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Bulletin No. 207

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1. Recent Corporate Law and Corporate Governance Developments

1.1 OTC derivatives regulators issue report to the G20 Leaders

On 7 November 2014, the Over-the-counter (OTC) Derivatives Regulators Group (ODRG) issued a report that provides an update to the G20 Leaders regarding the ODRG's continuing effort to identify and resolve cross-border issues associated with the implementation of the G20 OTC derivatives reform agenda. The ODRG is made up of authorities with responsibility for the regulation of OTC derivatives markets in Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Quebec, Singapore, Switzerland, and the United States.

The report reflects how the ODRG has addressed, or intends to address, cross-border issues identified since the publication of the report published in advance of the St Petersburg Summit in September 2013.

The report also reflects progress on cross-border issues identified by the ODRG in previous reports on which the group:

- continues to work to implement the relevant understandings; and
- monitors the relevant work of other multilateral working groups.

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

1.2 Draft legislation to strengthen and streamline Australia's personal bankruptcy and corporate insolvency regimes

On 7 November 2014, the Australian Government released draft legislation to implement the first phase of reforms to strengthen and streamline Australia's personal bankruptcy and corporate insolvency regimes.

These reforms are designed to empower creditors to better protect their own interests by enhancing communication and transparency between insolvency practitioners and creditors.

Specifically, creditors will be empowered to protect their own interests by being given the ability to determine when and what information they are provided by an insolvency practitioner. The government's reforms would also give creditors the power to remove poorly performing insolvency practitioners through a resolution of creditors instead of having to seek the Court's agreement.

New insolvency practitioners would be required to be interviewed by a three-person committee with appropriate expertise prior to registration. Registration would need to be renewed every three years with the provision of new requirements for insolvency-specific education as well. Mechanisms to address losses from any negligence or misconduct would be improved by making appropriate insurance a condition of registration.

Some of the other proposed changes designed to improve returns to creditors include:

- allowing the use of electronic provision of documents;
- streamlining remuneration approval processes; and
- aligning administrative rules across personal and corporate insolvency.

Creditors will be empowered to more easily remove a poorly performing insolvency practitioner and be able to appoint an independent specialist to review the performance of an insolvency practitioner.

The Australian Securities and Investments Commission will also have increased surveillance powers to proactively identify and investigate allegations of misconduct. The disciplinary mechanism will also be strengthened.

The draft Bill and a proposals paper on the proposed regulations and Insolvency Practice Rules is available for comment on the Treasury website and the Attorney-General's Department website.

1.3 FSB publishes progress report on implementation of OTC derivatives market reforms

The Financial Stability Board (FSB) has published its Eighth Progress Report on Implementation: OTC Derivatives Market Reforms (7 November 2014).

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

To achieve these objectives, the G20 agreed that:

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

The report finds that, although implementation of reforms to meet these commitments is not yet complete, progress has continued in reform areas across the FSB member jurisdictions and further progress is anticipated for 2015.

The main findings are that:

- The adoption of legislation, where this has been a necessary first stage of the reform process, is nearing completion. While jurisdictions vary in their stage of implementation of detailed regulations, the greatest progress to date has been made in adopting regulations that implement higher capital requirements for non-centrally cleared derivatives and trade reporting requirements. Implementation in other reform areas is also proceeding, though timetables stretch well into 2015 and beyond. Measures to promote trading on exchanges or electronic trading platforms continue to take longer than those in other reform areas.
- International standards and guidance in key areas (such as bank capital requirements for central clearing exposures, and recovery and resolution for financial market infrastructures) have been finalised over the course of 2014.
- In addition, bilateral and multilateral discussions addressing outstanding cross-border issues have intensified over the course of 2014.
- Across jurisdictions, the availability of market infrastructure, and market participants' use of that infrastructure, continues to gradually broaden.

Further information is available on the FSB website.

1.4 FSB announces update of group of global systemically important banks

The Financial Stability Board (FSB) has published 2014 update of list of global systemically important banks (G-SIBs) (6 November 2014). In November 2011 the FSB published an integrated set of policy measures to address the systemic and moral hazard risks associated with systemically important financial institutions (SIFIs). In that publication, the FSB identified as global SIFIs (G-SIFIs) an initial group of global systemically important banks (G-SIBs), using a methodology developed by the Basel Committee on Banking Supervision (BCBS).

The November 2011 report noted that the group of G-SIBs would be updated annually based on new data and published by the FSB every November. Beginning with the November 2012 update, the G-SIBs have been allocated to buckets corresponding to the higher loss absorbency requirements that they would be required to hold from January 2016.

The FSB and the BCBS have updated the list of G-SIBs, using end-2013 data and the updated assessment methodology published by the BCBS in July 2013. One bank has been added to the list of G-SIBs that were identified in 2013, increasing the overall number from 29 to 30.

Alongside this communication, the BCBS published the denominators used to calculate banks' scores, and the thresholds used to allocate the banks to buckets.

The BCBS also published a technical summary of the methodology (November 2014).

G-SIBs are also subject to:

- requirements for group-wide resolution planning and resolvability assessments. In addition, the resolvability of each G-SIB is reviewed annually in a high-level FSB Resolvability Assessment Process by senior policy makers within the firms' Crisis Management Groups.
- higher supervisory expectations for risk management functions, data aggregation capabilities, risk governance and internal controls.

The timelines for G-SIBs to meet these requirements were set out in the November 2013 update.

Further information is available on the FSB website.

1.5 IOSCO publishes strategic framework for investor education/financial literacy

On 4 November 2014, the International Organization of Securities Commissions (IOSCO) published a final report on the Strategic Framework for Investor Education and Financial Literacy, which describes IOSCO's role in promoting investor education and financial literacy and its strategic approach to both. The strategic framework will guide the Committee on Retail Investors' efforts in establishing investor education initiatives that produce meaningful results for investors.

IOSCO has long recognised investor education as a key strategy for enhancing investor protection, promoting investor confidence and fostering investor engagement in financial planning and decision-making. Investor education is complementary to the traditional tools of regulation, supervision and enforcement, and is recognised in IOSCO's guiding principles for securities regulation.

The report is available on the IOSCO website.

1.6 FSB publishes global shadow banking monitoring report 2014

On 4 November 2014, the Financial Stability Board (FSB) published its fourth annual Global Shadow Banking Monitoring Report (30 October 2014). The report presents data as of end-2013 from 25 jurisdictions and the euro area as a whole, covering approximately 80% of global GDP and 90% of global financial system assets.

The main findings from the report are as follows:

- The broadest measure, referred to as the Monitoring Universe of Non-Bank Financial Intermediation (MUNFI), grew by $5 trillion in 2013 to reach $75 trillion. This measure is based on the financial assets of Other Financial Intermediaries (OFIs) and captures all non-bank financial intermediation where shadow banking-related risks to the financial system might potentially arise.
- Globally, MUNFI assets represent on average about 25% of total financial assets, roughly half of banking system assets, and 120% of GDP. These ratios have been relatively stable since 2008.
- MUNFI assets grew by 7% in 2013 (adjusted for foreign exchange movements), driven in part by a general increase in valuation of global financial markets. In contrast total bank assets were relatively stable. Within the headline global growth figure of MUNFI assets exists considerable differences across jurisdictions and entities.
- This year, the FSB continued to refine the shadow banking measure to produce an estimate that more tightly focuses on shadow banking risks, narrowing down the broad MUNFI estimate by filtering out entities that are not part of a credit intermediation chain and those that are prudentially consolidated into a banking group. Using more granular data reported by 23 jurisdictions, the

broad MUNFI estimate of non-bank financial intermediation was narrowed down from $62 trillion to $35 trillion.
- The Hedge Funds sub-sector remains significantly underestimated in the FSB's data collection exercise. Further refinement of the data for this sector could provide important additions to future editions of the report.

1.7 Latest World Bank Doing Business Report

On 29 October 2014, the World Bank published its latest *Doing Business* report. The report finds that in the past year, governments around the world continued to implement a broad range of reforms aimed at improving the regulatory environment for local entrepreneurs. Economies that both improve the efficiency of regulatory procedures and strengthen the legal institutions that support enterprise, trade, and exchange are better able to facilitate growth and development, the report finds.

Doing Business 2015: Going Beyond Efficiency (undated) finds that local entrepreneurs in 123 economies saw improvements in their regulatory environment in the past year. From June 2013 to June 2014, the report, which covers 189 economies worldwide, documented 230 business reforms - with 145 aimed at reducing the complexity and cost of complying with business regulations, and 85 aimed at strengthening legal institutions. Sub-Saharan Africa accounted for the largest number of reforms.

The report finds that Singapore tops the global ranking on the ease of doing business. Joining it on the list of the top ten economies with the most business-friendly regulatory environments are New Zealand; Hong Kong SAR, China; Denmark; the Republic of Korea; Norway; the United States; the United Kingdom; Finland; and Australia.

The report is available on the World Bank website.

1.8 EU study on the promotion of employee ownership and participation

On 28 October 2014, the European Commission published a study (October 2014) that provides an overview of the development of employee financial participation, and in particular of employee share ownership, across the EU and highlights the growth of financial participation of employees over the last decade. The study describes and analyses in depth a range of policy options to be considered at the EU level to reduce the main obstacles to transnational employee financial participation and to encourage it throughout the EU. Overcoming such cross-border barriers is particularly important in view of the potential described in the study for EU companies to implement such schemes and benefit from their impact.

Further information is available on the European Commission website.

1.9 IOSCO updates information repository for central clearing requirements for OTC derivatives

On 28 October 2014, the International Organization of Securities Commissions (IOSCO) released an update of its information repository for central clearing requirements for OTC derivatives, which provides regulators and market participants with consolidated information on the clearing requirements of different jurisdictions.

By providing this information, IOSCO seeks to assist authorities in their rule making and help participants comply with the relevant regulations in the OTC derivatives market. The repository sets out central clearing requirements on a product-by-product level, and any exemptions from them. IOSCO first made the repository public in August 2014. The information in the repository will be updated quarterly.

The updated information repository is available on the IOSCO website.

1.10 APRA releases draft prudential practice guide on superannuation fraud risk management

On 27 October 2014, the Australian Prudential Regulation Authority (APRA) released for consultation a draft prudential practice guide that provides guidance on good practices for Registrable Superannuation Entity (RSE) licensees in relation to fraud risk management.

As part of the new superannuation prudential framework supporting the government's Stronger Super Reforms, APRA introduced *Prudential Standard SPS 220 Risk Management* (SPS 220) in late 2012. *Prudential Practice Guide SPG 220 Risk Management* was subsequently released in 2013 to support the requirements set out in SPS 220.

At that time, APRA foreshadowed it would update its existing guidance notes on the management of superannuation fraud risk: *How to Reduce the Risk of Fraud - A Best Practice Guide for Trustees* and *Superannuation Fraud Checklist for Trustees*, through the issue of a prudential practice guide.

Draft Prudential Practice Guide SPG 223 Fraud Risk Management (Draft SPG 223) outlines prudent practices in relation to the management of fraud risk, and focuses on current and emerging fraud risk factors impacting the superannuation industry from both an internal and external perspective.

Draft SPG 223 and an accompanying letter are available on the APRA website.

1.11 Progress report on implementation in the UK of the Kay review of equity markets and long-term decision making

On 27 October 2014, the UK Department for Business, Innovation and Skills (BIS) published a progress report (October 2014) concerning implementation of the recommendations made in the Kay review of UK equity markets and long-term decision making.

Two additional documents (both dated October 2014) accompany the progress report. The first, a BIS research paper, considers the metrics and models used to assess company and investment performance. The second document contains notes of a BIS roundtable on the practical and legal issues related to limiting the rights of short-term shareholders during takeover bids.

Further information is available on the BIS website.

1.12 Shareholder primacy discussion paper

On 24 October 2014, the Governance Institute of Australia published the discussion paper Shareholder Primacy: Is There a Need for Change? (undated). The discussion paper explores the means by which societal expectations in relation to moderating the influence of corporate activity on the community and environment can best be met. It examines the misalignment that is often experienced between societal expectation and the impact of corporate activity and poses the following questions:

1. Is there a view that there is no need for a change to the corporations law, as it currently allows directors to take account of the interests of stakeholders other than shareholders?
2. Is there a need for a change to the corporations law, and should the equivalent of s. 172 in the UK (permissive clause) be introduced to expand directors' duties so that they should have regard to the interests of stakeholders other than shareholders in promoting the best interests of the company?
3. Is there a need for a change to the corporations law, and should an explicit clause be introduced to expand directors' duties so that they must take account of the interests of stakeholders other than shareholders?
4. Is there a role for the government to play in protecting the interests of stakeholders - not through amendment to the corporations law, but through other forms of social policy?

Further information is available on the Governance Institute of Australia's website.

1.13 Government response to Senate inquiry into the performance of ASIC

On 24 October 2014, the Australian Government announced that it has considered all of the 61 recommendations made by the Senate Economics References Committee inquiry into the performance of the Australian Securities and Investments Commission (ASIC) and released its response to those recommendations (October 2014).

A large number of the recommendations are directly addressed to ASIC, which is an independent statutory authority. ASIC has responded to the Senate committee's report. Specifically, ASIC has agreed to establish an Office of the Whistleblower within ASIC to improve the way it deals with whistleblowers. ASIC has also started to improve its communications and enhanced transparency, by revamping its website to make it more accessible. It has increased its monitoring of enforceable undertakings, including the reporting of the outcomes. In the period since the release of the Senate committee report, ASIC has worked with the government on the establishment of an enhanced public register of financial advisers (see below).

1.14 Enhanced public register of financial advisers

The Australian Government has announced (24 October 2014) that it is establishing an enhanced, industry-wide public register of financial advisers. This register will enable investors, employers and ASIC to verify the credentials of financial advisers and be confident that they are appropriately qualified and experienced.

The register of financial advisers will include:

- the adviser's name, registration number, status, and experience;
- the advisers' qualifications and professional association memberships;
- the adviser's licensee, previous licensees/authorised representatives and business name;
- what product areas the adviser can provide advice on;
- any bans, disqualifications or enforceable undertakings; and
- details around ownership of the financial services licensee and disclosure of the ultimate parent company where applicable.

The register will be established by March 2015.

The register will cost approximately $5 million to set up and will be funded by increasing the current ASIC lodgement fee for Australian Financial Services licensees by $5 to $44. The government believes cost recovery is an appropriate method to finance this important transparency reform.

1.15 Review of shareholder activism in the US

On 23 October 2014, shareholder consulting services firm Georgeson published its 2014 review of shareholder activism in the US.

Shareholder activism continued to thrive in the 2014 proxy season, spurring corporate action as well as renewed engagement between issuers and investors. While the total number of shareholder proposals declined in 2014, lively activity continued with calls for independent chairs as well as burgeoning growth for social issues. And while few in number, change-in-control payout proposals were notably successful for the first time this year, while equity retention proposals continued to have a weak showing. In addition, support for proxy access proposals also grew at a rate greater than any other type of proposal. While contested situations and certain shareholder proposals saw greater investor support, companies also experienced greater success in heading off a negative vote by addressing shareholder concerns as they arose. The overall support for say on pay proposals remained high as outreach efforts by issuers continued to grow. Likewise, support for director elections continued to increase amid efforts by boards to avoid negative votes.

The review is available on the Georgeson website.

1.16 Capital requirements for global systemically important insurers

On 23 October 2014, the International Association of Insurance Supervisors (IAIS) announced that it has concluded development of the first-ever global insurance capital standard - Basic Capital Requirements (the BCR) for global systemically important insurers (G-SIIs). The BCR has also been endorsed by the Financial Stability Board (FSB).

Beginning in 2015, the BCR will be reported on a confidential basis to group-wide supervisors and be shared with the IAIS for purposes of refining the BCR as necessary. During this reporting period, the IAIS will review the suitability of the BCR factors to ensure that the BCR remains fit for purpose. From 2019, G-SIIs will be required to hold capital no lower than the BCR plus Higher Loss Absorption (HLA) capacity.

The development of the BCR is the first step of a long-term project to develop risk-based, group-wide global insurance capital standards. The second step is the development of HLA requirements to apply to G-SIIs, due to be completed by the end of 2015. The final step is the development of a risk-based group-wide global insurance capital standard (ICS), due to be completed by the end of 2016 and applied to Internationally Active Insurance Groups (IAIGs) from 2019.

Further information on the BCR is available on the IAIS website.

1.17 New Bill - Corporations Legislation Amendment (Deregulatory and Other Measures)

On 22 October 2014, the Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014 (Cth), which proposes to amend the Australian Securities and Investments Commission Act 2001 (Cth) and the Corporations Act 2001 (Cth) (the Corporations Act), was introduced into the House of Representatives and received its second reading speech.

According to the explanatory memorandum, the objective of the Bill is to remove unnecessary regulation, clarify existing regulatory obligations and enhance the efficient operation of certain government bodies.

Specifically, the Bill would make various amendments, including to:

- balance the rights of shareholders to raise issues with a company and the costs to the companies of being required to call and hold a general meeting, by providing that a general meeting must only be arranged if members with at least 5% of voting shares make the request, and to provide that 100 shareholders continue to be able to put a resolution on the agenda of general meetings and circulate the material to other members at the expense of the company;
- improve and reduce remuneration reporting requirements, including to provide that listed entities are no longer required to report the value of lapsed options and the percentage of the value of remuneration consisting of options;
- clarify the circumstances in which a financial year may be less than 12 months;
- exempt certain companies limited by guarantee from the need to appoint or retain an auditor;
- improve the operation of the Takeovers Panel by allowing takeover matters to be dealt with more efficiently, including to provide that the president of the Takeovers Panel may give a direction in respect of members who are to constitute the panel whether or not the president is in Australia;
- extend the Remuneration Tribunal's remuneration-setting responsibility to include certain bodies under the Corporations Act, including the Financial Reporting Council, the Australian Accounting Standards Board, and the Auditing and Assurance Standards Board; and
- make other related amendments, including to make transitional provisions.

1.18 Summary of 2014 SEC enforcement action

On 16 October 2014, the US Securities and Exchange Commission (SEC) announced that in fiscal year (FY) 2014, new investigative approaches and the innovative use of data and analytical tools contributed to a very strong year for enforcement marked by cases that spanned the securities industry.

In the fiscal year that ended in September 2014, the SEC filed a record 755 enforcement actions covering a wide range of misconduct, and obtained orders totalling US$4.16 billion in disgorgement and penalties, according to preliminary figures. In FY 2013, the Commission filed 686 enforcement actions and obtained orders totalling US$3.4 billion in disgorgement and penalties. In FY 2012, the Commission filed 734 enforcement actions and obtained orders totalling US$3.1 billion in disgorgement and penalties.

The SEC's enforcement actions also included a number of first-ever cases, including actions involving the market access rule, the "pay-to-play" rule for investment advisers, an emergency action to halt a municipal bond offering, and an action for whistleblower retaliation.

Further information is available on the SEC website.

1.19 FSB consults on the identification of critical functions for systemically important insurers

On 16 October 2014, the Financial Stability Board (FSB) launched a public consultation on guidance for the identification of the critical functions and critical shared services for systemically important insurers. The guidance aims to assist national authorities in implementing the recovery and resolution planning requirements set out in the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions and in the policy measures (18 July 2013) of the International Association of Insurance Supervisors (IAIS) for globally systemically important insurers (G-SIIs).

The draft guidance on the identification of critical functions and critical shared services for insurers is designed to support resolution planning for G-SIIs and other systemically important insurers by providing a framework for the identification of the functions and services that would need to be maintained in resolution consistent with the objectives of systemic stability and policyholder protection.

The consultation document is available on the FSB website.

1.20 Recovery of financial market infrastructures - final report issued by CPMI-IOSCO

On 15 October 2014, the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) published the report Recovery of financial market infrastructures (October 2014).

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

FMIs, which include payment systems, securities settlement systems, central securities depositories, CCPs and trade repositories, play an essential role in the global financial system. The disorderly failure of an FMI could lead to severe systemic disruption if it caused markets to cease to operate effectively.

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

1.21 Regulators and government agencies annual reports

Several regulators and other government agencies with responsibility for corporate law and corporate governance have recently released their annual reports for 2013-2014.

They include the following:

- Australian Accounting Standards Board (AASB)
- Australian Auditing and Assurance Standards Board (AUASB)
- Australian Office of Financial Management (AOFM)
- Australian Prudential Regulation Authority (APRA)
- Australian Securities and Investments Commission (ASIC)
- Australian Securities Exchange (ASX)
- Commonwealth Director of Public Prosecutions (CDPP)
- Commonwealth Treasury
- Financial Reporting Council (FRC)
- Australian Financial Security Authority (AFSA) (formerly ITSA)
- Takeovers Panel.

Two government agencies have not produced annual reports for 2013-14.

They are:

- Companies Auditors and Liquidators Disciplinary Board (CALDB). It appears as though the CALDB does not have the required number of members, including a chairperson and this may be why it has not as yet produced its annual report for 2013-14 (further information).
- Corporations and Markets Advisory Committee. The Commonwealth Government announced as part of the 2014-15 Budget Statement that CAMAC would be abolished. Although this has not yet occurred, CAMAC has not

operated since the announcement and has therefore not produced an annual report for 2013-14.

1.22 Latest Centre for Corporate Law and Securities Regulation research papers (Insider trading enforcement in Australia; and Consumer rights awareness of young Australians)

The following are the most recent research papers authored by members of Melbourne Law School's Centre for Corporate Law and Securities Regulation.

(a) Insider trading enforcement in Australia (by Victor Lei and Ian Ramsay)

Increased attention is being given to the enforcement of insider trading laws. In this paper the authors present the results of an empirical study of the enforcement of Australian insider trading laws since the first enforcement case in 1973. The issues examined by the authors include (a) the extent to which the enforcement of insider trading laws has increased over time; (b) details of the alleged contravention (such as the profit alleged to have been made and whether the alleged contravention was criminal or civil); (c) details of the defendant including the position they held at the time of the alleged contravention; (d) details of the company whose securities were the subject of the alleged insider trading; (e) details of the outcome of the matter (including the penalty imposed when the regulator was successful); and (f) the time taken to complete an insider trading matter. The key findings include that the regulator is bringing more insider trading cases, having greater success, and reducing the time to complete the cases.

The paper is available on the SSRN website.

(b) Consumer rights awareness of young Australians (by Paul Ali, Malcolm Anderson, Cosima McRae and Ian Ramsay)

Although young Australians are active consumers there is little evidence about their knowledge of consumer rights. The authors report the results of a survey of 207 Australian school students aged 16 to 17 aimed at ascertaining their knowledge of consumer rights. Focus group interviews were also conducted with 68 students. Factors that positively affect knowledge of consumer rights are the geographic location of the school that students attended, the proportion of students at each school that spoke a language other than English, the occupation of the parents of students, and whether students discussed money matters with parents or teachers. Insights from the focus group interviews include: the existence of significant differences in students' knowledge of consumer rights; that personal experience appears to make a difference to individual awareness of consumer rights; and that a substantial proportion of students lacked the confidence to exercise their consumer rights.

The paper is available on the SSRN website.

2. Recent ASIC Developments

2.1 Focus for 31 December 2014 financial reports

On 7 November 2014, ASIC announced its areas of focus for 31 December 2014 financial reports of listed entities and other entities of public interest with many stakeholders.

ASIC encourages preparers and auditors of financial reports to carefully consider the need to impair goodwill and other assets. ASIC continues to find impairment calculations that use unrealistic cash flows and assumptions, as well as material mismatches between the cash flows used and the assets being tested for impairment.

Fair values attributed to financial assets should also be based on appropriate models, assumptions and inputs.

Particular focus should be given to assets of companies in extractive industries and mining support services, as well as asset values that may be affected by digital disruption.

Preparers and auditors should focus on the appropriateness of key accounting policy choices that can significantly affect reported results. These include off-balance sheet arrangements, revenue recognition, expensing of costs that should not be included in asset values, and tax accounting.

ASIC's surveillance continues to focus on material disclosures of information useful to investors and others using financial reports, such as assumptions supporting accounting estimates, significant accounting policy choices, and the impact of new reporting requirements. ASIC does not pursue immaterial disclosures that may add unnecessary clutter to financial reports.

Even though directors do not need to be accounting experts, they should seek explanation and professional advice supporting the accounting treatments chosen if needed and, where appropriate, challenge the accounting estimates and treatments applied in the financial report. They should particularly seek advice where a treatment does not reflect their understanding of the substance of an arrangement.

Further information is available on the ASIC website.

2.2 Updated responsible lending guidance

On 5 November 2014, ASIC updated its guidance for credit licensees on their responsible lending obligations.

The updated guidance reflects:

- a recent Federal Court decision that is relevant to all credit licensees regarding their responsible lending obligations
- changes to statutory restrictions on charges for small amount credit contracts, and
- clarification of existing guidance, and removal of some material that ASIC considers to be repetitive or no longer necessary.

On 26 August 2014, the Federal Court handed down its first decision on the responsible lending obligations: *ASIC v The Cash Store (in liquidation)* [2014] FCA 926.

The Federal Court ruled that The Cash Store Pty Ltd (in liquidation) and loan funder Assistive Finance Australia Pty Ltd had failed to comply with their responsible lending obligations in relation to their customers, the majority of whom were on low incomes or in receipt of Centrelink benefits.

The Federal Court's decision makes it clear that credit licensees must, at a minimum, inquire about the consumer's current income and living expenses to comply with the responsible lending obligations. Further inquiries may be needed depending on the circumstances of the particular consumer.

ASIC has updated Regulatory Guide 209 Credit licensing: Responsible lending conduct (November 2014) (RG 209) to incorporate the general findings of the Federal Court on the responsible lending obligations for credit licensees.

ASIC has also updated RG 209 to make it clear that credit licensees cannot rely solely on benchmark living expense figures rather than taking separate steps to inquire into borrowers' actual living expenses.

The Australian Prudential Regulation Authority (APRA) also released on 5 November 2014 final guidance for authorised deposit-taking institutions on sound risk management practices for residential mortgage lending.

APRA's prudential practice guide APG 223 Residential mortgage lending is available on the APRA website. Credit providers should consider both sets of guidance when engaging in home lending.

2.3 Updated employee incentive scheme policy and release of class orders

On 31 October 2014, ASIC released an updated regulatory guide and new class orders on employee incentive schemes.

ASIC's updated Regulatory Guide 49 Employee incentive schemes (RG 49) follows Consultation Paper 218 Employee incentive schemes (CP 218), issued in November 2013.

ASIC has also replaced Class Order [CO 03/184] Employee share schemes with two new class orders to facilitate the offer of a range of financial products under employee incentive schemes. One class order relates to listed bodies and the other to unlisted bodies.

Employee incentive schemes are designed to encourage retention and long-term interdependence between employers and employees by improving business performance, engaging employees and strengthening employee commitment. They are structured to align the economic interests of both parties and many do this by offering an ownership interest in the company, or a financial return linked to the performance and success of the company.

While broadening the scope of ASIC's employee incentive scheme relief, ASIC has not changed its fundamental policy settings, that is, to require:

- the terms of the employee incentive scheme to support the long-term mutual interdependence between employer and employee
- that employees have adequate information to assess the value of what they are being offered and to understand the terms and conditions, and
- the employee incentive scheme is not offered for fundraising purposes.

ASIC also released Report 417 Response to submissions on CP 218 Employee incentive schemes (REP 417).

The regulatory guide and class orders are available on the ASIC website.

2.4 Areas for improvement in home insurance sales practices

On 28 October 2014, ASIC released two reports exploring consumer experiences with the sale of home building insurance.

The two reports are:

- Report 415 Review of the sale of home insurance (REP 415); and
- Report 416 Insuring your home: Consumers' experiences buying home insurance (REP 416).

Report 415 is an ASIC review of the sales practices of 12 insurers (representing 30 home insurance brands) who sell home insurance across Australia. The report reviews and makes findings in relation to the sale of home building insurance through telephone sales (which included the review of 400 telephone sales call recordings), online sales, online calculators, advertising and promotional materials, and staff training and monitoring.

Report 416 presents findings based on qualitative and quantitative research (conducted by Susan Bell Research) of consumers who inquired about or purchased home insurance during 2013.

ASIC's review also found a number of examples of potential misconduct in relation to the advertising of home insurance products. ASIC is currently communicating with some insurers and is considering undertaking further regulatory action with other relevant insurers, in relation to these issues.

2.5 Strategic outlook

On 20 October 2014, ASIC published its Strategic Outlook for 2014-15. A new initiative, the Strategic Outlook sets out the key risks ASIC sees to the markets it regulates, and how ASIC will respond—prioritising its tools of surveillance and enforcement.

This document brings analysis of underlying trends together with the key risks to investors, financial consumers, and the sectors and participants ASIC regulates for 2014-15.

ASIC has identified risks around globalisation, innovation-driven complexity, gatekeeper conduct, and the different expectations and uncertainty the public may have about what ASIC can achieve.

The strategic outlook can be found on the ASIC website.

3. Recent ASX Developments

3.1 Consultation Paper: "Reducing red tape - proposed amendments to ASX's admission and notification requirements"

On 31 October 2014, ASX released the consultation paper *Reducing red tape - proposed amendments to ASX's admission and notification requirements*.

ASX is proposing to standardise and streamline the admission and notification requirements for the ASX and ASX24 markets and the clearing and settlement facilities that service those markets (ASX Clear, ASX Clear (Futures) and ASX Settlement). This will make it easier, faster and cheaper for organisations to become participants in ASX's markets and facilities, encouraging more organisations to participate in Australia's financial markets and bringing added strength, liquidity and diversity to them. It will also reduce the ongoing compliance overhead for participants in those markets and facilities.

The consultation paper is available on the ASX website.

3.2 Reports

On 5 November 2014 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 October 2014.

4. Recent Research Papers

4.1 The impact of whistleblowers on financial misrepresentation enforcement actions

Whistleblowers are ostensibly a valuable resource to regulators investigating securities violations, but whether whistleblowers have any measurable impact on the outcomes of enforcement actions is unclear. Using a dataset of employee whistleblowing allegations obtained from the US government and all enforcement actions for financial misrepresentation, the authors find whistleblower involvement accounts for 30% of US$70.13 billion in total penalties assessed and more than doubles prison sentences against individuals. However, these benefits are not without cost as enforcement actions involving whistleblowers take nearly ten months longer to complete. The authors' findings are relevant to firms, policymakers, regulators, and researchers.

The paper is available on the SSRN website.

4.2 Do M&A lawsuits discipline managers' investment behaviour?

Using US securities lawsuits related to M&A as an industry shock, the authors examine whether litigation risk acts as an external governance mechanism by disciplining managers' investment decisions. In the two years following an M&A lawsuit (a lawsuit where plaintiffs allege that the firm hid poor performance related to a prior acquisition), the authors find that industry peers experience higher bidder announcement returns, choose more adequate methods of payment, and engage in fewer diversifying and smaller takeovers. Collectively, this evidence is consistent with post lawsuit deals being of higher quality. Furthermore, they find that peer firms respond to the increased litigation risk by reducing abnormally high investment expenditures. Finally, the reactions are stronger among firms with fewer anti-takeover provisions. Overall, the results show that M&A lawsuits can have an industry-wide deterrence effect on firms' suboptimal investment behaviour.

The paper is available on the SSRN website.

4.3 Executive compensation, director compensation and bank capital requirements reform

The authors study the executive compensation structure in the largest 14 US financial institutions during 2000-2008. They find that managerial incentives matter—

incentives generated by executive compensation programs led to excessive risk-taking by banks contributing to the current financial crisis. The authors recommend the following compensation structure for senior bank executives: Executive incentive compensation should only consist of restricted stock and restricted stock options—restricted in the sense that the executive cannot sell the shares or exercise the options for two to four years after their last day in office. Such an incentive compensation policy will discourage managers from undertaking high-risk investments that are value destroying; instead focus their attention on creating and sustaining long-term shareholder value.

Also, the authors suggest that director incentive compensation be constructed along the lines noted above. Specifically, all incentive compensation for directors should only consist of restricted equity (restricted stock and restricted stock option)—restricted in the sense that directors cannot sell the shares or exercise the options for two to four years after their last board meeting.

The above equity based incentive programs lose their effectiveness in motivating managers (and directors) to enhance shareholder value as a bank's equity value approaches zero (as they did for the too-big-to-fail banks in 2008). Additionally, the evidence suggests that bank CEOs sell significantly greater amounts of their stock as the bank's equity-to-capital ratio decreases. Hence, for equity based incentive structures to be effective, banks should be financed with considerable more equity than they are being financed currently. Greater equity financing of banks coupled with the above compensation structure for bank managers and directors will drastically diminish the likelihood of a bank falling into financial distress; this will effectively address the too-big-to-fail problem and the Volcker Rule implementation that are two of the more significant challenges facing the implementation of the Dodd-Frank Act.

The paper is available on the SSRN website.

4.4 Does shareholder scrutiny affect executive compensation? Evidence from say-on-pay voting

As a result of the Dodd-Frank Act of 2010, US public firms must periodically hold advisory shareholder votes on executive compensation (say-on-pay). The authors examine how firms change the structure and level of executive pay when they face a say-on-pay vote. Their identification strategy exploits within-firm variation in the intensity of shareholder scrutiny, by comparing compensation across years when a firm is expected to face a vote, versus years when it is not. This strategy is enabled by firms that hold votes every other two or three years, resulting in a predetermined cyclical schedule for whether a particular year's compensation will be put to a vote. The authors find that firms reduce salaries to CEOs but increase their stock awards, pensions, and deferred compensation in years when they face a vote. The additional pay (mainly from stock awards) outweighs the reduction in salaries, so total pay is higher in years with a vote. These results show that increased shareholder scrutiny—in the form of holding say-on-pay votes—changes how executives are compensated. However, these changes seem mainly to improve the "optics" of pay, and, contrary to the goals of the say-on-pay regulation, result in higher, not lower, total pay.

The paper is available on the SSRN website.

4.5 Do long-term investors improve corporate decision making?

The authors study the effect of investor horizons on a comprehensive set of corporate decisions. Long-term investors have the means and motive to monitor corporate managers, which generates corporate decisions that are consistent with shareholder value maximization. The authors find that long-term investors restrain numerous corporate misbehaviours such as earnings management and financial fraud and foster shareholder democracy. They discourage a range of investment and financing activities but encourage payouts. Shareholders benefit through higher stock returns, greater profitability, and lower risk. Firms diversify their operations. The authors use a popular identification strategy to establish causality of their results.

The paper is available on the SSRN website.

5. Recent Corporate Law Decisions

5.1 No breach of fiduciary duty by director in pursuing business opportunity

(By Rebecca Hahn and Will Heath, King & Wood Mallesons)

Cornerstone Property & Development Pty Ltd v Suellen Properties Pty Ltd [2014] QSC 265, Supreme Court of Queensland, Jackson J, 28 October 2014

The full text of the judgment is available here.

(a) Summary

The plaintiff company entered into a contract to purchase a property for development. The relationship broke down between the plaintiff company's directors, one being the second defendant, and the contract was not completed. Subsequently, the second defendant incorporated the first defendant and entered into an identical contract to purchase the same property. On the settlement date, the plaintiff brought proceedings against the first and second defendants based on: (1) the second defendant director breaching her general law fiduciary duty to the plaintiff, and ss. 181 and 182 of the Corporations Act 2001 (Cth) (the Corporations Act); and (2) the first defendant being knowingly concerned with the second defendant's contraventions under s. 79 of the Act.

Jackson J ordered that the plaintiff's claims be dismissed. It was held that, in pursuing the business opportunity, the second defendant had acted outside of her fiduciary duty owed to the plaintiff company or, in the alternative, had received the plaintiff's fully informed consent.

(b) Facts

Cornerstone Property & Development Pty Ltd, the plaintiff, had three directors, Mr and Mrs Chalmers (the Chalmers), and Suellen Rushbrook, the second defendant. Mr Chalmers and the second defendant each held half of the shares in plaintiff. In November 2011, the Chalmers and the second defendant caused the plaintiff to enter into a conditional contract for the purchase of certain land at Chinchilla (the Contract) with the intention of developing the land (the Lot 7 Project). Following this, the business relationship between the Chalmers and the second defendant broke down. The Chalmers no longer wished to continue with the Lot 7 Project and in late February 2012 they resigned as directors of the plaintiff and informed the plaintiff that the contract was not to proceed. The Chalmers also notified the second defendant that she may continue with the Lot 7 Project alone. The contract did not proceed and the second defendant remained as the sole director of the plaintiff.

The second defendant subsequently incorporated Suellen Properties Pty Ltd, the first defendant. In April 2012, as the sole director and shareholder of the first defendant, the second defendant obtained an investor to fund the Lot 7 Project and caused the first defendant to enter into a contract to purchase Lot 7 on substantially the same terms as the Contract. Following this, the investor became a shareholder in the first defendant and appointed representatives to the board. Prior to settlement, the investor purchased the second defendant's shares in the first defendant and the second defendant resigned as a director of the first defendant. The acquisition of Lot 7 was settled in March 2013. On the settlement date, the plaintiff company commenced proceedings against the first and second defendant, based on an alleged breach of fiduciary duty by the second defendant or breaches of ss. 181 and 182 of the Act. Before bringing the proceedings, the plaintiff company had remained dormant following the Chalmers' resignation as directors.

(c) Decision

(i) No breach of fiduciary duty by second defendant director

The plaintiff company claimed that, in pursuing the Lot 7 Project through the first defendant, the second defendant breached her fiduciary obligation owed to the plaintiff not to act in a position of conflict.

Jackson J held that no such breach had occurred, either on the basis that the second defendant acted outside of the scope of her fiduciary duty to the plaintiff company or, alternatively, that the plaintiff had consented to any breach. In reaching this conclusion, his Honour applied *Queensland Mines v Hudson* (1978) 52 ALJR 399.

His Honour accepted that the Chalmers did not intend the plaintiff to pursue the Lot 7 Project following February 2012 and, accordingly, there was no breach of fiduciary duty because the second defendant's action in pursing the Lot 7 Project fell outside the limits of her "trust and agency", i.e. the scope of her fiduciary duty as a director of the plaintiff.

Jackson J held in the alternative that the second defendant received fully informed consent from the plaintiff company to pursue the corporate opportunity. His Honour observed what is required for fully informed consent is a question of fact in all the circumstances and there is no precise formula which will determine in all cases if fully informed consent has been given. Although the second defendant did not inform Mr Chalmers of her intention to pursue the Lot 7 Project through the first defendant company rather than the plaintiff company, consent could be inferred from the Chalmers expressing that they would no longer deal with the second defendant and that she "could proceed without [the Chalmers]". His Honour also noted that the financial position of the plaintiff company at this time supported the inference of consent, namely it had no assets or provider of finance.

(ii) No liability for first defendant company in connection with second defendant's conduct

Jackson J considered in obiter the extent of the first defendant's liability if it was found, contrary to the primary conclusion, that the second defendant had breached her fiduciary duty as a director of the plaintiff. His Honour considered in detail the application of the first and second limbs of *Barnes v Addy* (1873-1874) LR 9 Ch App 244 (*Barnes v Addy*).

Jackson J observed that under the first limb of *Barnes v Addy*, a third party may be a constructive trustee of property misapplied by a director in breach of their fiduciary duty if the property received by the third party is "trust property". His Honour noted that the plaintiff company had no equitable interest in the property. However, the question arose if the business opportunity to purchase the property could be considered "trust property". His Honour considered extensive case law and commentary on this issue and concluded in obiter that where a director breaches their fiduciary duty by providing information or assisting a third party to buy property, but where that property was not pre-existing company property, the third party does not receive "trust property" for the purpose of the first limb of *Barnes v Addy*.

Jackson J then considered the second limb of *Barnes v Addy* which requires that the third party knowingly assists in the breach of fiduciary duty. The plaintiff alleged that the first defendant was liable as the second defendant imputed her knowledge of her breach of fiduciary duty onto the first defendant. His Honour rejected this argument as the second limb of *Barnes v Addy* requires "dishonest and fraudulent design" by the second defendant, being "a transgression of ordinary standards of honest behaviour". His Honour held that the second defendant did not act with a "dishonest and fraudulent design" as she did not intend to take the benefit of the Lot 7 Project from the plaintiff and she believed that there was no prospect of the plaintiff proceeding with the Contract.

In further *obiter*, Jackson J noted a third form of third party liability may arise "where the third party is the corporate creature, vehicle, or alter ego of the wrongdoing fiduciary, who uses that corporation to secure the profit from or inflict the losses caused by the breach of fiduciary duty", but concluded it was unnecessary to decide whether this type of liability applied.

(d) Further observations

Jackson J made further observations in obiter relating to defences, statutory liability and relief.

Noteworthy *dicta* were:

- It was unconscientious for the plaintiff to claim relief due to a breach of fiduciary duty as the plaintiff had engaged in unconscientious conduct and acquiescence by bringing the action after a range of expenses had already been incurred by the defendants. His Honour found that the mind set of Mr Chalmers was to be imputed onto the plaintiff as it was Mr Chalmers who brought the action on behalf of the plaintiff.
- His Honour dismissed the plaintiff's claims that the second defendant had breached ss. 181 or 182 of the Act. The second defendant had not acted improperly nor had she acted in bad faith. Similarly, the first defendant avoided liability as it could not be considered to have been knowingly concerned with a contravention under s. 79 of the Act.
- In relation to the relief available to the plaintiff, should his Honour have found in favour of the plaintiff, Jackson J made three key observations. First, ordering a constructive trust over Lot 7 would be inequitable due to extensive costs being incurred in obtaining Lot 7, a bank loan being owed, and the plaintiff not offering to reimburse any of these expenses. Second, that the plaintiff had not proved on the balance of probabilities that it had incurred any loss or damage and therefore it was not entitled to any equitable relief. Third, to the extent that the second defendant had been found liable, the remedy

would have been to account for profits, being the amount she received for her shares in the first defendant minus an allowance representing her skill, expertise and other expenses.

5.2 The Court's power to extend time under s. 1322(4)(d) of the Corporations Act cannot be used to extend the time limit placed on commencing proceedings by s. 1317K of the Act

(By Vince Murano, Clayton Utz)

Austructures Pty Ltd v Makin [2014] VSC 544, Supreme Court of Victoria, Almond J, 27 October 2014

The full text of this judgment is available here.

(a) Summary

On its face, s. 1322(4)(d) of the Corporations Act 2001 (Cth) (the Act) provides the Court with power to extend time for instituting proceedings under the Act.

In this decision, however, the Supreme Court of Victoria held that the 6 year time limit on commencing a proceeding for a declaration of contravention, pecuniary penalty order or compensation order under s. 1317K of the Act cannot be extended by the Court under s. 1322(4)(d) of the Act.

(b) Facts

In March 2013, Austructures Pty Ltd and Pages Hire Centre commenced proceedings against Victor Makin (Makin) and Roder HTS Hocker GmbH (Roder). In their statement of claim, the plaintiffs alleged, among other things, that Makin had breached his duties as a director under ss. 180(1), 181(1), 182(1) and 183(1) of the Act. The statement of claim also set out claims against Roder.

On 8 August 2014, the plaintiffs filed a summons seeking leave to amend their statement of claim to rely on facts which allegedly occurred more than seven years before the proceeding was commenced.

The plaintiffs contended that the six-year time limit on commencing a proceeding for a declaration of contravention, pecuniary penalty order or compensation order under s. 1317K of the Act could be extended by the Court under s. 1322(4)(d) of the Act.

Section 1317K states:

> Proceedings for a declaration of contravention, a pecuniary penalty order, or a compensation order, may be started no later than 6 years after the contravention.

Section 1322(4)(d) states:

> Subject to the following provisions of this s. but without limiting the generality of any other provision of this Act, the Court may, on application by any interested person, make all or any of the following orders, either unconditionally or subject to such conditions as the Court imposes:
> ...
>
> d. an order extending the period for doing any act, matter or thing or instituting or taking any proceeding under this Act or in relation to a corporation (including an order extending a period where the period concerned ended before the application for the order was made) or abridging the period for doing such an act, matter or thing or instituting or taking such a proceeding;
>
> and may make such consequential or ancillary orders as the Court thinks fit.

(c) Decision

The plaintiffs' proposed amendments to their statement of claim:

- included allegations that Roder was involved (as defined by s. 79 of the Act) in statutory breaches by Makin; and
- concerned Roder's knowledge of Makin's contravening conduct.

Almond J held that because the plaintiffs' proposed amendments did not enlarge upon exiting claims but raised new claims, the Court was required to consider whether those amendments were barred by s. 1317K of the Act.

The plaintiffs argued that their statement of claim could be amended on the basis of the decision in *PSL Industries Ltd v Simplot Australia Pty Ltd* (2003) 7 VR 106 (*PSL Industries*). In PSL Industries, the Supreme Court of Victoria held that s. 34 of the Limitation of Actions Act 1958 (Vic) and rl. 36.01 of the Supreme Court (General Civil Procedure) Rules 2005 (Vic) gave the Court a discretion to allow amendments to a statement of claim notwithstanding that the limitation period in s. 82(2) of the *Trade Practices Act 1974 (Cth)* (the TPA) had expired. On its proper construction, the Court held that s. 82(2) of the TPA only barred the remedy in s. 82(1) of the TPA and did not extinguish the right to make a claim out of time.

On the basis of *PSL Industries*, the plaintiffs contended that:

- the words "within 3 years" in s. 82(2) of the TPA are analogous with the words "no later than 6 years" in s. 1317K of the Act; and
- s. 1317K of the Act only bars recourse to remedies under the Act and does not extinguish the right to make a claim out of time.

Almond J dismissed the plaintiffs' argument and held that the Court does not have a discretion under s. 1322(4)(d) of the Act to extend the time limitation prescribed by s. 1317K of the Act for the following reasons:

- the words "no later than 6 years after the contravention" in s. 1317K of the Act were construed to have the same operative effect as the words "may only be begun 6 years after the contravention" in the repealed s. 1317HD of the Corporations Law 1989 (Cth) (the Law) (s. 1317HD of the Law was the predecessor to s. 1317K of the Act). On that basis, s. 1317K of the Act, like s. 1317HD of the Law, bars both the remedy and the right to commence an action;
- when s. 1317K of the Act was enacted, an intention to alter the effect of s. 1317HD of the Law was not evidenced in the Explanatory Memorandum that discussed "significant changes" in the new Part 9.4B of the Act;
- s. 1317K of the Act specifically regulates the time period within which an action may be commenced under Part 9.4B of the Act (which regulates the civil consequences of contravening civil penalty provisions). Instead, s. 1322(4)(d) of the Act is a separate general remedial provision located in Part 9.5 of the Act; and
- construing s. 1317K of the Act in favour of the defendants would not deprive s. 1322(4)(d) of the Act of its scope and operation as s. 1322(4)(d) of the Act may be used to extend time limits imposed:
    - under ASIC class orders: *Re Dana Australia (Holdings) Pty Ltd* (2006) 57 ACSR 99;
    - for seeking quotation of securities on a financial market: *Re Nusep* (2007) 62 ACSR 301;
    - on minority shareholders seeking relief in the nature of winding up orders or orders that shares be purchased at fair value; and
    - on proceedings brought derivatively on behalf of a company (depending on the orders sought).

Further, Almond J held that, in this case, an application to extend time would have been refused by the Court even if s. 1322(4)(d) of the Act allowed the Court to extend time for the purposes of s. 1317K of the Act. His Honour made the following observations in relation to why time would not have been extended:

- the plaintiffs provided no explanation regarding why the claims they sought to raise could not have been advanced when proceedings were issued in March 2013; and
- other evidence advanced by the plaintiffs did not provide any clear basis for the Court to exercise any discretion it may have had to extend time.

5.3 Court sets aside statutory demand in circumstances where there is genuine dispute about the existence of the debt and substantial injustice

(By Tom Ward, Minter Ellison)

In the matter of MK Group Phoenix Pty Ltd [2014] NSWSC 1467, Supreme Court of New South Wales, Black J, 24 October 2014

The full text of this judgment is available here.

(a) Summary

This case is an example of the Court setting aside a statutory demand pursuant to ss. 459H(1)(a) and 459J of the Corporations Act 2001 (Cth) (the Act) where the Court held there was a genuine dispute about the existence of the debt and that substantial injustice would be caused unless the demand was set aside.

(b) Facts

MK Group Phoenix Pty Ltd (MK Group) entered into a Mortgage Syndication Agreement (MSA) with Tripod Funds Management Pty Ltd (Tripod) to obtain funding for the potential development of a site at Crows Nest, New South Wales. The MKA was effectively an agreement for the provision of services that may or may not result in the provision of a loan, in exchange for fees made payable by MK Group.

Clause 15 of the MSA required MK Group to pay a fee when it received a letter of offer for a loan on specified terms. This fee was described as the "Entry Fee" and was calculated as 3.3% of the "indicative syndication fee," or proposed loan facility.

Clause 15.11 of the MSA provided that the "Entry Fee" was payable if, inter alia, MK Group repudiates or terminates the MSA.

While it is not expressly clear in the judgment, it appears that prior to 19 May 2014, an offer of loan for $32,000,000 was made to MK Group.

On 19 May 2014, MK Group sent an email to Tripod stating that MK Group was no longer pursuing the potential development at Crows Nest. Tripod considered this email to be a repudiation of the MSA and accordingly issued a default notice relying on cl. 15 of the MSA. The notice of default requested payment of $1,056,000 within 7 days, which was calculated as 3.3% of the proposed $32,000,000 loan.

On 22 May 2014, Tripod issued a statutory demand in the amount of $1,056,000 (the Demand).

MK Group, then applied to have the Demand set aside under s. 459H of the Act and alternatively under s. 459J of the Act.

(c) Decision

Justice Black set aside the Demand on two separate grounds.

Firstly, the Demand was set aside under s. 459H(1)(a) of the Act, which allows a statutory demand to be set aside if there is a genuine dispute about the existence of the debt. His Honour noted that to satisfy s. 459H(1)(a) of the Act, there must be a plausible contention requiring investigation.

His Honour was satisfied that there was a genuine dispute about the existence of the debt for three reasons. Prior to issuing the Demand, Tripod did not issue MK Group with a tax invoice. Clause 20 of the MKA provided that the obligation to make payment of the "Entry Fee" arose within seven days from the issue of a tax invoice. Thus his Honour was satisfied that there was a genuine dispute about whether an obligation to make the payment had arisen.

His Honour also accepted that there was a serious question regarding whether MK Group had repudiated or terminated the MKA in its email to Tripod on 19 May 2014. The email did not expressly state anything to this effect, and if it was no more than a summary of MK Group's position then Tripod had purported to act in a manner that was not properly available to it.

His Honour was also satisfied that there was a serious question to be tried as to the proper construction of cl. 15.11 of the MSA. It was noted that the construction proposed by Tripod could potentially require MK Group to pay the Entry Fee even if Tripod was in fundamental breach of the MSA.

Secondly, his Honour set aside the statutory demand under s. 459J of the Act, which allows a statutory demand to be set aside where substantial injustice will be caused unless the demand is set aside or there is some other reason why the demand should be set aside. The notice of default was sent on 19 May 2014, and required MK Group to pay Tripod the amount within 7 days. However Tripod then issued the Demand 3 days later on 22 May 2014. His Honour noted that the authorities make clear that a statutory demand that relies on, or includes, a debt that is not yet due for payment may be set aside, although the case law differs as to whether such an order may be made under s. 459H or s. 459J of the Act.

MK Group also claimed that the Demand should be set aside pursuant to s. 459H(1)(b) of the Act, as it had an offsetting claim in an amount exceeding the Demand. However, Justice Black did not consider it necessary to determine whether there was an offsetting claim since he had held that the Demand should be set aside on other grounds.

5.4 Extension of time to hold AGM granted

(By Katrina Fong, Ashurst)

MDA National Limited, in the matter of MDA National Limited [2014] FCA 1140, Federal Court of Australia, Yates J, 23 October 2014

The full text of this judgment is available here.

(a) Summary

The plaintiff, a public company, applied under s. 1332(4)(d) of the Corporations Act 2001 (Cth) (the Act) for an extension of time within which to hold its annual general meeting (AGM). Given the unusual circumstances which confronted the plaintiff, including the resignation of a number of officeholders and various constitutional processes required for the election of directors, the Court ordered that the time fixed by s. 250N(2) of the Act for holding the plaintiff's AGM be extended up to and including 31 March 2015.

(b) Facts

On 27 March 2014, the MDA National Limited (the plaintiff) and Medical Defence Association of South Australia Limited (MDASA) entered into a Merger Implementation Agreement to form a single medical defence organisation, Medical Defence Australia Limited. The merger was to be effected, in part, by a scheme of arrangement between the plaintiff and its members (the MDAN scheme).

On 20 August 2014, Justice Yates ordered, among other things, the convening of a meeting of the plaintiff's members to consider whether the MDAN scheme should be agreed to: *MDA National Limited v Medical Defence Australian Limited* [2014] FCA 954. At that meeting, held on 11 October 2014, the plaintiff's members did not agree to the MDAN scheme.

The plaintiff's company secretary gave evidence that the plaintiff's board of directors and management expected the MDAN scheme to be agreed to and the merger with MDASA to be completed before 30 November 2014. By s. 250N(2) of the Act, a public company, such as the plaintiff, must hold an AGM at least once every calendar year and within five months after the end of its financial year. At the time the matter came before the Court, the plaintiff was required to hold an AGM on or before 30 November 2014. However, had the MDAN scheme been agreed to and the merger completed, the plaintiff would not have been required to hold an AGM in light of the exception provided by s. 250N(4) of the Act.

Following the meeting held on 11 October 2014, the plaintiff's chairperson and another director resigned, and three of the remaining directors were required, by rotation, to step down. The plaintiff's constitution stipulated that a notice calling for nominations for election of directors was required to be published at least seven weeks before an AGM, and those directors seeking to be re-elected were required to give at least six weeks' written notice. It was also usual practice for the plaintiff to open nominations for up to three weeks and for its board elections to be facilitated through the Western Australian Electoral Commission (a process which takes at least one week). Additionally, the plaintiff's chief executive officer (CEO) had announced his retirement.

The plaintiff had considered the cost consequences of holding an AGM prior to 30 November 2014 and then holding a separate extraordinary general meeting (EGM) for the election of directors. However, the estimated cost of holding two meetings was approximately $31,000. Given these costs and its unusual circumstances, the plaintiff sought an extension to 31 March 2015 to hold an AGM.

(c) Decision

Justice Yates was of the opinion that the discretion to extend time pursuant to s. 1322(4)(d) of the Act should be exercised. As Yates J had observed in *Woolworths Limited v GetUp* (2012) 90 ACSR 670, the power reposed in the Court by s. 1322(4)(d) of the Act is a wide one, conditioned only by the requirement that no substantial injustice is likely to be caused to any person.

In this case, Yates J held that it was not unreasonable for the view to be taken that, if the merger were to proceed as expected, it would not be necessary for the plaintiff to hold an AGM and that accordingly, steps towards the convening the AGM would not be instituted. His Honour acknowledged that the outcome of the MDAN scheme vote could not have been predicted with certainty, such that the plaintiff could not reasonably hold the view that, after the announcement of the proposed merger, there was no prospect that it would be required to hold an AGM for 2014. However, his Honour accepted that communications with the plaintiff's members on the question of an AGM, at a time when the proposed merger had been announced and was under active consideration by the members, may have presented a confusing and contradictory picture for them as to what the future direction of the company was proposed to be. Furthermore, the plaintiff now faced organisational instability with the resignation of its CEO, chairman and one of the directors.

Justice Yates found that for the plaintiff to hold an AGM, and a further EGM at a later stage, would only lead to unnecessary expenditure. It was sufficient for a single meeting to be held, as an AGM, at which all current matters, including the election or re-election of directors, could be considered by the members at the one time without any real prejudice suffered by reasons of the delay. Accordingly, Yates J ordered that the time fixed for holding the AGM of the plaintiff be extended up to and including 31 March 2015.

5.5 Court dismisses securities class action proceedings

(By Daniel Kornberg, DLA Piper)

Melbourne City Investments Pty Ltd v WorleyParsons Ltd (No 2) [2014] VSC 523, Supreme Court of Victoria, Ferguson JA, 17 October 2014

The full text of this judgment is available here.

(a) Summary

Melbourne City Investments Pty Ltd (MCI) brought a securities class action against WorleyParsons Limited (WorleyParsons) for an alleged breach of ASX Listing Rule 3.1, breaching its continuous disclosure obligations under the Corporations Act (the Act), as well as misleading and deceptive conduct.

MCI sought direction from the Supreme Court of Victoria that WorleyParsons give corrective disclosure as well as a declaration from the Court that the breach occurred.

Ferguson JA dismissed MCI's proceeding on the basis that there was no reasonable prospect of success in regard to obtaining the direction and declaration that it sought. This was largely due to the fact that WorleyParsons had already corrected the breaches in an announcement to the ASX and the remedies sought would have no foreseeable effect on the parties. Furthermore, MCI had purchased the shares before the conduct had occurred and therefore had no real interest to protect.

While the Court agreed that there was public interest in ensuring compliance with the listing rules, it held that public interest alone was not sufficient to turn non-compliance with the ASX Listing Rules, a civil offence, into a quasi-criminal one through a court direction.

(b) Facts

MCI purchased, and still holds, a small shareholding in WorleyParsons. In August 2013, WorleyParsons published forecasts of increased earnings in the 2014 financial year. In November 2013, however, WorleyParsons in an announcement to the ASX, advised the market that its business would generate materially lower earnings than first forecast and that it would incur restructuring costs.

Despite being aware, allegedly, in August 2013, that its initial forecasts were incorrect, WorleyParsons did not disclose any expectation of restructuring costs, nor did it make available any information concerning the revised forecasts generally before the November 2013 announcement.

ASX Listing Rule 3.1 provides that an entity must disclose any information to the ASX that a reasonable person would expect to have a material effect on the price of that entity's shares. MCI, therefore, alleged that WorleyParsons' delay in disclosure constituted a breach of ASX Listing Rule 3.1 as well as its continuous disclosure obligations under the Act, and amounted to misleading and deceptive conduct.

MCI had standing to seek relief from the Court for WorleyParsons' failure to comply with ASX Listing Rule 3.1 as, by virtue of being a shareholder, it is a "person aggrieved" under s. 793C of the Act. MCI did not seek damages or compensation, instead it sought a direction that WorleyParsons comply with Listing Rule 3.1, as well as a declaration from the Court that WorleyParsons had contravened that rule.

(c) Decision

The Supreme Court of Victoria dismissed the proceeding on the basis that MCI was unable to articulate a cause of action that had a reasonable prospect of success and that it had no real interest in the litigation.

(i) Reasonable prospects for the direction sought by MCI

MCI sought a direction from the Court that WorleyParsons provide corrective disclosure relating to their past non-disclosure of matters that may have impacted the company's share price. The Court accepted MCI's argument that it had standing as an aggrieved person by virtue of being a shareholder. Additionally, Ferguson JA agreed with the applicant that there was a public interest in enforcing the observance of the ASX Listing Rules.

WorleyParsons argued that a direction could only be made under s. 793C of the Act where there is existing or continued non-compliance with the Listing Rules. There was no allegation by MCI that WorleyParsons continued to breach Listing Rule 3.1, nor that it was likely to contravene the rules in the future.

Her Honour stated that should the Court give a direction of the sort sought by MCI to make WorleyParsons comply in the future with Listing Rule 3.1, it would effectively turn that obligation from a civil one into a quasi-criminal obligation, punishable by contempt, which her Honour felt was inappropriate under the circumstances.

Further, as WorleyParsons had already corrected the alleged non-disclosure and misleading and deceptive conduct through their announcement in November 2013, the past breach could have little or no impact on WorleyParson's share price in the future. For these reasons, the Court stated that there was no reasonable prospect of success of MCI being granted relief in the form of a direction for corrective disclosure.

(ii) Reasonable prospects for the declaration sought

MCI also sought a declaration, ancillary to the direction, from the Court that WorleyParsons had contravened ASX Listing Rule 3.1.

Ferguson JA stated that a declaration cannot be made if it will produce no foreseeable consequences for the parties. Additionally, her Honour referred to *Ainsworth v Criminal Justice Commission* (1992) 175 CLR 564 in which it was stated that "declaratory relief must be directed to the determination of legal controversies and not to answering abstract or hypothetical questions". As such, her Honour found that a court would refuse the declaration sought on the same grounds as it would not grant the direction desired by MCI, as there was no reasonable prospects of the declaration sought being granted.

Her Honour went on to note that MCI was not affected by any alleged failure to disclose nor any misleading and deceptive conduct as the conduct in question occurred after MCI had purchased its shares in WorleyParsons. Therefore the declaratory relief would be for the sole purpose of satisfying the public interest or as a means to promote compliance in the ASX Listing Rules. Her Honour held that no court would grant declaratory relief on that basis.

(iii) Other complaints about the pleading

WorleyParsons made complaints that the proposed pleading was vague, embarrassing and an abuse of process. Given Ferguson JA's conclusion relating to the primary contentions of WorleyParsons, her Honour did not decide anything in regard to this issue. There is a separate group proceeding brought by another shareholder of WorleyParsons based on a similar pleading. The Court did not want to prejudice the other proceeding by expressing any further view on the pleading than was necessary in this instance.

(iv) Should the proceeding be dismissed?

Ferguson JA held that MCI ought not to be given a further opportunity to plead a case. Her Honour stated that MCI failed in all four of its proposed pleadings to articulate a viable case and it was unlikely that the situation would change in that regard. Additionally, her Honour felt that MCI had no real interest in pursuing the litigation as it had purchased the shares prior to the alleged conduct taking place.

Her Honour therefore dismissed MCI's case in accordance with the overarching principle contained in the Civil Procedure Act 2010 (Vic) to facilitate the just, efficient, timely and cost-effective resolution of the real issues in dispute.

5.6 Appeal granted against order staying part of oppression and derivative action claim pursuant to s. 8 of Commercial Arbitration Act 2011 (Vic)

(By Loretta Li, Clayton Utz)

Brazis v Rosati & Ors [2014] VSCA 264, Supreme Court of Victoria, Court of Appeal, Kyrou JA and Ginnane AJA, 17 October 2014

The full text of this judgment is available here.

(a) Summary

This is a decision of the Victorian Court of Appeal regarding an application for leave to appeal following an order made in *Re 700 Form Holdings Pty Ltd* [2014] VSC 385, 19 August 2014 (*Re 700 Form Holdings*). *Re 700 Form Holdings* concerned a dispute between various individuals and entities that are related by virtue of a formwork business (Business) they operated together. In that proceeding, Paul Brazis, Brazis Nominees Pty Ltd and Ferndell Pty Ltd (together, the Applicants) sought relief under the oppression and derivative action provisions of the Corporations Act 2001 (Cth) (the Corporations Act), against other members of the group of companies that operated the Business (the Group Companies) and the directors of the Group Companies (together, the Respondents).

The trial judge ordered part of that proceeding to be stayed pursuant to s. 8 of the Commercial Arbitration Act 2011 (Vic) (the Arbitration Act), as he found that the oppression claims (the Claim) brought by the Applicants enlivened the arbitration clauses (the Arbitration Agreement) contained in the shareholders' agreement which governed the relationship between some of the Applicants and some of the Respondents (the Shareholders' Agreement).

In this proceeding, Kyrou JA and Ginnane AJA granted the Applicants' application for leave to appeal the trial judge's decision, on the basis that there was sufficient doubt about whether the trial judge had erred by emphasising whether the matter was a dispute arising in connection with the Shareholders' Agreement or in relation to the

Business, instead of considering whether the Claim was an action brought in a matter which was the subject of an "arbitration agreement" within the meaning of s. 8 of the Arbitration Act.

(b) Facts

The Applicants were shareholders in some of the Group Companies, and Paul Brazis was a former director of each of the Group Companies. The Respondents, which included Wasyl Rosati, Emilio Rosati (father of Wasyl Rosati) and Nick Spiropoulos, were directors of each of the Group Companies.

Paul Brazis, Emilio Rosati and Nick Spiropoulos, among others who were party to this proceeding, were parties to the Shareholders' Agreement. Clause 12 of the Shareholders' Agreement provided a cascading set of dispute resolution mechanisms:

> If a dispute arises in connection with this Agreement or in relation to the Business, a party to the dispute must give the other party or parties to the dispute notice specifying the dispute and requiring its resolution under this clause 12.

If the dispute was not resolved within seven days of the notice being given, the dispute was to be mediated. Clause 12.6 then provided that if the dispute was not resolved within 28 days after the appointment of the mediator, the dispute was to be referred to arbitration.

On 23 August 2013, the Applicants gave a notice of offer in accordance with the Shareholders' Agreement to sell their shares in the relevant Group Companies. The offer was not accepted.

At trial, the Applicants sought relief under the oppression and derivative action provisions of the Corporations Act.

Among the allegations were:

- that Wasyl Rosati and Nick Spiropoulos carried out their duties as directors of the Group Companies under the dictation of Emilio Rosati and that they pressured Paul Brazis to resign as a director of the Group Companies;
- that various transactions had been undertaken by Emilio Rosati and the Group Companies without the Applicants' consent; and
- that Emilio and Wasyl Rosati and Nick Spiropoulos used funds and resources of the Group Companies to obtain substantial benefits for themselves.

The Applicants sought an order that the Respondents purchase the Applicants' shares in the Group Companies and that the Respondent directors pay statutory or equitable compensation, and or an account of profits, for breaches of their directors' duties.

The Respondents in turn sought an order that the proceeding be stayed pursuant to s. 8 of the Arbitration Act on the basis that the Arbitration Agreement required that the proceeding be resolved by arbitration. Section 8(1) of the Arbitration Act provides:

> A court before which an action is brought in a matter which is the subject of an arbitration agreement must, if a party so requests not later than when submitting the party's first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

The trial judge stayed the dispute between the Applicants and the Respondents on the basis that the words "in connection with" in the Arbitration Agreement were to be given a wide compass, as the connecting words went beyond disputes relating to the mere breach, construction, formation and performance of the Shareholders' Agreement, and therefore included the Claim brought by the Applicants.

The trial judge also considered that, since the result of the Claim might be to force one shareholder to purchase the shares of another shareholder, and therefore to terminate the relationship between the Applicant shareholders and the Respondent shareholders, the matter was a dispute arising in connection with the Shareholders' Agreement or in relation to the Business, again falling within the scope of the Arbitration Agreement.

To the extent that the Claim related to parties in the proceeding who were not parties to the Shareholders' Agreement, the Claim was not stayed.

(c) Decision

In their application for leave to appeal in this proceeding, the Applicants had to satisfy the Court of the two limbs in *Niemann v Electronic Industries Ltd* [1978] VicRp 44, [1978] VR 431:

- that the trial judge's decision was wrong or attended with sufficient doubt to justify the grant of leave; and
- that substantial injustice would arise if the decision was not set aside.

(i) Was there sufficient doubt in the trial judge's decision?

The Applicants alleged that the trial judge erred:

- by positing and answering an incorrect question in law - the incorrect question being whether the matter was a dispute arising in connection with the Shareholders' Agreement or in relation to the Business; and
- by failing to posit and answer the correct question in law - the correct question being whether the proceeding was an action brought in a matter which was the

> subject of an arbitration agreement within the meaning of s. 8 of the Arbitration Act.

They further alleged that the trial judge erred by placing an emphasis on the fact that the result of the Claim might be to terminate the relationship between the Applicant shareholders and the Respondent shareholders, as it was not relevant in determining whether the proceeding was an action brought in a matter which is the subject of an arbitration agreement within the meaning of s. 8 of the Arbitration Act. On the contrary, the termination of the relationship between the shareholders was merely a result that could occur if the proceeding was not held to be an action brought in a matter the subject of an arbitration agreement within the meaning of s. 8 of the Arbitration Act and the Applicants succeeded at trial.

The Court noted that the parties' focus on the degree to which the Claim raised matters that were governed by the Shareholders' Agreement and the extent to which the disputes covered by the Arbitration Agreement extended beyond those relating to the breach, construction, formation and performance of the Shareholders' Agreement was misguided. The matters pleaded by the Applicants in relation to the Claim were directed to the questions arising under ss. 232 and 233 of the Corporations Act for the purpose of attracting the Court's powers under s. 233. As the rights sought by the Applicants and the grounds relied on were statutory rather than contractual, the key consideration should instead have been whether those statutory questions arose "in connection with" the Shareholders" Agreement or in "relation to the Business". The Court was therefore of the opinion that the trial judge's decision was attended with sufficient doubt to justify the grant of leave to appeal.

(ii) Would substantial injustice arise if the decision was not set aside?

Given that the trial judge only granted a stay of part of the Claim, the Applicants submitted that substantial injustice would arise because it would split the Applicants' case between arbitration and trial, increasing the possibility of inconsistent factual findings. The Court agreed and added that the Applicants would experience delays and incur additional costs due to the bifurcation of their dispute with the Respondents.

Further, the Court held that the Applicants might not be able to obtain complete relief if they were unable to pursue their entire Claim in the Supreme Court. For example, insofar as the arbitration was successfully completed before the proceeding was finalised, the benefit of any judgment in any derivative action that was authorised by the Court would not enure for the benefit of the Applicants. This was because, at the time of any such judgment, the Applicants' shares might have been sold pursuant to the arbitrator's award, and any increase in the net assets of the relevant Group Companies resulting from the derivative actions would benefit only the then current shareholders.

5.7 Irreparable breakdown in business relationship satisfies just and equitable ground of court-ordered wind up

(By Jack Quirk, DLA Piper)

In the matter of David Ireland Productions Pty Ltd [2014] NSWSC 1411, Supreme Court of NSW, Black J, 15 October 2014

The full text of this judgment is available here.

(a) Summary

In this case, a shareholder and a creditor jointly applied to the Court under the Corporations Act 2001 (Cth) (the Corporations Act) to wind up the defendant company. This was on the grounds that, in light of the irreparable breakdown between the principals of the company, it was just and equitable to do so. The plaintiffs also claimed the company ought to be wound up on the ground of insolvency. While not finding the company insolvent, Black J was persuaded that the breakdown in relationship made any continuing relationship between the principals futile and as such it was just and equitable that the company be wound up.

(b) Facts

The defendant company, David Ireland Productions Pty Ltd (the Company) was established in order to run the film making business of the wildlife film maker, David Ireland. There were two directors of the Company, Mr Ireland and Anthony Alevras. Mr Ireland was responsible for the filming, editing and marketing of wildlife films produced by the Company while Mr Alevras was largely responsible for management and administration of the Company's affairs.

The first plaintiff, Eureka Multimedia Pty Ltd (Eureka) was one of two shareholders in the Company and held half of its issued shares. The second plaintiff, Nodtronics Pty Ltd (Nodtronics), claimed to be a creditor of the Company. Eureka and Nodtronics were both controlled by Mr Alevras. The other shareholder in the Company was Aquapro Australia Pty Ltd (Aquapro), which held half of the Company's issued shares and was controlled by Mr Ireland.

Over the course of a number of years, the business relationship between Mr Ireland and Mr Alevras broke down due a number of ongoing disputes as to the running of the Company. It was alleged that Mr Alevras had failed to properly administer the Company's financial affairs, had failed to properly file tax returns and had misappropriated funds.

After Mr Ireland refused any request for his consent to wind up the Company, Eureka and Nodtronics applied to the Court for orders that the Company be wound up on the grounds that:

- it was just and equitable to do so under s. 461(1)(k) of the Corporations Act due to the breakdown in the relationship between Mr Ireland and Mr Alevras, the principals of the Company;
- the Company was insolvent for the purposes of s. 459A of the Corporations Act, which provides that an application can be made under that s. to wind a company up in insolvency.

The Originating Process was served on Mr Ireland and on Aquapro, but they were not joined as defendants to the proceedings. Black J granted leave for Mr Ireland and Aquapro to be heard in opposition to the application under rule 2.13 of the Supreme Court (Corporations) Rules 1999 (NSW) which allows a Court to grant leave for a party to appear in opposition to an application if they are a creditor, contributory, officer of a corporation or any other interested person to the proceedings. His Honour also granted Mr Ireland leave to appear on behalf of Aquapro as its director, despite the fact that the affidavit requirements testifying that he had the requisite authority to do so had not been met as required by rl. 7.2(2) of the Uniform Civil Procedure Rules 2005 (NSW).

The plaintiffs also sought that Mr Ireland pay their costs of the Originating Process on the grounds that Mr Ireland's continued refusal to consent to the winding up resulted in the costs of the Court proceeding.

Mr Ireland resisted the application, contending that he had a right to production of financial documents before the Court made a decision to wind up the Company.

(c) Decision

(i) Claim for winding up on the just and equitable ground

On the issue of standing, Black J felt it was clear that Eureka had requisite standing as a contributory under s. 462(2)(c). As a result, his Honour felt it unnecessary to determine whether Nodtronics had the requisite standing based on Nodtronics' claim to be a creditor of the Company.

On finding that it would be just and equitable to wind up the Company based on the breakdown of the relationship between Mr Ireland and Mr Alevras, his Honour followed a line of authorities relating to "quasi-partnerships". In particular, attention was given to the decision of Owen J in *Thomas v Mackay Investments Pty Ltd* (1996) 22 ACSR 294, who stated (at 300):

> Where there is a breakdown in a relationship of mutual trust and confidence which was the foundation of an understanding by which the

> operations of the company were to be governed the court can order that the company be wound up. These have become known as the quasi-partnership cases. The reference to partnership can be misleading. The company is just that, a corporate structure. It is not necessary to show that any partnership agreement or deed was entered into before the principle can be invoked.

Black J felt that the Company, which had been established as a mutual arrangement whereby both Mr Ireland and Mr Alevras would work on different tasks but ultimately always towards the commercial production and exploitation of Mr Ireland's wildlife films, required a continuing relationship of material cooperation and a level of trust: *MMAL Rentals Pty Ltd v Bruning* [2004] NSWCA 451; *Nassar Innovative Precasters Group Pty Ltd* [2009] NSWSC 342. While it was not necessary that an applicant have clean hands, as was the case in *Re Amazon Pest Control* [2012] NSWSC 1568, s. 467(4) of the Corporations Act provides that the applicant must be acting reasonably without any unjustness or unfairness to other members of the Company.

While Mr Ireland submitted he would not consent to the winding up of the Company on account of Mr Alevras's refusal to deliver up certain financial documents, he did concede that there was no possibility the Company could continue its business or properly investigate those matters because it was hopelessly in deadlock since the two were incapable of working together.

Ultimately, his Honour felt that, based on the principles in Thomas v Mackay (above) it was plain that the Company was established as a relationship of mutual understanding or "quasi-partnership". Since that relationship had broken down, Black J held that the continuance of the parties' association would be futile. Coupled with the fact the Company had all together ceased to trade, his Honour was satisfied that it was just and equitable to wind up the Company.

As regards the ongoing disputes between the parties in the management of the affairs of the Company, Black J thought this was best left to a liquidator to investigate.

(ii) Claim for winding up on the basis of insolvency

Nodtronics also sought winding up under s. 459A of the Corporation Act based on its allegation that the Company had a loan debt to Nodtronics in excess of the assets of the Company, and as such the Company was insolvent.

His Honour felt that there was no determinative evidence to the effect that the Company had attained funds from Nodtronics by way of loan. As such, his Honour was not satisfied that the Company was presently insolvent and the application failed on this ground.

(iii) Orders and costs

While Mr Ireland and Aquapro were not parties to the proceedings, the plaintiffs sought an adverse cost order against them, alleging that their contesting of the application had resulted in increased costs for the plaintiffs, a submission which his Honour accepted.

However, in declining to grant such a costs order his Honour cited the decision of Barrett J in *Grocon Constructors Pty Ltd v Kimberley Securities Ltd* [2009] NSWSC 691, stating that such a costs order should only be granted against non-parties in exceptional circumstances.

His Honour ordered the Company be wound up, that liquidators be appointed and the cost of the proceedings be costs in the winding up of the Company.

5.8 Liquidators are not required to retain funds for tax prior to the issue of an assessment

(By Skanda Kumble and Josh Underhill, King & Wood Mallesons)

Commissioner of Taxation v Australian Building Systems Pty Ltd (in liq) [2014] FCAFC 133, Federal Court of Australia, Full Court, Edmonds, Collier and Davies JJ, 8 October 2014

The full text of this judgment is available here.

(a) Summary

This case concerned appeals by the Commissioner of Taxation (Commissioner) from a judgment of a single judge of the Federal Court of Australia relating to s. 254(1)(d) of the Income Tax Assessment Act 1936 (Cth) (the Act).

The liquidators of the respondent, Australian Building Systems Pty Limited (ABS), caused ABS to sell a property in Queensland. The issue raised by this case was whether s. 254(1)(d) of the Act obliged the liquidators to retain from the proceeds of the sale an amount sufficient to pay the tax to be assessed in respect of the sale in the period prior to the issue of an assessment, or whether the obligation to retain only arose after the issue of an assessment.

Edmonds J, in the leading judgment of the Full Court, upheld the decision of the primary judge, confirming that s. 254(1)(d) of the Act only imposes an obligation of retention once a relevant assessment has been issued.

(b) Facts

During the financial year ended 30 June 2012, the liquidators of ABS caused it to sell a property at Crestmead in Queensland. ABS made a capital gain on the sale of some $1.12 million, which entered into the calculation of ABS's assessable income for that year.

Section 254(1) of the Act provides that "[every trustee] is hereby authorized and required to retain from time to time out of any money which comes to him or her in his or her representative capacity so much as is sufficient to pay tax which is or will become due in respect of the income, profits or gains".

The liquidators of ABS are "trustees" under s. 6 of the Act.

At first instance, the Commissioner submitted that the effect of s. 254(1)(d) was that the liquidators of ABS became liable to retain from the proceeds of sale of the property an amount sufficient to pay the tax that will become due in respect of the net capital gain arising from the disposal of that property. The Commissioner submitted that it was not necessary for there to be a notice of assessment before the retention obligation under s. 254(1)(d) could arise.

ABS and the liquidators submitted that, in the absence of an assessment, there could be no such obligation.
The same submissions were respectively made on the hearing of the appeals.

(c) Decision

(i) Decision at first instance

The primary judge relied on the decision of the High Court of Australia in *Bluebottle UK Ltd v Deputy Commissioner of Taxation* (2007) 232 CLR 598 (*Bluebottle*). In *Bluebottle*, the High Court was required to construe the meaning of the words "tax which...will become due" in s. 255(1) of the Act. The High Court held that those words must be read as referring to an amount of tax that has been assessed but is not yet due for payment. By analogy, the primary judge found that a liquidator is only subject to the payment and retention obligations under s. 254(1) if and when an assessment has been issued, and accordingly found against the Commissioner.

(ii) Decision of Edmonds J on appeal

The Commissioner submitted on appeal that the word "due", in the phrase "is or will be due" in s. 254(1)(d) of the Act means "owing" and not "presently payable", and that this is supported by a proper interpretation of *Bluebottle*.

However, Edmonds J (with whose judgment Collier J agreed) held that even if the word "due" in the phrase "is or will become due" in s. 254(1)(d) means "owing", nothing is or will become owing by the liquidators prior to the issue of an assessment to them, and therefore no retention obligation will arise in terms of s. 254(1)(d) prior to that point in time.

His Honour characterised s. 254 as a "collecting section", which has no operation to render a trustee liable to be assessed to tax if the trustee is not otherwise liable to be assessed under the Act. The s. contemplates an existing liability or a state of affairs of which it can be presently said a liability will arise in the future.

Edmonds J went on to state that the words "will become due", in the sense of "owing", predicate nothing less than certainty and cannot be predicted prior to the issue of a relevant assessment. However, even if it were capable of being predicted on the facts of a particular case, it cannot be so on the facts of this case where it was common ground that the assessment, when it did issue, would issue to ABS (rather than to the liquidators).

The Commissioner further submitted that on the liquidators' entry into the contract of sale of the property, a tax liability for the capital gain arising from the sale arose. Accordingly, on receipt of the proceeds of sale, the liquidators were obliged under s. 254(1)(d) to retain from the proceeds of sale an amount sufficient to pay that tax liability (whether or not an assessment had then been issued).

Edmonds J stated that no tax liability arose on the entry into the contract of sale, either for ABS or, more relevantly, the liquidators. His Honour stated that upon entering into the contract for sale, at most, ABS made a capital gain which entered into the computation of its net capital gain for that financial year. The most that could be said is that on 30 June 2012, ABS had an obligation to pay income tax in the future.

However his Honour stated that even if ABS had, on 30 June 2012, an obligation to pay income tax in the future, that does not trigger a retention obligation for the liquidators as trustees in terms of s. 254(1)(d) for the simple reason that, as at that date, no tax "is...due" in the sense of "owing", by them, and no tax "will become due", in the sense of "owing", by them. His Honour referred again to the fact that it was common ground that the assessment, when it did finally issue, would issue to ABS. Edmonds J confirmed that s. 254(1)(d) applies to tax due or to become due by the liquidators (trustees) in their representative capacity, and did not embrace tax due or to become due in the future under an assessment of ABS.

The Commissioner argued that s. 254(1)(d) of the Act applied to income, profit or gains received by a trustee. However Edmonds J emphasised the fact that s. 254(1)(d) is not confined to receipt of income, profit or gains, and extends to any money which comes to the trustee in his or her representative capacity. His Honour stated that it would include, for example, money coming to the trustee by way of further settlement. On the Commissioner's construction of the section, the trustee would be obliged, prior to assessment, to retain out of money coming to the trustee by way of further settlement, so much as is sufficient to pay tax to be assessed in the future. His Honour characterised that proposition as "so bizarre as to immediately cast doubt on its propriety".

(iii) Decision of Davies J on appeal

Davies J agreed with the judgment of Edmonds J save in one respect, stating that when engaged, s. 254 contemplates that any post appointment tax liability will be assessed to the liquidator in his or her representative capacity, rather than to the company. However, Davies J agreed that s. 254(1)(d) is to be read as referring to an amount of tax that has been assessed.

5.9 Investigation ordered into controller's performance of its functions and powers under s. 423 of the Corporations Act

(By Clementyne Rawlyk and Simone Lim, Corrs Chambers Westgarth)

Re Quality Blended Liquor Pty Ltd [2014] QSC 234, Supreme Court of Queensland, Wilson J, 8 October 2014

The full text of this judgment is available here.

(a) Summary

In this case in the Queensland Supreme Court, Justice Wilson was required to consider the validity of the appointment of a controller and whether an inquiry should be conducted into the functions and powers of the controller during his appointment.

(b) Facts

Quality Blended Liquor Pty Ltd (QBL) was in the business of selling alcohol wholesale and was operated by the Lewis family through a company they controlled called International Network Consultants Pty Ltd (INC).

The facts were contested, however for the purposes of this case note it may be said that:

- QBL invited Warren Tschannen to invest in it, through a company called Toyco Australia Pty Ltd (Toyco) of which Mr Tschannen's niece, Ms Gorham, was the sole director.
- In late 2013, Toyco loaned QBL, and the companies associated with it, approximately $1 million (the Loan). The documents purportedly recording the terms of the Loan were executed in January 2014.

- In February 2014, Toyco claimed that the associated companies of QBL had defaulted on the Loan and appointed Mr Tschannen as controller of the QBL companies to take control over the day to day business of the QBL companies.
- The parties undertook mediation soon after and signed a settlement deed on 27 February 2014 (the Settlement Deed). The Settlement Deed included terms that the Lewis family would have access to the QBL premises to carry on work, and be provided access to the books and records of QBL.

Various proceedings arose from the dispute. During the interlocutory steps in the proceedings, Mr Tschannen gave an undertaking to the Court that he would carry on the business of QBL in its ordinary course until the matter was resolved.

(c) Issues

(i) The validity of Mr Tschannen's appointment as controller

INC sought a declaration under s. 418A of the Corporations Act 2001 (Cth) (the Corporations Act) that the initial appointment of Mr Tschannen as controller of QBL was invalid. In particular, INC contended that, among other things:

- the original Loan documents were not validly executed and therefore Mr Tschannen was not validly appointed as controller; and
- Toyco never actually advanced the Loan funds to the QBL business, meaning that no default could occur under the Loan entitling the appointment of a controller.

(ii) Inquiry into Mr Tschannen's conduct as controller

INC also sought an order under s. 423 of the Corporations Act that an inquiry be conducted into Mr Tschannen's performance as controller of QBL. In support of this application, INC submitted that after the Settlement Deed was entered into, Mr Tschannen denied the Lewis family access to the QBL premises and engaged security guards to prevent them from accessing the books and records of QBL.

It was also alleged that Mr Tschannen:

- effectively ceased any trading on behalf of the QBL business by not paying trade creditors and refusing to purchase stock;
- directed an accountant to make entries in the QBL business records showing that a debt of $1.3 million was owed to him;
- informed QBL's employees that they would not have employment with the business following his controllership;
- failed to secure liquor licenses necessary to carry on the QBL business;
- removed the personal files of the Lewis family; and
- sold stock of the business at undervalued prices.

Mr Tschannen, in his submissions, did not reply (or provided only a limited reply) to the majority of these allegations. He did, however, submit that his actions as controller were "commercially necessary and appropriate".

(d) Decision

(i) The validity of Mr Tschannen's appointment as controller

The Loan documentation all bear the date 3 January 2014. However, INC alleged that the Loan documents were not signed on this date but at some other time. Indeed, Ms Gorham agreed that she most likely signed the Loan documents on behalf of Toyco towards the end of January 2014. On this basis, INC submitted that Ms Gorham may not have been properly appointed as a director of the companies on behalf of which she purported to sign documents, and accordingly the Loan itself was invalid (as well as Mr Tschannen's appointment as controller).

Due to the high level of evidential uncertainty, the Court was not able to determine the exact date on which the Loan and security documents were executed. However, the Court held that is was not necessary to make a conclusive finding of fact on this point because:

- Mr Tschannen's appointment as controller was, on any view, at a much later date in February 2014, well after the date on which the parties acknowledged having executed the documents (i.e. in January 2014); and
- the fact that the Loan documents might record a date different to that upon which the last person executed them does not, at law, invalidate them.

INC also suggested in its cross-examination of Mr Tschannen and in its written submissions after the hearing that there was no evidence that Toyco had ever advanced the Loan, nor that there had been any actual default under the Loan. This, INC contended, meant that there was no legal basis for making the demand or issuing the notice triggering Mr Tschannen's appointed as controller. However, the Court refrained from considering this argument on the basis that INC had not raised this matter in its points of claim. Accordingly, the failure of Mr Tschannen and Toyco to attempt to strictly prove the existence of the Loan could not be considered persuasive evidence that it did not exist.

(ii) Should an inquiry be conducted into Mr Tschannen's controllership?

The Court approved the following principles set out in *Oswal v Carson (No 3)* (2013) 300 ALR 149 in deciding whether an inquiry under s. 423 of the Corporations Act should be ordered:

- first, the Court must decide whether there is a prima facie case laid out that the inquiry is appropriate; and

- secondly, if so, the discretion to decide whether an inquiry should be ordered is enlivened.

The Court also confirmed that it will not lightly interfere with the commercial judgment of a controller.

The Court considered that the factors relevant to the exercise of the discretion once it is enlivened include the strength and nature of the allegations; any answers offered by the controller; any other available remedies; the stage to which the matter had progressed; and the likely amounts of money involved.

On consideration of the evidence, the Court found that while Mr Tschannen's appointment may have been valid, the circumstances surrounding it and its speed provided the context for the actions undertaken during his controllership which could be taken into account in exercising discretion. The Court found that Mr Tschannen's actions were of such a concerning nature that it warranted an order for an inquiry.

In particular, the Court considered that Mr Tschannen's purported failure to carry on the business, despite agreeing to do so in the Settlement Deed and undertaking to do so to the Court, was compelling evidence of his failure to faithfully perform his powers and functions. The Court also considered that the failure of Mr Tschannen to provide adequate responses to the allegations warranted a further investigation and compelled a conclusion that he did not faithfully perform his functions.

Although the matters complained of in this case are at the higher end of the scale, it is a timely reminder of the Court's willingness to exercise its discretion under s. 423 of the Corporations Act to order an investigation into the performance of a controller's functions and powers in a broad manner of circumstances.

5.10 Recent guidance from the Federal Court on proving uncommercial and insolvent transactions

(By Sue Soueid, Corrs Chambers Westgarth)

Rathner in his capacity as Official Liquidator of Kalimand Pty Ltd (in liq) v Hawthorn [2014] FCA 1067, Federal Court of Australia, Gordon J, 8 October 2014

The full text of this judgment is available here.

(a) Summary

This decision considered a claim by the Liquidator of Kalimand Pty Ltd (Kalimand) against High Country Meats (Vic) Pty Ltd (HCMV) to recover transfers of cash and assets alleged to have been voidable transactions under s. 588FE of the Corporations Act 2001 (Cth) (the Corporations Act).

The Liquidator relied on considerable circumstantial evidence disclosing payments made to HCMV, including Kalimand's business activity statements, bank records and accounting records, and a public examination of the sole director of Kalimand. Notwithstanding this, the Court held that in respect of the asset transfers, the most the Liquidator could show was highly suspicious activity that resulted in a significant reduction in the payments received and stock held by Kalimand, in circumstances where HCMV received considerable payments into its accounts.

The decision confirms the importance of adducing specific evidence of a company's insolvency and identifying with precision the material circumstances of each voidable transaction.

(b) Facts

The Liquidator of Kalimand sought to recover certain payments made by Kalimand to HCMV on the basis that the transactions were voidable transactions pursuant to s. 588FE of the Corporations Act. The second respondent to the proceedings (Mr Hawthorn) was the sole director of Kalimand, and the sole director and shareholder of HCMV. Neither Mr Hawthorn (who was the subject of a sequestration order made after the proceedings commenced) nor HCMV were represented in the proceedings.

The transactions the subject of the proceedings included:

- a transfer of $60,000 in cash (the Transfer); and
- a transfer of assets including stock in the sum of $1,090,400 and trade debtors in the sum of $959,079 for nil consideration (the Assets).

The evidence presented by the Liquidator was comprised of the Liquidator's Report, business activity statements, tax returns, bank statements and other records obtained pursuant to a subpoena to Kalimand's accountants. Additionally, the Liquidator sought to tender parts of the public examination of Mr Hawthorn against Kalimand pursuant to s. 597(14) of the Corporations Act.

(c) Decision

(i) Admissibility of public examinations

As a preliminary point, the Court considered whether the public examination of Mr Hawthorn could be tendered as evidence against Kalimand. Relevantly, s. 597 of the

Corporations Act only provides that "any written record of an examination [of] a person...may be used in evidence in any legal proceedings against the person".

Accordingly the Court held that the transcript of the public examination was not admissible under s. 597 but could be admitted on the basis that the exception to the hearsay rule contained in s. 63 of the Evidence Act 1995 (Cth) (the Evidence Act) applied. Section 63 provides that, if a person who made a previous representation is not available to give evidence about an asserted fact, the hearsay rule does not apply to a document so far as it contains the representation, or another representation to which it is reasonably necessary to refer in order to understand the representation made by that person.

It was noted that the Liquidator had failed to provide adequate notice of his intention to adduce the public examination (as required by the Evidence Act). However, the Court considered that the potential unfairness to HCMV did not outweigh the importance of the evidence in the proceedings. Consequently, the Court exercised its discretion to admit the public examination of Mr Hawthorn.

(ii) Statutory framework

Having considered the evidentiary issues, the Court set out the applicable statutory framework. A transaction will be voidable pursuant to s. 588FE of the Corporations Act if it is an uncommercial transaction and an insolvent transaction that took place during the 2 years ending on the relation-back day (being the date that winding up proceedings commenced).

This may be established where:

- there is a "transaction", or conduct or dealing engaged in by a company that effects a change in that company's rights, liabilities or property;
- that transaction is "uncommercial" insofar that it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction; and
- the transaction is entered into when (i) the company is insolvent; or (ii) the company becomes insolvent because of entering into the transaction or the giving effect to the transaction (s. 588FC(b) of the Corporations Act).

In considering whether a company has become insolvent "because of" a transaction, an expansive notion of causation is not consistent with the purpose of Part 5.7B of the Corporations Act, which is to consider the relationship between the solvency of a company and the impugned transaction. The Court held that an applicant must present clear evidence as to how a transaction affects a company's solvency.

(iii) Analysis

The Liquidator was expected to present "clear evidence as to how a transaction affects a company's solvency" and identify "with some precision" the transactions in issue. The Liquidator successfully met this standard with respect to the Transfer, but not the Assets.

With respect to the Transfer, the Liquidator unsuccessfully attempted to demonstrate that Kalimand was insolvent at the time the Transfer occurred by reference to the Liquidator's Report. The Court rejected this evidence on the basis that the Report in itself is not evidence of the truth of its contents (ss. 48(1)(b) and 59 of the Evidence Act). Furthermore, the balance of the evidence was considered insufficient as it failed to disclose the debtors and the assets of Kalimand at the time of the transaction.

However, the Liquidator was able to demonstrate by reference to bank statements dated before and after the transaction that Kalimand became insolvent "because of" the Transfer.

The evidence presented in relation to the Asset transactions was less convincing. The Liquidator failed at the first hurdle by insufficiently indentifying the content of the Assets alleged to have been transferred to HCMV.

In the Court's view, the most the Liquidator could show was highly suspicious activity that resulted in a significant reduction in the payments received and stock held by Kalimand, in circumstances where HCMV received considerable payments into its accounts. Crucially, the Court concluded that "without the source documents and, for example, a matching of the invoices issued by Kalimand and evidence of payment by the payees of that invoice into HCMV's account, it is not possible to conclude that the payments into HCMV's account in fact belonged to Kalimand".

The Court declared that the Transfer was a voidable transaction, and orders were made requiring HCMV to pay Kalimand $60,000.

5.11 Deed signed with company insufficient to support claim for compensation for insolvent trading where payments not made to that company or under the deed

(By James Siemon, Minter Ellison)

Re Matlic Pty Ltd (in liq) [2014] NSWSC 1342, Supreme Court of New South Wales, Black J, 1 October 2014

The full text of this judgment is available here.

(a) Summary

This case involved a transaction in which the plaintiff, Mr Luff, lent money to "take out" the interest of Taylered Development Pty Ltd (Taylered) in an investment opportunity with Terrigal Development Co Pty Ltd (TDC). Those payments were allegedly made under a deed executed by the plaintiff and Matlic Pty Ltd (Matlic). When the loan was not repaid, the plaintiff brought an application under sections 588G and 588M of the Corporations Act 2001 (Cth) (the Corporations Act) seeking compensation from the directors of Matlic. Black J also considered whether the person who signed that deed on behalf of Matlic had authority to do so.

(b) Facts

Matlic and the Matlic Property Trust were formed for use as a vehicle for investment opportunities for Mr and Mrs Matthews and Mr and Mrs Licuria. The directors of Matlic were Mrs Matthews and Mr Licuria, who were the first and second defendants respectively. Although not a director of Matlic, Mr Matthews was employed as a financial planner and therefore worked to actively identify investment opportunities for Matlic.

In early 2005, the directors of TDC approached Mr Matthews regarding an opportunity to purchase and develop land at Tumut, New South Wales. TDC sought funding for that opportunity from Mr Matthews or his clients. A loan agreement was subsequently executed between Matlic and TDC, providing a loan of $280,000 to TDC and providing for prepayment of three months' interest and other amounts. Mrs Licuria, who was not a director or officer, signed that agreement on behalf of Matlic but did not recall doing so.

Mr Matthews also sought that three other parties would invest $100,000 each in the TDC opportunity: Mr and Mrs Licuria, Mr Davison (a client of Mr Matthews), and Mr Luff (with whom Mr Matthews worked). Evidence suggested this was intended to take the form of a loan by each investor to Matlic, which would, in turn, provide a loan to TDC.

In respect of Mr Luff, the terms of his alleged loan to Matlic were set out in a Deed of Agreement dated 19 May 2005, signed by him and purportedly executed for Matlic by Mr Matthews. Mr Matthews was not a director of Matlic. Furthermore, as Mr Luff did not have funds available at that time to invest in the TDC opportunity, the funds were advanced to TDC by a company associated with Mr Matthews, Taylered. Mr Luff gave evidence that he later paid the relevant funds to Taylered (as opposed to Matlic) by cheque to "take out" that interest in the opportunity. The first of those payments, for $30,000, was made on the date of execution; the second, for $70,000, was made three months later.

Due to delays in relation to the rezoning and subdivision of the land and the development application, TDC was unable to repay the loan and outstanding interest to Matlic. Mr and Mrs Licuria and Mr and Mrs Matthews fell out, and in November 2007, Mr Licuria resigned as a director of Matlic. Mr Luff subsequently brought an application in June 2010, seeking orders that Matlic be wound up in insolvency, which was successful.

The present case involved an application brought by Mr Luff claiming that Matlic was insolvent at the time of or as a result of incurring the alleged debt to him, and seeking compensation from the defendants under section 588M of the Corporations Act, on the basis that, as directors of Matlic, they had contravened section 588G.

(c) Decision

Section 588G of the Corporations Act:

1. applies if:
    a. a person is a director of a company at the time when the company incurs a debt; and
    b. the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
    c. at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and
    d. that time is at or after the commencement of this Act.

The section goes on to provide that:

2. By failing to prevent the company from incurring the debt, the person contravenes this section if:
    a. the person is aware at that time that there are such grounds for so suspecting; or
    b. a reasonable person in a like position in a company in the company's circumstances would be so aware.

Subsection 588G(3) then sets out when a person will commit an offence by breaching their duty as a director to prevent insolvent trading by a company.

In turn, s. 588M of the Corporations Act:

1. ... applies where:
    a. a person (in this section called the director) has contravened subsection 588G(2) or (3) in relation to the incurring of a debt by a company; and
    b. the person (in this section called the creditor) to whom the debt is owed has suffered loss or damage in relation to the debt because of the company's insolvency; and

c. the debt was wholly or partly unsecured when the loss or damage was suffered; and
d. the company is being wound up ...

and provides that:

2. The company's liquidator may recover from the director, as a debt due to the company, an amount equal to the amount of the loss or damage.
3. The creditor may, as provided in Subdivision B but not otherwise, recover from the director, as a debt due to the creditor, an amount equal to the amount of the loss or damage.

In reaching his decision, Black J preferred the objective evidence of the transactions to the evidence provided by the witnesses, which his Honour considered less reliable.

In relation to the Deed of Agreement allegedly executed by Mr Luff and Matlic, his Honour considered at [29] that the Deed "was not put into effect in accordance with its terms", particularly as Mr Luff did not make the payments to Matlic (but instead to Taylered) and did not make them upon execution of the Deed. His Honour therefore considered that the payments to Taylered were not made pursuant to that Deed and that Matlic did not incur a debt to Mr Luff.

In the alternative, his Honour also considered the question of whether Mr Matthews had actual or implied authority to execute the Deed on behalf of Matlic and, therefore, whether it was enforceable against Matlic. His Honour found that there was no express actual authority granted to Mr Matthews. Further, although he may have had implied actual authority regarding joint investments on behalf of himself and Mrs Matthews and Mr and Mrs Licuria, his Honour did not consider that this extended to borrowing on Matlic's behalf from third parties (such as Mr Luff). His Honour also did not find that the assumptions permitted by section 129 of the Corporations Act altered that conclusion.

Finally, his Honour turned to examine the question of Matlic's insolvency at the time of incurring the debt. His Honour considered that the commercial logic of the transaction was such that Mr and Mrs Licuria and Mr Davison would have extended the time for repayment by Matlic of their loans in the event that Matlic was unable to secure repayment by TDC. His Honour also considered that the same result would have followed for the loan by Mr Luff, supported by evidence of his similar actions at earlier stages of the TDC opportunity.

Despite Matlic's lack of financial records, his Honour therefore considered that there were not reasonable grounds for suspecting that Matlic was, or would become, insolvent. His Honour therefore found that the application by Mr Luff was not made out, and dismissed the proceedings.

5.12 Merger defence letter permitted to be sent to members; register access granted

(By Lachlan Salt, Ashurst)

MDA National Limited v Medical Defence Australia Limited (No 2) [2014] FCA 1071, Federal Court of Australia, Yates J, 1 October 2014

The full text of this judgment is available here.

(a) Summary

The plaintiffs made two applications to Yates J. The first was whether they should be permitted to disseminate to their members a letter defending a merger proposal ahead of a scheme of arrangement meeting. It was claimed that the letter was necessary to correct inaccuracies said to be contained in an earlier email sent to the some of the plaintiffs' members (among others) by an individual who opposed the merger. The second application concerned whether the plaintiffs should accede to that same opposing individual's application to access a copy of the plaintiffs' register of members and if so, what information should be included in fulfilling that request. Yates J permitted the proposed letter to be sent, and further ordered that the plaintiffs provide the opposing individual with all of the information then contained in their register of members - not just the information required by the Corporations Act 2001 (Cth) (the Corporations Act) to be provided at a bare minimum.

(b) Facts

Ahead of a meeting to be held on 11 October 2014 for the purpose of considering a scheme of arrangement in a merger proposed between the plaintiffs, MDA National Limited (MDAN) and Medical Defence Association of South Australia Limited (MDASA), Dr Michael Gannon, President of the Australian Medical Association (WA) Inc (AMA(WA)) on 9 September 2014 sent an email, apparently to members of the AMA(WA), expressing concerns held by the AMA(WA) about the proposed merger. MDAN considered that these statements were inaccurate, and was concerned that, if left unanswered, they would cause or result in misconceptions or confusion among MDAN's members as to the effects of the proposed merger. Its concerns were heightened by the fact that Dr Gannon's email invited members of the AMA(WA) to give him their undirected proxies to vote at the meeting that had been convened. There was also evidence that suggested a material number of AMA(WA) members may also be members of MDAN and/or MDASA.

Against this background, the first matter to be considered by Yates J was MDAN's application for a direction that it be permitted to send a letter to its members defending the merger in response to Dr Gannon's email. A second matter was another application by MDAN, this time seeking a direction as to whether it should approve an application made by Dr Gannon to access a copy of MDAN's register of members and, if so, specifically the information to be included in providing such a copy.

(c) Decision

Dealing with the first matter, Yates J noted the authorities stating that where the Court has ordered the convening of a meeting under s. 411(1) of the Corporations Act and has approved an explanatory statement, as was the case here, the company itself should not dispatch additional material without first obtaining court approval to that step.

Yates J balanced his concern that by giving a direction in those terms, the Court might be seen to be participating in the debate about whether the proposed scheme should be agreed to, against the notion that if the Court did not give an appropriate direction, the debate on important issues affecting members' rights would be stifled by MDAN not having the opportunity to correct what it considers to be inaccuracies in Dr Gannon's email about the effects upon members of the proposed merger. Ultimately, Yates J was persuaded that he should give a direction permitting MDAN to send its proposed letter.

Regarding the second matter, Yates J commenced by noting that under the Corporations Act a company must allow anyone to inspect its register of members and provide a copy of the register within seven days if an application is made in the proper form. Having acknowledged that Dr Gannon's application for a copy of the database of all MDAN members was in the proper form, Yates J also observed that it was not made for a prescribed purpose that otherwise would have allowed MDAN to refuse to provide a copy of the register.

MDAN had asked Yates J to consider whether the obligation to provide a copy of its members' register under s. 173 of the Corporations Act required it to also provide a copy of the other information contained in the register, such as the email addresses of members who had provided them. Yates J concluded that the obligation to provide access to the register means all information contained in the register, not simply the information that the register, as a minimum, must contain. Yates J also noted that Dr Gannon's intended use of the information was relevant to the holding of the interests recorded in the register or the exercise of the rights attaching to them, bringing his application within the meaning of s. 177(1A)(a) of the Corporations Act - an exception to a prohibition on using information about a person obtained from a register to contact or send material to the person, or knowingly disclosing such information for that purpose. Accordingly, Yates J made a direction that MDAN provide a copy of its register of members to Dr Gannon.

5.13 Purported resolutions to vote for removal of director declared to be in breach of separate commercial agreement

(By Jeremy Tan, Herbert Smith Freehills)

In the matter of BG Iron and Steel Pty Ltd [2014] NSWSC 1283, Supreme Court of New South Wales, Black J, 19 September 2014

The full text of this judgment is available here.

(a) Summary

Resolutions passed at a meeting of directors of a Company were held to be in breach of a separate "Cooperation Agreement" between the two shareholders of the Company, the Company and a director of the Company.

(b) Facts

BG Resources Pty Ltd (BG Resources), the fourth plaintiff and Nanyang Mining Resources Investment Pty Ltd (Nanyang), the sixth defendant each hold 50% of the issued shares in BG Iron and Steel Pty Ltd (BGIS), the first defendant.

There are seven directors of BGIS. Three of the directors, Mr Xiao, Mr Lee and Mr Ye being plaintiffs one to three are associated with BG Resources and four of the directors, Mr Fung Wa Wong, Mr Yingkin Wong, Ms Choi and Mr Chan, being defendants two to five, are associated with Nanyang. Mr Yingkin Wong and Ms Choi are the parents of Mr Fung Wa Wong. BGIS owns 85% of the issued shares in 3E Steel Pty Ltd (3E Steel), an iron ore exploration and mining development business which holds mining tenements in New South Wales.

The directors of 3E Steel are Mr Xiao and Mr Lee, appointed by BG Resources, Mr Fung Wa Wong and Mr Yingkin Wong, appointed by Nanyang and an independent director not associated with either BG Resources or Nanyang.

BGIS, Nanyang, BG Resources and Mr Lee entered into a Cooperation and Investment Agreement (the Cooperation Agreement) dated 2 December 2010. The commercial effect of that agreement was that BG Resources and Nanyang would hold an equal number of shares in BGIS, which would in turn be the majority shareholder in 3E Steel. 3E Steel is the holder of the relevant mining assets of the business.

On 23 December 2013, Nanyang and others commenced proceedings against Mr Lee and others which alleged that Nanyang had paid $1 million with the intention that this be paid to the two other entities which held shares in 3E Steel (as compensation for the dilution of their shares in 3E Steel) but Mr Lee did not disclose the availability of those funds to those entities and instead retained the funds himself or in companies in which he held a financial interest.

In light of these proceedings, Mr Fung Wa Wong, as director of 3E Steel sent a notice of a meeting of directors of 3E Steel on 10 January 2014, which proposed a resolution that a general meeting of 3E Steel be called to consider and, if thought fit, pass an ordinary resolution removing Mr Lee as a director of 3E Steel.

In response, solicitors for Mr Lee and BG Resources wrote to the solicitors for Nanyang conveying an offer by Mr Lee to resign from the board of 3E Steel, on condition that the board of 3E Steel approve the appointment of a named other person as a director of 3E Steel at the relevant meeting.

Clause 11 of the Cooperation Agreement provided that both Nanyang and BG Resources would be able to nominate an equal number of directors to the board of 3E Steel and this was relied upon by solicitors for Mr Lee and BG Resources in requesting the appointment of a named other person on the 3E Steel board representing their interest.

Nanyang associated directors acknowledged that they would adhere to cl. 11 but were of the view that the appointment of a director of 3E Steel was a separate matter from the removal of Mr Lee as a director and accordingly, appointment of a new director should be considered at a separate time.

A written resolution of four directors of BGIS being the four directors associated with Nanyang was signed on 17 February 2014 which recorded that Mr Chan be appointed as representative of BGIS for the purpose of attending and voting at the general meeting of 3E Steel and that he vote, in his capacity as the representative of BGIS to remove Mr Lee as director of 3E Steel. This resolution took effect under the BGIS constitution which provided that any resolution signed by a majority of directors of the company would be valid.

The plaintiffs, being directors associated with BG Resources and BG Resources itself, brought an application seeking a declaration that the resolutions passed by BGIS was passed in breach of cl. 10 of the Cooperation Agreement. Clause 10 provided that "All major decisions of [BGIS] must be agreed by a minimum 5 out of its 7 members of its board".

(c) Decision

The major issue in these proceedings was the interpretation of the words "major decisions". Black J found that the subject of the relevant resolutions constituted a major decision as intended by the Cooperation Agreement. Accordingly, he found that cl. 10 was breached and granted a declaration that the resolutions were passed in breach of the Cooperation Agreement.

The plaintiffs submitted that any decision on the part of BGIS to bring about the removal of a director of 3E Steel, or at least any such decision which is not combined with the appointment of a replacement director nominated by the other party constituted a "major decision" of BGIS. They argued that the relevant decisions were a "major decision" because what was to be done was to remove one of the directors of 3E Steel, who was a nominee appointee of BG Resources without appointing an immediate replacement, with the consequence that BG Resources and Nanyang would then have unequal representation on the board of 3E Steel.

The defendants on the other hand argued that the concept of "major decisions" was directed to matters concerning the business undertaking of 3E Steel, being financial arrangements for, and exploration and development of the relevant mining assets held by 3E Steel only and excluded the matters the subject of the resolutions.

Black J arrived at his decision by considering the ordinary meaning of the term "major decisions" and its purpose in the context of the agreement. Accordingly, Black J rejected the defendants" arguments and accepted the plaintiffs' submissions based on the following:

- The removal of Mr Lee without a subsequent appointment of another director by BG Resources would place Nanyang in the position where it could have controlled the board of 3E Steel if its appointees voted together and one other director voted with them or did not attend the meeting.
- There was a risk that if an appointment of a BG Resources director was not made subsequent to the removal of Mr Lee but at a separate meeting, BG Resources might not be able to retain equal representation on the board based on the majority position of the Nanyang directors.
- If the board of BGIS (comprised at all relevant times by a majority of people appointed by Nanyang) could take steps to bring about the removal of the first director nominated by BG Resources on the board of 3E Steel (being Mr Lee), they could just as easily remove the second BG Resources nominated director by the same process thereby depriving BG Resources of any representation on the 3E Steel board.

5.14 Reinterpreting *Codelfa*: A new approach to contractual interpretation?

(By Yi Long Li, Herbert Smith Freehills)

Newey v Westpac Banking Corporation [2014] NSWCA 319, Supreme Court of New South Wales, Court of Appeal, Basten, Meagher and Gleeson JJA, 11 September 2014

The full text of this judgment is available here.

(a) Summary

The NSW Court of Appeal upheld an appeal in regards to the trial judge's declaration that a reference to "Westpac" in settlement deeds entered into between the parties was ambiguous and was to be read as a reference to "Westpac or any of its related bodies corporate". In its decision, the New South Wales Court of Appeal reinterpreted the "true rule" in regards to the admissibility of evidence of surrounding circumstances where the language of a contract is ambiguous found in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 (*Codelfa*). The departure by the Court is inconsistent with decisions of other courts in Australia.

(b) Facts

The appellants, members of the law firm Gillis Delaney, were retained by former St George Limited (St George) employees to commence actions against Westpac Banking Corporation (Westpac) arising from the termination of their employment follow the merger of Westpac and St George on 1 December 2008. From that date, St George became a wholly owned subsidiary of Westpac until it ceased to exist and its assets and liabilities were transferred to Westpac on 1 March 2011.

The appeal concerned the proper construction of cl. 1 of the settlement deeds entered into between the appellants and respondent in March 2011, which provided that the appellants would not bring or otherwise aid, abet, counsel or procure the bringing of:

> any claim against Westpac or any of its related bodies corporate ... on behalf of:
>
> c. any person formerly employed by St George Bank Limited ... who at any time worked in what was known as the Institutional & Business Banking Division, and prior to about 1999 the Treasury & Capital Markets division; or
> d. any former employee of St George whose employment was or is terminated by Westpac at any time up to the date on which the last of the claims brought by an Applicant or Prospective Applicant is resolved by settlement or final judgment (including in respect of any appeal), other than the Applicants and the Prospective Applicants.

In March 2013, Gillis Delaney commenced proceedings on behalf of two former employees of St George in the NSW Local Court. Those employees were former employees of St George whose employment had been terminated by St George. The respondent commenced proceedings in the Supreme Court of New South Wales against the appellants seeking a declaration that the reference to "Westpac" in cl. 1(d) included a reference to its subsidiaries (including St George), injunctive relief and rectification of the deeds in the alternative.

At first instance, Pembroke J made the declarations sought and granted final injunctions restraining the appellants from continuing to act against Westpac in the Local Court proceedings. His Honour also noted that had he not been satisfied on the construction issue, he would have rectified the deeds.

The primary issues on appeal concerned the construction of cl. 1(d) and whether the trial judge erred in finding that the reference to "Westpac" was ambiguous so that it was appropriate to have regard to the surrounding circumstances; and whether the trial judge erred in construing "Westpac" as meaning "Westpac or any of its related bodies corporate". The secondary issue on cross-appeal was whether, if the declaration should not have been made, an order for rectification of the deeds in the terms sought by Westpac should be made.

(c) Decision

The leading decision was delivered by Gleeson JA, with whom Basten and Meagher JJA agreed, albeit in separate decisions.

(i) Construction: the proper approach to textual ambiguity

The crux of Gleeson JA's judgment hinged on the proper approach to the construction of cl. 1(d), which was alleged to be ambiguous. Both the appellants (at [79]) and respondents (at [82]-[83]) submissions were based on the "true rule" that there is a threshold requirement of ambiguity in a contract before a court may have regard to the surrounding circumstances. That proposition was based on the statement of Mason J (Stephen and Wilson JJ agreeing) in *Codelfa* at 532.

However, Gleeson JA considered that this approach overlooked the Court of Appeal's decision in *Frankins Pty Ltd v Metcash Trading Ltd* [2009] NSWCA 407, and Mason J's approving citation of Lord Wilberforce's remarks in *Reardon Smith line Ltd v Hansen Tangen* [1976] 1 WLR 989 at 995-6 that:

> In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this is turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating [sic].

Gleeson JA held that the correct approach, following the Court of Appeal's previous decision in *Mainteck Services Pty Ltd v Stein Heurty SA* [2014] NSWCA 184 (*Mainteck*), is to allow evidence of surrounding circumstances when construing commercial contracts. Contrary to the "true rule", ambiguity is not a threshold requirement for the admissibility of such evidence. Rather, the question of whether the language of a contract is ambiguous is to be "evaluated having regard to the surrounding circumstances and commercial purposes or objects" of the contract (at [89]). Gleeson JA (as did the Court in *Mainteck*) relied on the High Court's most recent statement on contractual construction in *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7 (*Woodside*) in support of that proposition. In that case the majority (French CJ, Hayne, Crennan and Kiefel JJ) said (at [35]) that the objective approach to contractual construction "required consideration of the language used by the parties, the surrounding circumstances known to them and the commercial purposes or objects to be secured by the contract.'

Gleeson JA qualified the statements above in saying that there is no licence for "judicial rewriting" of an agreement, and that the court's ability to give commercial agreements a "commercial and business-like interpretation" is ultimately constrained by the language used by the parties (at [91]). If there is no ambiguity in the language of a contract having regard to the background circumstances known to both parties, then the Court must give effect to that language.

The effect of this decision departs from the decisions in other courts in Australia, which have applied the "true rule" in *Codelfa* strictly. In *Hockey v Win Corp Pty Ltd* [2013] FCA 772, Robertson J held that evidence of surrounding circumstances was inadmissible in the absence of ambiguity (at [50]). In *Technomin Australia Pty Ltd v Xstrata Nickel Australasia Operations Pty Ltd* [2014] WASCA 164, the majority concluded that the "true rule" ought to be followed until the High Court held otherwise. In *Mainieri v Cirillo* [2014] VSCA 227, the Victorian Court of Appeal appears to have treated ambiguity as a threshold to reliance on evidence of surrounding circumstances (at [24]).

(ii) No ambiguity in the deeds

Accordingly, Gleeson JA found that there was no ambiguity in the reference to "Westpac" in cl. 1(d) of the deeds, having regard to the surrounding circumstances. It was noted that whether a statement is ambiguous will be a matter of impression in accordance with those principles (at [107]). His Honour did not consider the case to be an exceptional one where the application of ordinary rules of syntax to cl. 1 would produce an interpretation that made "no commercial sense" (at [124]). The trial judge therefore erred in departing from the meaning of "Westpac". Gleeson JA, in obiter dicta, also supported the appellant's alternative construction argument that even if "Westpac" was read as a reference to "Westpac and its related bodies corporate", it could not include St George because that entity had ceased to exist by the time of entry into the deeds (at [127]-[132]).

(iii) The rectification claim

Gleeson JA also held that the cross-claim for rectification of the deeds was not made out because the parties had conflicting intentions as to the effects of the deeds.

The onus on the respondent was a heavy one, Westpac having to show "clear and convincing proof" that the written contract did not embody the final intention of the parties (at [170]). As such, Gleeson JA at [176] held that there needed to be a consensual common intention between all the parties, "manifested in the words or conduct of the parties and not merely one which remained undisclosed", citing *Bishopgate Insurance Australia Ltd v Commonwealth Engineering (NSW)* [1981] 1 NSWLR 429, 431 (Yeldham J).

The evidence showed that the appellants did not intend that the deeds would preclude them from acting for those employees of St George who had been terminated by St George unless covered by cl. 1(c) of the deeds.