 233" [42]. However, those provisions could be relevant to the exercise of the Court's discretion under s. 233.

Justice McMurdo undertook a wide consideration of s. 233 analogues in other jurisdictions where there is a power to order compensation in favour of the company notwithstanding the availability of a derivative action. In *Campbell v Blackoffice Investments Pty Ltd* [2008] NSWCA 95 Basten JA held that whilst ss. 232 and 233 could not be allowed to "subvert the established constraints" on derivative actions brought by shareholders on the company's behalf, relief under s. 233 was not precluded simply because the conduct complained of was actionable by the company.

His Honour also rejected the defendants' submissions that to allow compensation in favour of the company under s. 233 would render ss. 236 and 237 irrelevant. This was because conduct must first be proven under s. 232 and that the granting of relief under s. 233 is discretionary and is based on whether an action brought by the company under s. 237 is the more appropriate course.

His Honour also held that proceedings brought under s. 232 are not proceedings brought on behalf of a company as "they are not proceedings to prosecute a cause of action" belonging to the company [52]. As a result the "absence of jurisdiction" claimed by the defendants was rejected [53].

Justice McMurdo also considered the issue of whether the directors of a company would pay compensation to the shareholders rather than the company. His Honour held that, in principle, there was no objection to such an order under s. 233 for losses which are distinct rather than derivative from a loss of the company. However, in inspecting the pleadings, "only a small part of the plaintiff's overall case" was directly linked to its losses.

Justice McMurdo then turned to an examination of the plaintiff's pleadings. His Honour made several orders for their amendment due to many irregularities and new pleadings and further particulars were ordered.

5.7 The standard of "reasonable diligence" which directors must prove to avoid being held liable for false or misleading representations under s. 81 of the Fair Trading Act 1987 (WA)

(By Jane Xu, DLA Piper)

Carey v Commissioner for Consumer Protection [2013] WASCA 195, Supreme Court of Western Australia, Court of Appeal, Martin CJ, Pullin and Newnes JJA, 28 August 2013

The full text of this judgment is available here.

(a) Summary

The Appellant (Carey) sought to appeal his conviction by a magistrate of five counts of making a false or misleading representation under the Fair Trading Act 1987 (WA) (the Fair Trading Act).

Mr Carey appealed on the basis that the magistrate was wrong in finding that Carey had failed to establish a defence under s. 81 of the Fair Trading Act.

The Court held that the Magistrate's finding was correct and that Carey had failed to establish the defence provided by s. 81 of the Fair Trading Act.

In order to satisfy the defence and prove the exercise of "reasonable diligence", the director seeking to rely on the defence must show that, on the balance of probabilities, he or she could not have prevented the commission of the offence by the exercise of "reasonable diligence".

Carey's appeal was dismissed.

(b) Facts

Carey sought to appeal his conviction by the magistrate on five counts of making a false or misleading representation concerning the use to which land was capable of being put contrary to s. 12(2)(b) of the Fair Trading Act.

At all material times, Carey was the director of Westpoint Realty Pty Ltd (Westpoint), a company that engaged in the business of selling real estate and managing property, and which was convicted of the same five offences as a result of representations made by agents which it employed.
Mr Carey was also convicted of those offences, pursuant to s. 81 of the Fair Trading Act, which provided that each person who was a director of a company convicted of an offence against the Fair Trading Act at the time of the commission of that offence, is also guilty of the offence unless he or she establishes a defence provided by the section.

Carey's grounds of appeal did not challenge any of the findings of fact by the magistrate. The facts of the initial case are as set out below.

The charges brought against Westpoint and Mr Carey arose from representations made by three agents employed by Westpoint (Mr David Lewis, Mr Daniel Egan and Mr Thomas Haynes) to the purchasers of five apartments so as to secure their agreement to terminate the contracts for the purchase of the apartments. In each case the representations were generally to the effect that the project was not going ahead, or might never be finished, and that the purchasers' only option was to agree to terminate their respective contracts and obtain a refund of all the moneys that they had paid. Those representations were untrue, and were known by the agents to be untrue. Each of the agents pleaded guilty to a charge or charges of making a false or misleading representation concerning the use to which land was capable of being put, contrary to s. 12(2)(b) of the Fair Trading Act.

Identical charges were brought against Westpoint and a number of persons said to be officers of Westpoint, including Mr Carey. As the representations were made by the agents in their capacity as employees or agents of Westpoint, pursuant to s. 82 of the Fair Trading Act, their conduct was deemed to be the conduct of Westpoint, and Westpoint was convicted of each count.

As Mr Carey was a director of Westpoint at the time of the commission of each offence, and was found by the magistrate to have failed to establish the defence provided by s. 81 of the Fair Trading Act, he was also convicted of each offence.

Carey appealed this finding by the magistrate that he had failed to establish the defence provided by s. 81 of the Fair Trading Act.

(c) Decision

Martin CJ stated that:

when a defendant relies upon the defence provided by s. 81 of [the Fair Trading Act], it is necessary for him or her to establish, on the balance of probabilities, that by the exercise of reasonable diligence he or she could not have prevented the commission of the offence.

The Court held that, accordingly, Carey had not sufficiently made out a defence under s. 81 of the Act.

(i) Reasonable diligence

Section 81 of the Fair Trading Act is directed to the capacity of the accused - namely, whether he or she has established that by the exercise of reasonable diligence the commission of the offence could have been prevented.

So, when a defendant relies upon the defence provided by s. 81 of the Fair Trading Act, it is necessary for him or her to establish, on the balance of probabilities, that by the exercise of reasonable diligence he or she could not have prevented the commission of the offence.

Under s. 81 of the Fair Trading Act, the question to be determined is whether the accused has established that there is nothing that could have been done, falling within the range of actions properly taken in the exercise of reasonable diligence, which would have prevented the commission of the offence.

This is not to say that the actions of the accused are irrelevant to the defence created by s. 81 of the Fair Trading Act. If the offence was committed notwithstanding the exercise of reasonable diligence by the accused, it might be readily inferred that the accused could not have prevented the commission of the offence by the exercise of reasonable diligence. However, it is the capacity of the accused which is the focus of inquiry. So an accused who has done nothing at all to prevent the commission of the offence might nevertheless establish a defence under the s. if he or she establishes that there was nothing he or she could have done, in the exercise of reasonable diligence, which would have prevented the commission of the offence.

The question posed by s. 81 of the Fair Trading Act is whether Mr Carey could have prevented a specific result, namely, the commission of the relevant offences, by the exercise of reasonable diligence. The relevant offences were the making of false and misleading statements for the purpose of encouraging purchasers to surrender their contracts.

Martin CJ held that "in the circumstances which I have related, there is much that Mr Carey could have done to prevent false and misleading statements being made by the agents, [which fall] readily within the range of actions properly undertaken in the exercise of reasonable diligence".

For these reasons, the Court of Appeal dismissed Carey's appeal.

5.8 Winding up on just and equitable grounds

(By Amy Dunphy, Minter Ellison)

Irwin v Yule [2013] SASC 132, Supreme Court of South Australia, White J, 19 August 2013

The full text of this judgment is available here.

(a) Summary

This case demonstrates the factors which a Court may consider when determining whether or not to wind up a company on just and equitable grounds.

(b) Facts

Bonshaw Pty Ltd (Bonshaw) was an investment company and the principal asset in the estate of the late James Campbell Irwin (the Testator). The executors of the estate were the Testator's three sons, James, Angus and Campbell, and a solicitor, Ms Yule.

The application for winding up of Bonshaw was made by James and the Testator's widow (the Plaintiffs), and supported by Angus, on the basis that there was an irretrievable breakdown in the relationships between its members which affected its ongoing management and, in turn, prevented the winding up of the estate. Further, it was contended that Bonshaw had no on-going purpose for which to continue.

The dispute arose in relation to the valuation of the assets making up the Testator's estate. The Testator had bequeathed interests in a fertiliser business to Angus and in certain rural land to James (the Specific Bequests), and for the residuary estate to be shared equally between the three sons. The shares of Angus and James in the residuary estate were intended to take account of the value received from the Specific Bequests, so that ultimately each of the three sons would receive equal shares of the estate. The will explicitly identified that the Specific Bequests were to be valued as at the date of the Testator's death but did not specify the date of valuation for the residual estate.

The Plaintiffs contended that the valuation of the shares was at the date of their distribution. Conversely, Campbell (the Defendant) asserted that the appropriate valuation date of the shares was the date of the Testator's death. Following advice from the estate's accountants, some two and a half years after the Testator's death, the shares in Bonshaw were transferred to the beneficiaries. To effect the sale loans were created for the value of the shares. The intention was for the company to be placed into liquidation and the remaining assets to be distributed to the three sons. The Plaintiffs argued that by accepting the transfer of the shares the Defendant agreed to the valuation being on the date of distribution.

In communications between James, Angus and the Australian Taxation Office (ATO), the ATO indicated that it could not provide a ruling on whether, for tax purposes, the distributions from Bonshaw would be treated as loans or dividends until the pending litigation (being the application before White J) was decided. The estate's accountants advised that they were unable to finalise the financial statements until the ATO's determination was received.

The Defendant denied that there had been an agreement that the transfer would take place by way of sale or that loans had been established for the value of the shares. In a separate proceeding, the Defendant brought a claim against Ms Yule, James and Angus asserting maladministration of the estate, and a breach of trust, contract and professional duties. These proceedings were dismissed for want of prosecution.

A mediation of the issues had failed to achieve a resolution.

By the time the application came before White J, Bonshaw no longer conducted any business or made or held investments.

(c) Decision

White J found that given the irreconcilable differences between the beneficiaries as to the administration of the estate it was just and equitable for the company to be wound up.

White J considered the applicable legal principles to be well settled. He cited with approval the decision of Dodds-Streeton JA in *Accurate Financial Consultants Pty Ltd v Koko Black Pty Ltd* (2008) 66 ASCR 325 at 341 that "winding up is the characteristic remedy where a working relationship predicated on mutual cooperation, trust and confidence has broken down". Further, White J noted that the Courts have ordered a company to be wound up in the situation where there has been a deadlock or the "ill-will that exists between them will never end": citing *Johnny Oceans Restaurant Pty Ltd v Page* [2003] NSWSC 952 and *Booker v You Run the Business Pty Ltd* [2008] FCA 1762 respectively.

Applying the decided principles, White J considered a Court mandated winding up to be appropriate. Further, in his Honour's opinion no alternative option existed. White J noted that a members' voluntary winding up of the company under s. 491 of the Corporations Act 2001 (Cth) requires a 75% majority on the motion, which could not be achieved due to Campbell's opposing stance.

White J noted that it was significant that all parties, other than Campbell and Ms Yule, sought the winding up order. Ms Yule had adopted a neutral position but previously acknowledged her support for winding up. Moreover, all parties, including Campbell, had acknowledged that Bonshaw should be liquidated. The correspondence from the ATO also pointed in favour of a winding up order.

White J was satisfied that the effect of the liquidator taking control of Bonshaw would be to extinguish the loans and resolve the present management deadlock. In White J's opinion, the matters raised by the Defendant as to the administration of the estate, to the extent they related to Bonshaw, could be dealt with in the context of liquidation.

5.9 Court could not validate the invalid appointment of an administrator under s. 447A of the Corporations Act

(By James Apps and Marissa Bendyk, King & Wood Mallesons)

Correa v Whittingham [2013] NSWCA 263, New South Wales Court of Appeal, Barrett and Gleeson JJA and Tobias AJA, 15 August 2013

The full text of this judgment is available here.

(a) Summary

This case concerned the validity of the appointment of an administrator, and considered whether Courts are able to validate an invalid appointment under s. 447A of the Corporations Act 2001 (Cth) (the Corporations Act).

The respondent, Mr Whittingham, was purportedly appointed as voluntary administrator of the second appellant, the Spanish Club (the Club), between 14 and 17 November 2008. However, Mr Whittingham did not obtain the necessary consent under s. 41 of the Registered Clubs Act 1976 (NSW) (the RCA) from the Casino Control and Gaming Authority (the Authority) until 27 November 2008 to act in the capacity of administrator before his appointment.

Ms Correa, the first appellant, and the second appellant challenged Mr Whittingham's appointment on a number of grounds. At first instance, Black J held that s. 41 of the RCA did not invalidate Mr Whittingham's appointment as the Authority had subsequently approved the appointment. The appellants challenged this finding. The Court allowed the appeal, finding that the contravention of s. 41 of the RCA rendered Mr Whittingham's appointment invalid.

(b) Facts

The Club was a company limited by guarantee and registered under the RCA. Its constitution required a minimum of seven directors to constitute a board and four directors for quorum.

On 12 November 2008, Mr Whittingham attended a meeting with Yolanda Sanchez, one of the directors of the Club. They discussed a number of issues concerning the Club and Mr Whittingham recommended the appointment of a voluntary administrator. He subsequently provided copies of documents to effect this. That same day he obtained an ASIC search of the Club which showed that it had only four directors: Yolanda Sanchez, Maria Sanchez, Faustino Garcia and Daniel Garcia.

On 14 November, Yolanda Sanchez returned to Mr Whittingham an amended form of the documents he had originally provided. These documents were deficient in a number of respects. Notably, there was no record of quorum or of the directors present at the meeting (although the signatures on the documents suggested that Yolanda Sanchez and Maria Sanchez had attended). Further, there was a record of a resolution appointing Mr Whittingham as administrator in accordance with s. 436A of the Corporations Act.

On 17 November, Yolanda Sanchez confirmed in a response to a query by Mr Whittingham that she had phoned "the other two directors" and that they had indicated their consent to Mr Whittingham's appointment. On the same day, Mr Whittingham gave a signed consent to act as administrator to Yolanda Sanchez. Mr Whittingham also sought advice from a lawyer who informed him that his appointment as administrator was valid.

On 26 November 2008, Mr Whittingham was given approval by the Authority to act as administrator.

A deed of company arrangement (DoCA) was executed on 16 March 2009, providing for the sale of the Club's core property and non-core property. The sale of the core property was subject to the approval of members, as required by the RCA or the Club's constitution. The sale of the non-core property was also subject to the decision of the members under a clause in the DoCA, although Mr Whittingham was not bound by that decision.

On 1 July 2009, Mr Whittingham entered into a contract to sell two properties of the Club - one a core property and the other non-core property. On 31 July 2009, the members resolved overwhelmingly not to approve the sale.

Various proceedings were instituted which resulted among other things in the variation of the DoCA to enable the sale of the core and non-core property.

On 28 February 2011, Ms Correa sought a declaration that Mr Whittingham had not been validly appointed. On 19 July 2011, Mr Whittingham sought orders under s. 447C of the Corporations Act that he had been validly appointed on 17 November 2008. Alternatively he sought curative relief under ss. 447A and 1322(4)(a) of the Corporations Act and, further and alternatively, that he was entitled to be paid out of the assets of the Club his reasonable remuneration and costs and expenses.

(c) Decision

There were seven main issues before the Court.

(i) The respondent's failure to obtain approval from the Authority prior to his appointment rendered him incapable of appointment

The Court held that the primary Judge had erred in finding that s. 41 of the RCA required that an administrator's appointment should be treated as invalid only where no approval had "ever" been given for the appointment by the Authority. The Court cited the High Court decision in *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 that determining the validity of an act done in breach of a statutory provision requires an assessment of whether the legislation intended that such an act should be invalid.

The Court held that the proper reading of s. 41 was that the failure by a person to obtain approval from the Authority to act in the capacity of administrator prior to such appointment rendered the person incapable of appointment and the appointment invalid. This reading was, in the Court's view, consistent with the language and purpose of the statute. The Court further held that s. 447A of the Corporations Act did not empower the Court to validate an invalidity under s. 41 of the RCA, as that section was not a general power without limit. The section is directed to the operation of Part 5.3A of the Corporations Act, rather than separate state or territory legislation such as the RCA.

(ii) The respondent was entitled to rely on the statutory assumptions in ss. 128(1) and 129(1) of the Corporations Act

The appellants submitted that the assumptions in ss. 128(1) and 129(1) of the Corporations Act were not available to the respondent. They argued that he was on notice of the possible invalidity of his appointment, that he breached his fiduciary duties by not satisfying himself of the validity of his appointment and that he knew or suspected that the assumptions he was making were incorrect.

The Court found that the respondent could not be disqualified from the statutory assumption in s. 128(1) by operation of s. 128(4) as he did not know or suspect any invalidity "at the time of the dealings". The Court held that the appellants had no authority to support their position that the administrator's actions constituted a breach of fiduciary duties, nor that the evidence established actual knowledge or actual suspicion of invalidity. The respondent was therefore permitted to rely on the statutory assumptions.

(iii) The appellants could not rely on the absence of a resolution of insolvency to challenge the respondent's appointment

The appellants submitted that as there had been no proper resolution of insolvency as required by s. 436A(1) of the Corporations Act, the appointment of Mr Whittingham was invalid.

The Court accepted the primary Judge's finding that even if there had been a resolution, such a resolution would have been invalid as the number of directors at the relevant time was less than the Club's constitution required. The Court further agreed with the primary Judge that ss. 128 and 129 of the Corporations Act allowed Mr Whittingham to assume that the Board had validly passed a resolution of insolvency.

The Court also noted the appellants' failure to prove at first instance that the board had not formed a genuine opinion as to the Club's insolvency and to prove that four directors were not in attendance personally or by telephone at the 14 November 2008 meeting.

(iv) The respondent's appointment was capable of challenge on the basis that he did not provide his written consent prior to his appointment

The Court held that the primary Judge had erred in finding that the terms of the instrument of appointment passed on 14 November 2008 had the effect that the respondent's appointment commenced when he consented on 17 November 2008. The Court did not agree with the primary Judge that the instrument of appointment was intended to remain in a "state of suspended effect" until the respondent gave his consent.

The Court held that the words "the company hereby appoints" in the instrument were clearly a purported appointment "then and there", made without the respondent's consent. Consequently, the purported appointment contravened s. 448A of the Corporations Act.

(v) The appellants' alternative claim that the administration ceased on 19 December 2008 was not established

The appellants submitted that if the respondent's appointment was found to be valid, his appointment ended on 19 December 2008 pursuant to s. 435C(3)(b)(i) of the Corporations Act. This was because the Corporations Act prescribes a period during which a creditors' meeting must be convened, and the respondent did not convene such a meeting during that period.

The Court rejected this argument as the appointment had not been valid in the first place, and thus the primary Judge's curative orders in this regard were founded on an invalid basis.

(vi) The primary Judge correctly exercised the discretion to make curative orders (other than in relation to the contravention of s. 41 of the RCA)

The appellants submitted that the primary Judge erred in making discretionary orders validating the respondent's appointment under ss. 447A and 1322 of the Corporations Act.

The Court accepted the appellants' submission that the primary Judge could not rely on s. 447A to validate an invalidity arising from s. 41 of the RCA (see the discussion at (i) above).

However the Court held that the primary Judge was correct in his grant of curative orders in respect of the other grounds of invalidity asserted by the appellants. The factors in support of the grant of curative orders were broad. They included the company's financial position at the time, the short delay between execution of the appointment and the respondent's consent and the acquiescence of the appellants to changes to the DoCA.

Further, the Court held that s. 1322(4)(a) was available to validate the contravention of the required number of directors and quorum requirements of the constitution in accordance with the decision in *Weinstock v Beck* [2013] HCA 14.

(vii) The attempted sale of the core property of the Club without member approval was not prejudicial to the interests of its members

Finally the Court held that the appellants failed to demonstrate that the members would have been in a better position if the respondent had not proceeded with the sale of the Club's property. The Court also found that the respondent's attempt to sell the core property without the approval of the members was contrary to s. 41J(3) of the RCA, although ultimately it was not found to be prejudicial to their interests.

The Court remitted the matter to the Supreme Court of New South Wales to determine some outstanding issues.

5.10 Unequal distribution of representative proceeding settlement money not fair and reasonable

(By Nicola Giarratana, Ashurst)

Australian Securities and Investments Commission v Richards [2013] FCAFC 89, Federal Court of Australia, Full Court, Jacobson, Middleton & Gordon JJ, 12 August 2013

The full text of this judgment is available here.

(a) Summary

A settlement approved by the Federal Court following a representative proceeding resulted in group members who had helped fund the legal costs of the proceedings receiving a higher apportionment of the settlement proceeds (due to the inclusion of a funders' premium) compared to the remaining group members. The Full Federal Court upheld an appeal of this decision by ASIC on the basis that the distribution amongst group members was not fair and reasonable.

(b) Facts

Tracey Richards commenced a representative proceeding against Macquarie Bank Ltd (MBL) and Storm Financial Ltd (in liquidation) (Storm) under Part IVA of the Federal Court of Australia Act 1976 (Cth) (the Act). Orders were made under ss. 33V and 33ZF of the Act approving the settlement of these proceedings. The settlement provided for the distribution of $82.5 million (inclusive of interest and costs) between approximately 1,050 group members.

Three-hundred-and-seventeen of these group members (the Funding Group Members) were represented by Levitt Robinson and had contributed a levy to cover the legal costs of the proceedings. The amounts of the proposed levies were set out in a sliding scale by reference to the amount of a person's losses as a share of their investment in, and funding of, Storm's financial products. They were not calculated mathematically, and therefore not proportional to the losses suffered by investors.

The Funding Group Members would receive approximately 42% of the quantum of their claimed and lost equity contributions and be reimbursed their legal costs. This included a "funders' premium" of about 35% of the settlement monies. Approximately 733 remaining group members (the Unrepresented Group Members) would recover 17.6% of their claims to lost equity. They were not represented by Levitt Robinson. On appeal, ASIC argued that the settlement should not be upheld because the distribution of the settlement funds between all group members was not fair and reasonable.

(c) Decision

The Full Federal Court upheld the appeal by ASIC and held that the distribution of the settlement funds was not fair and reasonable across all group members. The Court set out several reasons in support of this decision.

The claims made by all group members were virtually identical and no difference existed between the merits of the Funding Group Members' claims and the Unrepresented Group Members' claims. The disparity in distribution between these different groups was due to the proposed payment of the funders' premium which presented several difficulties in itself.

Firstly, the prospect of the Funding Group Members claiming, or seeking, any premium for funding the litigation was not directly or indirectly mentioned until at least two years after the litigation had commenced, by way of a news bulletin distributed by Levitt Robinson to Funding Group Members stating that those who had paid a levy should receive a higher apportionment of settlement monies. No specific mention of the funder's premium was made in any Levitt Robinson retainer agreements and any prior bulletins issued by Levitt Robinson to Funding Group Members only made references to possible adjustments in settlement payments occurring in favour of clients who had paid the levy. Therefore, notice of the terms of the funders' premium had not been given to all group members.

Secondly, unlike a commercial litigation funder, the Funding Group Members funded the litigation in the hope, rather than any expectation, that they would receive full reimbursement of their funding contributions in addition to a premium. They made a decision to fund the litigation on certain terms and conditions which did not contemplate any premium. Due to the absence of such contemplation, the Unrepresented Group Members were also not aware of the prospect of a premium being paid to those who decided to fund the litigation.

Thirdly, the financial effect of paying the funding premium to Funding Group Members was disproportionate in at least three respects. The funders' premium was on top of repayment of the funds paid to conduct the litigation, in effect forming a substantial profit on the initial levies paid. The Funding Group Members had funded the litigation not to make a profit, but to seek compensation for damages suffered due to failed investments in Storm products.

Further, this profit was not paid in proportion to the levies advanced by each Funding Group Member. The funders' premium was to be distributed between members rateably in proportion to their claimed lost equity, not the amount they each contributed to fund the litigation. Levitt Robinson also retained and exercised a complete discretion to reduce a Funding Group Member's contribution, and the length of time over which the funding was provided by

Funding Group Members varied.

Fourthly, the funders' premium was paid only to Funding Group Members. Funding Group Members were defined in the settlement distribution scheme as essentially any client of Levitt Robinson, provided they were a client before the settlement was approved, who made a funding contribution of at least $500. Consequently, several clients of Levitt Robinson became Funding Group Members even though they did not contribute $500 until after the settlement was reached. This was not fair or reasonable as this group of Levitt Robinson clients were afforded the opportunity of obtaining the premium at the expense of Unrepresented Group Members.

Fifthly, the quantum of the funders' premium also raised difficulties. It was calculated at 35% of the settlement funds and there was no rational explanation for rewarding the Funding Group Members by paying a premium on an amount inclusive of costs and interests which did not mathematically correlate with the amount they paid to fund the litigation. The quantum of the premium was also obtained by reference to premiums charged by commercial litigation funders. This was inappropriate because unlike commercial litigation funders, the Funding Group Members were not in the business of funding litigation to make a profit. Also, evidence adduced in support of adopting a figure of 35% was limited to printed website information of litigation funders who imposed an uplift of between 25% and 45% due to a number of complicated and interconnected factors.

In upholding the appeal, the Federal Court noted that the form of litigation funding used in this case was still an important alternative to using commercial litigation funders. It was acceptable, provided that terms and conditions which included the prospect of a premium on actual monies contributed to fund the litigation were agreed at the outset and that the process was managed fairly.

5.11 Liability of a partnership for wrongful actions of its partners

(By Olivia Draudins and Shanee Goldstein, Corrs Westgarth Chambers)

Crouch and Lyndon (a firm) v IPG Finance Australia Pty Ltd [2013] QCA 220, Supreme Court of Queensland, Court of Appeal, Holmes and Fraser JJA and Dalton J, 9 August 2013

The full text of this judgment is available here.

(a) Summary

This appeal was brought against a decision of the Supreme Court of Queensland. It considers the liability of the appellant partnership for wrongful actions of its partners under the Partnership Act 1891 (Qld) (the Act) and in negligence. The first instance decision considered an application to recover losses sustained by the respondent companies, IPG Finance Australia Pty Ltd and IPG Investments Australia Pty Ltd, as a result of the misconduct of a partner of the appellant, Wood, under ss. 13 and 14 of the Act or by way of damages for negligence. As the relevant legislation governing partnerships in other Australian states and territories contains similar, if not identical, provisions to those considered in this case, the potential applicability of this decision in other jurisdictions should be heeded.

In order to establish liability for a wrongful act of a co-partner under s. 13(1) of the Act, the wrongful act committed by a partner must occur under one of two limbs: either "in the ordinary course of the business of the firm" or "with the authority of his or her co-partners". Section 14(1)(b) of the Act provides that a firm is liable to make good loss where it receives the money or property of a third person "in the course of its business" and a partner misapplies that money or property while it is in the custody of the firm.

To fall within the first limb of s. 13(1) of the Act, the actions of the partner must have such a close connection with acts the partner is authorised to do so as to be fairly and properly regarded as being within the ordinary course of the firm's business. Illegal actions undertaken by partners in a firm, in circumstances where it would be understood by the partners that such actions are illegal, will not usually satisfy this threshold. As Wood's conduct was illegal under rl. 87A of the Legal Profession (Solicitors) Rule 2006 (Qld) (Rule 87A), which regulates solicitors' conduct in relation to "excluded mortgages", the Court held that Wood was not acting "in the ordinary course" of the appellant's business.

Under the second limb of s. 13(1) of the Act, partners are liable for the actions of their co-partners where the co-partner has the "apparent authority" to undertake the improper conduct. A broader test applies than for the first limb of s. 13(1), as the acts undertaken must be analysed in light of what is within the class of acts fairly and properly carried out in the ordinary business of a solicitor. The appellant was ultimately found liable under the second limb of s. 13(1), as well as under s. 14(1), for the same reason that Wood had acted with the "apparent authority" of his co-partner.

The respondents also sought to establish that the appellant owed them, as future money lending clients, a novel duty to take reasonable care to discover whether a partner's conduct might adversely affect their interests. The Court found that the appellant did not owe the alleged duty of care. As the scope of a solicitor's duties is ordinarily determined by the scope of the retainer, the alleged duty of care went beyond the scope of the various retainers between the appellant and respondents (Retainers). Further, finding such a duty would cut across the general law and the relationship of trust and confidence which is the foundation of a partnership.

(b) Facts

The partnership comprised two partners, Wood and Scott. From the second half of 2006, Wood encouraged the decisionmakers for the respondent companies, Salameh and Winder, to embark upon a mortgage lending business. In reliance on Wood's representations and other conduct, the respondents paid money into the appellant's trust account with a view to lending that money to six of the appellant's clients, all except one of which were fictitious (Transactions). Rule 87A applied at the time of the relevant conduct, as the Transactions involved Wood introducing borrowers to lender-clients. Contrary to Rule 87A, the appellant did not secure mortgage fidelity insurance over the "excluded mortgages" that the Transactions encompassed.

After the purported loans fell into default, the respondents sued the appellant to recover the losses sustained as a result of Wood's misconduct under ss. 13 and 14 of the Act, or by way of damages for negligence. The trial Judge found the appellant liable under both ss. 13 and 14 of the Act, but rejected the negligence claim on the ground that the respondents had failed to establish breach of the alleged duty of care.

On appeal, the appellant argued that the trial Judge erred in:

- identifying Wood's wrongful acts, including in finding that the appellant had not warranted both the truth of Wood's representations and that any future loan transactions arranged by the appellant would be enforceable in the Retainers;
- finding that Wood committed wrongful acts in the ordinary course of the appellant's business or with its apparent authority for the purposes of s. 13(1) of the Act; and
- finding that the appellant received the respondents' money in the course of its business for the purposes of s. 14(1)(b) of the Act.

The respondents argued that the trial Judge erred in rejecting their negligence claim.

(d) Decision

(i) Liability under the Act

The appellant argued that the trial Judge's finding on s. 13(1) of the Act should be set aside as there were no breaches of contractual warranties in the Retainers that could be regarded as "wrongful acts". The Court accepted the appellant's argument that a breach of the contractual warranty could not be regarded as a "wrongful act". By analogy to the Partnership Act 1890 (UK) and the UK decision of *Dubai Aluminium Co Ltd v Salaam* [2002] UKHL 48, the Court held that s. 13(1) is concerned with fault-based liability. Sections 8, 9 and 12 of the Act are not fault based, but these were not pleaded by the respondents.

The appellant accepted that the false and deceitful representations made by Wood were "wrongful acts" under s. 13(1), but argued that these wrongful acts were not carried out "in the ordinary course of the [appellant's] business". The Court accepted this, finding that acting for lenders in excluded mortgages could not be regarded as part of the appellant's business where both partners must have understood that by being uninsured, the partnership was acting contrary to Rule 87A.

The Court ultimately concluded that the trial Judge's findings should be sustained on the ground that the respondents suffered their losses as a result of the misleading and deceptive representation made by Wood with the appellant's "apparent authority". After a close analysis of the existing authorities in order to determine whether the acts undertaken by Wood were part of the class of acts fairly and properly carried out in the ordinary business of a solicitor, the Court found that Wood had apparent authority to engage in the Transactions.

In this case:

- each of the Transactions involved work within the scope of the kind of business carried out by the appellant;
- each of the Transactions was undertaken using the appellant's trust account, premises, facsimile and telephone facilities, and standard loan and security documentation; and
- the respondents knew that Wood was acting as a partner of the appellant, were not aware that he lacked authority and should not have been caused to question the Transactions based on any "usual" action.

Although the trial Judge found that the appellant was responsible for Wood's misapplication of the respondents' money received "in the course of its business" under s. 14(1)(b) of the Act, the Court found that the appellant was liable due to Wood receiving and misapplying the respondents' money in the scope of his "apparent authority" for the same reasons as under s. 13(1).

(ii) Liability under the negligence claim

The respondents alleged that:

- the appellant owed a duty to take reasonable care to prevent the partnership from acting in transactions that were unauthorised by law or were sham transactions; and
- Scott failed in this duty through his involvement in reviewing two loans which pre-dated the Transactions, but which were allegedly of the same nature.

As the appellant was not in the business of money lending at the time Scott was argued to have breached the alleged duty of care, a novel duty would need to be established; one owed to future money lending clients to take reasonable care to discover whether one of the partners had engaged in conduct which might adversely affect their interests in the future. The Court found this duty should not be upheld as it went beyond the scope of the Retainers and would apply to persons who had no relevant relationship with the firm when the duty was said to be applicable. It would also cut across duties owed at general law by enlarging the liability of firms beyond the scope of the Act and would undermine the relationship of trust and confidence in partnerships by requiring each partner to "look over the shoulder" of his or her co-partners.

In relation to breach of duty, the respondents argued that Scott did not exercise the requisite skill and care in conducting the appellant's business to prevent future clients from suffering loss through ill conduct. The Court found that the respondents failed to establish that anything should have alerted Scott to make further inquiries when considering the limited activities he carried out in connection with the relevant transactions, all of which pre-dated the Transactions.

5.12 When granting security is uncommercial and voidable

(By Steven Grant, Minter Ellison)

In the matter of Ashington Bayswater Pty Ltd (in liq) [2013] NSWSC 1008, Supreme Court of New South Wales, Black J, 30 July 2013

The full text of this judgment is available here.

(a) Summary

This case demonstrates the various considerations when determining whether there are uncommercial transactions or insolvent and voidable transactions particularly in the context of granting security.

(b) Facts

Ashington Bayswater Pty Ltd (the Company) borrowed funds from third party financiers and from the defendant, Bayswater Capital Pty Ltd (Bayswater Capital) as trustee of the Cross + Trust (the Trust). A creditor's winding up application was filed in the Supreme Court of New South Wales on 22 December 2011 and the liquidator (the Liquidator) was appointed to the Company on 9 February 2012.

The Liquidator sought orders under s. 588FF of the Corporations Act 2001 (Cth):

- discharging a fixed and floating charge (the Charge) granted by the Company to Bayswater Capital by deed dated 9 September 2010 or, alternatively, declaring the Charge to be void or unenforceable;
- directing Bayswater Capital to assign to the Company certain property, rights and interests which were assigned to it by the Company under an Assignment Deed or, alternatively, declaring that assignment to be void; and
- directing Bayswater Capital to pay an amount to the Company equal to the amount paid by the Company in eight payments over the period August - November 2011 (the Payments).

(c) Decision

(i) The Company's solvency as at September 2010

Black J concluded that the Company was insolvent when the Charge was granted on 9 September 2010 and at all relevant times thereafter, having regard to the following matters (among others):

- the size of the Company's debts to the ATO, Clayton Utz, HDY and other trade creditors;
- the fact that payment arrangements in respect of the debts owed to the ATO and Clayton Utz were not complied with and other debts were overdue;

- the Company's liabilities to the Office of State Revenue; and
- the fact that Company's only source of funds sufficient to meet these debts was revenue generated from the sale of properties that was not sufficient to meet its debts as and when they fell due.

(ii) Whether the grant of the Charge was an unfair preference

The Company granted the Charge to Bayswater Capital, of which Mr Anderson was then the sole director. The Charge and the associated Facility Agreement related to a loan made by the Trust, of which Bayswater Capital was trustee, to the Company.

The Facility Agreement related only to money that had already been loaned to the Company up to 9 September 2010 (as well as any interest and costs subsequently incurred) and did not require or provide for any future advances of funds from the Trust to the Company. Any funds advanced by the Trust to the Company after 9 September 2010 were therefore not subject to the Facility Agreement and also not subject to the Charge.

Section 588FA(1) provides that a transaction is an unfair preference if the company and the creditor are parties to the transaction (even if someone else is also a party) and the transaction results in the creditor receiving from the company, in respect of an unsecured debt that the company owes to the creditor, more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company.

Black J accepted the Liquidator's submission that the grant of the Charge converted an unsecured debt owed by the Company to Bayswater Capital into a secured debt and thereby conferred an additional benefit on Bayswater Capital (not least that it could then retain the benefit of the assignment) to that which it would have received had it submitted a proof of debt as an unsecured creditor. The Liquidator's evidence was that unsecured creditors are, at present, unlikely to receive any distribution in the winding up. The grant of the Charge was therefore a preference for the purposes of s. 588FA.

(iii) Whether the grant of the Charge was an uncommercial transaction

Section 588FB provides that a transaction of a company is an uncommercial transaction of the company if, and only if, it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction, having regard to:

- the benefits (if any) to the company of entering into the transaction;
- the detriment to the company of entering into the transaction;
- the respective benefits to other parties to the transaction of entering into it; and
- any other relevant matter.

Bayswater Capital ultimately accepted that the Charge and associated Facility Agreement only secured money lent to the date of that document and interest and charges accruing thereafter on that money and did not secure any moneys to be lent after the date of the Charge. Black J accepted that the effect of the Charge was that the Company encumbered its assets so as to convert Bayswater Capital's loan from an unsecured interest to a secured interest, with no substantial corresponding commercial benefit. Black J considered that the detriment suffered by the Company in granting the Charge was disproportionate to any benefit obtained and this transaction involved a bargain for Bayswater Capital of such a magnitude that it could not be explained by normal commercial practice. Black J therefore considered that the entry into the Charge was an uncommercial transaction for the purposes of s. 588FB.

(iv) Whether the grant of the Charge was an insolvent and voidable transaction

A transaction is an insolvent transaction of a company, as defined in s. 588FC, if, relevantly, it is an unfair preference or uncommercial transaction of the company and the transaction is entered into at a time the company is insolvent or the company becomes insolvent because of matters including entry into the transaction. There was no dispute that the grant of the Charge occurred during the relation-back period, so that it was also a voidable transaction for the purposes of s. 588FE, if, as Black J held, it was an unfair preference and uncommercial transaction and an insolvent transaction.

Section 588FF allows the Court to make any one or more of the orders set out in the s. on the application of a liquidator, where a transaction is voidable because of s. 588FE, including an order declaring that an agreement constituting, forming part of, or relating to the transaction was void at and after the agreement was made. Black J was satisfied that this was the appropriate relief.

(v) The Assignment Deed

The Company reached a settlement of other proceedings brought against it by a hotel operator which operated a hotel from the Potts Point property in February 2011, paying $750,000 in settlement of the proceedings and incurring legal costs of $332,424. On 24 January 2012, Bayswater Capital and the Company filed proceedings against their former solicitors, Sparke Helmore, claiming damages in excess of $1 million for negligence in drafting the hotel lease and sales contract which were the subject of those other proceedings. On 3 June 2011, the Company assigned, broadly, its rights against Sparke Helmore and the claims in those proceedings to Bayswater Capital by the Assignment Deed.

The Liquidator contended that, if the Charge is avoided, the entry into the Assignment Deed was an unfair preference for the purposes of s. 588FA, since Bayswater Capital received a benefit by way of the assignment that it would not have been entitled to had it proved as an unsecured creditor in insolvency. Black J considered that the assignment plainly gave rise to such a preference, since Bayswater Capital obtained the full value of the rights assigned to it in consideration of the offset of $325,000 due to it but would have received little or none of that amount in a liquidation of the Company.

Black J further considered that the Company was insolvent at June 2011, and that the preference arising in respect of the entry into the Assignment Deed was therefore an insolvent transaction under s. 588FC and, being within the relation-back period, a voidable transaction under s. 588FE. The Liquidator sought an order under s. 588FF directing Bayswater Capital to assign to the Company the property, rights and interests which were assigned to it by the Company under the Assignment Deed or alternatively declaring that assignment to be void. Black J considered that the Liquidator would be entitled to either of those orders, but would need to make clear which of them is pressed.

(vi) Application in respect of the Payments

It was accepted in cross-examination that when amounts were caused to be paid to related parties from the Company's bank account in August 2011, the Company was then not in a position to pay its debts to third parties as and when they fell due as at that date or before or after it. Accordingly, Black J found that the Payments were preferences within the meaning of s. 588FA and insolvent and voidable transactions under ss. 588FC and 588FE(4) and the Liquidator was entitled to an order under s. 588FF in this regard.

5.13 The meaning of "associates" under the Corporations Act

(By Katrina Sleiman, Corrs Westgarth Chambers)

Perpetual Custodians Ltd as custodian for Tamoran Pty Ltd as trustee for Michael

Crevelli v IOOF Investment Management Ltd; Murray v Perennial Investment Partners Ltd [2013] NSWCA 231, New South Wales Court of Appeal, McColl, Gleeson and Leeming JJA, 19 July 2013

The full text of this judgment is available here.

(a) Summary

The issue in the two appeals was whether the acquisition of one listed company by another using a scheme of arrangement under the Corporations Act 2001 (Cth) (the Act) amounted to a "Change in Control" in the acquirer within the defined meaning of that term in two pre-existing commercial contracts.

There was a Change in Control within the meaning of the contracts if a person and its "Associates", as defined in the Act, together became entitled to more than 40% of the voting shares in the acquirer.

Leeming JA, with whom McColl and Gleeson JJA agreed, held that those target shareholders who voted in favour of the scheme of arrangement were not Associates as that term is used in the Act.

(b) Facts

In 2006, a subsidiary of IOOF Holdings Ltd (IOOF), purchased shares from the appellants in the first appeal. Under the Share Sale Agreement, the appellants were entitled to an accelerated deferred payment if there was a Change in Control in IOOF. At the same time, a Shareholders' Agreement entered into by the appellants in the second appeal was varied so that it could be terminated and certain put and call options exercised if there was a Change in Control. In both contracts, Change in Control was defined to include "in relation to the shareholding of IOOF where a person and that person's Associates together become entitled to more than 40% of the voting shares in IOOF" "Associate" was defined by reference to the Act. The contractual definition separately addressed change in the board of IOOF.

In 2008, IOOF and Australian Wealth Management (AWM) announced that they had entered into an Implementation Deed pursuant to which they would merge through a scheme of arrangement between AWM and its members (the Scheme). Under the Scheme, AWM would be authorised to transfer all of its members' shares to IOOF in consideration for their receiving IOOF shares. AWM would become a wholly owned subsidiary of IOOF, and, because the market capitalisation of AWM was greater than that of IOOF, AWM's members would dominate IOOF's register.

The Scheme was unanimously supported by the boards of IOOF and AWM. At a meeting of AWM members on 22 April 2009, 99.7% of votes cast were in favour of the Scheme, amounting to around 68% of AWM's shares. When the Supreme Court of Victoria approved the Scheme and the orders were lodged with ASIC, the members who voted in favour of the Scheme (the Voting Members) became entitled, on 30 April 2009, to be issued with approximately 48% of the voting shares in IOOF. On 12 May 2009, they were issued with those shares.

The appellants claimed that there had been a Change in Control on the basis that in the period from the time of the vote until the issue of shares, AWM and the Voting Members were Associates, who had together become entitled to more than 40% of the voting shares in IOOF. They submitted that AWM and the Voting Members were Associates on three grounds pursuant to ss. 12(2) and 15(1) of the Act. First, that the Scheme was a "relevant agreement" between AWM and Voting Members for the purpose of controlling or influencing the composition of IOOF's board or the conduct of IOOF's affairs. Second, that AWM and the Voting Members were acting in concert. Third, that AWM and the Voting Members were, or were proposing to become, associated, whether formally or informally in any other way.

(c) Decision

(i) Was the Scheme a "relevant agreement" between AWM and Voting Members for the purpose of controlling or influencing the composition of IOOF's board or the conduct of IOOF's affairs?

Contrary to the finding of the primary Judge, Leeming JA considered (in obiter as it was not within the scope of the appeal) that it may be doubted whether the Scheme was a "relevant agreement", because its binding force did not come from the agreement of the parties, nor was there a meeting of minds so as to constitute an "arrangement or understanding".

On the assumption that the Scheme was a "relevant agreement", Leeming JA held that the Scheme was not a relevant agreement for the purpose of controlling or influencing the conduct of IOOF's affairs for the purposes of s. 12(2)(b) of the Act. Rather, the purpose of the Scheme was confined to conferring authority on AWM to transfer members' shares to IOOF in consideration of IOOF shares.

Although the definition in the Act of "Associate" extended to relevant agreements for the purpose of controlling or influencing the composition of IOOF's board, his Honour held that that limb of the definition was displaced by the specific provision in the contractual definition of Change in Control relating to change in the IOOF board.

(ii) Were AWM and the Voting Members acting in concert?

Other than the Scheme booklet, there was no communications between AWM and its members. The Voting Members had nothing to do with any of the steps taken by AWM in advance of the Scheme meeting, nor could they prevent AWM from taking those steps. Likewise, the Voting Members had nothing to do with any of the steps taken by AWM after the Scheme meeting, save in the sense that a statutory majority was a statutory and contractual precondition to those steps being taken.

In voting on the Scheme, Leeming JA considered that the Voting Members were acting in their own respective self-interest. Further, his Honour considered it necessary for there to be conduct aside from the vote itself in order for shareholders to be associates.

His Honour concluded that AWM and the Voting Members were not shown to be acting in concert for the purposes of ss. 12(2)(c) or 15(1)(a) of the Act.

(iii) Were AWM and the Voting Members associated in any other way?

His Honour considered that to the extent that s. 15(1)(c) of the Act expands the concept of "Associate" at all, it does so by relaxing questions of timing and formality. However, the appellants' failure on the first and second grounds of their case was not because of some question of timing or lack of formality.

In this respect, his Honour agreed with the primary Judge's statement that "in the circumstances of this case, it is hard to see how the requirements of s. 15(1)(c) could be satisfied if those of ss. 12(2)(c) and (d) and s. 15(1)(a) were not".