SAI Global Corporate Law Bulletin No. 189>

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Bulletin No. 189

Legislation Hotline

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 Creating a safer financial system: IMF paper

On 14 May 2013, the International Monetary Fund (IMF) released a staff discussion note entitled "Creating a Safer Financial System: Will the Volcker, Vickers, and Liikanen Structural Measures Help?"

The US, the UK, and more recently, the EU, have proposed policy measures directly targeting complexity and business structures of banks. Unlike other, price-based reforms (e.g., Basel 3 and G-SIFI surcharges), these proposals have been developed unilaterally with material differences in scope, design and implementation schedules. This may exacerbate cross-border regulatory arbitrage and put a further burden on consolidated supervision and cross-border resolution.

This paper provides an analysis of the potential implications of implementing different structural policy measures. It proposes a pragmatic and coordinated approach to development of these policies to reduce risk of regulatory arbitrage and minimise unintended consequences. In doing so, it also aims to identify a set of common policy measures that countries could adopt to re-scope bank business models and corporate structures.

The paper is available from the IMF website.

1.2 European Corporate Governance Codes Network

On 13 May 2013, the European Corporate Governance Codes Network launched a new website.

The European Corporate Governance Codes Network is an informal network of the organisations responsible for writing and/or monitoring the implementation of national corporate governance codes in European Union and European Economic Area countries, and which exists primarily for the sharing of views, experiences and practice. In addition to providing links to relevant codes and guidance, the website contains links to monitoring reports for the codes.

The website is available here.

1.3 Sustainability reporting

On 9 May 2013, the Australian Council of Superannuation Investors (ACSI) released "The Sustainability Reporting Journey: Corporate Reporting in Australia - Disclosure of Sustainability Risks Among S&P/ASX200 Companies".

This is the sixth year that ACSI has conducted a study into the sustainability reporting practices of Australia's largest listed companies.

Key findings of the 2013 research include that:

- 85% of companies in the ASX200 provide at least a basic level of sustainability risk reporting;
- as has been the case in previous years, there appears to be a notable degree of correlation between company size and sustainability reporting level;
- 39 companies in the ASX200 have at least some of their sustainability reporting data verified by an external party and almost all of these companies fall into the reporting category of comprehensive;

- the number of ASX200 companies structuring their sustainability reports to the Global Reporting Initiative (GRI) framework has increased by five companies to 43, with 80% of those companies reporting to the GRI falling into the ASX100;
- 78 companies have been included in all six of ACSI's research projects, and all of these now provide some level of sustainability reporting, with a significant number reporting to a level of comprehensive or detailed; and
- 135 companies have been included in the research since 2009 (when the research was expanded from the ASX100 to the ASX200) and there has been a notable increase in the number of these companies reporting to a comprehensive level in 2013.

The report is available from the ACSI website.

1.4 APRA releases second set of draft prudential practice guides (PPGs) for superannuation and updates to two cross-industry PPGs

On 9 May 2013, the Australian Prudential Regulation Authority (APRA) released for consultation eight draft prudential practice guides (PPGs) for the superannuation industry and updates to two cross-industry PPGs.

These PPGs include practical guidance on matters that a registrable superannuation entity (RSE) licensee may consider to assist it in meeting the requirements in APRA's prudential standards.

The draft PPGs includes five new PPGs and updates to three existing superannuation PPGs.

The draft PPGs are:

Proposed new superannuation PPGs:

- Prudential Practice Guide SPG 160 Defined Benefit Matters;
- Prudential Practice Guide SPG 222 Management of Reserves;
- Prudential Practice Guide SPG 511 Remuneration;
- Prudential Practice Guide SPG 532 Investment Risk Management; and
- Prudential Practice Guide SPG 533 Valuation.

Draft updates to existing superannuation PPGs:

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

The draft PPGs are available on the APRA website.

1.5 APRA releases second consultation package for the supervision of conglomerate groups

On 9 May 2013, the Australian Prudential Regulation Authority (APRA) released proposed risk management and capital adequacy requirements for the supervision of conglomerate groups for consultation.

Conglomerate groups, referred to as Level 3 groups, are groups comprising APRA-regulated institutions that perform material activities across more than one APRA-regulated industry and/or in one or more non-APRA-regulated industry.

The consultation package includes a response to submissions received on APRA's March 2010 discussion paper on the supervision of conglomerate groups and a set of draft prudential standards. The package, on risk management and capital adequacy, complements the consultation package released in December 2012 on proposed requirements for group governance and risk exposures.

Over the course of 2013, APRA will consult on a set of prudential practice guides, reporting standards, reporting forms and instructions, and consequential amendments to other prudential standards that give effect to the Level 3 framework. The Level 3 prudential standards are expected to take effect from 1 January 2014.

The response paper and draft prudential standards are available on the APRA website.

1.6 APRA releases consultation on harmonised and enhanced risk management requirements

On 9 May 2013, the Australian Prudential Regulation Authority (APRA) released for consultation a package that would ensure the consistent application of its risk management requirements across its regulated industries and that reflects its heightened expectations in this area.

The package proposes harmonised risk management requirements for authorised deposit-taking institutions (ADIs), general insurers, life insurers, single industry groups (Level 2 groups) and conglomerate groups (Level 3 groups). It includes a discussion paper, a draft new cross-industry risk management prudential standard and an updated cross-industry prudential standard on governance.

The proposed cross-industry Prudential Standard CPS 220 Risk Management (CPS 220) consolidates existing risk management standards for insurers and includes some risk management requirements for ADIs that are currently spread across a number of ADI prudential standards. The new standard will not apply in superannuation. Registrable Superannuation Entity (RSE) licensees must comply with the superannuation-specific risk management standard that comes into effect on 1 July 2013.

The discussion paper and draft prudential standards are available on the APRA website.

1.7 Audit committee issues transcend geographic borders: report

On 7 May 2013, the Center for Audit Quality, the Federation of European Accountants and the Institute of Chartered Accountants in Australia jointly released a report summarising a set of roundtable discussions that they convened in January 2013 in Brussels, Hong Kong and New York City. The roundtables were attended by members of governance and audit committee communities in the respective jurisdictions.

The published report summarises common themes that emerged from roundtable discussions with respect to the role of the audit committee, the scope of its responsibilities, audit committee transparency, and education on the role of the audit committee.

The Report is available from the Center for Audit Quality website.

1.8 APRA releases second consultation package on Basel III liquidity reforms

On 6 May 2013, the Australian Prudential Regulation Authority (APRA) released a second consultation package outlining its proposed implementation of the Basel III liquidity reforms for authorised deposit-taking institutions (ADIs) in Australia.

The package includes a discussion paper, a revised draft Prudential Standard APS 210 Liquidity (APS 210) and a draft Prudential Practice Guide APG 210 Liquidity. The package addresses the main issues raised in submissions to APRA's previous discussion paper released in November 2011, and incorporates revisions to the Basel III liquidity reforms published by the Basel Committee on Banking Supervision (Basel Committee) in January 2013.

In the 2011 discussion paper, APRA outlined proposals to implement the Basel III liquidity reforms. These proposals included two new quantitative measures - a 30-day Liquidity Coverage Ratio (LCR) to address an acute stress scenario and a Net Stable Funding Ratio (NSFR) to encourage longer-term funding resilience. These requirements would apply to those ADIs that are currently required to conduct scenario analysis of their liquidity needs under different operating circumstances. This approach is unchanged in the updated draft APS 210.

This discussion paper includes responses to the main issues raised in submissions on APRA's 2011 proposals that have not been affected by the Basel Committee's recent revisions.

The consultation package and discussion paper are available from the APRA website.

1.9 IOSCO publishes principles for CIS valuation

On 3 May 2013, the International Organization of Securities Commissions published its final report on the "Principles for the Valuation of Collective Investment Schemes". The report contains a list of principles intended to serve as a basis for both industry practitioners and regulators to assess the quality of regulation and industry practices regarding the valuation of collective investment schemes (CIS).

The final report revises IOSCO's Principles for CIS Valuation, originally developed in 1999, to take into account subsequent regulatory, industry and market developments.

The revised Principles contained in the report also take into account the IOSCO 2007 Principles for the Valuation of Hedge Fund Portfolios, as well as other relevant Principles elaborated for investment managers more recently.

The report is available on the IOSCO website.

1.10 Corporate governance code for small and mid-size quoted companies

On 1 May 2013, the Quoted Companies Alliance published an updated edition of its Corporate Governance Code for Small and Mid-Size Quoted Companies. The Code, which is endorsed by the UK Financial Reporting Council, is intended for companies not subject to the UK Corporate Governance Code, including standard listed companies and those on AIM and the ICAP Securities and Derivatives Exchange.

The QCA Code is intended to help quoted companies put into practice appropriate corporate governance arrangements and encourage positive engagement between companies and shareholders.

The QCA Code adopts key elements of the UK Corporate Governance Code, current policy initiatives and other relevant guidance and then applies these to the needs and particular circumstances of small and mid-size quoted companies on a public market. Focusing on 12 principles and a set of minimum disclosures, the QCA Code encourages companies to consider how or whether they should apply each principle to achieve good governance and provide quality explanations to their shareholders about what they have done.

The Code is available for a fee on the Quoted Companies Alliance website.

1.11 Research finds tax laws adversely affect participation in employee share schemes

In April 2013, an expert panel of Employee Ownership Australia and New Zealand (EOA) released a report entitled "The Changing ESS Landscape since 1 July 2009". This EOA Report argues that the introduction of Division 83A of the Income Tax Assessment Act 1997 (Cth) in 2009 has reduced participation in employee share schemes (ESSs).

The study found that concerns about tax evasion in a period when there was a strong focus on rising executive pay levels, which motivated the legislation, could have been addressed through ESS reporting alone. In addition to complicating companies' administrative and compliance processes, broad-based ESSs have been most affected by the amendments.

The report found that:

- the huge majority of ESS plans were suspended during the first year. Some 30 per cent of plans were suspended for up to two years and many have not been reinstated;
- Section 83A-105 included a limit of $5,000 on salary sacrifices which affected broad-based employee groups, middle management and employee savings plans; and
- the overall number of employees participating in share ownership plans and he amount invested in such plans has been reduced markedly since the introduction of Division 83A.

The report makes a number of recommendations including - in the short term - removing or increasing the cap on salary sacrifices. More significantly, in the long term, the report suggests that termination of employment needs to be removed as a deferred taxing point, and that a broader review of the operation of Division 83 is warranted.

The report is available on the Chartered Secretaries Australia website.

1.12 Guidelines for gender balance reporting

On 1 May 2013, "Guidelines for Gender Balance Reporting" were published. The Guidelines are intended to be a practical and relevant framework to enable Australian entities to raise their performance and reporting of gender balance in their workplace.

The Guidelines contain gender balance indicators that entities can adopt in order to:

- collect and analyse data on gender balance;
- report on the current state of gender balance; and
- report on progress against measurable targets to improve gender balance outcomes.

The Guidelines also contain a framework for data collection, analysis, reporting and performance improvement.

The Guidelines are available on the Women on Boards website.

1.13 SEC proposes rules for cross-border security-based swap activities

On 1 May 2013, the US Securities and Exchange Commission (SEC) voted unanimously to propose rules and interpretive guidance for parties to cross-border security-based swap transactions. The proposal explains which regulatory requirements apply when a transaction occurs partially within and partially outside the US. The proposed rules also set forth when security-based swap dealers, major security-based swap participants, and other entities - such as clearing agencies, execution facilities, and data repositories - must register with the SEC.

The proposal outlines a "substituted compliance" framework in order to facilitate a well-functioning global security-based swap market. It is an approach that recognises that market participants may be subject to conflicting or duplicative compliance obligations in the global derivatives market.

Further information is available on the SEC website.

1.14 Central bank finances: research report

On 29 April 2013, the Bank for International Settlements (BIS) released a paper entitled "Central Bank Finances". The paper looks at the relevance of a central bank's own finances for its policy work. Some central banks are exposed to significant financial risks, partly due to the environment in which they operate, and partly due to the nature of policy actions.

While financial exposures and losses do not hamper central banks' operational capabilities, they may weaken the effectiveness of central bank policy transmission. Against this backdrop, the paper analyses the determinants of a central bank's financial position and the possible implications of insufficient financial resources for policymaking. It also provides a conceptual framework for considering the question of whether central banks have sufficient financial resources.

The paper is available from the BIS website.

1.15 Inspector-General in Bankruptcy releases personal insolvency activity by postcode

On 29 April 2013, the Inspector-General in Bankruptcy released a report entitled "Personal Insolvency Activity by Postcode 2011-12" and an accompanying guide. The report provides statistical information on data on personal insolvency activity by postcode.

The report and accompanying guide are available from the Insolvency and Trustee Service website.

1.16 Structural bank regulation initiatives: approaches and implications

On 26 April 2013, the Bank for International Settlements (BIS) released a paper entitled "Structural Bank Regulation Initiatives: Approaches and Implications". The paper examines the basic rationale and features of the proposals adopted to separate specific investment and commercial banking activities, following the global financial crisis (GFC).

In response to the GFC, several advanced economies have either adopted or are considering structural bank regulation measures. The common element of the various initiatives is a mandatory separation of commercial banking from certain securities markets activities. The paper explores the effects of these proposals and initiatives.

In particular, it focuses on the likely implications of such initiatives for:

- financial stability and systemic risk;
- banks' business models; and
- the international activities of global banks.

This paper is available from the BIS website.

1.17 Review of the Trio Capital fraud and assessment of the regulatory framework

On 26 April 2013, Treasury released a "Review of the Trio Capital Fraud and Assessment of the Regulatory Framework".

The Review considered the events behind the collapse of Trio Capital, the responses of the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) and aspects of the regulatory framework.

The Review found that:

- ASIC and APRA carried out their roles and responsibilities appropriately, under the current regulation framework;
- the Board of Trio Capital failed to manage and monitor risks associated with overseas investments;
- certain financial planners may not have put member interests first and may not have adequately advised their clients of their responsibilities to manage investment risks when choosing to invest through a self-managed superannuation fund (SMSF); and
- some SMSF trustees had an insufficient understanding and knowledge of the risks pertaining to their investments. Inadequate financial advice may have been a contributing factor.

The Review is available from the Treasury website.

1.18 European financial stability and integration report

On 25 April 2013, the European Commission released the "European Financial Stability and Integration Report" for 2012. The report emphasises the importance and urgency of the need for financial sector reforms to restore long term growth.

Overall, the report shows that despite improvements, the financial crisis continued to exert a significant impact in holding back economic growth in 2012.

More specifically, the report:

- shows that European proposals for the establishment of a banking union stem from the need to deepen economic and financial integration in Europe;

- covers the main policy initiatives that have been or are being implemented, adopted, presented, or developed in 2012;
- takes stock of the important debate to analyse the business models of the financial institutions; in particular, the desirability of adopting structural reforms in the banking sector;
- describes and takes stock of progress in regulating the over-the-counter (OTC) derivatives markets; and
- underscores the pivotal role the financial sector has in supporting the real economy and in providing jobs and growth for society, by examining the difficulties small and medium-sized enterprises experience in their access to funding.

The report is available from the European Commission website.

1.19 ASIC market supervision cost recovery arrangements July 2013 - June 2015

On 24 April 2013, Treasury released for comment a set of proposed amendments to the ASIC market supervision cost recovery arrangements for the period from 1 July 2013 to 30 June 2015.

The proposed amendments are intended to enable the Government to recover over that period:

- costs incurred by ASIC in the performance of its market supervision functions and the implementation of market competition; and
- costs associated with the Enhanced Market Supervision (EMS) measure announced at the 2012-13 Budget to replace ASIC's integrated market surveillance system (IMSS), enhance its market surveillance and supervision systems and tools and deliver improvements to those ASIC portals and registers accessed by market participants.

The consultation is based on two documents, being a set of proposed amendments to the relevant provisions in the Corporations (Fees) Regulations 2001 (Cth) (the Regulations) and a draft Cost Recovery Impact Statement (CRIS) compiled by ASIC. The proposed amendments to the Regulations implement the following policy decisions:

- the introduction of a fixed fee component of $1,835 per quarter for cash equity market participants;
- increased messaging fees to shift a portion of ASIC's staff costs from trade activity to messaging activity; and
- changes to the late payment fees to make them administratively simpler and more efficient.

The proposed amendments and the draft CRIS will be finalised following conclusion of the consultation. Subject to the appropriate approvals by Government, it is proposed to make the amendments to the Regulations in time for the new arrangements to apply from 1 July 2013.

The proposed amendments and explanatory commentary are available from the Treasury website.

1.20 IOSCO publishes report on technological challenges to market surveillance

On 22 April 2013, the International Organization of Securities Commissions (IOSCO) published a report entitled "Technological Challenges to Market Surveillance: Issues and Regulatory Tools".

This report provides an overview of current market surveillance regimes and identifies the main challenges that technological developments pose to these regimes.

It also makes final recommendations to help market authorities develop the regulatory tools for addressing these challenges, particularly with respect to:

- improving surveillance capabilities on a cross-market and cross-asset basis; and
- making more useful to market authorities the data collected for surveillance purposes.

The report is available from the IOSCO website.

1.21 FSB reports to G20 on progress of financial regulatory reforms

On 19 April 2013, the Financial Stability Board (FSB) published a letter from the Chairperson to the G20 Finance Ministers and Central Bank Governors describing progress on the financial regulatory reform program as well as a progress report on reforming resolution regimes and resolution planning for globally systemically important financial institutions (G-SIFIs).

The Chairperson's letter summarises the progress being made on:

- implementation of the Basel III capital and liquidity requirements, supporting the goal of increasing the resilience of banks and banking systems;
- implementation of reforms to resolution regimes, supporting the goal of ending "too big to fail" attitudes; and
- implementation of OTC derivatives reforms, supporting the goals of reducing systemic risks and creating continuous core markets.

The letter and the progress report are available from the FSB website.

1.22 Report on global M&A activity for the first quarter of 2013

In April 2013, the International Institute for the Study of Cross-Border Investment and M&A released its quarterly review for the first quarter of 2013.

Highlights included that:

- global M&A volume in Q1 was US$546 billion, up 10% from the same quarter last year but down from last year's strong finish in the fourth quarter;
- Q1 saw a number of transformative transactions across the globe, including four transactions exceeding US$15 billion in value (Berkshire Hathaway/3G Capital - Heinz, Michael Dell/Silver Lake Partners - Dell, Liberty Global - Virgin Media, and Comcast - NBC Universal Media);
- the United States had an unusually strong quarter compared to other regions, with eight of the 10 largest deals and over 50% of global M&A volume;
- cross-border deal activity fell, accounting for just 25% of global M&A volume as compared to 37% of 2012 volume.
- Energy & Power continued to produce the most M&A volume of any sector, but barely edged out the High Technology and Real Estate sectors, each of which had relatively strong quarters. None of the five largest deals of Q1 were Energy & Power deals; and
- financial sponsors have reemerged, playing a leading role in some of the largest transactions. In addition to buyouts and traditional strategic M&A, spinoffs, divestitures, and other corporate restructurings continue to present attractive opportunities for many

companies.

The quarterly review is available from the International Institute for the Study of Cross-Border Investment and M&A website.

2. Recent ASIC Developments

2.1 Guidance for new hardship obligations

On 9 May 2013, ASIC updated Information Sheet 105 Dealing with consumers and credit (INFO 105) to assist industry meet new hardship obligations under the National Consumer Credit Protection Act 2009 (Cth).

Under the new obligations, credit providers have set time frames in which to respond to a hardship notice from a consumer, based on whether they request further information from a consumer or not.

The update clarifies for credit providers when they are required to make a decision about whether a hardship variation is granted, particularly if there is a delay by the consumer in providing the information required to make a decision.

The hardship obligations under the Consumer Credit Legislation Amendment (Enhancements) Act 2012 (Cth) apply to new credit contracts from 1 March 2013.

The Information Sheet is available on the ASIC website.

2.2 Rules for ASX 24 market

On 9 May 2013, ASIC released new market integrity rules for the Australian Securities Exchange Limited derivatives market (ASX 24).

The rules cover risk management, supervisory policies and procedures, and foreign participants. New ASX 24 market participants need to comply with the rules immediately. For existing participants, there will be a three month transition period. ASIC will issue regulatory guidance during this time.

There are also rules that cover disclosure about clearing arrangements and obligations on participants to give priority to the client's instructions where there is a conflict between the client's interests and the participant's interests. These will need to be complied with immediately.

The updated rules are available from the ASIC website.

2.3 Quarterly cash equity market data

On 2 May 2013, ASIC released the first of its new quarterly series of data relating to Australia's cash equity markets. The data consists of a set of indicators of market characteristics and efficiencies calculated from ASIC's market surveillance system. These indicators provide a quarterly snapshot of the entire market landscape that is not otherwise available.

The data includes information gathered during the first quarter of 2013, with subsequent updates to be published every quarter. A review of the data will be made after 12 months.

The quarterly series of cash equity markets data is available on the ASIC website.

2.4 Supervision of registered liquidators

On 1 May 2013, ASIC released its annual report for the 2012 calendar year into the supervision of registered liquidators.

The report highlighted that:

- ASIC completed more than 200 reviews examining issues including practitioner independence, competence and remuneration;
- there was a 10% increase in inadequate declarations relating to disclosure about independence. More than half of all declarations in 2012 were considered inadequate;
- there were 19 registered liquidators subject to formal investigation or enforcement action at the end of 2012; and
- 69% of reports of alleged misconduct against registered liquidators resulted in educative outcomes for those making the report.

The report also highlights the supervisory enforcement and educative work ASIC was involved in throughout 2012 as well highlighting that in 2012, as part of the review process, ASIC initiated a new, proactive transactional review program. These reviews target company failures where ASIC is concerned directors may have engaged in phoenix type activities.

The report is available from the ASIC website.

2.5 Capital protected products

On 1 May 2013, ASIC released a report on the Australian market for unlisted retail structured products promoted as having capital protection or a capital guarantee.

The report highlights that:

- capital protection or capital guarantee products are complex;
- complex products can be difficult for investors to understand; and
- those selling complex products need to ensure marketing and advice directed at retail investors are accurate.

The Report found that retail investors often had a poor understanding of these products and highlighted the way that some of these products are labelled, with confusing or potentially misleading messages about the level of risk investors are exposed to.

The report highlights concerns around:

- the accuracy and balance of advertising for these products;
- the labelling and description of reverse convertible products as offering "conditional capital protection" or "conditional protection". The value of these investments is usually linked to the worst performing reference share, meaning investors could lose some or all of their money; and
- certain "internally geared" structured products that are described as entailing a compulsory capital protected loan, where all of the investor's outlay is at risk of loss if reference assets do not perform. Where the investment exposure is "notional", there may also be risks for

investors who claim tax deductions on their payments.

The report is available from the ASIC website.

2.6 National financial literacy strategy

On 30 April 2013, ASIC published a consultation paper relating to updating its financial literacy strategy. The consultation paper should be read in conjunction with the background report which discusses the range and diversity of financial literacy programs being delivered in Australia.

Further information is available on the ASIC website.

2.7 Guidance on managing conflicts of interest in litigation schemes and proof of debt schemes

On 22 April 2013, ASIC released guidance to help third-party litigation funders manage conflicts of interest. Regulatory Guide 248, "Litigation schemes and proof of debt schemes: Managing conflicts of interest" (RG 248), also applies to insolvency practitioners and lawyers involved in proof of debt schemes during the winding-up of insolvent companies.

RG 248 provides guidance on:

- effective disclosure of conflicts of interest to members of the scheme;
- controlling situations where interests may diverge or conflict (including identifying divergent interests, assessing and evaluating those interests and implementing an appropriate response);
- recruitment of prospective members (including designating a senior person to oversee recruitment practices and ensure they are not misleading and deceptive);
- the situation where the lawyer acts for both the funder and the members (including ensuring that the members' interests are adequately protected);
- the situation where there is a pre-existing relationship between the funder, lawyers and members (including disclosure of any pre-existing relationship);
- the terms of any funding agreement; and
- approval of the terms of settlement of a litigation scheme where proceedings have not been commenced by an independent panel or counsel.

The Regulatory Guide is available on the ASIC website.

2.8 The SMSF sector - Improving the quality of advice

On 18 April 2013, ASIC Released Report 337 "SMSFs: Improving the quality of advice given to investors" (REP 337). The report summarises the findings from the first major project undertaken by ASIC's Self-managed superannuation fund (SMSF) taskforce.

ASIC conducted a review of over 100 investor files relating to the establishment of an SMSF that were provided by financial planners and accountants. The files targeted were considered to be in higher risk categories through, for example, having lower balances or less diversified investments.

While most advice provided was rated as adequate there were pockets of poor advice. ASIC found issues in the following areas:

- advice was not sufficiently tailored to the needs of the investor;
- replacement product disclosure was absent or inadequate;
- insurance recommendations were absent or inadequate;
- an inappropriate single asset class was provided to investors;
- suitable alternatives to an SMSF were not considered; and
- there was inadequate consideration of the investor's long-term retirement planning objectives.

The report is available from the ASIC website.

3. Recent ASX Developments

3.1 Exchange-traded Australian Government Bonds commence trading on ASX

Exchange-traded Australian Government Bonds (AGBs) commenced trading on ASX on 21 May 2013. Exchange-traded AGBs are quoted and transacted on ASX in a similar way to shares, with each bond quoted as a gross price (capital plus accrued interest) with a face value of $100.00. The launch of Exchange-traded AGBs increases the amount of ASX-quoted assets for retail investors in the interest rate category from $35 billion to approximately $280 billion, an eight-fold increase.

Investors in Exchange-traded AGBs hold beneficial ownership of the Australian Government Bonds in the form of CHESS Depositary Interests (CDIs). This means investors obtain all of the economic benefits (including coupon and principal payments) attached to the legal ownership of the Australian Government Bond over which the CDI has been issued. Trades in Exchange-traded AGBs are cleared by ASX Clear and settled through CHESS.

Further information is available on the ASIC website.

3.2 ASX electricity futures and options: New contracts, enhancements and rulebook restructure

On 8 May 2013, ASX launched Base Load Calendar Month Electricity Futures and Financial-Year Strip Options over Base Load Calendar Quarter Electricity Futures. ASX also updated the structure of all Electricity contracts in the ASX 24 Operating Rules to better support new contracts in the future and introduced enhancements to the expiry process for existing Australian Electricity Calendar-Year Strip Options to align with the expiry process of the new Australian Electricity Financial-Year Strip Options.

The Notice is available on ASXGroup.com.au.

3.3 Modernising the timetable for rights issues: Response to market and exposure draft

On 6 May 2013, ASX released a market response and exposure draft Modernising the Timetable for Rights Issues: Draft ASX Listing Rules. The market response and exposure draft provide a response to feedback received through consultation undertaken in 2012 on proposals to reduce the timetables for rights issues. It also sets out draft amendments to the ASX Listing Rules to reduce the standard timetables for traditional rights issues from 26 to 19 business days, and to introduce standard timetables for accelerated rights issues.

The market response and exposure draft are available on ASXGroup.com.au.

3.4 Reports

On 5 May 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 April 2013.

3.5 ASX OTC interest rate derivatives clearing: Response to consultation feedback on draft operating rules

On 19 February 2013, ASX released a Consultation Paper seeking comment on the draft Operating Rules that will provide the foundation for the first phase of ASX's central counterparty clearing service for OTC Interest Rate Derivatives (OTC Clearing Service). Following this, on 1 May 2013, ASX released a Response document which summarises the feedback received from stakeholders on and ASX's response to that feedback. The Response document also attaches revised Operating Rules, incorporating changes made in response to stakeholder input, that are subject to formal approval by Clearing Participants and regulatory clearance.

The Response document is available on ASXGroup.com.au.

4. Recent Takeovers Panel Developments

4.1 Firestone Energy Limited - Declaration of unacceptable circumstances and orders

On 17 May 2013, the Takeovers Panel announced that it had made a declaration of unacceptable circumstances and final orders in relation to an application dated 18 April 2013 by Firestone Energy Limited in relation to its affairs.

Firestone has a right to a 60% participation interest in the Waterberg coal project in South Africa. On 17 December 2012, The Waterberg Coal Company Limited announced an off-market scrip bid for Firestone.

On 30 January 2013, Waterberg issued its bidder's statement, which included a statement that "[Firestone] shareholders will have exposure to a 70% interest in the Waterberg Project (whereas currently [Firestone] holds a 60% interest)". On 27 March 2013, Waterberg increased the bid consideration to 1.25:20 (post consolidation) and declared the offer unconditional. Also on 27 March 2013, Waterberg's shareholders approved (among other things) the acquisition of 46.88% of Waterberg by Haworth Finance Limited.

The Panel made a declaration of unacceptable circumstances on the basis that the original and supplementary bidder's statements were deficient, in that they did not:

- adequately disclose Haworth's shareholding in Waterberg, or the identities of the owners and controllers of the investors in Haworth;
- adequately identify the lenders under the convertible financing facility between Waterberg and Standard Bank of South Africa and the facility's potential impact on Waterberg's capital structure; and
- adequately inform Firestone shareholders of their exposure to the Waterberg coal project, given the contemplated capital structure of Waterberg.

The Panel made orders that Waterberg dispatch a supplementary bidder's statement in a form approved by the Panel, provide Firestone shareholders who have accepted the offer with a withdrawal right and extend its offer until at least 7 days after the conclusion of the withdrawal right.

The Panel stated that it will refer the matter of the ownership and control of certain of the Haworth trust beneficiaries to ASIC for investigation.

Further information is available on the Takeovers Panel's website.

4.2 Touch Holdings Limited - Declaration of unacceptable circumstances

On 6 May 2013, the Takeovers Panel announced that it had made a declaration of unacceptable circumstances in relation to an application made on 5 April 2013 by Mr Philip Course in relation to the affairs of Touch Holdings Limited.

Touch Holdings Limited is an unlisted public company with more than 50 members. In November 2012, Sabatica Pty Ltd entered an agreement to sell its entire shareholding in Touch (56.04%) to Cleevecorp Pty Ltd as trustee of The Cleeve Trust (8.02%), ATC Capital Pty Ltd (20.00%), Mr Allan Sullivan (8.02%) and Kekal Capital Ltd Co (20.00%).

Mr Philip Course, a shareholder in Touch, applied to the Panel for a declaration and made submissions that:

- Mr Adrian Cleeve, ATC and Cleevecorp are associated;
- Mr Sullivan, Mr Jonathan Teck-Cheng Chi, Kekal, Mr Duncan Saville and Touch Network Investments Pty Ltd are associated; and
- there have been acquisitions of shares in Touch in breach of s. 606.

The Panel declared that:

- Mr Cleeve, ATC and Cleevecorp are associated:
  - under s. 12(2)(b) for the purpose of controlling or influencing the conduct of Touch's affairs; and
  - under s. 12(2)(c) in relation to the affairs of Touch;
- the share sale agreement is a relevant agreement for the purpose of controlling or influencing the conduct of Touch's affairs and controlling or influencing the composition of its board and by reason of the share sale agreement:
  - Cleevecorp, ATC, Mr Sullivan and Kekal are associated in relation to Touch; and
  - Sabatica is associated with each of Cleevecorp, ATC, Mr Sullivan and Kekal in relation to Touch; and
- the voting power of Cleevecorp, ATC, Mr Sullivan and Kekal in Touch has increased from 20% or below to more than 20% other than through one of the exceptions in s. 611.

The Panel (by 2:1 decision) was not satisfied that there is an association in relation to Touch between Mr Saville (Touch Network), Cleevecorp, ATC, Mr Sullivan and Kekal.

Further information is available on the Takeovers Panel's website.

5. Recent Research Papers

5.1 The separation of investments and management

This paper suggests a basic shift in the way we think about investment funds. The essence of these funds and their regulation lies not just in the nature of their investments, as is widely supposed, but also and more importantly in the nature of their organisation. All types of investment funds - including hedge funds, private equity funds, venture capital funds, mutual funds, exchange-traded funds and closed-end funds - adopt a structure that the author terms "the separation of investments and management". Investment enterprises place all of their investment assets into a "fund" with one set of owners, and all of their managers, workers and operational assets into a "management company" or "adviser" with a different set of owners. Investment funds also radically limit investors' control, sometimes eliminating voting rights and boards of directors entirely.

This pattern of organisation has never been clearly explained or identified as a common feature of investment funds, but it has often worried and confused commentators and was recently the subject of a case in the US Supreme Court. The paper explains this pattern by showing how it limits fund investors' control over their managers and exposure to their managers' profits and liabilities. Investors benefit from these limits for a combination of reasons having to do with exit rights, risk management and the economies of scale that managers can achieve by operating multiple funds. This pattern of organisation is a large part of what defines investment funds and animates their regulation.

The paper is available on the SSRN website.

5.2 Lawyers in the shadows: The transactional lawyer in a world of shadow banking

This article examines the role of transactional lawyers in a world of shadow banking. By reducing the dominance of banks as financial intermediaries, shadow banking has transformed the financial system, causing transactional lawyers to face an array of novel issues. The article focuses on one of those issues: to what extent should transactional lawyers address the potential systemic consequences of their client's actions? First, the article shows that the legal system itself inadvertently enables or requires firms operating as shadow banks to engage in uniquely risky behaviour, without protecting against the resulting systemically risky externalities. That finding, in turn, broadens the legal ethics inquiry to two issues: what duty should transactional lawyers have to try to improve the legal system to protect against those externalities, and what duty should transactional lawyers have to try to prevent those externalities, assuming the legal system is not improved.

The paper is available on the SSRN website.

5.3 Evolving directors' duties in the common law world

Legal scholars have long discussed the gap, or "acoustic separation", between stringent standards of conduct (conduct rules) and more lenient standards of review (decision rules) in legal regulation. This gap has been particularly stark in the United States in relation to directors' duty of care.

The paper explores a range of developments relating to directors' duties across several common law jurisdictions, including the US, UK Australia and Canada against the backdrop of conduct and decision rules. For example, contemporary Australian case law on the duty of care and diligence, although highlighting the ongoing tension between conduct rules and decision rules, diverges from US law in many key respects. Also, under Australia's regulatory model, the Australian Securities and Investments Commission, the primary corporate regulator, operates as the main enforcement mechanism for breach of directors' duties. Finally, the paper assesses some recent developments in the common law world on the perennial issue of to whom directors owe their duties, and the extent to which stakeholder interests can, or must, be taken into account in board decision-making.

The paper is available on the SSRN website.

5.4 Governing financial markets: Regulating conflicts

Payment, clearing, and settlement systems constitute a central component in the infrastructure of financial markets. These businesses provide channels for executing the largest and smallest commercial transactions in local, national, and international financial markets. Notwithstanding this significant role, there is a dearth of legal scholarship exploring central clearing counterparties (CCPs) and their contributions to the regulation of financial markets. To address this gap in the literature, this article sketches the contours of the theory that frames regulation within financial institutions and across financial markets, examines the merits of implementing CCPs, and explores the role of CCPs as primary regulators within financial markets. Applying these theoretical constructs to a practical issue, the article analyses Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the statute's introduction of mandatory clearing requirements in the over-the-counter (OTC) derivatives market.

The paper is available on the SSRN website.

6. Recent Corporate Law Decisions

6.1 High Court confirms power to make invalid actions contravening a company's constitution "not invalid"

(By Amit Chowdhury and Marissa Bendyk, King & Wood Mallesons)

Weinstock v Beck [2013] HCA 14, High Court of Australia, French CJ, Hayne, Crennan, Kiefel and Gageler JJ, 1 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/HCA/2013/14.html

(a) Summary

This case considered whether an invalid action in contravention of a company's constitution can be held to be "not invalid" under s. 1322(4)(a) of the Corporations Act 2001 (Cth) (the Act). The High Court held that the remedial purpose of the section should be applied liberally and that limitations will not be imposed on applications of the section which are clearly not contemplated or not found in the express words.

Further, the Court considered the meaning of a 'contravention' of a corporation's constitution. This was relevant in the circumstances as a 'contravention' is required to invoke a remedy pursuant to s. 1332(4)(a). In this respect the Court found this to simply be that something has happened that is different to what the constitution of the corporation requires.

(b) Facts

LW Furniture Consolidated (Aust) Pty Ltd (LWC), an Australian company, was incorporated on 30 April 1971. The founding directors were Leo Weinstock and Hedy Weinstock, the parents of the Appellant and Respondent. On 29 June 1973, Mr A D Weinstock (Amiram) and Mrs Beck (Tamar) were appointed as additional directors of the company to hold office until the next annual general meeting of the company. At subsequent meetings, resolutions were passed resolving to reappoint directors retiring in accordance with the provisions of the company's articles of association. It is now accepted that none of those resolutions had the effect of appointing either Amiram or Tamar as a director because the shareholders voting on the resolution held shares which conferred no right to vote. The resolutions were therefore ineffective and neither Amiram nor Tamar had been validly appointed as a director. However, during the relevant period, both had acted as if validly appointed as a director, that is, a *de facto* director, until Tamar gave notice of her resignation from office in 1982. Amiram continued to act as a director of the company.

In 2003, Amiram was the only remaining director of LWC. LWC's articles require a quorum of two directors at directors' meetings unless otherwise fixed by the directors. The articles provide that if the number of directors is reduced below the number fixed, the continuing directors or director may act to increase the number of directors to that number. Amiram used this power to appoint his wife Mrs H Weinstock (Helen) as a director to bring the number to two.

Following Helen's appointment, Tamar sought orders for winding up of the company on the basis that it was just and equitable to do so because it had no directors and no means of validly appointing directors.

The Supreme Court of New South Wales made an order under s. 1322(4)(a) of the Act validating Helen's appointment as director and disposing of the winding-up application as Helen, as a valid director, could return LWC to a functioning corporation. On appeal, the New South Wales Court of Appeal reversed the decision and held in favour of Tamar. Amiram was granted special leave to appeal to the High Court challenging the Court of Appeal's decision that Helen had not been validly appointed.

(c) Decision

The key issue before the High Court was whether Helen's appointment, otherwise than in accordance with LWC's articles, could be declared as not invalid pursuant to s. 1322(4)(a) of the Act. In particular whether the appointment of Helen was a "contravention" of LWC's constitution for the purposes of triggering remedial action under s. 1322(4)(a). The facts relating to the purported appointment of Helen by Amiram, who himself had not been validly appointed, were not in dispute.

French CJ delivered a separate judgment, with Gageler J agreeing with the joint judgment of Hayne, Crennan and Kiefel JJ. All of the judges agreed that the appeal should be allowed and agreed with the orders proposed in the joint judgment.

(i) Operation of s 1322(4)(a)

Section 1322(4)(a) appears in Part 9.5 of the Act, which is entitled "Powers of Courts". Section 1322(4)(a) gives a court the power to make an order declaring that any act, matter or thing purporting to have been done under the Act or in relation to a corporation is not invalid by reason of any contravention of a provision of the Act or a provision of the constitution of a corporation. A Court may only make an order under s. 1322(4)(a) if satisfied a requirement under s. 1322(6)(a) has been met and that no substantial injustice has been or is likely to be caused to any person.

French CJ analysed the historical development and application of s. 1322(4)(a). In concurring with French CJ, the other Justices concluded that s. 1322(4)(a) is to be applied 'with all the liberality that its language permits'.

(ii) The concept of "contravention"

The effect of a declaration under s. 1322(4)(a) is limited to overcoming invalidity arising from a contravention. The respondent's key argument was that such a declaration could not be made in this case, as a contravention of the constitution had not occurred. The respondents sought to distinguish between what cannot be done at all under the Act or under the constitution of a company and what can be done but has not been done validly. The respondents argued that the actions of Amiram fell into the former category. Amiram had no power to appoint Helen as a director because he was not a director and could not be appointed to the office of director. On this argument, the appointment of Helen was not made in contravention of the articles of the company as the appointment was made outside any mechanism contemplated by LWC's articles.

This argument was unanimously rejected. French CJ stated that such an approach "would require finegrained analysis quite at odds with the remedial and practical purpose of the provision" and was also "at odds with the legislative history". Hayne, Crennan and Kiefel JJ held that the distinction is of no consequence as in both cases the action would be invalid. The distinction cannot be drawn when the very premise for the application of s. 1322(4)(a) is that what has been done is invalid.

The Court favoured the approach of the minority judgment of Campbell JA in the Court of Appeal. Campbell JA stated that all that is required for there to be a contravention of the constitution is "that something ha[d] happened that is different to what the constitution of the corporation requires". Hayne, Crennan and Kiefel JJ explained why a contravention had occurred in this case:

"Mr A D Weinstock purported to appoint Mrs Helen Weinstock as a director. That appointment was not made by a continuing director for the purpose of increasing the number of directors to the number fixed as the quorum for a meeting of directors. It was, therefore, not made in accordance with the requirements of the company's articles. Because the appointment was not made in accordance with those requirements, it was made in contravention of the company's constitution".

The Court unanimously ruled in favour of the Appellants and remitted the case to the Equity Division of the Supreme Court of New South Wales to determine whether an order under s. 1322(4)(a) should be made.

(d) Implications of broad application of s. 1322(4)(a)

The High Court's liberal application of s. 1322(4)(a) raises a concern regarding what limits exist in respect of this provision. French CJ briefly addressed this issue by stating that "[i]t is not appropriate to torture a limit out of the language of s. 1322(4)(a)" against extreme cases which may arise. French CJ stated that extreme cases 'are amply covered by the discretionary nature of the power and the constraints upon its exercise by s. 1322(6)'. Section 1322(6)(a) in particular requires the Court to be satisfied of at least one of the listed considerations before making an order under s. 1322(4)(a).

These considerations are whether:

- the act, matter or thing or the proceeding is of a procedural nature;
- the persons party to the contravention acted honestly; or
- it is just and equitable that the order be made.

In addition s. 1322(6)(c) requires that no substantial injustice has been or is likely to be caused to any person.

Therefore, despite the liberal approach taken in this case, a Court's discretion and consideration of matters in s. 1322(6) will ensure that extreme cases are dealt with appropriately.

6.2 Can a company issue preference shares without ever issuing ordinary shares?

(By Hael Musa and Kate Johnson, King &Wood Mallesons)

Beck v Weinstock [2013] HCA 15, High Court of Australia, French CJ, Hayne, Crennan, Kiefel and Gageler JJ, 1 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/HCA/2013/15.html

(a) Summary

This case considers whether the class C shares in LW Furniture Consolidated (Aust) Pty Limited (LWC) were redeemable preference shares for the purposes of the Corporations Act 2001 (Cth) (the Act).

The High Court considered whether the class C shares were redeemable preference shares, in circumstances where there were no ordinary shares on issue in LWC over which the class C shares could take preference. The issue for the High Court was whether preference shares could be issued in the absence of ordinary shares in the company.

Tamar (the Appellant) argued that the class C shares could not be considered preference shares unless the company had ordinary shares on issue. The Appellant submitted that the right to redeem preference shares in the absence of issued ordinary shares would offend the maintenance of capital doctrine. Therefore, the Appellant argued that, by implication, the class C shares were not redeemable preference shares for the purposes of the Act.

The High Court dismissed the appeal and held that the class C shares were preference shares and could be redeemed. Ultimately, the High Court noted that there was nothing in the Act that prevented a company from issuing a preference share in the absence of issued ordinary shares.

(b) Facts

LWC was incorporated in 1971. LWC's articles of association provided for several different classes of shares including class C shares. In 1971, eight class C shares were issued to Mrs Hedy Weinstock (Mrs Weinstock). The company issued other preference shares having the same rights as the class C shares, but never issued any ordinary shares.

Mrs Weinstock died in 2004 and, after her death, LWC sought to redeem the class C shares for one dollar each. As executor of the estate of Mrs Weinstock, Tamar claimed that the class C shares were not redeemable because they were not preference shares.

In 2007, Tamar commenced proceedings in the Supreme Court of New South Wales seeking a declaration that the redemption of the class C shares was void and of no effect. Hamilton AJ at first instance agreed and held that the class C shares were not validly issued as preference shares because there were no other shares on issue over which they had preference.

On appeal, the majority set aside the orders made by Hamilton AJ, and substituted a declaration that the eight class C shares held by Mrs Weinstock were redeemable preferences shares which were validly redeemed by the Company.

The Appellant argued, on appeal to the High Court, that the Court of Appeal erred in holding that the class C shares in LWC were redeemable preference shares for the purposes of the Act.

(c) Decision

The High Court unanimously dismissed the appeal. French CJ delivered a separate judgment, as did Gageler J. A joint judgment was delivered by Hayne, Crennan and Kiefel JJ.

(i) Historical purpose of preference shares (French CJ)

The Appellant submitted that historically the purpose of preference shares was to increase capital for a company. In particular, it was submitted that implicit in this purpose was that the company had already issued ordinary shares representing ordinary capital of the company.

French CJ stated that the Appellants' argument was an "unduly narrow view of the legitimate purpose for which preference shares can be used". French CJ noted that preference shares were historically used as a "device for emergency finance" directed at raising additional capital for companies. However, over time preference shares were put to wider use including the retirement of debt. Furthermore s. 254A(2) of the Act provides that a company can issue preference shares provided the rights attached to the preference shares in relation to specified matters are set out in the company's constitution or have been approved by special resolution, with the specified matters including:

- repayment of capital;
- voting;
- participation in the surplus assets and profits; and
- cumulative and non-cumulative dividends.

As a result, French CJ held that, considering the variety of purposes for which preference shares could be used, the Appellant's argument could not be accepted.

(ii) Authority to issue preference shares (Hayne, Crennan and Kiefel JJ)

Hayne, Crennan and Kiefel JJ held that there was nothing in the Act that suggested a preference share could not be issued in the absence of issued ordinary shares.

Their Honours held that a company's constitution is to be used to determine whether preference shares can be issued. The existence of preference shares is not dependent on the state of the issued capital of a company at any time. At the time of issue, LWC's articles of association described the preferential rights attaching to those class C shares which included preferential treatment in respect of dividends and voting rights. As a result, not only was the issue of preference shares authorised by LWC's articles of association, but it specifically contemplated preferential rights attaching to class C shares. This was sufficient for the class C shares to be described as preference shares.

The Appellant argued that in classifying a share as a preference share, regard should be had to the capital already held by the company, or there is otherwise a risk that the company could be left without members. The Appellant referred to the example where a company had only redeemable preference shares on issue where all of those shares are redeemed.

Their Honours accepted that this scenario was theoretically possible, however under s. 461(1)(d) of the Act such circumstances may be grounds for winding up of a company. Accordingly, they held, the Act adequately addresses this scenario.

(iii) Maintenance of capital (Gageler J)

Gageler J focused on the text of the Act to determine whether the class C shares in LWC were redeemable preference shares. Ultimately, he rejected the Appellant's argument because there was nothing in the text or the policy of the Act that prevented preference shares from being issued in the absence of issued ordinary shares in the company.

Gageler J held that for a preference share to be issued it is sufficient that the company's constitution provides for preferential rights attaching to shares that are consistent with those listed in s. 254A(2)(a) of the Act. In this case, the class C shares contained the preferential rights with respect to:

- dividends;
- voting; and
- participation in profits.

As such, Gageler J considered that this was sufficient for the class C shares to be classified as redeemable preference shares.

Gageler J also considered the Appellant's argument that the redemption of class C shares would lead to a reduction of capital. He noted that this argument paid little regard to s. 254J(1) of the Act, which provides that a preference share can only be redeemed out of the profits of the company or the proceeds of a new issue made for the purpose of the redemption. Provided that LWC satisfies this provision, the net capital of the company could not be reduced. His Honour therefore held that the Appellant failed to demonstrate that the class C shares in LWC were not preference shares capable of redemption under s. 254J(1) of the Act.

6.3 Trustee enforcing right to indemnity under a trust

(By Rebecca Ebzery, Minter Ellison)

Alphena Pty Limited (in liq) v PS Securities Pty Ltd as Trustee of the Joseph Family Trust [2013] NSWSC 447, Supreme Court of New South Wales, Kunc J, 29 April 2013.

The full text of this judgment is available at:

http://www.caselaw.nsw.gov.au/action/PJUDG?jgmtid=164410

(a) Summary

This case examined the point at which a trustee ceases to be able to enforce their right to indemnity under the trust, including the extent to which they are able to claim indemnity for performing services referable to the role of trustee, even after ceasing to be trustee. It also considered whether a former trustee should be indemnified for costs incurred for defending an action commenced as a result of their former position, and whether this can be classed as an action to preserve a right to indemnity under the trust.

(b) Facts

The action was commenced by Alphena Pty Limited (in liq) (Plaintiff) against PS Securities Pty Ltd (Defendant) seeking an adjustment of the scale of remuneration as liquidator for services done in the role of trustee of the Joseph Family Trust (the Trust) and a declaration that costs incurred during litigation against Helena Hu (the Hu Proceedings) were necessarily incurred pursuant to the Plaintiff's right to indemnity as former trustee (the Legal Costs Issue).

The Defendant countered that the Plaintiff should not be entitled to a trustee's right to indemnity, arguing the fees should be calculated pursuant to the ordinary scale of a liquidator's remuneration, and that costs accrued in the Hu Proceedings should therefore be met by the company as they were incurred in the ordinary administration of the company's winding up.

The Trust was established on 31 January 1995. The Deed of Settlement provided that the position of trustee should be vacated if the trustee were to enter into either compulsory or voluntary liquidation. On 20 November 2009, action was commenced by an outside party, Ms Hu, and subsequently judgment was awarded against the Plaintiff, including costs on an indemnity basis. On 9 December 2009 the Defendant was appointed as co-trustee of the Trust in anticipation that the Plaintiff would soon become insolvent as a result of the judgment debt.

As a result of a statutory demand made by Hu, the Plaintiff entered into a members' voluntary winding up, with liquidators appointed on 5 January 2010. The Plaintiff ceased to be a trustee and the Defendant continued on as sole trustee. Hu then sought leave to bring proceedings against the Defendant on behalf of the Plaintiff to enforce a right of indemnification from the Trust assets for the judgment debt incurred by the Plaintiff, which was later dismissed.

(c) Decision

The Plaintiff submitted that its right of indemnity should extend to the liability to remunerate its liquidator to the extent that work was done in connection with the administration of the Trust. It argued that, although it ceased to be a trustee, it remained a bare trustee at common law, and was entitled to be reimbursed for expenses incurred during the course of that role.

Kunc J disagreed, noting that the approach confused the position of the trustee and its liquidator, effectively merging them for the purposes of the scale assessment. While work done in a capacity as liquidator may relate to the Trust, and therefore has the right to be indemnified, it should not naturally follow that the rate of remuneration be assessed on a higher basis. Kunc J also disagreed with the Defendant's notion that the indemnity should not extend to costs incurred by the Plaintiff pursuing the right to indemnity, and allowed costs of and incidental to the enforcement of the right to be incorporated.

When considering readjusting the rate of remuneration, Kunc J again referred to case law which noted that, provided a liquidator is acting reasonably, its entitlements should be assessed using the scale applied by the Registrar in assessing an Official Liquidator's remuneration under s. 473 of the Corporations Act 2001 (Cth). This incorporated costs and disbursements of the liquidator of the Plaintiff which were reasonable, subject to further argument by the parties as to the form of the orders.

In respect of the Legal Costs Issue, Kunc J emphasised that the reason Hu was denied leave to proceed was because the Plaintiff's liquidators gave an undertaking that they were prepared to initiate proceedings (Current Proceedings) to recover Trust assets, from which debts owing (namely the judgment debt) could be paid.

The Defendant submitted that the costs should not be included under the Plaintiff's right to indemnity due to the following:

- the beneficiaries of the Trust should not be forced to pay for costs incurred for the Plaintiff's defence in the Hu Proceedings, as it was not a necessary step in pursuing the indemnity, but rather a fight between two parties who could have claimed the costs as liquidator for the Plaintiff;
- the Hu Proceedings stated that the costs were to be recouped out of assets of the Plaintiff realised in the ordinary course of winding up; and
- the liquidator should not have the costs out of the Trust assets because it was their own delay in bringing the Current Proceedings that necessitated the Hu Proceedings.

Kunc J disagreed, siding with the Plaintiff's submissions that the liquidator incurred the legal costs on behalf of the Plaintiff in defending the Hu Proceedings, effectively in order to preserve the Plaintiff's right to indemnity out of the Trust assets. The judge in the Hu Proceedings did not make a finding of delay against the liquidator, and so Kunc J was unwilling to exercise any discretion that would find as such.

The following conclusions were reached:

- the legal costs included were only to be those that the liquidator was unable to recover from Hu;
- insofar as the legal costs fell within the indemnity, a declaration was made by Kunc J that the Defendant was liable to indemnify the Plaintiff in relation to them, with the Defendant becoming a third party payer;
- the scale on which the costs were to be assessed was on an ordinary basis; and
- a declaration was made that the Plaintiff secured a lien over the Trust assets to protect their indemnity.

6.4 A statutory oppression action survives the hiatus between a shareholder's cessation and subsequent reregistration of its shareholding in a company

(By Thomas G A Fearis, Ashurst Australia)

Trafalgar West Investments Pty Ltd as Trustee for the Trafalgar West Investments Trust v Superior Lawns Australia Pty Ltd (No 2) [2013] WASC 143, Supreme Court of Western Australia, Martin J, 29 April 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/wa/WASC/2013/143.html

(a) Summary

The Supreme Court of Western Australia has held that a shareholder's statutory oppression action under s. 234 of the Corporations Act 2001 (Cth) (the Act) survives the hiatus between a shareholder's temporary cessation and subsequent re-registration of shareholding in a company.

(b) Facts

Trafalgar West Investments Pty Ltd (Trafalgar) was a minority shareholder in Superior Lawns Australia Pty Ltd (Superior Lawns). On 24 March 2011, Trafalgar commenced a statutory oppression action in its capacity as a registered minority shareholder of Superior Lawns. Also in 2011, Trafalgar voluntarily transferred its shares to Trafalgar's sole director, Mr Patrick Jebb (Mr Jebb). Mr Jebb subsequently sought to retransfer those same shares in Superior Lawns back to Trafalgar. Superior Lawns applied to have Trafalgar's statutory oppression action dismissed on the basis that it was bound to fail and therefore wholly futile to pursue any further.

(c) Decision

The Supreme Court dismissed Superior Lawns' futility application. Justice Martin held that there was no convincing basis shown to dismiss Trafalgar's statutory oppression action, thereby forcing Trafalgar to commence fresh proceedings in pursuit of relief against oppression. Such a course was likely to have forensic disadvantages for Trafalgar in terms of limitation of action considerations as well as affecting the overall discretion of the Court to grant relief. The Court held that Trafalgar's statutory oppression action under s. 234 of the Act survived the hiatus between its cessation and subsequent re-registration of membership in Superior Lawns.

(i) The legislation

Section 233 of the Act deals with the kinds of orders that a court can make if oppression is established. s. 234 of the Act deals with standing to make an application for an order under s 233.

(ii) Existing case law

Justice Martin commented that there was no prior case dealing directly with the futility argument advanced by Superior Lawns. *Re Spargos Mining NL* (1990) 3 WAR 166 was of some peripheral assistance, but only to the extent that it emphasised the criterion of membership in the company against which relief was sought, at the time the relevant application was brought by the member and, in respect of the plaintiff in that case, the relevance of his continuing membership in the corporation up to the point of trial and judgment.

(iii) Viability of a statutory oppression action

Based on the Court's reasoning, a shareholder's statutory oppression action is viable even when there is a hiatus between a shareholder's cessation and subsequent reregistration of shareholding in a company.

6.5 England and Wales Court of Appeal upholds consent solicitation for votes

(By Will Barker, Ashurst Australia)

Azevedo v Imcopa Importacao, Exportacaoe Industria De Oleos Ltda [2013] EWCA Civ 364, England and Wales Court of Appeal (Civil Division), Lloyd, Aikens and Beatson LJJ, 22 April 2013

The full text of this judgment is available at:

http://www.bailii.org/ew/cases/EWCA/Civ/2013/364.html

(a) Summary

The England and Wales Court of Appeal has upheld the practice of consent solicitation. It has held that a company is permitted to solicit and procure votes in support of a financial restructuring proposal by offering and making cash payments to those members of the relevant class who vote in favour of the proposal but excluding from the payment those who vote against it or do not vote on the resolution at all.

(b) Facts

The Appellants were the holder of notes issued and guaranteed by the Respondents. The notes were governed by a trust deed. In October 2010, the Respondents proposed a resolution to restructure their obligations under the notes by postponing a payment of interest. The trust deed provided that postponement of the date on which interest was payable was subject to a special quorum (75% of holders eligible to vote must attend the meeting) and an extraordinary resolution (75% of those attending must vote in favour of the resolution). The notice of meeting for the resolution explained that a payment would be made to those voting in favour of the resolution but would not be made to other noteholders (the process being a "consent solicitation", the payment being a "consent payment"). The resolution was passed by an overwhelming majority but the Appellants were not among those voting in its favour, despite having voted in favour of earlier similar resolutions.

The Appellants brought an action arguing that the making of consent payments only to those voting in favour was unlawful, either because it was a breach of the *pari passu* principle or because, although not secret, it was in the nature of a bribe and as such not permitted under English company law. The Appellants were unsuccessful at first instance and appealed.

(c) Decision

The Court of Appeal (Civil Division) unanimously dismissed the appeal by judgment of Lloyd LJ on behalf of the majority

(i) Breach of pari passu principle

The rule requiring pari passu (literally "on equal footing") treatment of all members of a class is a basic principle of insolvency law in England, whether as regards companies or individuals. The case was not concerned with insolvency law, however the principle was invoked by reference to certain terms of the trust deed which provided that money passing through the hands of the trustee had to be distributed pari passu. Lloyd LJ affirmed the finding at first instance that the consent payments made to the noteholders did not pass to the noteholders via the hands of the trustee, therefore the argument that the relevant funds had to be applied pari passu as between all the noteholders did not arise.

(ii) Unlawfulness of consent solicitation under English company law

Lloyd LJ rejected the Appellant's contention that the consent payments were akin to a bribe as the details of the scheme were fully disclosed to all noteholders. His Honour held that there was nothing wrong or unlawful, in general terms, with a company putting to all members of a class a proposal which offers benefits open to all who vote in favour of the resolution, but not to others. No member of the class is thereby excluded from participation in the offered benefits except by his or her own choice as to whether, and if so how, to vote. If a vote is cast in the way which the company has proposed and asked for, and has encouraged noteholders to think would be in their best interest as well as in those of the company, that is not the "sale" of a vote even if the company has offered an incentive to fortify the encouragement. Lloyd LJ therefore upheld the first instance decision and rejected the appeal.

It is important to note that the Appellant's case did not include any allegation of oppressiveness, unfairness or bad faith in relation to the solicitation or any other aspect of the process which led to the passing of the resolution.

6.6 Enforcing foreign arbitral awards made in China against Australian companies in liquidation

(By Rebecca Ebzery, Minter Ellison)

Eopply New Energy Technology Co Ltd v EP Solar Pty Ltd [2013] FCA 356, Federal Court of Australia, Foster J, 19 April 2013

The full text of this judgment is available at:

http://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/single/2013/2013fca0356

(a) Summary

This case considers whether a foreign arbitral award made in China can be enforced against an Australian corporation currently in liquidation.

(b) Facts

The application, commenced on 28 March 2013, was made by Eopply New Energy Technology Co Ltd (the Applicant) against EP Solar Pty Ltd (the Respondent), seeking to be granted leave to enforce an arbitral award made against the respondent by the China International Economic and

Trade Arbitration Commission (CIETAC). The original arbitration, made on 12 February 2012, concerned payment of the purchase price under supply agreements for the provision of solar modules by the Applicant to the Respondent.

On 5 April 2013, the sole shareholder for the Respondent passed a resolution to enter into a voluntary liquidation, with liquidators appointed for the purposes of winding up the company. Section 500(2) of the Corporations Act 2001 (Cth) (the Act) provides that no action or civil proceedings may be commenced against a company in liquidation without leave of the Court, and so the Applicant duly sought, with leave, to have the arbitration amount declared a provable debt with the leave of the Court. The Applicant also sought to rely on the operation of the International Arbitration Act 1974 (Cth) (the IAA), which allows for foreign awards to become enforceable by Australian Courts unless a contrary intention of the parties appears.

(c) Decision

Foster J found in favour of the Applicant, stating that he did not oppose leave being granted to proceed with the claim pursuant to s. 500(2) of the Act. Foster J further granted leave to the Applicant under the IAA, allowing the foreign award to operate as if it were a judgment of the Federal Court, thus enabling the company to rank the award as a provable debt in the liquidation.

The liquidators of the Respondent advised that they did not oppose leave to proceed being granted under the Act. However the Court was required to first determine whether the proceedings would cause unnecessary expense for the Respondent. Section 500(2) allows for the barring of claims against insolvent companies to prevent an adverse impact on funds which should be kept available for creditors of the company. The Respondent did not submit a declaration of solvency, and so the Court was required to consider whether the balance of convenience lay in allowing the Applicant to proceed.

Considerations supporting the granting of leave included:

- no additional expense or inconvenience would be incurred by the Respondent;
- if leave were granted, judgment would be entered immediately;
- the Applicant would be able to circumvent the usual "proof of debt" process undertaken in the path to recovery of a foreign award, and it was arguably appropriate to allow the judgment to be entered without requiring further steps to be taken to give effect to the award; and
- there was no opposition to leave being granted.

Foster J consequently held that, based on the above, there was no issue which would weigh in the balance against granting leave.

The final issue was whether the initial arbitration decision handed down by CIETAC was an arbitral award within the definition contained in the IAA. When examining the award, it was noted that the decision of the Arbitral Tribunal was final and effective from the date it was made, and consequently there was no doubt that it came within the meaning under the IAA. Foster J was satisfied that the Applicant had established its entitlement to have the award enforced, however he gave further consideration with respect to the quantum.

The initial award clearly outlined that the Applicant was responsible for the payment of 20% of the arbitration fee, due to part of the Applicant's initial claim being rejected by the arbitrators. Foster J incorporated this into the final judgment award and proportioned the amount accordingly.

6.7 When will a court order an inquiry into the conduct of receivers and managers?

(By David Miller, DLA Piper Australia)

Oswal, in the matter of Burrup Fertilisers Pty Ltd (Receivers and Managers Appointed) v Carson, McEvoy and Theobald (Receivers and Managers) (No 3) [2013] FCA 357, Federal Court of Australia, Siopis J, 19 April 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/357.html

(a) Summary

In this decision the Federal Court maintained a relatively high threshold for exercising its discretion to grant an inquiry into the conduct of receivers and managers. In this regard, decisions including entering into new agreements on less favourable terms, failure to pay down secured debt and general complaints about fees were seen in the light of commercial reality and found to be insufficient bases for an inquiry.

(b) Facts

This case is one of many proceedings filed by the plaintiff, Mr Oswal, in relation to the receivership of his company Burrup Fertilisers Pty Ltd. In this proceeding the plaintiff sought relief under s. 423 of the Corporations Act 2001 (Cth) in respect of the conduct of the defendants, which were receivers and managers of his company. Under this provision, the plaintiff claimed that the Court should order that there be an inquiry as to whether the defendants had failed to carry out their duties or observe a requirement of the section in the following respects:

- retaining in the company large amounts of cash and not using such cash to liquidate the company's indebtedness to the secured creditor;
- using documents of the company for the purpose of marketing the sale of shares held by the plaintiff;
- disclosing to third parties documents in respect of which the company owed contractual and equitable duties of confidentiality;
- causing the company to enter into a new gas supply agreement on substantially less favourable terms than the previous agreement;
- arranging for themselves to continue, after their proposed resignation as receivers and managers of the company, to have the right to commence or to continue proceedings in the name of the company not for the purpose of enforcing the security, but for the purpose of facilitating the sale of shares which the plaintiff held in the company;
- procuring for themselves, as part of the share sale agreements, a covenant from each of the purchasers, that each would use all reasonable endeavours to procure that the company would not make any claim against them in relation to their conduct as receivers and managers of the company; and
- charging fees which were excessive and incurring disbursements which were unnecessary or excessive.

(c) Decision

(i) The law

In considering the plaintiff's application, the court undertook detailed consideration of the case law discussing s. 423 and comparable provisions.

In summary, the court held that:

- the barrier over which plaintiffs should be made to pass to have an inquiry mounted should not be a very high one and that all that was necessary to show was that there was a prima facie case that something needed to be investigated;
- prima facie case here is not as formal as in other contexts and means simply that an applicant must show a sufficient basis for making an order, that there is something which requires inquiry;
- the court then has a discretion which it must exercise;
- many factors will be relevant to that exercise. They include the strength and nature of the allegations, any answers offered by the liquidator, other available remedies, the stage to which the liquidation has progressed, the likely amounts of money involved, the availability of funds to pay for any inquiry, the likely benefit to be derived from it and the legitimate "interest" of the applicant in the outcome;

- the process of determining whether to inquire into the conduct of a receiver and manager involved two stages. First, whether the complainant had established a prima facie case that there was something which required inquiry. Secondly, if the complainant did establish an initial case, as a first step, then whether the court in its discretion should order an inquiry;
- however, it is clear that there are limits on the circumstances in which it will be appropriate for a court to order an inquiry under s. 423. Otherwise this provision would have the propensity to undermine ordinary litigation processes.

The court then considered each of the plaintiff's allegations in turn concluding on balance that all but one did not constitute a sufficient basis for inquiry. The court presented its judgment under the following headings.

(ii) The failure by the defendants to pay the secured debt

The plaintiff complained that during their appointment as receivers and managers of the company the defendants held large amounts of cash and did not use the cash to liquidate the company's indebtedness to the secured creditor. In this respect, the defendants were said to have failed to act for a proper purpose and so breached their duties at law and under the instruments pursuant to which they were appointed. The court found this to be an insufficient basis for inquiry, namely because it was merely a matter of commercial judgment.

(iii) Use of confidential documents

The plaintiff complained the defendants disclosed information which was confidential to the company and in respect of which it owed obligations of confidentiality to a number of third parties. Further, the plaintiff complained that the disclosure of the documents to third parties was made for the purpose of selling the plaintiff's and his wife's shares, a purpose foreign to the interests of the company or the enforcement of the security. The court found this to be an insufficient basis for inquiry, namely because the complaint raises matters of legal and factual complexity which, applying the approach of courts in previous decisions, renders it inappropriate to order an inquiry under s. 423.

(iv) Entering into a new supply contract on less favourable terms

The plaintiff complained the defendants failed to carry out their duties as receivers and managers of the company because they had entered into a new supply contract on terms which were substantially less favourable than those in the previous instrument. The court found this to be an insufficient basis for inquiry, namely because the nature of the complaint is not of such a character as would be liable to attract disciplinary sanctions. In other words, the complaint seeks to impugn a decision which was made by the defendants in the exercise of their commercial judgment in relation to the business of the company.

(v) Retaining the right to conduct proceedings in the name of the company

The plaintiff complained that in negotiating the share sale agreements the defendants sought to retain rights to continue or commence proceedings in the name of the company not for the purpose of enforcing the security, but for the purpose of facilitating the sale of the shares which the plaintiff and his wife held in the company. The court found this to be an insufficient basis for inquiry, namely because the court lacks jurisdiction in this area. In negotiating and concluding the share sale agreements the defendants were acting in their capacity as receivers and managers of the couple's shares.

(vi) Procuring that the company not make any claim against the defendants

The plaintiff complained that the defendants, whilst acting in their capacity as receivers of the shares held by the plaintiff and his wife, procured for themselves the benefit of a covenant in each of the share sale agreements that each purchaser would use all reasonable endeavours to procure that the company would not make any claim against them in respect of their conduct of the receivership. The court declined to rule on this complaint as it is the subject of Victorian proceedings.

(vii) Fees charged

The plaintiff complained that the defendants' fees were excessive. The court held that there may be cases where the circumstances are such that even without the benefit of expert evidence, a court may come to the view that an inquiry is warranted on the basis that fees charged appear to be excessive. However, this was not the case here. The court declined to order an inquiry into the general level of fees, but did however grant an inquiry into fees charged for the last six weeks of receivership. This is because the fees and expenses charged in the last six weeks of the receivership were very high in relation to the rest of the period of the receivership, particularly having regard to the very high volume of work undertaken during the initial period of the receivership.

6.8 Disqualification clauses, trust deeds and court directions: Liquidators of a corporate trustee excused from potential liability for the sale of property in breach of trust

(By John O'Grady and Simon G Frauenfelder, Corrs Chambers Westgarth)

Pleash, In the matter of Suncoast Restoration Pty Ltd (in liq) [2013] FCA 355, Federal Court of Australia, Reeves J, 18 April 2013

The full text of this judgement is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/355.html

(a) Summary

In Pleash, In the matter of Suncoast Restoration Pty Ltd (in liq) (Pleash), joint liquidators of a corporate trustee successfully applied under of s. 1318 of the Corporations Act 2001 (Cth) (the Corporations Act) and s. 310 of the Superannuation Industry (Supervision) Act 1993 (Cth) (the Supervision Industry (Supervision) Act) to be excused from civil liability for negligence or breach of trust. Reeves J of the Federal Court found that the liquidators had acted honestly when they sold property in breach of trust, as they had not been advised that the corporate trustee had been removed as trustee of the fund pursuant to a disqualification clause in the trust deed.

(b) Facts

Suncoast Restoration Pty Limited (Suncoast) was the corporate trustee of an asphalt business' staff superannuation fund. Suncoast was placed into administration on 15 February 2012 and subsequently into liquidation. The property of the superannuation fund was limited to some motor vehicles and a Queensland residential property. Blair Pleash and Richard Albarran were appointed as joint and several liquidators of Suncoast.

Shortly after being appointed, the liquidators entered into sale contracts for both the motor vehicles and the property. However, unbeknown to Mr Pleash and Mr Albarran, the trust deed contained a disqualification clause in the following terms:

3.1 Ceasing to act as trustee: a trustee shall cease to be a trustee if:
...
3.1.6 In the case of the Trustee being a company, a resolution is passed or a petition is presented for its winding up or liquidation or a receiver or administrator of its assets is appointed (at [13])

As Reeves J found, the disqualification meant Suncoast was now a "bare trustee" - its trust obligations and powers were limited to the preservation of the trust property. Therefore, when selling the motor vehicles and the property, the liquidators were purporting to exercise a power - the power of sale of the trust assets - that Suncoast no longer had.

Importantly, the disqualification clause only came to the liquidators' attention after they had employed new solicitors - the previous advice the liquidators received did not refer to the disqualification clause. This previous (deficient) advice was submitted to the Court as an exhibit to an affidavit sworn by Mr Pleash.

(c) Decision

The liquidators applied to the Federal Court to be excused from an apprehended civil liability dependent upon the breach of trust occurring when they purported to sell the property when they were not, as liquidators, empowered to do so. Reeves J ordered that:

- the liquidators be excused from any apprehended breach of the Corporations Act or the Superannuation Industry (Supervision) Act;
- Suncoast and the liquidators be indemnified out of the assets of the trust for costs of selling the trust property; and
- the liquidators be empowered to complete the sale of motor vehicles and property, but would need to apply to the Court for further directions if further assets of the trust were identified.

(i) Should the liquidators be excused for the possible breaches of trust under s. 1318 of the Corporations Act?

Section 1318 of the Corporations Act grants Courts a discretion to excuse persons from civil liability for actual or apprehended civil proceedings for negligence, default or breach of trust, where the person has acted honestly. As no civil proceedings had been issued against the liquidators of Suncoast, s. 1318(2) applied:

"Where a person to whom this section applies has reason to apprehend that any claim will or might be made against the person in respect of any negligence, default, breach of trust or breach of duty in a capacity as such a person, the person may apply to the Court for relief, and the Court has the same power to relieve the person as it would have had under subsection (1) if it had been a Court before which proceedings against the person for negligence, default, breach of trust or breach of duty had been brought".

His Honour excused the liquidators from future civil liability under s. 1318(2), holding that:

- there was a real, in the sense of "not fanciful", possibility that a claim would be pursued against the liquidators for this breach in the future;
- the liquidators dealing with the assets of the trust was a clear breach, on the basis that Suncoast, and therefore the liquidators, had no relevant power of sale at the time that the liquidators purported to sell the property; and
- the liquidators had "acted honestly" as they had not been advised of the disqualification clause by their previous solicitors and, once they were made aware of the disqualification clause, they promptly applied to the Court for the relevant relief.

Crucial to the above findings was the fact that no replacement trustee had been appointed, and there was no proposal to do so. As Reeves J observed, if a replacement trustee had been appointed, the "countering rights" of that replacement trustee would have affected the outcome.

(ii) Section 310 of the Superannuation Industry (Supervision) Act

Section 301 of the Superannuation Industry (Supervision) Act is a section with broadly the same effect as s. 1318 of the Corporations Act, which provides a discretion to excuse a "superannuation official" who has engaged in "official misconduct" but has "acted honestly" and "ought fairly to be excused" for that misconduct.

Reeves J held that the liquidators were, as the liquidators of a bare trustee, a superannuation official for the purposes of the Superannuation Industry (Supervision) Act. His Honour also held that, as with the Corporations Act liability, the liquidators ought to be excused from any liability as they had acted honestly in the circumstances.

(iii) Should the liquidators and Suncoast be indemnified for costs incurred in realising the trust assets?

In selling the fund property, the liquidators incurred expenses and created debts on Suncoast's behalf in arranging for the sale of the trust property. Usually, a trustee has a right of indemnity from the fund assets for such costs and expenses.

The question was therefore whether the liquidators and Suncoast were still entitled to an indemnity after disqualification, and where the sale was a breach of trust. On this point, Reeves J approved of and adopted the principles set out by Justice Gordon in *Caterpillar Financial Australia Ltd v Ovens*

Nominees Pty Limited [2011] FCA 677.

Accordingly, Reeves J held that, as no replacement trustee had been appointed to Suncoast, the liquidators and Suncoast were entitled to be indemnified for the debts incurred and the expenses involved in selling the trust property. However, as his Honour noted, if a replacement trustee had been appointed, then that trustee's rights would "counter" the rights of the disqualified trustee, with the outcome perhaps affecting the disqualified trustee's right to an indemnity.

(iv) Should the liquidators be given power to deal with the trust fund, including the final sale of the trust property?

Even though the liquidators and Suncoast were entitled to an indemnity, Suncoast was still only a "bare trustee". This meant that the liquidators and Suncoast could not realise the property to provide funds for the indemnity. The liquidators therefore sought an order under section 479(3) of the Corporations Act empowering them to sell the trust property. That section allows liquidators to "apply to the Court for directions in relation to any particular matter arising after the winding up".

Reeves J made the order sought, holding that, in order for the liquidators to undertake the "orderly winding up of Suncoast", it was necessary that the liquidators be granted the power to deal with and to complete the sale of the motor vehicles and residential property.

However, Reeves J also noted that the liquidators would need to apply for further directions if they identified further assets of the trust. In this regard, his Honour did not negate the effect of the disqualification clause by effectively re-elevating Suncoast to the position of trustee, but rather made a limited order to allow the sale of particular property.

6.9 Commencing litigation against the insurer of a deregistered company - when does time start running?

(By Aditi Kogekar, Corrs Chambers Westgarth)

Mercer v Allianz Australia Insurance Ltd [2013] TASSC 11, Supreme Court of Tasmania, Blow CJ, 12 April 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/tas/TASSC/2013/11.html

(a) Summary

This case related to proceedings commenced against Allianz Australia Insurance Ltd (Allianz) under s. 601AG of the Corporations Act 2001 (Cth) (the Corporations Act). That section provides a mechanism for a plaintiff to commence a claim against a deregistered company's insurer without the need to first apply to a court for an order that the company be reinstated. The claim was a workers compensation claim brought by Ivan Mercer against Allianz, the insurer of a company that had subsequently been deregistered.

Allianz argued the claim was statute barred on the basis Allianz stood in the deregistered company's shoes and the limitation period for the underlying cause of action against the now deregistered company had expired prior to the proceeding being brought.

Blow CJ found that s. 601AG of the Corporations Act creates a new cause of action against an insurer, and therefore the relevant limitation period commenced upon the company's deregistration.

(b) Facts

Mr Mercer was the managing director of Windsor Agencies Pty Ltd (Windsor). On 11 March 2008, Mr Mercer was injured at Windsor's premises and, as a result, became a quadriplegic. On 26 January 2011, Windsor was deregistered. At all material times, Windsor had a workers compensation insurance policy with the defendant, Allianz.

On 21 February 2012, Mr Mercer brought an action against Allianz under s. 601AG of the Corporations Act claiming his injuries were caused by the negligence of a forklift operator employed by Windsor, and were suffered during the course of his employment. Section 601AG provides:

"A person may recover from the insurer of a company that is deregistered an amount that was payable to the company under the insurance contract if:

(a) the company had a liability to the person; and
(b) the insurance contract covered that liability immediately before deregistration".

Allianz submitted that for the purpose of determining whether Windsor "had a liability" to Mr Mercer under s. 601AG(a) of the Corporations Act, Allianz should be treated as if it were Windsor. Under s. 5A(3)(a) of the Limitation Act 1974 (Tas) (the Limitation Act), a limitation period of 3 years, commencing on the "date of discoverability", applies to personal injury actions for damages in negligence. Allianz submitted that that limitation period expired on or about 3 September 2011 and, accordingly, Mr Mercer's claim was statute-barred. Section 5A(3)(a) of the Limitation Act does not provide a statutory discretion to extend the limitation period.

In support of its claim that Mr Mercer's action was statute barred, Allianz brought a number of cases commenced under s. 601AG of the Corporations Act to his Honour's attention (including *Almario v Allianz Australia Workers Compensation (NSW) Insurance Ltd* [2005] NSWCA 19; *Tzaidas v Child* [2009] NSWSC 465; *Murdock v Lipman Pty Ltd* [2012] NSWSC 983; and *Pagnon v WorkCover Queensland* [2000] QCA 421).

Mr Mercer argued that s. 5A(3)(a) of the Limitation Act did not apply to this action. Conversely, the relevant limitation period was contained in s. 4(1)(d) of the Limitation Act, which deals with "actions to recover any sum recoverable by virtue of an enactment". The limitation period under s. 4(1)(d) of the Limitation Act is six years.

(c) Decision

Blow CJ rejected Allianz's submissions in respect of each of the cases it referred to. On many occasions, this was due to clearly distinguishable facts, or a misunderstanding on Allianz's part of the propositions for which each case stood. In dismissing Allianz's arguments in respect of each of the cases upon which it purported to rely, Blow CJ drew a number of conclusions in relation to the purpose and effect of s. 601AG of the Corporations Act and the applicable limitation period.

These conclusions were that:

- s. 601AG of the Corporations Act creates a new cause of action, which is not a claim for damages, but rather for an amount payable to the deregistered company under an applicable insurance contract;
- "liability" within the meaning of s. 601AG(a) of the Corporations Act refers to the liability a company had prior to deregistration. Any statutory discretion to extend that limitation period is irrelevant unless the limitation period expired prior to deregistration;
- the relevant time under s. 601AG(b) of the Corporations Act for determining whether the insurance contract covered the liability is "immediately before deregistration." Therefore, the new cause of action does not arise until the company is deregistered. While the insurer is entitled to stand in the insured company's shoes, this is only to the extent that it allows creditors to recover money owed to them from the insurer. It does not mean the time for an action against the insurer continues from the time an action crystallised against the insured company; and
- if s. 601AG of the Corporations Act was not construed in this way, it would mean the plaintiff would need to apply to the court to reinstate the company's registration, and "that is exactly the sort of situation that s. 601AG was intended to avoid."

Ultimately, his Honour found that because Windsor had a liability to Mr Mercer upon deregistration, s. 601AG(a) of the Corporations Act was satisfied. The only relevant limitation period was the 6 year limitation period under s. 4(1)(d) of the Limitation Act for bringing an action to recover a sum recoverable under an enactment.

6.10 Rights under SOP Act are inconsistent with the objectives of Part 5.3A of the Corporations Act

(By Phillip Coady, Clayton Utz)

Modcol Pty Limited v National Buildplan Group [2013] NSWSC 380, New South Wales Supreme Court, McDougall J, 12 April 2013

The full text of this judgment is available at:

http://www.caselaw.nsw.gov.au/action/pjudg?s=1000,jgmtid=164164

(a) Summary

This decision of the Supreme Court of New South Wales addressed whether leave should be granted to a subcontractor to allow it to commence proceedings against a contractor in administration in respect of the subcontractor's rights under the Building and Construction Industry Security of Payment Act 1999 (NSW) (the SOP Act).

In determining that leave should not be granted, the Court held that the rights of a subcontractor under the SOP Act were inconsistent with the objectives of the relevant provisions of Part 5.3A of the Corporations Act 2001 (Cth) (the Corporations Act). In particular, the main purpose of the relevant provisions of Part 5.3A is either to give the company the best chance of continuing business or to maximise the return for creditors if the company was wound up.

The subcontractor's rights under the SOP Act cut across both of these objectives.

In circumstances where state law is inconsistent with Commonwealth law, Commonwealth law prevails (s. 9 of the Constitution). Consequently, the objectives of the Corporations Act prevailed and leave was not granted.

(b) Facts

National Buildplan Group (Buildplan) was contracted to carry out work by Health Infrastructure (HI) in respect of Dubbo Base Hospital. Buildplan subcontracted part of the works to Modcol Pty Limited (Modcol).

On 6 March 2013, Modcol served a payment claim on Buildplan. On 22 March 2013, Buildplan provided a payment schedule. The payment schedule was out of time.

In these circumstances, Modcol was entitled to either:

- obtain a judgment against the contractor (s. 15(2)(a)(i) of the SOP Act); or
- obtain an adjudication determination against the contractor and have this registered as a judgment of the Court (s. 15(2)(a)(ii) of the SOP Act).

Once judgment was obtained, Modcol would be entitled to then obtain a "debt certificate" from the Court and recover the outstanding amount directly from HI (Part 2 of the Contractors Debts Act 1997 (NSW) (the Contractors Debts Act)).

Modcol chose the first option and commenced proceedings against Buildplan on 10 April 2013 for summary judgment of the amount claimed in the payment claim together with interest.

Two days before the summons was filed, administrators were appointed to Buildplan.

(c) Decision

As Buildplan was in administration, Modcol was required to seek the leave of the Court to commence proceedings against Buildcorp pursuant to s. 440D of the Corporations Act.

Consequently, the Court was asked to consider the following.

- whether leave pursuant to s. 440D of the Corporations Act should be granted to allow Modcol to commence proceedings against Buildplan in respect of the amount claimed under the SOP Act;
- if granted, whether a certificate should be issued pursuant to s. 7 of the Contractors Debts Act to enable Modcol to access money said to be owing by HI to Buildplan.

(i) The objectives of the Corporations Act

In respect of the first question, Justice McDougall noted that granting leave was discretionary. His Honour went on to consider the circumstances in which leave should be granted. His Honour stated that whether leave should be granted must be weighed against the objectives of the Corporations Act as a whole and the importance of protecting the company's property during administration.

His Honour noted that the object of Part 5.3A is to:

- maximise the chance of the company continuing in business; or
- get a better return for creditors than would result from immediate winding up (s. 435A of the Corporations Act).

Further, these objectives are reflected in s. 439C of the Corporations Act, which provides that the creditors shall meet to decide the Company's future. At this meeting, the creditors have three choices:

- the company execute a deed of company arrangement;
- the administration should end; or
- the company be wound up.

(ii) When to grant leave under s. 440D?

McDougall J noted that the Courts have previously taken two approaches to this question:

- leave will be granted rarely in situations other than where the company was insured against the liability that is the subject of the proceedings (*Foxcroft v The Ink Group Pty Ltd* [1994] 15 ACSR 203 per Young J); and
- the Court should not start from the position that leave will be granted rarely but should grant leave where the circumstances of the particular case warrant the granting of leave (*Larkden Pty Ltd v Lloyd Energy Systems Pty Ltd* [2011] NSWSC 1305 per Hammerschlag J).

Although concluding that he did not have to express a definitive view as to which of the above positions he preferred (because the result in this case would be the same either way), his Honour's judgment suggests that Hammerschlag J's approach is to be preferred.

(iii) Should leave be granted in respect of claims under the SOP Act?

Modcol argued that the policy of the SOP Act justified the grant of leave which would enable it to pursue its rights in full (i.e. the recovery of judgment and the obtaining of a s. 7 certificate). This was consistent with White J's reasoning in *Sam the Paving Man Pty Ltd v Berem Constructions Pty Ltd (in liq)* [2010] NSWSC 868 that an unpaid person within the meaning of s. 5 of the Contractors Debts Act may obtain priority over other creditors.

However, McDougall J did not agree. Instead, McDougall J preferred the view expressed by Byrne J in *Belmadar Constructions Pty Ltd v Environmental Solutions International Ltd (recvrs and mgrs. apptd) (subject to deed of company arrangement)* [2005] VSC 24 that:

"It is important that once the processes for an orderly management and winding up of the affairs of a company in financial distress are set in train that the statutory rights of and limitations upon the rights of all concerned, including unsecured creditors under [the Corporations Act], be respected and given effect to".

His Honour went on to say that the main objectives of Part 5.3A noted above would be subverted by the exercise of discretion in favour of Modcol.

In particular:

"On the first basis, the effect of intercepting what might be a substantial amount owed by Health Infrastructure to Buildplan would in my view be subversive of the primary object of Part 5.3A. I say that because it seems to me that if the chances of the company's continuing in business are to be maximised, it will need as much cash as it can get its hands on for the purpose of funding both the administration, any deed of company arrangement and the subsequent continuation of business. If, however, there is no arrangement and the company does not continue in business, the likely result is winding-up. Clearly, a payment which would have the effect of giving a significant advantage to one unsecured creditor over others would not be consistent with the scheme of [the Corporations Act] for winding-up on insolvency".

His Honour also noted that the first meeting of creditors had not taken place. In these circumstances, it was premature to take any action that may adversely affect Buildplan's chances of continuing its business.

Accordingly, leave was not granted and there was therefore no need to consider the second question relating to whether a debt certificate should be issued pursuant to the Contractors Debts Act.

6.11 Determining the contracting party for the purposes of a proof of debt in a liquidation

(By Laura Loftus, DLA Piper Australia)

In the matter of DCM Solar Pty Limited (in liquidation) [2013] NSWSC 323, Supreme Court New South Wales, Black J, 10 April 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/323.html

(a) Summary

This case considered issues that arose as a result of a proof of debt lodged by Soanar Pty Limited (Soanar) in the liquidation of DCM Solar Pty Limited (in liquidation) (DCMS). The court considered:

- whether debts incurred were incurred by a company other than DCMS;
- the relevant party to the contract with Soanar; and
- whether the contracting party had changed.

The court determined that the contracting party had not changed and that DCMS had incurred all of the relevant debts.

(b) Facts

Soanar lodged a Proof of Debt dated 10 May 2012 (the Proof of Debt) in the liquidation of DCMS.

This was rejected by the liquidators on 30 May 2012 on the following grounds:

- Public examinations (including whether Soanar's claim should be admitted) were not complete;

- The debts which were the subject of the claim were incurred by DCM Green Pty Ltd (in liquidation) (DCMG) rather than DCMS; and
- Soanar recovered possession of significant amounts of stock and obtained assignments of other agreements relating to stock, to which the debts relate.

This case concerned Soanar's application under s. 1321 of the Corporations Act 2001 (Cth) for a revocation of the rejection of the Proof of Debt and admission of the Proof of Debt. The first ground above was not considered in these proceedings.

In relation to the second ground, Soanar had the onus of establishing that DCMS was the relevant contracting party, and the identification of the parties to the contracts had to be determined by "what each party by words and conduct would have led a reasonable person in the position of the other party to believe".

Soanar sold solar panels and associated equipment to DCMS in September 2009. DCMS's main business was installing solar power systems as part of the Federal Government's Solar Homes Community Project (SHCP). These goods were sold on credit, and an account application was lodged by DCMS in September 2009, followed by a further Application for Credit Account in late March 2010, which incorporated Soanar's standard terms and conditions (March 2010 Terms). Contracts were formed between the parties by DCMS lodging written orders and Soanar accepting those orders.

Purchase orders were issued by DCMS in two forms:

- containing a logo with the words "DCM Solar" in the top right hand corner and company details referring to DCM Sanctuary (the former name of DCMS) and the ACN of DCMS in the bottom right hand corner; and
- containing a logo with the words "DCM Solar" in the header and footer of the invoice and the words "Invoice to: DCM Solar Pty Ltd" in the top right hand corner.

The liquidators contended that the contracting parties changed in mid-2010, with DCMG replacing DCMS. According to the liquidators, DCMG dealt directly with Soanar in place of DCMS or DCMS dealt with Soanar as disclosed agent for DCMG.

To support this contention, the liquidators relied upon:

- a business lunch and business dinner held in mid-2010, at which the change in the structure of DCMS's business to include DCMG was explained by representatives of DCMS and DCMG (so that any orders placed by DCMS should be treated as being placed by DCMG). However, the court did not consider that the people at these events did in fact notify Soanar of the changes;
- an email sent on 28 June 2010 from the operations manager of Soanar to other employees of Soanar which contained the word "DCM?" at the bottom of the email. The liquidators contended that this indicated that the operations manager did not know whether she was dealing with DCMS or DCMG. However, the court did not read the email as indicating this - rather, it was a query in relation to outstanding amounts owed by DCMS and whether any further deliveries of goods should be made; and
- two purchase orders which contained a reference to "DCM Green" at the top right hand corner of the order. However, the court did not consider that, objectively, these documents would be considered to amount to a change of contracting party, because the purchase orders also contained the company name "DCM Sanctuary Pty Limited" (the previous name of DCMS) and the ACN for DCMS. Banking records for these orders indicate that the relevant payments were made by DCMS.

Soanar held credit insurance in respect of debts incurred by DCMS, and DCMS (and DCMG) knew of the existence of this insurance (including the fact that the insurer required a balance sheet of the creditor to satisfy itself of the creditworthiness of the debtor). The liquidators asserted that this provided motivation for Soanar to assert that the debt was owed by DCMS. However, the court considered an objective observer would consider that this insurance (and DCMS's knowledge of it) would be more likely to indicate that Soanar was contracting with DCMS to ensure it could obtain the benefit of the insurance.

Soanar lodged a proof of debt in the liquidation of DCMG for an amount that was similar to the amount claimed in this proceeding. However, the court considered that the information available to Soanar was "plainly somewhat confusing", including information that Soanar was likely to be a creditor of either DCMS or DCMG and therefore Soanar's approach to lodging a proof of debt in both proceedings was reasonable.

Soanar instead contended that although equipment it supplied ultimately found its way to DCMG, DCMS was the relevant contracting party by virtue of the purchase orders given by DCMS.

(c) Decision

The court held that the contracts were between Soanar and DCMS, not between Soanar and DCMG. The March 2010 Terms governing the agreements were between Soanar and DCMS and it would be unlikely that Soanar would abandon those terms and agree to deal with DCMG without making any amendments to the terms. The court also considered that it would be unlikely for Soanar to agree to deal with DCMG rather than DCMS where doing so would have the effect of defeating the directors' guarantee contained in the March 2010 Terms and denying Soanar the benefit of the credit insurance it had taken out in respect of dealings with DCMS. In addition, financial information of DCMS was provided to the insurance brokers (not financial information of DCMG).

6.12 Creation of equitable charges and the appropriate circumstances for liquidators to seek directions regarding distribution of funds

(By Tom Fallon, Herbert Smith Freehills)

Re Crown Meats Pty Ltd (in liq) [2013] VSC 118, Supreme Court of Victoria, Robson J, 5 April 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/vic/VSC/2013/118.html

(a) Summary

A group of liquidators sought a series of directions from the court regarding distribution of funds from the sale of property. The court decided that the wording of an order by the Family Court of Australia in earlier proceedings was specific enough to create an equitable charge over funds generated from the sale of a particular property. It was also decided that the liquidators were entitled to a lien over the proceeds of sale from a particular asset to meet the cost of the proceedings. This was because the proper order of distribution had been sufficiently unclear when the proceedings were originated that it was appropriate for the liquidators to seek directions. The court also made other orders and directions which were not contested between the parties.

(b) Facts

The plaintiffs were the liquidators of four meat processing companies who shared common directors and were part of the West Meats group.

Each company owned real property (set out below) which the liquidators sold:

- Dakiri Pty Ltd (in liquidation) - the Cahill Street Property;
- Southern Cross Frozen Foods (Vic) Pty Ltd (in liquidation) - the Colebrook Street Property;
- Crown Meats Pty Ltd (in liquidation) - the 322 Hammond Road Property; and
- Anend Pty Ltd (in liquidation) - the 314 Hammond Road Property.

The liquidators sought directions as to how to distribute the net proceeds of sale and a number of issues arose

(i) Was Mrs Weiselmann entitled to an equitable charge over the Cahill Street Property?

Mr Weiselmann was the principal of the West Meats group. Mr Weiselmann was married to Eileen Weiselmann (Mrs Weiselmann). The marriage broke down and Mrs Weiselmann commenced proceedings against Mr Weiselmann in the Family Court of Australia. Mrs Weiselmann claimed to have an equitable charge over the proceeds of sale of the Cahill Street Property based on the extract from the Family Court judgment set out below:

"In the event that any of the amount referred to in paragraph 3 shall not be made in accordance with that paragraph the whole of the sums required to be paid shall fall due and payable and in that event [Mr Wieselmann] personally and [Mr Watson] and the Companies shall within 90 days sign all documents and all acts and things required of them to sell the real property at:
(a) 43 Colebrook Street, Brunswick;
(b) 79 Cahill Street, Dandenong; and/or
(c) 322 Hammond Road Dandenong
and they shall irrevocably authorise and direct their agents to pay the sums referred to in paragraph 3 to [Mrs Wieselmann]".

The judge cited authorities on the creation of an equitable charge which provide that an equitable charge is created when specific property is expressly or constructively made liable to the discharge of a debt of some other obligation. In particular *Porter v Bonarrigo* [2009] VSC 500, [63]-[73] and *Palmer v Carey* (1926) CLR 545 at 845. The question to be decided was whether the order of the Family Court of Australia quoted above was particular enough that it created an equitable charge over the Coleman Street Property in favour of Mrs Weiselmann.

(ii) Were the liquidators entitled to a lien over the funds for the purposes of covering the cost of the proceeding?

Robson J cited the principal from *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171,174-5 and said "a liquidator who incurs expenses to care for, preserve or realise property to create a fund is entitled in equity to a first-ranking charge (lien) against the fund or the property".

The liquidators claimed that this encompassed the cost of the court proceedings regarding the Colebrook Street Property because, at the time of commencement, there was uncertainty as to whether Mrs Wieselmann or another creditor (Martman Nominees) should be distributed to first. They asserted that it was necessary to consult the court prior to distributing and as such the cost should be paid out of the proceeds of sale. Martman Nominees said there was no uncertainty because a previous Federal Court order had, in effect, already judged the matter. They therefore claimed that the liquidators were unnecessarily seeking direction and, because of that, they should have to meet their own costs in relation to the issue.

(c) Decision

(i) Mrs Weiselmann was entitled to an equitable charge over the Cahill Street Property

An equitable charge was created by the court order and the liquidators would be justified in treating Mrs Wieselmann as holding an equitable charge over the Cahill Street Property. Although the court orders did not expressly refer to payment of the debts out of the proceeds of sale, this was implied so that the orders contemplated an irrevocable direction to pay the proceeds of sale of the Cahill Street Property to Mrs Wieselmann. The liquidators could distribute to her accordingly.

(ii) The liquidators were entitled to a lien over the property for the purposes of covering the cost of the current proceeding

The court decided that it was appropriate to seek directions and the lien should extend to the costs of the proceedings because the liquidators were faced with possibly inconsistent orders from the Family Court of Australia and the Federal Court of Australia. The court noted that the activities which are involved in the "care, preservation and realisation" of the assets are to be interpreted widely. The court also noted that it is usually not difficult for a liquidator to satisfy the court that it should have such costs paid out of the proceeds of sale.

6.13 Unconscionable conduct of lender and mortgage originator

(By Tina Kostelenos, Herbert Smith Freehills)

Violet Home Loans Pty Ltd v Schmidt [2013] VSCA 56, Supreme Court of Victoria, Court of Appeal, Warren CJ, Cavanough and Ferguson AJJA, 25 March 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/vic/VSCA/2013/56.html

(a) Summary

In *Perpetual Trustees Australia Limited v Schmidt* [2010] VSC 67 at [213], the trial judge found that Violet Home Loans (Violet) had acted unconscionably and in breach of the general law, s. 51AC of the Trade Practices Act 1974 (Cth) (the TPA) and s. 12CB of the Australian Securities and Investments Commission Act 2001 (Cth) (the ASIC Act).

In *Violet Home Loans Pty Ltd v Schmidt* the Court of Appeal of the Victorian Supreme Court unanimously upheld the decision of the trial judge.

(b) Facts

Mr Schmidt was born in Australia in December 1939 and had only a rudimentary knowledge of the English language. In May 2003, Schmidt responded to an advertisement which gave an opportunity to invest $40,000 for a net return of $80,000 within 12 months. Through Mr Maddocks, Schmidt invested. Schmidt did not obtain advice on the matter from any lawyer or accountant and used the funds from his previous loan account with the Bank of Melbourne.

In early 2004, Maddocks persuaded Schmidt to make further investments in the property. Bank of Melbourne told Schmidt that he could not borrow the money for his further investment because he was a pensioner and did not have the capacity to repay. Maddocks then arranged a loan for Schmidt from Perpetual Trustees Australia Limited (Perpetual) by preparing a form of loan application and an income declaration. The documents contained false information, as to Schmidt's fictitious business for 25 years and annual income (reporting it as $75,000 in the loan application and $65,000 in the income declaration). Schmidt signed the documents without reading them. The signed documents were then provided to a financial broker, Medallion Finance Concepts Pty Ltd (Medallion) who forwarded them to Violet. Tammi Bonnici, a credit officer at Violet processed the application requiring information on the failure to provide an Australian Business Number (ABN), inconsistencies in income and proof of identity. The paperwork was completed and $190,000 was approved by Macquarie Securitisation Limited (MSL) who were appointed by Perpetual to manage its fund.

At no time throughout the process did anyone from Perpetual, MSL, Violet or Medallion deal directly with Schmidt.

The $190,000 credit limit was fully drawn by Schmidt in May 2004 and by 2 February 2005, he was in default. On 8 July 2005 Perpetual issued a notice to pay and subsequently commenced proceedings in November 2005 to take possession of Schmidt's home.

Schmidt relied on s. 12CB ASIC Act and s. 51AC TPA as well as unconscionable conduct at the general law.

The trial judge took into account the following in determining if the conduct of Violet was unconscionable:

- the irregularities on the loan application;
- lack of an ABN;
- Violet's knowledge of Schmidt's being close to retirement age and that his home was his only substantial asset;

- that there was significant doubt as to Schmidt's ability to repay the loan;
- that Bonnici knew the figures were fudged and chose to make no further inquiry; and
- that Violet knew that as part of the arrangements, a personal interview of the borrower should have been conducted.

Violet submitted that Schmidt's knowledge and understanding did not allow for unconscionable conduct.

The trial judge formed the view that Schmidt was vulnerable in the sense that he was unsophisticated, naïve and gullible and therefore concluded that Violet's conduct was unconscionable.

(c) Decision

Violet appealed the decision on 26 grounds. The Court of Appeal held that the appeal should be dismissed.

Their reasons are summarised as follows:

(i) Whether Violet's conduct was unconscionable when the position and conduct of Schmidt is considered

Violet claimed that Schmidt had investment experience and knew what he was doing. The Court of Appeal distinguished *Permanent Mortgages Pty Ltd v McFadyen* [2012] NSWSC 130 and accepted that the trial judge's finding that Schmidt was not knowingly responsible for the inclusion of false information in the documents.

(ii) Whether Violet's conduct involved statutory unconscionability

Violet claimed that the inconsistencies as to Schmidt's income on the loan documentation did not demand further inquiry since there was no reason for Violet to doubt Schmidt's capacity to service the loan from his income or that it involved asset based lending. Violet further claimed that Schmidt needed to prove some moral fault or responsibility or that its actions were highly unethical. The Court of Appeal held that there was little to be gained by a closer factual analysis of cases that have considered whether particular conduct was unconscionable. Rather, the discrepancy in the figures in the loan application and income declaration (on two occasions), and the absence of the ABN, which was requested but never provided, ought to have raised suspicion on the part of Violet that something may be mistaken with the application.

The Court of Appeal cited *Tonto Home Loans Australia Pty Ltd v Tavares* (2011) 15 BPR 29 at 699:

"[s]ometimes a risk eventuates and, depending on all the circumstances, the lender may be held responsible for the consequences, partly because the very system the lender has established facilitates the perpetration of the frauds upon the borrower".

The Court of Appeal held that Violet had turned a "blind eye" to the numerous irregularities and that its further failure to conduct an interview supported the proposition that Violet's conduct was unconscionable.

(iii) Whether the services acquired were of a kind ordinarily acquired for personal, domestic or household use

Section 12CB of the ASIC Act prohibits unconscionable conduct in relation to a consumer. Violet claimed that Schmidt's application was for business credit and not "of a kind ordinarily acquired for personal, domestic or household use". The Court of Appeal analysed Young J's authority in *Bunnings Group Ltd v Laminex Group Ltd* (2006) 153 FCR 479 and found that "the question is ultimately a question of fact and degree" and that in this case, the financial services were of a kind ordinarily acquired for personal use.

(iv) Whether the services were acquired for the purpose of trade and commerce

Having reached the view that the judge correctly concluded that s. 12CB(1) of the ASIC Act was contravened, there was no need to consider whether there was a contravention of s. 51AC of the TPA. Additionally, it was not necessary for the Court of Appeal to decide whether Violet's conduct was unconscionable at general law.

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