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Legislation Hotline

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 SEC proposes rules for enhanced disclosure of hedging policies for directors, officers and employees

On 9 February 2015, the US Securities and Exchange Commission (SEC) announced that it has approved the issuance of proposed rules that would enhance corporate disclosure of company hedging policies for directors, officers and employees, as mandated by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the *Dodd-Frank Act*).

The proposal would require disclosure about whether directors, officers and other employees are permitted to hedge or offset any decrease in the market value of equity securities granted by the company as compensation or held, directly or indirectly, by employees or directors.

The proposed rules would require disclosure in proxy and information statements for the election of directors and apply to companies subject to the federal proxy rules, including smaller reporting companies, emerging growth companies, business development companies, and registered closed-end investment companies with shares listed and registered on a national securities exchange.

The proposal specifies that disclosure would apply to equity securities of the company, its parent, subsidiary, or any subsidiary of any parent of the company that is registered under s. 12 of the *Exchange Act*.

Section 955 of the *Dodd-Frank Act* amended *Exchange Act* s. 14 to add paragraph (j), which requires annual meeting proxy statement disclosure of whether employees or members of the board of directors are permitted to purchase financial instruments, including prepaid variable forward contracts, equity swaps, collars, and exchange funds that are designed to hedge or offset any decrease in the market value of company equity securities.

The proposed rules are available on the SEC website.

1.2 Institutional investors set goal of 30% women on Australian boards

On 5 February 2015, the Australian Council of Superannuation Investors (ACSI) announced that it has launched an initiative aiming to have women comprise 30% of all boards in ASX 200 companies within the next three years. Women now represent 30% of all new appointments to the boards of ASX 200 companies—compared with an extraordinarily low 5% in 2009. By the end of 2014, women were occupying almost 300 seats in ASX 200 boardrooms (19.3% of all directors), which was a more-than-doubled presence since 2010. As at February 2015, almost half the companies in the S&P/ASX 200 index have one or fewer women at board level. There are now 36 companies—including one in the ASX 50 and another three in the ASX 100—that have no women on their boards.

ACSI's initiative will be a key priority of ACSI's engagement with ASX 200 boards in 2015, with a focus on the large number of companies without a single female director. Each year, ACSI meets privately with directors representing almost three-quarters of the S&P/ASX 200. In 2015 ACSI will be asking companies with poor records on gender diversity to explain how they aim to address the issue in the near term. In the worst cases, ACSI may recommend to its member funds (who collectively speak for more than 10% of the votes in most ASX 200 companies) to vote against re-elections of directors in those companies.

Further information is available on the ACSI website.

1.3 Institutional investors lobby Italy to reject "loyalty shares"

On 5 February 2015, Financial Times (FT) reported that Italy has staged a U-turn on the issue of creating "loyalty shares" by Italian companies after pressure from some of the world's largest institutional investors. According to FT more than 100 institutional investors wrote an open letter to the Italian Prime Minister calling for him to strike down a provision supporting the creation of multiple voting rights at Italian listed companies which they said made Italy hostile to foreign investment. In response to the complaints, the government has decided not to extend a legal provision that enabled listed companies to grant double voting rights to shareholders that had owned their shares for at least two years. The investors had sought to prevent the extension of the provision which allowed the loyalty shares to be approved by a simple 50% majority. It created a situation, they argued, that favoured controlling shareholders and punished minorities.

The so-called loyalty shares were intended to reward long-termism after a period of extreme volatility in the Italian stock market during the eurozone debt crisis. However, those who signed the letter maintained that the experience of France, which has held this type of loyalty share for years, has shown that it tended to favour controlling shareholders. Instead, they asked for the reinstatement of a previous Italian law that demanded a two-third majority vote.

Further information is available from the FT news item (5 February 2015 - subscriber access only).

1.4 Joint Forum releases report on credit risk management across sectors

On 5 February 2015, the Joint Forum released its report Consultative document - Developments in credit risk management across sectors: current practices and recommendations (February 2015) for public comment. The Joint Forum was established in 1996 under the aegis of the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) to deal with issues common to the banking, securities and insurance sectors, including the regulation of financial conglomerates.

The Joint Forum surveyed supervisors and firms in the banking, securities and insurance sectors globally in order to understand the current state of credit risk management given the significant market and regulatory changes since the 2008 financial crisis. Fifteen supervisors and 23 firms from Europe, North America and Asia responded to the survey.

Based on its analysis of the responses and subsequent discussions with firms, the Joint Forum puts forward the following recommendations for consideration by supervisors:

- "*Recommendation 1*: Supervisors should be cautious against over-reliance on internal models for credit risk management and regulatory capital. Where appropriate, simple measures could be evaluated in conjunction with sophisticated modelling to provide a more complete picture";
- "*Recommendation 2*: With the current low interest rate environment possibly generating a 'search for yield' through a variety of mechanisms, supervisors should be cognisant of the growth of such risk-taking behaviours and the resulting need for firms to have appropriate risk management processes";
- *"Recommendation 3*: Supervisors should be aware of the growing need for high-quality liquid collateral to meet margin requirements for OTC derivatives sectors, and if any issues arise in this regard they should respond appropriately. The Joint Forum's Parent Committees (BCBS, IAIS and IOSCO) should consider taking appropriate steps to monitor and evaluate the availability of such collateral in their future work while also considering the objective of reducing systemic risk and promoting central clearing through collateralisation of counterparty credit risk exposures that stems from non-centrally cleared OTC derivatives"; and
- "*Recommendation 4*: Supervisors should consider whether firms are accurately capturing central counterparty exposures as part of their credit risk management".

Further information is available on the IOSCO website.

1.5 UK review of crowdfunding

On 3 February 2015, the UK Financial Conduct Authority (FCA) published the report A review of the regulatory regime for crowdfunding and the promotion of non-readily realisable securities by other media (February 2015).

Crowdfunding is a way in which people, organisations and businesses, including business start-ups, can raise money through online portals (called crowdfunding platforms) to finance or re-finance their activities. Money is subscribed mainly by individuals but also by institutions.

The FCA is responsible for regulating:

- loan-based crowdfunding platforms, on which people lend money to individuals or businesses in the hope of a financial return in the form of interest payments and a repayment of capital over time (this excludes some business-to-business loans). The rules the FCA applies to protect investors in this part of the crowdfunding market focus on ensuring that consumers interested in lending to individuals or businesses have access to clear information. This allows them to assess the risk and to understand who will ultimately borrow the money. The FCA also applies core consumer protection requirements to firms operating in this market. For example, client money must be protected and firms must meet minimum capital standards. Finally, the FCA requires firms running these platforms to have resolution plans in place that mean, in the event of the platform collapsing, loan repayments will continue to be collected so those lending money do not lose out;
- investment-based crowdfunding platforms, on which people invest in unlisted shares or debt securities issued by businesses. The FCA introduced new consumer protection rules for the sale of these securities in 2014. These rules include marketing restrictions, so firms may only make direct offer promotions to retail consumers who meet certain criteria: those who take regulated advice; (b) those who qualify as high net worth or sophisticated investors; or (c) those who confirm they will invest less than 10% of their net assets in this type of security. The FCA rules also require firms to check whether customers understand the risks if they do not take regulated advice.

The report examines the implementation of the new rules so far. In the months since the rules were introduced, the crowdfunding market has grown rapidly. The report finds that there is no need to change the regulatory approach to crowdfunding, either to strengthen consumer protections or to relax the requirements that apply to firms.

1.6 Annual review of cross-border investment and M&A

On 30 January 2015, the International Institute for the Study of Cross-Border Investment and M&A (the Institute) published its annual review for 2014.

Global M&A was robust in 2014: total global volume reached US$3.5 trillion, and cross-border volume reached US$1.38 trillion. More than 90 deals over US$5 billion were announced in 2014.

Cross-border M&A volume in 2014 also reached its highest levels since the financial crisis, with total cross-border deal volume up 89% from 2013. Cross-border M&A accounted for 40% of global M&A in 2014. Deals involving an emerging economy acquirer and a developed economy target grew 26.7%, while deals involving a developed economy acquirer and an emerging economy target grew 4.7%. Cross-border M&A volume involving a Chinese target or acquirer rebounded in 2014, with Chinese inbound M&A activity up 63% and outbound M&A activity up 42%. Of the top ten deals in 2014, five were cross-border.

The US accounted for over 44% of global M&A volume in 2014, 6% higher than its recent historical percentage, with US participation in all but two of the ten largest deals of 2014. Despite a number of announced inversions, European M&A was flat compared to 2013, accounting for approximately a quarter of global M&A volume, slightly lower than its recent historical percentage. China's share of M&A volume grew 15% from 2013 and accounted for approximately 13% of global M&A volume, continuing to exceed its recent historical percentage.

The report is available on the Institute website.

1.7 Canadian securities regulators publish report on proxy voting infrastructure

The Canadian Securities Administrators (CSA) have published CSA Staff Notice 54-303 - Progress Report on Review of the Proxy Voting Infrastructure (29 January 2015) to report on the progress made in their review and to outline next steps.

The proxy voting infrastructure is central to Canada's public markets and includes the network of organisations, systems, rules and practices that support the solicitation, collection, submission and tabulation of proxy votes for shareholder meetings. The review's findings to date confirm that the current proxy voting infrastructure is fragmented and needs to be modernised and improved.

The progress report identifies five improvements that must be made to vote reconciliation:

- modernising how meeting tabulators receive information about who is entitled to vote;
- ensuring that the information meeting tabulators receive is accurate and complete;
- enabling each intermediary who submits proxy votes on behalf of clients to find out how many shares a meeting tabulator has determined that the intermediary is entitled to vote (its Official Vote Entitlement);
- increasing consistency in how meeting tabulators reconcile proxy votes submitted by intermediaries to Official Vote Entitlements; and
- establishing communication between meeting tabulators and intermediaries about whether proxy votes are accepted, rejected or pro-rated.

The CSA is directing all entities that play key roles in vote reconciliation to assess their processes and identify and implement any appropriate steps they can take to improve vote reconciliation for the 2015 proxy season. In 2015, the CSA intends to review one or more proxy contests to determine if there are any vote reconciliation issues that are specific to proxy contests.

For the 2016 proxy season, the CSA is directing the key entities involved in vote reconciliation to develop industry protocols that, at a minimum, address the five required improvements. The CSA will oversee the development of these protocols and may consider mandating aspects of them or regulating entities in the proxy voting infrastructure as necessary.

Further information is available on the British Columbia Securities Commission website.

1.8 IOSCO publishes final report on risk mitigation standards for non-centrally cleared OTC derivatives

The International Organization of Securities Commissions has published the final report Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives (28 January 2015), which sets out nine standards aimed at mitigating the risks in the non-centrally cleared OTC derivatives markets.

The global financial crisis highlighted how the inter-connectedness across financial institutions engaged in trading OTC derivatives led to contagion and heightened systemic risk. One of the key components of the G20 reform programme has been to encourage the central clearing of standardised OTC derivatives. However, a substantial proportion of OTC derivatives are not standardised and hence not suitable for central clearing. To reduce counterparty credit risk and limit contagion, IOSCO and the Basel Committee on

Banking Supervision (BCBS) had in 2013 published a framework which establishes minimum standards on margin requirements for non-centrally cleared OTC derivatives.

This set of risk mitigation standards, which were developed in consultation with the BCBS and the Committee on Payments and Market Infrastructures, will further strengthen the non-centrally cleared OTC derivatives market. The standards encourage the adoption of sound risk mitigation techniques to promote legal certainty over the terms of the non-centrally cleared OTC derivatives transactions, to foster effective management of counterparty credit risk and to facilitate timely resolution of disputes.

The risk mitigation standards cover the following key areas:

- trading relationship documentation and trade confirmation;
- process and/or methodology for determining valuation;
- portfolio reconciliation;
- portfolio compression; and
- dispute resolution.

Further information is available on the IOSCO website.

1.9 Revised Pillar 3 requirements issued by the Basel Committee

On 28 January 2015, the Basel Committee on Banking Supervision issued Standards - Revised Pillar 3 disclosure requirements (January 2015) (the Revised Standard). The revised disclosure requirements will enable market participants to compare banks' disclosures of risk-weighted assets. The revisions focus on improving the transparency of the internal model-based approaches that banks use to calculate minimum regulatory capital requirements.

The revised requirements will take effect from end-2016. They supersede the existing Pillar 3 disclosure requirements first issued as part of the Basel II framework in 2004 and the Basel 2.5 revisions and enhancements introduced in 2009.

The Revised Standard retains the structure of the Committee's June 2014 consultative paper. Compared with the consultative version, the key changes involve:

- rebalancing the disclosures required quarterly, semi-annually and annually;
- streamlining the requirements related to disclosure of credit risk exposures and credit risk mitigation techniques; and
- clarifying and streamlining the disclosure requirements for securitisation exposures.

Further information is available on the Bank for International Settlements website.

1.10 Audit committee survey results

On 27 January 2015, KPMG published its Global Audit Committee Survey (undated). Over 1,500 audit committee members were surveyed across 36 countries.

Some of the key findings are:

- audit committees want to devote more-or significantly more-agenda time to overseeing the company's risk management processes and operational risk controls, as well as cyber security and the pace of technology change;
- three out of four audit committee members said that the time required to carry out their responsibilities has increased significantly (24%) or moderately (51%). Half said the job continues to grow more difficult given the committee's time and expertise;
- more than one-third of boards have recently reallocated risk oversight duties among the full board and its committees (up from 25% last year), and 32% said they may consider doing so in the near future; and
- many audit committees want more information about the finance organisation's work, including financial risk management, capital allocation, tax, and debt.

1.11 Report on the post-crisis EU financial regulatory framework

On 27 January 2015, the UK House of Lords' European Union (EU) Select Committee (the Committee) published the report The post-crisis EU financial regulatory framework: do the pieces fit? (2 February

2015). The Committee concludes that "the bulk of the new regulatory framework was necessary and proportionate, and would have been implemented by the UK even if action had not been taken at EU level. We also find that it was highly desirable that regulation should be produced for the EU as a whole, both to strengthen the Single Market and to avoid regulatory arbitrage". The Committee also concludes, however, that "The UK has the largest financial sector in the EU, and the implications of these reforms for this country are therefore immense. We believe and regret that the UK's influence over the EU financial services agenda continues to diminish. The UK Government and other UK authorities must take urgent steps to correct this, and to enhance the UK's engagement with our European partners".

The matters dealt with in the report include:

- Chapter 1: The regulatory framework in context (including the outbreak of the crisis and the EU's regulatory response, categorising the nature and objectives of the legislative response, the international agenda, and the creation of the European Supervisory Authorities (ESAs);
- Chapter 2: The role of the EU institutions;
- Chapter 3: The role of the European Supervisory Authorities (ESAs);
- Chapter 4: The EU financial regulatory framework in detail (including financial stability, market transparency, consumer protection, assessing the costs of regulatory reform, and the politicisation of regulation);
- Chapter 5: The international regulatory agenda (including inconsistencies of approach and the role of international bodies);
- Chapter 6: The implications for the UK (including the UK and the Single Market and the City of London as the EU financial centre); and
- Chapter 7: The future (including shadow banking and bank structural reform).

The report is available on the UK Parliament website.

1.12 US securities class action filings against large companies drop to lowest levels since 2000

On 27 January 2015, Cornerstone Research published a research report showing that the likelihood of securities class action litigation against companies in the S&P 500 declined to the lowest levels since 2000. About one in 45 of these companies was a defendant in a new class action during the year, compared with the historical average of approximately one in 17. In addition, only 1.3% of S&P 500 market capitalisation was subject to new filings in 2014, compared with the historical average of 10.1%.

Other measures of case size were also at or near historic lows, even though the total number of securities class actions filed by plaintiffs increased slightly to 170 in 2014, from 166 in 2013. The total Maximum Dollar Loss (MDL) for filings, a measure of the largest amount that plaintiffs might seek to recover, sank to its lowest level since 1997. The Disclosure Dollar Loss (DDL) Index, which calculates investor losses at the time that an alleged fraud is disclosed, decreased 45% from 2013 to 2014.

There were only two mega filings in 2014, both in the oil and gas industry.

The key findings include the following:

- The likelihood that a public company was the subject of a filing remained above the historical average, continuing a five-year trend. In 2014, approximately one in 28 companies listed on US exchanges was the subject of a class action.
- Filings increasingly targeted firms in the pharmaceutical and biotechnology industries.
- Six class actions were filed against energy companies in the fourth quarter of 2014, as oil and gas prices slumped.
- Dismissals of securities class actions continued to increase for recent years, with dismissal rates at 59% and 58% of cases filed in 2010 and 2011, respectively.
- The percentage of filings against foreign issuers increased in 2014 for the first time in three years, with a distinct increase in suits against firms headquartered in Europe.

The report is available on the Cornerstone Research website.

1.13 Securitisation reform proposals: IMF discussion paper

On 26 January 2015, the International Monetary Fund (IMF) published a discussion paper identifying potential reforms to the regulation of securitisation. The proposed reforms seek to preserve the beneficial features of securitisation while mitigating those that may pose risks to financial stability. A comprehensive set of reforms-targeting both supply- and demand-side inefficiencies-will be needed to put securitisation back on a sound, growth-supportive footing. The paper proposes a broad suite of principles applicable to various elements of the financial intermediation chain. After identifying where policy makers have already made progress, the paper proposes measures to address remaining impediments to the rehabilitation of securitisation markets. The paper also encourages more consistent industry standards for the classification of risk (albeit applied at a granular rather than overarching level).

The paper is available on the IMF website.

1.14 Progress report on banks' adoption of risk data aggregation principles issued by the Basel Committee

On 23 January 2015, the Basel Committee on Banking Supervision (the Committee) issued a second progress report (January 2015) on banks' adoption of the Committee's Principles for effective risk data aggregation and risk reporting (January 2013). Published in 2013, the Principles aim to strengthen risk data aggregation and risk reporting at banks to improve their risk management practices and decision-making processes. Firms designated as global systemically important banks (G-SIBs) are required to implement the Principles in full by 2016.

The report reviews banks' progress in 2014 and updates a 2013 "stocktaking" self-assessment survey completed by G-SIBs (further information), other large banks and supervisors. It outlines the measures G-SIBs have taken to improve their overall preparedness to comply with the Principles, as well as the challenges they face. G-SIBs are increasingly aware of the importance of this topic and have moved towards implementing the Principles. Of the 31 participating banks, however, 14 reported that they will be unable to fully comply with the Principles by the 2016 deadline, compared with 10 G-SIBs in 2013.

The Principles apply initially to all systemically important banks. In addition, the Committee recommends that national supervisors apply the Principles to institutions identified as domestic systemically important banks three years after their designation as such. The Basel Committee believes that the Principles can be applied to a wider range of banks in a way that reflects their size, nature and complexity.

Further information is available on the BIS website.

1.15 Investments by shareholder activists decline in Europe but increase in the US

On 21 January 2015, law firm Freshfields Bruckhaus Deringer published data showing that despite a continued increase in activism and investment in the US and other regions in 2014, the number of new investments in listed European companies by activist investors fell by a third (33%) to 49 in 2014, down from 73 in 2013.

There was an even bigger decline in the UK, where the number of new investments by activist investors fell by 45% to its lowest in three years. There were 32 last year (down from 58 in 2013 and 45 in 2012). In contrast, the number of new activist investments in listed US companies increased by 61% to 624 in 2014 (up from 388 in 2013).

The decline in new European activism and investment in Europe in 2014 reverses a significant increase in 2013. In that year, the number of new activist investments in European companies surged by 49% to 73 (up from 49 in 2012).

Further information is available on the Freshfields Bruckhaus Deringer website.

1.16 Consultation - Draft regulation exempting ERF participants under the Corporations Act

On 21 January 2015, the Commonwealth Treasury released Exposure Draft - Corporations Amendment (Emissions Reduction Fund Participants) Regulation 2015 (undated) and an accompanying draft explanatory statement (undated) and consultation paper (January 2015) for public comment. According to the Treasury, the draft regulation will amend the Corporations Regulations 2001 (Cth) to "provide certain targeted exemptions from the financial services provisions of [the Corporations Act 2001 (Cth)] for participants in processes relating to [the Emissions Reduction Fund (ERF)]".

Specifically, the Treasury states that the Draft Regulation would provide that:

- carbon abatement contracts, which a project proponent and [the] Clean Energy Regulator enter into after a successful ERF bid, would not be regulated as financial products;
- certain eligible aggregation arrangements would not be regulated as financial products; and
- carbon service providers who only provide financial product advice which is incidental to technical

advice relating to an ERF project would not be regulated as financial advisers.

The Commonwealth Department of the Environment states that under the proposed changes, "most aggregators and carbon service providers would not be required to hold an Australian Financial Services Licence or provide a Product Disclosure Statement to retail clients". Among other things, the consultation paper considers "whether persons bidding into ERF auctions (known as aggregators) also require exemptions for dealing in carbon credits on behalf of members of the aggregation arrangement or for providing custodial or depository services in relation to carbon credits on behalf of the members".

Further information is available on the Treasury and Department of the Environment websites.

1.17 More women moving into corporate management

On 12 January 2015, the International Labour Organisation (ILO) published a report showing that while women are still under-represented in top management, the number of women in senior and middle management positions has increased over the last 20 years. Gaining Momentum - Women in Business and Management (undated) shows that in 80 of the 108 countries for which ILO data is available, the proportion of women managers has increased during this period.

Only 5% or less of the CEOs of the world's largest corporations are women. The larger the company, the less likely the head will be a woman. All-male company boards are still common but are decreasing in number, with women attaining 20% or more of all board seats in a handful of countries. A global survey quoted in the study shows that Norway has the highest global proportion of companies (13.3%) with a woman as company board chairperson, followed by Turkey (11.1%).

Today, women own and manage over 30% of all businesses, but they are more likely to be found in micro and small enterprises. Getting more women to grow their businesses is not only critical for equality but also for national development, according to the report.

The report is available on the ILO website.

1.18 Publication of Bank for International Settlements papers on debt

In January 2015, the Bank for International Settlements (BIS) published the proceedings of its 2014 conference on debt:

- BIS Working Papers No 479 - Understanding the role of debt in the financial system (January 2015) by Bengt Holmstrom, with comments by Philipp Hildebrand and Ernst-Ludwig von Thadden (both undated);
- BIS Working Papers No 480 - Trilemmas and trade-offs: living with financial globalisation (January 2015) by Maurice Obstfeld, with comments by Otmar Issing and Takatoshi Ito (undated);
- BIS Working Papers No 481 - Credit booms: implications for the public and the private sector (January 2015) by Tano Santos, with comments by Andrés Velasco (undated);
- BIS Working Papers No 482 - Secular stagnation, debt overhang and other rationales for sluggish growth, six years on (January 2015) by Stephanie Lo and Kenneth Rogoff; and
- BIS Papers No 80 (January 2015) contains the opening address by BIS general manager Jaime Caruana on "Debt: the view from Basel" and a keynote address by Benjamin Friedman entitled "A predictable pathology".

1.19 Key governance issues for directors in 2015

In January 2015, Deloitte published the report Through the eyes of the board - Key governance issues for 2015 (undated). The report reflects the views of Deloitte staff and independent directors. The matters covered include shareholder activism, board composition, corporate reporting, corporate reputation, regulatory issues, corporate strategy, subsidiary governance, sustainability, technology and organisational talent.

The report is available on the Deloitte website.

2. Recent ASIC Developments

2.1 Amendment of rules on trade reporting obligations for OTC derivatives

The ASIC Derivative Transaction Rules (Reporting) Amendment 2015 (No. 1) (further information) has been made to amend the ASIC Derivative Transaction Rules (Reporting) 2013 (the Derivative Transaction Rules (Reporting)) (further information), following industry consultation and feedback on ASIC's Consultation Paper 221 - OTC Derivatives Reform: Proposed amendments to the ASIC Derivative Transaction Rules (Reporting) 2013 (July 2014) (further information).

The changes to the derivative transaction rules (reporting) include:

- introducing end-of-day or "snapshot" reporting instead of intraday or "lifecycle" reporting as a permanent reporting option;
- introducing a "safe harbour" from liability for reporting entities using delegated reporting, if certain conditions are met;
- expanding the ability for foreign firms to rely on foreign reporting requirements in order to comply with their obligations under the Derivative Transaction Rules (Reporting), known as alternative reporting, while introducing a requirement for foreign entities who use alternative reporting to designate (or "tag");
- transactions as being reported under the rules to enable that information to be made available for financial regulators; and
- making a number of other technical changes to the Derivative Transaction Rules (Reporting) reflecting proposals in CP 221 and/or feedback received.

ASIC has decided, after consultation with other financial regulators, not to proceed with the proposal to require larger foreign subsidiaries of Australian authorised deposit-taking institutions (ADIs) and Australian financial services licence (AFS) licence holders to report OTC derivative transactions. ASIC concluded that the regulatory benefit would not outweigh the additional compliance cost, however, regulators will keep the issue of the materiality of OTC derivatives holdings in foreign subsidiaries under review.

As part of the amendment to allow the option for reporting entities to use end-of-day (or "snapshot") reporting on a permanent basis, ASIC has also introduced a determination power for ASIC to require the reporting of intraday trades in a derivative or class of derivative. Although ASIC does not presently intend to exercise the power to require these intraday trades to be reported, for market integrity purposes it will continue to keep under review the need to require certain intraday OTC derivative transactions to be reported, such as for contracts for difference or margin foreign exchange derivatives.

The amendment commenced on 13 February 2015.

Further information is available on the ASIC website.

2.2 ASIC enquires into risk management by responsible entities

On 13 February 2015, ASIC announced that it is making enquiries of a number of responsible entities of registered managed investment schemes regarding their risk management practices. The enquiries are a proactive response to the increased market volatility in global and domestic markets and aim to examine the adequacy of risk management and disclosure practices in the current environment. Effective management of these issues leads to less risk being borne by investors.

ASIC is currently undertaking enquiries with a range of responsible entities of registered managed investment schemes, focussing particularly on fixed income funds, exchange-traded funds and other funds that may experience liquidity issues during periods of market volatility. Responsible entities will be reminded of their obligations and asked to provide ASIC with information regarding the adequacy of the arrangements addressing risk.

All Australian financial services licensees are required to have adequate risk management systems. In 2013 ASIC published Consultation Paper 204 - Risk management systems of responsible entities (March 2013) (further information), which proposed guidance-based on the current practices of responsible entities. ASIC's final policy position is under consideration. Responsible entities should, however, continue to ensure that adequate risk management systems are in place to comply with their obligations.

2.3 ASIC enforcement report - July to December 2014

On 30 January 2015, ASIC released its latest six-monthly enforcement report Report 421 - ASIC enforcement outcomes (January 2015), detailing outcomes achieved between 1 July 2014 and 31 December 2014. ASIC achieved 348 enforcement outcomes. This included criminal as well as civil and administrative (e.g. banning or disqualification) actions, and negotiated outcomes, including enforceable undertakings.

These outcomes were achieved across the financial services, market integrity, corporate governance and small business areas.

Further information is available on the ASIC website.

2.4 ASIC report on decisions on relief applications

On 28 January 2015, ASIC issued its latest report outlining decisions on relief applications covering the period 1 June to 30 September 2014. Businesses frequently approach ASIC for assistance to help make the law work better for them. ASIC uses its discretion to vary or set aside certain requirements of the law where there is a net regulatory benefit or where ASIC can facilitate business or cut red tape without harming other stakeholders. This is a key part of ASIC's function and between 1 June - 30 September 2014, ASIC approved 474 relief applications.

Report 420 - Overview of decisions on relief applications (June to September 2014) (January 2015), aims to improve the level of transparency and the quality of publicly available information about decisions ASIC makes when asked to exercise its discretionary powers to grant relief from provisions of the:

- Corporations Act 2001 (Cth) (the Corporations Act); or
- National Consumer Credit Protection Act 2009 (Cth) (the National Credit Act).

The report summarises examples of situations where ASIC has exercised, or refused to exercise, its exemption and modification powers under the Corporations Act and the licensing and responsible lending provisions of the National Credit Act. The report also highlights instances where ASIC has considered adopting a no-action position regarding specified non-compliance with statutory provisions.

Finally, the report provides examples of decisions that demonstrate how ASIC has applied its policy in practice which ASIC considers will be of particular interest for capital market participants and for participants in the financial services industry. The report includes an appendix detailing the relief instruments referred to in the report.

Background

ASIC can modify or set aside certain provisions of Chapters 2D (officers and employees), 2G (meetings), 2M (financial reporting and audit), 5C (managed investment schemes), 6 (takeovers), 6D (fundraising) and 7 (financial services) of the Corporations Act.

ASIC also has powers to grant relief under the National Credit Act from the licensing provisions in Chapter 2 and the responsible lending conduct provisions in Chapter 3.

In limited situations, ASIC may also consider providing a no-action letter when instances of non-compliance with certain statutory provisions have been brought to ASIC's attention. A no-action letter states to a particular person that ASIC does not intend to take regulatory action over a particular state of affairs or particular conduct. The factors that ASIC will consider when dealing with a request for a no-action letter are set out in Regulatory Guide 108 - No-action letters (December 2009) (further information).

Further information is available on the ASIC website.

3. Recent ASX Developments

3.1 ASX issues updated guidance on share trading policies and debt securities

As part of ASX's Guidance Note refreshment program, ASX has issued updated Guidance Notes in relation to trading policies and debt securities. The updated guidance incorporates learning since the previous review in January 2012.

Guidance Note 27 - Trading Policies (updated 30 January 2015) aims to have listed entities minimise the risk of insider trading, avoid the appearance of insider trading and avoid the reputational damage that insider trading can cause. Thus, Guidance Note 27 addresses why listed entities are expected to have a trading policy, to whom and when restrictions on trading a listed entity's securities should occur, the types of trading that should be restricted, exceptions to trading restrictions and procedures entities should have to grant clearances to trade.

ASX has issued various Guidance Notes regarding debt securities. Guidance Note 29 - ASX Debt Listings (30 January 2015) assists entities desiring to apply for admission to the official list as a debt listing rather than as an equity listing. Guidance Note 34 - Naming Conventions for Debt and Hybrid Securities (30 January 2015) assists entities desiring to issue ASX-quoted debt or hybrid securities on how such securities should be labelled in relevant documentation. Finally, Guidance Note 30 - Applying for Quotation of Additional Securities (updated 30 January 2015) provides updated guidance on quotation of additional debt securities.

Further information is available on the ASX website.

3.2 ASX introduces Automatic-Exercise for ASX Exchange Traded Options

As of 2 February 2015, the default position for all in-the-money cash settled and deliverable option contracts is automatic exercise on expiry date. Participants have the ability to exclude automatic exercise for a specific position or to provide for a specific position that is not in-the-money. ASX Operating Rule Amendments simplify the description of the relevant expiry date to reflect clearly that the expiry date is the one notified by ASX.

When a participant makes an exercise error, the rule amendments provide transparency as to the error resolution process. The amendments provide for enhanced ASX powers to support ASX Clear's performance of functions in the exercise and settlement process, including when there is a participant or ASX error.

Further information is available on the ASX website.

3.3 Reports

On 5 February 2015, ASX released:

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

for January 2015.

4. Recent Research Papers

4.1 Litigating the financial crisis

The US government's response to the financial crisis was dramatic, enormous, and unprecedented, and nothing about it has been overseen by the courts. In the US federal system, the courts are supposed to put the policies of presidents and congresses to the test of judicial review, to evaluate decisions by the executive to sanction individuals for wrongdoing, and to resolve disputes between private parties. But during and after the financial crisis, there has been almost none of that sort of judicial review of government, few sanctions on the private sector for conduct during the crisis, especially criminal ones, for the courts to scrutinise, and a private dispute process that, while increasingly active, has resulted in settlements, rather than trials or verdicts. This article tells the story of the marginal role of courts in the financial crisis, evaluates the costs of that role, and provides suggestions to ensure a real, if not all-encompassing, judicial role during the next economic emergency.

The paper is available on the SSRN website.

4.2 Liability for financial failure: Corporate risk-taking and the decline of personal blame

US federal agencies and prosecutors are being criticised for seeking so few indictments against individuals in the wake of the 2008 financial crisis and its resulting banking failures. This article analyses why—contrary to a longstanding historical trend—personal liability may be on the decline, and whether agencies and prosecutors should be doing more. The analysis confronts fundamental policy questions concerning changing corporate and social norms. The public and the media perceive the crisis's harm as a "wrong" caused by excessive risk-taking. But that view can be too simplistic, ignoring the reality that firms must take greater risks to try to innovate and create value in the increasingly competitive and complex global economy. This article examines how law should control that risk-taking and internalise its costs without impeding broader economic progress, focusing on two key elements of that inquiry: the extent to which corporate risk-taking should be regarded as excessive, and the extent to which personal liability should be used to control that excessive risk-taking.

The paper is available on the SSRN website.

4.3 The soft law nature of Basel III and international financial regulations

The global financial crisis (GFC) of 2007 to 2009 prompted international soft law institutions, such as the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (the Basel Committee), to streamline the governance of internationally active banks by imposing upon them new capital requirements through Basel III which has both micro-prudential and macro-prudential aspects. Although Basel III is shaped by and embodies the response to the GFC of 2007 to 2009 by the Group of Twenty Finance Ministers and Central Bank Governors from the world's 20 major economies (G20), Basel III does not have legally binding effect but the G20 operates through transnational regulatory networks (TRNs) which comprise many international standard-setting bodies. This article explains and analyses why the pursuit of the common good in political economies by participants in TRNs, international financial regulations in general and Basel III in particular will facilitate greater convergence in supervisory practices and deepen cooperation between supervisory authorities.

The paper is available on the SSRN website.

4.4 Do governance indicators explain development performance? A cross-country analysis

The central question addressed by this study is whether countries with above-average governance grew faster than countries with below-average governance. Using the World Bank's worldwide governance indicators to measure governance performance, it examines whether a country with governance "surplus" in a given base year (1998) grew faster on average in a subsequent period (1998–2011) than a country with governance "deficit". Governance is defined in several dimensions, including government effectiveness, political stability, control of corruption and regulatory quality, voice and accountability, and rule of law. The study finds that government effectiveness, political stability, control of corruption and regulatory quality all have a more significant positive impact on country growth performance than voice and accountability and rule of law. Developing Asian countries with a surplus in government effectiveness, regulatory quality and corruption control are observed to grow faster than those with a deficit in these indicators up to two percentage points annually, while Middle East and North African countries with a surplus in political stability, government effectiveness, and corruption control are observed to grow faster than those with a deficit in these indicators by as much as 2.5 percentage points annually. Good governance is associated with both a higher level of per capita GDP as well as higher rates of GDP growth over time. This suggests that good governance, while important in and of itself, can also help in improving a country's economic prospects.

The paper is available on the SSRN website.

4.5 The market for director reputation around the world: Evidence from shocks to international reputation

Using data on over 40,000 outside directors from 38 non-US countries, the authors show that changes in directors' international reputation have significant labour market consequences. Outside directors experience a change in their international reputation when their firm cross-lists its shares in the US, become subject to class action lawsuits in US courts, and upon the first-time block equity investments by foreign institutional investors. The authors find that outside directors are rewarded (penalised) with additional (fewer) external directorships in their home country and abroad following such positive (adverse) shocks. They also show that these affects are larger when directors' pre-shock reputational stock is low and when the aggregate strength of investor protection in a country is high. Total director compensation is similarly affected by these shocks. Overall, the evidence suggests that outside directors' international reputation is important in directorial labour markets around the world and that the market for shareholder-friendly director reputation is complementary to the aggregate governance quality of the country.

The paper is available on the SSRN website.

5. Recent Corporate Law Decisions

5.1 Court rejects creditor's challenge to application for interim distribution

(By Tom Ward, Minter Ellison)

Re Anglican Development Fund Diocese of Bathurst Board (recs and mgrs apptd) [2015] NSWSC 6, Supreme Court of New South Wales, Black J, 22 January 2015

The full text of this judgment is available here.

(a) Summary

This case is an example of a creditor challenging an application to the Court by receivers and managers for approval to make a distribution to creditors, in the context of ongoing litigation and an earlier consent judgment.

(b) Facts

On 30 September 2013, the solicitors for the Anglican Development Fund Diocese of Bathurst Board (ADF) advised the Commonwealth Bank of Australia (CBA) that ADF could not roll over commercial bills which matured on that day. On 1 October 2013, the Plaintiffs Barry Kogan and Joseph Hayes (the Receivers), were appointed as receivers of ADF by an interim order.

By orders made on 15 October 2013, judgment was given by consent for CBA in the amount of $36,063,742. The orders also affirmed the Receivers' appointment as receivers and managers and provided that they were to have all the powers of receivers of a corporation under ss. 420, 430 and 431 of the Corporations Act 2001 (Cth) (the Corporations Act), they were to take all reasonable steps to ascertain the assets and liabilities of ADF (including any *chose* in action), they were to realise the assets of ADF (including any *chose* in action), and they were to apply to the Court for approval to make any distributions to persons adjudicated to be creditors or for the compromise or forgiveness of any debt owed to ADF. The Anglican Property Trust Diocese of Bathurst (APT) subsequently lodged a proof of debt with the Receivers.

The Receivers sought interlocutory orders, which were not opposed, permitting an interim distribution to creditors and that the costs of the application be costs of the receivership. Those orders proposed that funds be set aside for claims by APT, the Diocese of Bathurst (the Diocese) and two other entities, which were treated as under adjudication, and proposed a distribution of funds to CBA on the basis that its claim had been adjudicated.

In March 2014, the Receivers caused ADF to commence two proceedings. The first proceedings were brought against the Bishop of the Diocese and other persons. Those proceedings related to guarantees allegedly given by the Bishop in respect of loans made by ADF and sought to realise assets of the Diocese and have the net proceeds paid to the Receivers. The second proceedings were brought against the former Bishop of the Diocese and other persons who constituted the board of ADF, seeking compensation under s. 1317H of the Corporations Act plus interest or, alternatively, damages and interest.

The former Bishop and others filed a defence in the second proceedings and a cross-claim cross-summons (the Cross-claim). Those parties sought an order that, by reason of CBA's alleged unconscionable conduct, CBA be enjoined from enforcing the CBA facilities against ADF. They also sought damages in respect of any liability to ADF. APT was not party to that Cross-claim.

As with the earlier interim distribution, the Plaintiffs sought interlocutory orders permitting them to make an interim distribution to the creditors of ADF in accordance with a Distribution Schedule and that the costs of the application be costs of the receivership. That Distribution Schedule identified four claims (including claims by APT and the Diocese) as under adjudication, with funds proposed to be set aside, and identified a claim by CBA as adjudicated, with funds proposed to be distributed.

(c) Decision

The application for leave to make an interim distribution was opposed by APT on several bases summarised in their Points of Contention.

(i) Should the Receivers have investigated action against CBA?

In their first and second Points of Contention, APT submitted that, given particular factors, the Receivers should have investigated whether ADF should take any action against CBA with a view to relieving ADF of some or all of its liability to CBA. APT further submitted that the Receivers had not placed evidence before the Court that showed that they had considered the potential liability of CBA to ADF.

Black J did not accept those submissions. ADF's liability to CBA was established by a consent judgment, and there was no suggestion made that ADF's directors or legal representatives did not act properly in taking that course. Additionally, no claim was identified which would give rise to a liability of CBA to ADF.

His Honour reasoned that, before the Receivers could be required to devote resources or incur costs in investigating the prospect of action against CBA, there would first need to be identified facts which might give rise to a basis for such a liability.

His Honour also disagreed with APT's submission that, if the Cross-claim was successful, then ADF will have either no or a reduced liability to CBA. Instead, his Honour noted that the Cross-claim was directed not to the existence of a liability of ADF to CBA, but to the enforcement of that liability and the identity of the assets against which it may be enforced.

(ii) Should the Receivers have considered whether the consent judgment could be set aside?

In the Point of Contention, APT submitted that the Receivers were required to consider whether the consent judgment is liable to be set aside. APT noted that the Receivers were appointed before the consent judgment and given the power to defend any proceedings in the name of and on behalf of ADF, but did not appear before the Court on 15 October 2013 or consent to that judgment.

His Honour was not satisfied that any factual basis had been established for a suggestion that the consent judgment would be set aside. APT did not establish that the Receivers could not properly decide not to oppose the directors' decision to consent to the judgment, where the directors were independently represented and familiar with the matter and the Receivers appointed about two weeks before.

(iii) Should the interim distribution be made before the claims are determined?

APT also submitted that the proposed interim distribution to CBA should not be made at the present time because the liability of CBA to ADF under the various claims had not been determined and/or because there was no evidence before the Court that the Receivers had considered such matters. APT also asked why there should be any payment until the liability raised in the Cross-claim had been determined.

His Honour rejected these submissions on the grounds that the Cross-claim was not filed until some months after the Receivers allowed CBA's proof of debt, that no interested party, including APT, had sought to challenge the decision to allow that proof of debt, and that the matters alleged in the Cross-claim did not establish any factual or legal basis for such liability on the part of CBA, as discussed above.

(iv) Were the Receivers impartial?

Finally, APT pointed to evidence of dealings between the Receivers and/or their solicitors and CBA and submitted that it is open to the Court to inquire into whether a fair minded lay observer would reasonably apprehend that the Receivers and/or their solicitors might not bring an impartial mind to an examination of the matters for consideration. Specifically, APT emphasised the difficulty of the Receivers taking legal advice concerning potential liability of CBA to ADF, given the connection between CBA on the one hand and the Receivers and their solicitors on the other.

Black J considered that the matters raised by APT may raise a question whether a fair-minded lay observer would reasonably apprehend that the firm of solicitors that had acted for CBA would have difficulty in providing, even with fully informed consent and a Chinese wall arrangement, impartial advice to ADF against CBA. However his Honour held that, for the reasons noted above, the evidence led in the application did not identify any factual or legal basis for a claim by ADF against CBA. Accordingly his Honour did not consider that there was a present need for any advice by that firm as to that question.

(v) Conclusion

Black J rejected APT's challenge and was satisfied that the Receivers' approach to the identification of persons to whom an interim distribution should be made, or set aside pending adjudication of their claims, was appropriate. His Honour granted leave to make the interim distribution, subject to a condition that CBA repay such a distribution if a court order was made that reduced, extinguished or gave rise to a set-off against the debt.

5.2 Shareholder reliance: Fraud on the market theory lives to fight another day

(By Ashley Wharton, Partner, James Clarke, Senior Associate and Eleanor Morrison, Lawyer, Ashurst)

Caason Investments Pty Ltd v Cao [2014] FCA 1410, Federal Court of Australia, Farrell J, 23 December 2014

The full text of this judgment is available here.

(a) Summary

In this matter *(Caason*), the Federal Court of Australia held that it is open to plead a claim for misleading or deceptive conduct based on the "fraud on the market" doctrine. Such a claim cannot be said to have no reasonable prospect of success. *Caason* emphasises that when the "fraud on the market" doctrine is considered, it will be in the context of the specific factual circumstances and applicable statutory environment, meaning that a uniform answer may not be reached in all shareholder class actions (where the doctrine is most prevalent). The decision also casts doubt on whether the doctrine could apply to allegedly misleading or deceptive statements made in relation to securities that have not yet commenced trading on the ASX.

(b) Facts

In *Caason*, the applicants applied to consolidate two class action proceedings against directors and auditors of Arasor International Ltd (Arasor), in respect of allegedly misleading or deceptive statements or omissions in:

- Financial statements that allegedly failed to comply with relevant standards for disclosing information about the company's financial position.
- A prospectus for the initial public offering of Arasor shares, which fixed the share price and made forecasts about Arasor's performance.
- A short form prospectus, which addressed the collectability of accounts for deals involving Arasor.

The applicants also sought leave to amend the statement of claim, in particular, to expand the definition of a Group Member so that it was not limited to investors who had directly relied on the allegedly misleading or deceptive statements. For the reasons below, Justice Farrell allowed the application and ordered that the parties confer as to the proposed terms of the amendments in light of her Honour's reasons.

The amendments that were proposed by the applicants in effect, introduced claims based on the "fraud on the market" doctrine. The doctrine presumes that information disclosed in an efficient market is incorporated into the price of securities and is therefore taken into account by investors trading in that market. The purpose of the doctrine is to overcome the need to prove direct reliance by shareholders on allegedly misleading or deceptive statements, which is instead replaced by "market based causation".

The applicants submitted that there was "no judgment of a superior court which resolves the question of whether individual reliance must be proved to establish a relevant causal connection between a contravention and any loss suffered by the claimants".

The respondents submitted that, in cases of misrepresentation inducing a transaction (such as here the purchase of securities), the courts have required reliance on the misrepresentation as essential to establishing the causal link between the contravening conduct and the loss. More broadly, the respondents contended that a claim of misleading or deceptive conduct based on the "fraud on the market" doctrine was unknown to Australian law and should not be permitted.

While the Supreme Court of the United States recently affirmed the role of the doctrine in US law in *Halliburton Co et al v Erica P John Fund, Inc*, Australian proceedings in which the doctrine has been raised have so far been resolved before judgment. The doctrine is yet to be considered by the High Court of Australia.

(c) Decision

Her Honour found that it could not be said that a claim based on the "fraud on the market" doctrine had no reasonable prospect of success. This result is consistent with the Victorian Supreme Court's decision in *Camping Warehouse Australia Pty Limited v Downer EDI Limited* [2014] VSC 357, which was handed down after the parties' final submissions were made in *Caason*.

In reaching her decision, Justice Farrell carefully considered both parties' submissions and a number of relevant authorities in the course of her judgment. Her Honour observed that the position of the High Court in recent times has been that the test for causation must be construed in the context of the particular statute, read as a whole. Her Honour reasoned that it is the "subject, scope and objects" of the statutory regime which determine the test for causation.

Here, attention needed to be given to the intention and effect of the ASX's continuous disclosure regime. Her Honour observed that Chapter 6CA of the Corporations Act 2001 (Cth) (the Corporations Act) has regard to the influence of information disclosed to the market and further that, in the context of prospectuses, features of Part 6D.3 indicate that information contained in disclosure documents is integral to an investor's decision to invest.

In a careful analysis, her Honour found that the weight of intermediate authority favoured the proposition that a "sufficient and direct link" is required in the context of a claim for misleading or deceptive conduct. In particular, Justice Farrell rejected the applicants' contention that *ABN Amro v Bathurst City Council* [2014] FCAFC 65 (*ABN Amro*), (which was handed down six days prior to the hearing in *Caason*) supported a construction of causation that did not require reliance. Her Honour said that *ABN Amro* stands for the proposition that reliance by a third party (in that case, the product issuers) on the misleading conduct of the defendant (the ratings agency) may be sufficient to make out causation for the plaintiff (the councils). But *ABN Amro* does not support an argument that reliance in some form is not required.

Nevertheless, her Honour found that the existing cases do allow scope to explore the limits of causation; and that a novel cause of action should not be shut out at the pleading stage, provided it was arguable.

In respect of the representations in (or omissions from) the Financial Statements, her Honour held that the applicants had not pleaded a link or mechanism which showed how the allegedly misleading or deceptive conduct was said to have caused the market price of Arasor shares to be inflated. Since the concept of "the market" was pivotal to the applicants' claim of causation, the applicants needed to plead, with precision, material facts to convey that concept.

Justice Farrell found that, in the context of pre-trading conduct, the applicants faced significant difficulty in establishing how a pleading of "fraud on the market" could sufficiently show a link between conduct and loss. Her Honour said that "it would not be usual for there to have been trading in a market operated by the ASX which would have established a 'market price' ahead of allocation of entitlements". The applicants sought to contend that expert evidence would establish the difference between the "real value" of the Arasor shares and the price under the prospectus for the IPO. Her Honour held that such an approach would demonstrate loss, but not causation.

Similarly the applicants' proposed pleadings in relation to the short form prospectus were insufficient. The applicants' contention that the acquisition of shares "only occurred because the March prospectus was issued in the form it was issued" implied reliance but did not show a causal chain. Further, the applicants did not show how omissions from the document caused Group Members to retain shares. Justice Farrell questioned whether, in the context of share retention, the applicants claimed that Group Members expected to be alerted of a need to sell, if indeed it came to light that material had been omitted from the short form prospectus.

Her Honour also observed that some of the proposed amendments had the effect of hindering the claims of those Group Members who did allege that they directly relied on the representations. Her Honour was not prepared to allow those claims to be struck out.

(d) Implications

It appears that courts will permit pleadings that incorporate the "fraud on the market" doctrine, if they adequately plead material facts that may support a sufficient and direct link between the conduct and the loss. Whether the doctrine will be accepted into Australian law remains an open question for the superior courts and ultimately the High Court to determine.

The Australian courts' approach to the doctrine is likely to be deeply connected to the facts of the individual case and to the particular statute alleged to have been contravened.

Justice Farrell's decision points to one limit on the scope of the doctrine, even if it is ultimately accepted. It is doubtful that a claim based on the "fraud on the market" doctrine can succeed if the allegedly misleading conduct occurred prior to active trading on the ASX. That outcome seems consistent with the economic theory underlying the doctrine, which assumes that there is an active market responding to available information.

5.3 What are you licensed for? A warning for financial services businesses

(By James Siemon and Harrison Cross, Minter Ellison)

Australian Securities and Investments Commission v Monarch FX Group Pty Ltd [2014] FCA 1387, Federal Court of Australia, Gordon J, 17 December 2014

The full text of this judgment is available here.

(a) Summary

This case involved an application by ASIC for declarations that Monarch FX Group Pty Ltd (Monarch) had contravened ss. 911A and 911B of the Corporations Act 2001 (Cth) (the Corporations Act) and that James Hunter had been involved in those contraventions. ASIC also sought financial services disqualification orders against both defendants.

Gordon J found that Monarch had contravened those sections and that Hunter was involved in those contraventions, granted declarations to that effect against Monarch but not Mr Hunter and made disqualification orders against both defendants.

(b) Facts

Monarch conducted a business of promoting and providing foreign exchange trading signals and executing those signals via an automated trading system. To implement the automated system, Monarch assisted clients to set up an account with a broker for trading foreign exchange. Monarch had master accounts with the broker, which virtually pooled clients' accounts. Monarch entered into membership agreements with clients to provide these services. Where clients did not have access to funds for investment, Monarch recommended that they set up a self-managed superannuation fund (SMSF) to access their superannuation funds. The majority of Monarch's clients followed this course and were referred to Breakaway Finance Group Pty Ltd (Breakaway).

Mr Hunter was the sole director of Monarch from 1 June 2012 to 5 December 2013 and, at the time of judgment, was the General Manager. Gordon J found that Mr Hunter had general and effective responsibility for the operations of Monarch.

Neither Monarch nor Mr Hunter held an Australian Financial Services Licence (AFSL) and were only authorised representatives of (in turn) AFSL holders Audrn Financial Group Pty Ltd (Audrn), Avestra Capital Pty Ltd (Avestra) and Forex TG Pty Ltd (Forex TG). The extent of that authorisation varied but was at most (through Audrn) to apply for, acquire or dispose of financial products on another's behalf, to issue or vary a financial product, to arrange for a person to deal in a financial product or to provide general financial product advice.

ASIC brought an application against Monarch and Mr Hunter for declarations that Monarch had contravened ss. 911A or 911B of the Corporations Act and that Mr Hunter was involved in those contraventions. ASIC alleged that Monarch had contravened those sections through the provision of managed discretionary account services (MDA Services) or through providing advice as to superannuation interests. ASIC also sought financial services disqualification orders under ss. 1101B or 1324(1) of the Corporations Act restraining Monarch and Mr Hunter from carrying on a financial services business.

(c) Decision

(i) Contravention of ss. 911A or 911B by Monarch

Section 911A(1) requires that "[s]ubject to this section, a person who carries on a financial services business in this jurisdiction must hold an Australian financial services licence covering the provision of the financial services".

Gordon J found that Monarch's master account with the broker and its membership agreement with each client constituted a facility which was a financial product. Similarly, Gordon J found that Monarch's marketing communications constituted financial product advice and its coordination of its clients' procurement of a SMSF from Breakaway constituted dealing in financial products and the provision of financial services. These activities constituted financial services businesses which took place in this jurisdiction. Finally, her Honour found that Monarch never held an AFSL for the purpose of s. 911A and that at no time were Monarch or Mr Hunter authorised to deal in MDA Services or superannuation interests. The elements of s. 911A were therefore established in respect of both contraventions.

Section 911B(1) provides that "[a] person (the provider) must only provide a financial service in this jurisdiction on behalf of another person (the principal) who carries on a financial services business if one or more of the following paragraphs apply ...". The subsequent paragraphs each set out particular conditions. In the present case, proving a breach of the section required ASIC to prove that the principal did not hold an AFSL covering the provision of the service or, alternatively, that Monarch was not an authorised representative for the provision of that service.

As noted above, Gordon J found that Monarch never held an AFSL. Furthermore, her Honour found that Monarch was not an authorised representative for the MDA Services it provided. This was because, as principals, Audrn and Forex TG were not authorised to provide those MDA Services and Monarch's authorisation as Avestra's representative did not extend to those services. Her Honour also found that the authorisation did not extend to the provision of advice regarding superannuation interests. The elements of s. 911B were therefore established in respect of both contraventions.

Gordon J noted the wide discretionary power of the Court under s. 21 of the Federal Court of Australia Act 1976 (Cth) to grant declarations that Monarch and Mr Hunter had contravened the Corporations Act. Her Honour noted relevant considerations as being whether the declaration would have any utility, whether the proceedings involved a matter of public interest and whether the circumstances called for the marking of the Court's disapproval of the contravening conduct. On the basis that the conduct of Monarch was a matter of public interest of which it was appropriate for the Court to disapprove, Gordon J made declarations that Monarch had contravened ss. 911A and 911B.

(ii) Mr Hunter's involvement in those contraventions

ASIC alleged that Mr Hunter was "involved" in Monarch's contraventions. Section 79(c) of the Corporations Act states that "[a] person is involved in a contravention if, and only if, the person ... has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention ...". Although Gordon J found that Mr Hunter was knowingly concerned or otherwise involved in Monarch's contraventions, her Honour expressed doubt as to whether s. 79 is available as a stand-alone provision that operates in respect of each contravention of the Corporations Act or only those provisions which impose liability on a person involved in a contravention (e.g. s. 181(2)).

Gordon J, however, noted that the financial services disqualification order sought by ASIC identified the penalty imposed on Mr Hunter as disqualification for four years. On that basis, her Honour held that a declaration against Mr Hunter was neither necessary nor appropriate. As a result, her Honour found that it was not necessary to resolve the question of the operation of s. 79.

(iii) Injunctive relief under ss. 1101B or 1324(1)

Section 1101B(1) of the Corporations Act provides a wide discretion for the Court to make such orders as it thinks fit where it appears that a person has contravened Chapter 7, but only "if the Court is satisfied that the order would not unfairly prejudice any person". Under s. 1101B(4), this may include "an order restraining a person from carrying on a business, or doing an act or classes of acts, in relation to financial products or financial services".

Section 1324(1) also provides the Court with the power to grant an injunction on such terms as the Court thinks appropriate, restraining a person from engaging in conduct which constituted, constitutes or would constitute a contravention of the Corporations Act.

In reaching her decision, Gordon J had regard to the factors outlined in *Australian Securities and Investments Commission v Adler* [2002] NSWSC 483 at [56] and noted the relevance of considerations of public policy in relation to the discretion under s. 1324. Her Honour also considered and agreed with a number of circumstances outlined by ASIC that were relevant for the length of the period of disqualification.

Under s. 1101B, Gordon J restrained Monarch from carrying on a financial services business for four years. Her Honour considered that s. 1101B did not apply in relation to Mr Hunter, who had not contravened the Corporations Act (but was instead involved in Monarch's contraventions). Referring to the decision of Ward JA in *Re Idylic Solutions Pty Ltd; Australian Securities and Investments Commission v Hobbs* [2013] NSWSC 106, her Honour concluded that s. 1101B did not operate as an exclusive code to preclude similar injunctive relief being granted under s. 1324. Her Honour therefore also restrained Mr Hunter from carrying on a financial services business for four years.

5.4 Claim for specific performance of agreement rejected by Court - "Unanimous Assent" principle not applied

(By Jeremy Tan, Herbert Smith Freehills)

Rilgar Nominees Pty Ltd v BHA Holdings Pty Ltd [2014] VSC 632, Supreme Court of Victoria, Sifris J, 17 December 2014

The full text of this judgment is available here.

(a) Summary

The plaintiff brought a claim for specific performance of an alleged settlement agreement arising from a mediation conference between the plaintiff and the defendants. The parties were shareholders of a private company and the mediation was in relation to existing proceedings. No written agreement detailing settlement was ever signed. It was argued by the defendants that the private company, despite being a key party to any settlement agreement was not present at the mediation and therefore not a party to any alleged agreement. Furthermore, there was no intention for the discussions at the mediation to be binding and no document was written or signed. The defendants filed an application for summary judgment. The Court accepted the defendants submissions and found that the plaintiffs case had no real prospect of success.

(b) Facts

Plaintiff Rilgar Nominees Pty Ltd (Rilgar) and the second, third and fourth defendants (the HPE Defendants) are the holders of all the ordinary shares in the first defendant, BHA Holdings Pty Ltd (BHA). Rilgar commenced proceedings against the HPE Defendants alleging oppressive conduct by reason of a proposed issue of ordinary shares in BHA to existing shareholders at an issue price which Riglar argued was low and designed to substantially dilute Rilgar's shareholding (the Oppression Proceeding).

Representatives for Rilgar and the HPE Defendants attended a mediation in relation to the Oppression Proceeding on 25 September 2014 (the Mediation). This meeting was not attended by or on behalf of BHA. At the Mediation, Howard Riley attended on behalf of Rilgar and David Plumridge and Brendan Sulway attended on behalf of the HPE Defendants. Each of the three representatives were also directors of BHA. However, on the evidence, none of the three were authorised to act for BHA nor were they attending in their capacity as directors of BHA.

The parties agreed on certain terms and transactions to resolve their dispute which were written on a whiteboard and included that:

- Rilgar would loan $772,000 to BHA at a rate of 10%;
- the loan would be able to be converted at any time into BHA shares at $55.73 per share;
- Rilgar would subscribe to $772,000 of additional shares in BHA at a price of $55.73 per share; and
- the HPE defendants would surrender/cancel $1.44 million of its shares.

Rilgar alleged that the terms discussed and matters resolved at the Mediation constituted a binding agreement (the Settlement Agreement). Handwritten notes of this Settlement Agreement were taken by solicitors acting for Rilgar. The evidence indicated that the parties stated that they agreed to the terms on the whiteboard and shook hands. The parties then took photos of the whiteboard and agreed that formal documentation would be necessary and that Rilgar's solicitors would prepare a written document.

Subsequently, a draft agreement was prepared by Rilgar's solicitors and submitted to the solicitors for the HPE Defendants. This draft agreement included additional terms to the matters agreed to at the Mediation. A week after the draft agreement was submitted, David Plumridge, on behalf of the HPE Defendants told Howard Riley, the Rilgar representative that the finance committee had rejected the draft proposed agreement.

On 7 November 2014, Rilgar commenced proceedings, alleging that a binding agreement had been made at the Mediation and that the parties had agreed to settle the matters the subject of the Oppression Proceeding in dispute. Rilgar sought an order for specific performance of the Settlement Agreement.

On 11 and 12 November 2014, BHA and the HPE Defendants made an application for summary judgment against Rilgar alleging that Rilgar's claim had no real prospects of success and should be dismissed. They relied on the following four grounds:

- BHA, a relevant and necessary party, did not attend the mediation and was not a party to the Settlement Agreement.
- The Settlement Agreement was required to be in writing and signed by the parties.
- Uncertainty - the defendants contend that important matters were not agreed and the Settlement Agreement was uncertain and incomplete.
- The alleged Settlement Agreement affected the pre-emptive rights agreed by the parties.

(c) Decision

Sifris J found for the defendants and decided that Rilgar's claim should not proceed on the basis that it did not have any real prospect of success.

In coming to his decision, his Honour found that:

- BHA was a necessary party to the Settlement Agreement, however, there was no evidence that it was;
- the Settlement Agreement did not represent a binding agreement between the parties to settle the matters in dispute at the Oppression Proceeding as no written agreement had been signed; and
- the draft written agreement went beyond matters which were the subject of the Settlement Agreement, as such the Settlement Agreement was incomplete and too uncertain to be enforced.

His Honour did not consider the HPE Defendants' submission regarding pre-emptive rights as in his view, it was not necessary to deal with them given the earlier three submissions had been accepted.

In deciding that BHA was a necessary party to the Settlement Agreement, his Honour accepted the defendants submissions that Mr Riley's case had no chance of success as it had not alleged that a critical party to the agreement, being BHA was a party to the agreement. His Honour held that BHA had to be a party to the agreement because there were numerous obligations on its part that it needed to fulfil. Evidence was brought and accepted by his Honour that BHA had not been present at the meeting and that Mr Riley, Mr Plumridge or Mr Sulway were not authorised by the BHA board to represent the company.

Rilgar submitted that because Rilgar and the HPE Defendants held 100% of the ordinary shares of BHA, it was within the powers of their representatives to approve BHA entering into the Settlement Agreement as shareholders in general meeting. In submitting this argument, Rilgar sought to rely on the "unanimous assent" principle enunciated in *Re Duomatic* [1969] 2 Ch 365, that the company is bound in a matter which is *intra vires* of the company by the unanimous agreement of its members, even where that agreement is given informally.

This application of the Duomatic principle was rejected by his Honour. In the current case, the directors were charged with the management and operation of BHA and as such should have had the chance to consider the matter. Therefore, there could be no application of the unanimous assent principle.

In deciding that the Settlement Agreement did not represent a binding agreement on the parties, his Honour accepted that a clause stipulated in the mediation agreement signed prior to the mediation should be interpreted as requiring any settlement of the dispute between the parties to be in writing and signed. His Honour held that there was no evidence of a waiver of that requirement and that there was nothing in the conduct of the parties to suggest that the requirement for a signed settlement had been dispended with. He held that clear and unequivocal conduct was required to vary or waive such a specific requirement of a signed settlement document.

Finally, in accepting that any agreement reached at the Mediation was incomplete or insufficiently certain to be enforceable, his Honour held that the drafted proposed agreement went beyond matters which were the subject of the Settlement Agreement. These were not simply matters of form but of sufficient substance so as to require consideration and assent.

On the basis of these three submissions, his Honour held that Rilgar had no real prospect of proving any of the above critical issues to claim specific performance of the Settlement Agreement.

5.5 Claimant for unpaid salary sent to the back of the line: Damages claim for wrongful dismissal not a retrenchment payment for the purposes of s. 556(1)(b) of the Corporations Act

(By Clementyne Rawlyk and Vidit Mehraf Corrs Chambers Westgarth)

Schmitt v Carter [2014] FCA 1370, Federal Court of Australia, Gleeson J, 15 December 2014

The full text of this judgment is available here.

(a) Summary

In this decision of the Federal Court of Australia, Justice Gleeson concluded that damages payable to a former employee for a wrongful dismissal did not constitute a "retrenchment payment" for the purposes of s. 556(1)(h) of the Corporations Act 2001 (Cth) (the Corporations Act), and thus were not required to be paid in priority to other unsecured creditors in the voluntary winding up of the employer.

Additionally, the Court held that even if damages payable to a former employee for wrongful dismissal could be construed as a "retrenchment payment" for the purposes of the Corporations Act, in this case the former employee would still have been ineligible for priority payment. This is because he was a director of the company at the time of his alleged wrongful termination, and retrenchment payments accruing to employees while they are a director are excluded from the priority payment regime under the Corporations Act.

(b) Facts

The plaintiff, Mr Schmitt, was at various times between May 2008 and December 2012 the Company Secretary, the Chief Financial Officer and a director of CMA Corporation Limited (subject to deed of company arrangement) (CMA). In December 2012, the plaintiff was summarily dismissed from his fixed term employment with CMA. Shortly thereafter he commenced proceedings for wrongful dismissal, however these proceedings were stayed as a result of CMA entering into voluntary administration in August 2013.

CMA and its subsidiaries executed a deed of company arrangement at the end of 2013 which provided that, consistent with the priority payment regime under the Corporations Act, CMA's current and former employees would be entitled to receive their outstanding employee entitlements in priority to other unsecured creditors.

The plaintiff subsequently lodged two proofs of debt, one of which included a claim for "unpaid salary", being the damages he claimed was owed to him as a result of his alleged wrongful termination under his fixed term contract. The plaintiff contended that the damages he claimed for wrongful dismissal constituted a "retrenchment payment" for the purposes of s. 556(1)(h) of the Corporations Act, and were therefore required to be paid to him in priority to other unsecured creditors. The administrators rejected this aspect of the plaintiff's proof of debt, and the plaintiff initiated proceedings against the administrators challenging this decision.

The key issue before the Court was whether the plaintiff's damages claim for wrongful termination constituted a "retrenchment payment" within the meaning of s. 556(1)(h) of the Corporations Act. That provision relevantly provides that retrenchment payments payable to employees of a company shall be paid in priority to other unsecured creditors in the winding up of the company. Importantly however, s. 556(1C) of the Corporations Act also provides that retrenchment payments attributable to any day on which an employee is a director of the company are excluded from the operation of s. 556(1)(h).

(c) Decision

Section 556(2) of the Corporations Act defines a "retrenchment payment" as:

> ... an amount payable by the company to the employee, by virtue of an [employment contract], in respect of the termination of the employee's employment by the company ...

The plaintiff contended that the expression "by virtue of" in the definition of "retrenchment payment" should be construed broadly, and that there was a sufficient causal relationship between the damages he claimed for wrongful dismissal and his employment contract forming the basis of that claim, to render those damages as being payable "by virtue of" his employment contract (even if they were not specifically payable "under" his employment contract).

The Court rejected this submission, determining that although there was a clear connection between the plaintiff's claim for damages and his employment contract on which his claim was based, the damages claim cannot be described as arising "by virtue of" his employment contract because it only arose upon the termination of that contract. In reaching this conclusion, her Honour stated that for the purposes of interpreting s. 556(1)(h) of the Corporations Act, the expression "by virtue of" an employment contract can be read as being synonymous with the expression "under" an employment contract.

Justice Gleeson further held that even if the plaintiff's damages claim was a "retrenchment payment" for the purposes of the Corporations Act, the plaintiff still was not eligible for a priority payment in respect of that claim. In this regard, her Honour held that because the plaintiff's damages claim accrued on the date he was allegedly wrongfully terminated, this was the only date on which the payment could sensibly be "attributable" to. Given that the plaintiff was a director of CMA on this date, her Honour held that the exception in s. 556(1C) applied to the damages claim and therefore the plaintiff was precluded from obtaining priority payment under the Corporations Act.

5.6 In considering whether to approve the compromise of a company debt by a liquidator under s. 477(2A) of the Corporations Act, the Court will assess whether the settlement is for the benefit of those concerned in the winding up, giving significant weight to commercial considerations and the judgment of the liquidators

(By Lucienne Cassidy, Ashurst Australia)

ACN 104 635 369 (formerly known as Total Plant Services Pty Ltd) (in liquidation) v Combined Group Management Pty Ltd [2014] FCA 1402, Federal Court of Australia, Gleeson J, 15 December 2014

The full text of this judgment is available here.

(a) Summary

This Federal Court of Australia decision revisits the principles a Court must apply in determining whether to approve a compromise of a company debt by a liquidator under s. 477(2A) of the Corporations Act 2001 (Cth) (the Corporations Act). Justice Gleeson's decision also provides some additional commentary on when the Court will refuse to grant an adjournment of an application under s. 477(2A), in particular having regard to the history of the company's liquidation and the prospect of any further recoveries being made that would warrant a delay to the settlement of the company's claims.

(b) Facts

ACN 104 635 369 (formerly known as Total Plant Services Pty Ltd) (in liquidation) (TPS) was a contractor of RailCorp, a NSW government instrumentality. As part of the contractual arrangements, TPS provided RailCorp with a bank guarantee from the ANZ for $500,000, which (according to evidence given in public examinations conducted by liquidators of TPS) was ultimately returned to ANZ.

Following public investigations into alleged corruption affecting RailCorp, TPS lost its contract with RailCorp or the contract was not renewed. TPS was subsequently wound up as a members' voluntary winding up. Allegations were later made that the directors of TPS had declared a dividend of $600,000, despite knowing that a substantial debt was owed by TPS to a sub-contractor creditor, being the tenth defendant in this proceeding (Azzopardi Industries). The declaration was made shortly before the solvent winding up of TPS, in spite of the debt owed to Azzopardi Industries and the likelihood that if TPS was unable to pay that debt it was in fact insolvent.

Subsequently, various liquidators were appointed to TPS, and investigations and public examinations were conducted by them. The ultimate liquidators of TPS commenced this proceeding in the Federal Court of Australia seeking to recover from the directors, among other things, the value of the $600,000 dividend. A mediation was held between the parties at which the liquidators agreed to accept $600,000 to settle TPS's claims for the value of the dividend plus interest, as well as the costs of the litigation and the liquidators' costs on the basis that the directors had acted improperly in resolving to commence a members' voluntary winding up (in circumstances where TPS was likely insolvent). The terms of settlement were agreed to be subject to the Court's approval being obtained by the liquidators.

Accordingly, the liquidators made an interlocutory application in this proceeding for Court approval under s. 477(2A) of the Corporations Act of the terms of settlement. Section 477(2A) requires that a liquidator obtain the approval of the Court, of the committee of inspection or of a resolution of the creditors before compromising a debt owed to the company that exceeds $20,000 or some other greater amount prescribed by the regulations.

Certain creditors of TPS, including Azzopardi Industries, sought an adjournment of the interlocutory application so that they or the liquidators could have the opportunity to investigate the bank guarantee and to properly consider the proposed settlement. The liquidators also applied for their remuneration and the remuneration of certain previous liquidators of TPS to be fixed.

(c) Decision

(i) Application by creditors to adjourn interlocutory application refused

Justice Gleeson refused to adjourn the interlocutory application. Her Honour considered that the submissions filed in support did not support the application, rather seemed "to be predicated upon a confusion about the value of the bank guarantee" and her Honour "would simply be perpetuating an apparent confusion by allowing an adjournment".

In relation to the matters raised in the applicants' submissions, her Honour concluded that:

- there was no evidentiary basis for the creditors' assertions that, first, the liquidators ought to have investigated the existence of a cause of action relating to the bank guarantee and, second, the liquidators should have conducted further investigations into additional causes of action beyond what had already been undertaken;
- although it was "regrettable" that the creditors would be substantially out of pocket as a result of the liquidation, an adjournment would be more likely to incur further expenses and, in the absence of a clear plan of action concerning what the creditors would do if an adjournment was granted, it would not have any utility; and
- it is unnecessary to order the liquidators to prepare a report to creditors, as was requested by certain of the creditors, in circumstances where the relevant information had already been set out in the material filed by the liquidators in support of the interlocutory application and requiring a report in addition would only add cost without conferring additional benefit.

(ii) Application by liquidators for approval of settlement granted

Justice Gleeson approved the terms of settlement agreed between the parties pursuant to s. 477(2A) of the Corporations Act. Her Honour cited the summary of relevant principles that the Courts are to apply in considering whether to exercise their discretion to grant approval under s. 477 set out in the judgment of Justice Gordon in *Australian Securities and Investments Commission v GDK Financial Solutions Pty Ltd (In Liq) (No 14)* [2013] FCA 459 at [9] to [10], namely that:

- the Court will generally not interfere unless there can be seen to be some lack of good faith, some error in law or principle, or real and substantial grounds for doubting the prudence of the liquidator's conduct;
- the compromise of claims will involve assessment on a legal basis, and a liquidator will be expected to obtain advice from practitioners appropriate to the nature and value of the claims;
- the Court must consider whether a compromise is for the benefit of the creditors, giving significant weight to commercial considerations and the judgment of the liquidators;
- the Court will not approve an agreement if its terms are unclear;
- the Court's role is to grant or deny approval, not to develop some alternative proposal which might seem preferable; and
- generally, the Court is to weigh up whether there is any good reason to intervene in terms of the expeditious and beneficial administration of the winding up.

Her Honour considered it relevant that a detailed legal advice had been given that recommended the liquidators accept the proposed settlements, having regard to both legal and commercial considerations in favour. Further, her Honour observed that no allegations had been made that the proposed settlements involved any error of law, or that there was any reason to suspect any bad faith or impropriety in connection with the proposed settlements. Her Honour also noted that she had paid "due regard to the liquidators' commercial judgment and knowledge of all of the circumstances of the liquidation".

(iii) Application for remuneration to be fixed

The liquidators sought to rely on ss. 473 and 511(1)(b) of the Corporations Act to have their remuneration and the remuneration of other liquidators of TPS fixed by a Registrar. Justice Gleeson took the view that the Court's power in s. 473 was not engaged because no resolution had been put to the creditors to approve remuneration and the source of the Court's power (if any) to dispense with that requirement had not been identified.

Justice Gleeson considered it necessary to assess whether the process for fixing remuneration in s. 499(3) was engaged given the winding up was a creditors' voluntary winding up. However, her Honour ultimately concluded it had no relevant application because, given the history of the matter and the material before the Court, it was reasonable to conclude that the creditors (including Azzopardi Industries) would not agree to the remuneration entitlement as provided for in that section.

Her Honour ultimately concluded that the Court had power under s. 511(1)(a) of the Corporations Act to determine the liquidators' remuneration, which power can be exercised by a Registrar. Her Honour relied on the decision of Barrett J in *Re Walker* [2005] NSWSC 557; (2005) 221 ALR 320, in particular his Honour's comment at [6] that "[a] liquidator in a creditors' voluntary winding up, as in any other winding up, has an entitlement to be remunerated and an entitlement to have the remuneration fixed".

5.7 Court finds director's actions constituted an unreasonable director-related transaction under s. 588FDA of the Corporations Act and a breach of duty

(By Jessica Taylor, DLA Piper)

Weaver v Harburn [2014] WASCA 227, Supreme Court of Western Australia, Court of Appeal, McClure P, Buss JA and Murphy JA, 11 December 2014

The full text of this judgment is available here.

(a) Summary

The Court of Appeal of the Supreme Court of Western Australia considered the actions of a company director who made payments for the purchase of a boat amounting to $385,219.35 in the name of the company. The question before the Court of Appeal was whether the trial judge had erred in finding that the transaction for the purchase of the boat by the company was a reasonable director-related transaction and that the director had not breached any of his duties to the company.

Mr Harburn unsuccessfully submitted that the money used as payment for the boat was a dividend to him. This was rejected by the Court which found that there was no evidence to support the assertion that such a dividend was proposed to be issued. Mr Harburn also attempted to argue that, because of the financial position of the company, there was no obligation to have regard to the best interest of creditors and thus the best interests of the company were equivalent to his own interests. This was rejected, with the Court noting that there was no evidence that the sole shareholder had consented to the payment and consent of the shareholder could not be implied from the director's knowledge and involvement in the transactions.

The court found that impropriety or other breach of a director's duty is not an element of an unreasonable director-related transaction. That was reinforced by s. 588FDA(3) which recognises that the transaction may otherwise be valid and enforceable. The focus in s. 588FDA is not the director's conduct but the reasonableness of the company's conduct, objectively assessed, in entering into the transaction. Based on this, the Court concluded that a reasonable person in the company's circumstances would not have entered into the transaction (s. 588FDA(1)(c)) and that there was no clear benefit to the company, with there being a detriment to the company to the extent of the payments. Furthermore, the benefit of the payments was only to Mr Harburn's spouse.

(b) Facts

The first respondent (Mr Harburn) was the director of Harburn Group Australia Pty Ltd (Harburn Group), which provided financial, share broking and mortgage broking services. The sole shareholder of the company was Harburn Investments Pty Ltd. In June 2007 Harburn Group sold its financial services business client list. In July 2007 Mr Harburn purchased a boat, Stardust, for his spouse and second respondent (Ms Chivers). On 19 July 2007 Ms Chivers entered into a contract to buy the boat for $385,219.35.

Throughout June and July 2007, the boat was paid for in four instalments by Harburn Group. Ms Chivers became the sole registered owner of the boat on 5 August 2007.

In 2008 Mr Harburn received an offer of permanent employment at Aspen Group, and he sublet Harburn Group's premises to Aspen Group. Harburn Group subsequently went into liquidation in 2011.

In the original decision of Weaver (as joint and several liquidators of *Harburn Group Australia Pty Ltd (in liq)) v Harburn* [2013] WASC 441, the liquidators brought an action against Mr Harburn and Ms Chivers for unreasonable director-related transactions. They sought relief under s. 588FF, alternatively s. 1317H of the Corporations Act 2001 (Cth) (the Corporations Act) as well as a declaration from the court that the transaction was voidable and that the purchase money should be paid back to the company. They also alleged that Mr Harburn breached his duties as a director under ss. 181 and 182 of the Corporations Act. At trial Master Sanderson J dismissed these claims, and instead found that Mr Harburn had not acted unreasonably.

On appeal, the Court reversed the trial judge's decision on two grounds.

(c) Decision

(i) Ground 1: Unreasonable director-related transaction

The liquidators claimed that the payments by the company constituted unreasonable director-related transactions under s. 588FDA of the Corporations Act. The court accepted that at the time the payment for the boat was made, Harburn Group was in an uncertain financial position whereby its solvency could be reasonably questioned in the short to medium term.

The Court considered s. 588FDA of the Corporations Act and found that the following factors were instrumental in a finding that the boat purchase was an unreasonable director-related transaction:

- The payment was made by the company (s. 588FDA(1)(a));
- The payment was made "to a close associate of a director of the company" (s. 588FDA(1)(b)), as under s. 9 of the Corporations Act a "close associate" includes a "relative" which includes a "spouse"; and
- A reasonable person in the company's circumstances would not have entered into the transaction (s. 588FDA(1)(c)).

In regards to the final point the Court outlined that the "company's circumstances" encompass all relevant matters including its status as a company; its controllers, shareholders, business and other activities; and the circumstances of the transaction itself. The court considered under s. 588FDA(1)(c) that:

- There were no benefits to the company in making any of the payments;
- There was detriment to the company by way of the full extent of the payments; and
- Mr Harburn's spouse benefited from the transaction.

This led to the Court's conclusion that a reasonable person in the company's circumstances would not have made the payments, regardless of the financial health of the company.

(ii) Ground 2: Breach of director's duties

The liquidators also claimed against the first respondent for compensation for breach of his director's duties in s. 181 (duty of a director to exercise powers in good faith and the duty to act for a proper purpose) and s. 182 (duty not to improperly use position to gain a personal advantage or cause detriment to the company) of the Corporations Act. The Court found that the payment for the boat constituted a gift to Mr Harburn's spouse, which was of a very significant amount for which there was no commercial justification. Additionally, the sole shareholder of the company had not consented to the payments.

The Court concluded that Mr Harburn had not exercised his powers or discharged his duties for a proper purpose. Thus, he was in breach of s. 181(1)(b) of the Corporations Act. He was also in breach of s. 181(1)(a) as he knew at the time of the boat payments that the company was in uncertain financial and commercial circumstances. Thus, by making those payments he was not acting in good faith in the best interests of the company.

It was also found that Mr Harburn had used his position to gain an advantage for his spouse at the obvious detriment of the company, and thus his actions were found to be in breach of s. 182.

5.8 Examination of the validity of the convening of a general meeting by a director

(By Katrina Sleiman and Erin Kiley, Corrs Chambers Westgarth)

Charmaine Adams, Ken Sandy and John Sandy v Yindjibarndi Aboriginal Corporation RNTBC [2014] WASC 467, Supreme Court of Western Australia, Kenneth Martin J, 9 December 2014

The full text of this judgment is available here.

(a) Summary

This case concerned the validity of the convening of a general meeting by two directors of an Aboriginal and Torres Strait Islander corporation and of the materials issued to give members notice of that meeting. The central issue was whether the meeting was convened in good faith and for a proper purpose. The Court also considered whether the notice could state that non-member proxies could be appointed for the meeting.

Both the convening of the meeting and the materials were declared to be valid.

(b) Facts

The proceeding was listed for an expedited hearing ahead of a looming general meeting of Yindjibarndi Aboriginal Corporation RNTBC (YAC), an Aboriginal and Torres Strait Islander corporation governed by the Corporations (Aboriginal and Torres Strait Islander) Act 2006 (Cth) (the CATSI Act). The general meeting was called by Charmaine Adams and Jill Tucker, two directors of YAC, for 10 November 2014.

The notice of meeting stated that Ms Adams had been contacted by a large number of members and that it appeared that the current directors of YAC did not have member support. As a result, Ms Adams explained that she was calling a general meeting for the purpose of considering and, if appropriate, passing resolutions removing ten of the current twelve directors and appointing replacements. YAC accepted that the purpose as stated was Ms Adams's reason for calling the meeting.

The previous general meeting of YAC had been held on 10 September 2014 and was the occasion on which all twelve directors had been elected.

The plaintiffs were Ms Adams and two nominees for director election at the requisitioned general meeting. They sought declarations as to the validity of their convening of the general meeting, and of the materials they caused to be issued to YAC's members to give them notice of the meeting. YAC sought a declaration that the notice and any meeting held in response to it was invalid and of no force and effect.

(c) Decision

Before considering the substantive issues, Kenneth Martin J noted that the CATSI Act and the Corporations Act 2001 (Cth) (the Corporations Act) are materially similar in many of their provisions, particularly those touching on the convening of general meetings and the obligations and duties of directors. For that reason, judges have interpreted provisions of the CATSI Act by reference to case law applicable to regulations of companies under the Corporations Act.

(i) Procedural irregularities

Procedural irregularities were raised in correspondence but were not a live issue at trial. Despite this, Kenneth Martin J did comment on YAC's claim that while a director may call a general meeting, all the procedural steps in terms of issuing notifications need to be done by the corporation. Justice Martin rejected this claim and accepted the reasoning of Lindgren J in *NSX Ltd v Pritchard*, where his Honour stated that sending a notice is an essential element of calling a meeting ((2009) 178 FCR 151 [22]).

(ii) Proxy votes

Justice Kenneth Martin dismissed YAC's contention that non-members of a corporation cannot be appointed as proxies for the purpose of general meetings. His Honour noted that not only does the CATSI Act require a notice calling a general meeting to state whether proxies must be members or not, but the CATSI Act also allows companies to be appointed proxies (ss. 201-35 and 201-90). As a result, without explicit denial in YAC's rule book (which is effectively YAC's Constitution), non-member proxies were permitted.

(iii) Good faith and proper purpose

The focus of the trial was whether Ms Adams had acted in good faith and for a proper purpose when convening the general meeting. Justice Kenneth Martin first established that both the CATSI Act (s. 201-1) and the Corporations Act (ss. 249C and 249CA) state that a director may call a general meeting and noted that YAC had not altered this replaceable rule.

Justice Kenneth Martin then accepted that a director's power to convene a meeting must be exercised in good faith and for a proper purpose, as required by ss. 201-55 and 265-5 of the CATSI Act.

An examination of case law followed, with Kenneth Martin J considering the following authorities dealing with calling a meeting of members under the Corporations Act:

- the court should be very reluctant to interfere with a minority shareholder's statutory right to requisition a general meeting. It should only do so when it is clear that the purpose for calling the meeting is something other than the passing of the resolutions contained in the requisition : *Humes Ltd v Unity APA Ltd [No 1]* [1987] VR 467 at [472];
- if the purpose for which the requisition is made is truly to have a meeting of members convened in order to consider, and if thought fit then to pass, a relevant resolution, then it did not matter that the requisitionist was motivated to pursue that purpose by "ill-will or self-interest": *National Roads and Motorists' Association Ltd v Scandrett* (2002) 171 FLR 232 at [52]-[56]; and
- the fact that one of the purposes of a meeting was not a "proper purpose" will not affect the holding of the meeting if the other purpose was a "proper purpose": *Dhami v Martin* (2010) 241 FLR 165.

Applying these authorities, as YAC had conceded that Ms Adams's purpose in convening the meeting was that stated in the notice (being to consider and, if thought appropriate, pass resolutions for the removal and replacement of certain directors), Kenneth Martin J concluded that Ms Adams had acted for a proper purpose and in good faith.

YAC argued, however, that an additional requirement of consensus in decision-making applied to Aboriginal and Torres Strait Islander corporations, particularly corporations with a similar rule book (or Constitution) to YAC. Consensus in this case required Ms Adams to tell the other directors about the requests for a general meeting she had received and then discuss whether that meeting was in the best interest of YAC, particularly when there had very recently been an annual general meeting.

Justice Kenneth Martin noted that there were obvious practical difficulties to achieving consensus among directors on removal decisions and even more obvious difficulties in seeking consensus in general meetings of hundreds of members. His Honour also noted that there was no express support for a requirement of consensus in the CATSI Act and that the definition of "consensus" in the YAC rule book was vague and problematic. Finally, his Honour stated that the rule book expressly provided for alternative decision mechanisms if consensus failed, namely voting. His Honour determined that YAC's argument that consensus was a prerequisite to a decision to convene a general meeting was misconceived.

Justice Kenneth Martin concluded by stating that a director's power to call a general meeting should not be lightly interfered with by the courts, given its fundamental character as a democratic corporate governance protection meant to ensure accountability and member confidence in directors. As a decision to call a meeting is essentially a decision to allow the members to make a decision, the courts should be more sensitive to intruding here than in other director decisions. This applied equally to both CATSI Act and Corporations Act corporations.

5.9 Offsetting claim held as a basis to set aside statutory demand, despite lack of mutuality

(By James Byrnes, Clayton Utz)

In2Ply Pty Ltd v Amerind Pty Ltd (in liq) (receivers and managers appointed) [2014] VSC 603, Supreme Court of Victoria, Randall AsJ, 2 December 2014

The full text of this judgment is available here.

(a) Summary

In this decision, Randall AsJ set aside a statutory demand served on In2Ply Pty Ltd (In2Ply) in the name of Amerind Pty Ltd (in liquidation)(receivers and managers appointed) (Amerind) because:

Amerind had previously assigned the debt to the Bendigo and Adelaide Bank Limited (the Bank) and therefore Amerind did not have standing to serve the statutory demand and there was no debt due and payable to it; and

in any event, In2Ply had an "offsetting claim" pursuant to s. 459H of the Corporations Act 2001 (Cth) (the Corporations Act) due to a cross-claim, which exceeded the amount of the statutory demand. Randall AsJ reached this conclusion notwithstanding that the assignment of the debt to the Bank would, given the lack of mutuality, exclude the cross-claim from being relied upon as a set-off in a recovery proceeding.

The decision contains a useful analysis of authorities on mutuality in the context of s. 459(H) of the Corporations Act and the wide meaning of "cross-demand", from which Randall AsJ distilled a set of principles apparent from the cases.

(b) Facts

Amerind served a statutory demand on In2Ply seeking payment of $20,650.37. The affidavit accompanying the statutory demand was sworn by one of Amerind's joint and several receivers and managers and referred to Amerind as the creditor.

It was also the case that Amerind was in debt to In2Ply for an amount greater than the amount of the statutory demand. The goods, which were the subject of Amerind's debt to In2Ply, had been ordered prior to the appointment of receivers and managers.

The Bank appointed the receivers and managers pursuant to its security, which permitted the appointment of receivers and provided that whenever Amerind obtained rights in debtors, the Bank's security interest would also attach to those debtors.

The Bank and Amerind had also entered into Debtor Finance Agreements, under which the Bank agreed to purchase Amerind's existing and future debts. In2Ply's debt had been factored to the Bank and the Bank had notified In2Ply of the assignment of debt, as well as directing payments to be made into the Bank's debtor finance account for Amerind.

(c) Decision

There were two major issues in this case:

- Amerind's standing to serve the statutory demand; and
- whether In2Ply had an offsetting claim within the purview of s. 459H(1)(b) of the Corporations Act given the lack of mutuality.

(i) Amerind's standing to serve the statutory demand

Randall AsJ held that Amerind did not have standing to serve the statutory demand because it had assigned In2Ply's debt to the Bank and, accordingly, there was no debt due and payable to Amerind.

In reaching this conclusion, Randall AsJ considered parts of s. 459E (who may make a demand) and s. 459G (regarding the affidavit in support of a demand) of the Corporations Act, as well as the terms of the Debtor Finance Agreements. Randall AsJ considered the terms of the Debtor Finance Agreements did not assist Amerind.

(ii) In2Ply's offsetting claim and mutuality

Even if wrong about Amerind's standing, Randall AsJ would have set aside the statutory demand on the basis that In2Ply had a valid offsetting claim that exceeded the amount of the demand.

In general terms, under s. 459H of the Corporations Act, if an offsetting claim results in the amount demanded being less than the statutory minimum, then the Court must set aside the demand. "Offsetting claim" is defined in s. 459H of the Corporations Act as follows:

> ... "offsetting claim" means a genuine claim that the company has against the respondent by way of counterclaim, set-off or cross-demand (even if it does not arise out of the same transaction or circumstances as a debt to which the demand relates) ...

Amerind argued that In2Ply's cross-claim was not an "offsetting claim" because the Bank, not Amerind, was the person against whom In2Ply had an offsetting claim and the two liabilities were not in the same right.

In response to these submissions, Randall AsJ reviewed a number of authorities and extrapolated the following principles from the cases:

- the purpose of the statutory demand process is to provide a reliable indicator of likely inability to pay debts;
- the indicator is not safe where the company shows that it has an equal or greater claim against the demanding creditor, whether or not the equal or greater claim could be litigated in proceedings in which the demanding creditor sought to recover the demanded debt;
- the rigors of mutuality applicable to assessing whether a "set-off" is available do not and should not limit the application of a "cross-demand" in a statutory demand context;
- "cross-demand" is not a technical term. It is a word introduced to give a wider ambit to the meaning of these claims, something that would not be described as a set-off, something that could not have been brought in the action, something that still lies outside a counterclaim;
- although Lord Hanworth MR declined to define such a "cross-demand" (*In re A Bankruptcy Notice* [1934] 1 Ch 431) a useful illustration of the nature or effect of a "cross-demand" is found in *Leichhardt Emporium Pty Ltd v AGC (Household Finance) Ltd* [1979] NSWLR 791 where Yeldham J permitted judgment on the cross-claim but determined that such cross-claim was not available as a set-off; and
- although there is a line of authority which preserves mutuality, that line may be confined to "mutuality" in the context of the identity or capacity of the creditor or debtor.

After articulating the above principles, Randall AsJ concluded that In2Ply had a cross-claim against Amerind that was a valid offsetting claim under s. 459H(2) of the Corporations Act in relation to Amerind's demand, although the cross-claim could not be relied on as a set-off in a recovery proceeding due to the lack of mutuality.

5.10 Barrister denied consideration for silk as a result of late application - no oppressive conduct

(By Emily Steiner, DLA Piper)

In the matter of The New South Wales Bar Association [2014] NSWSC 1695, Supreme Court of New South Wales, Brereton J, 1 December 2014

The full text of this judgment is available here.

(a) Summary

The plaintiff, Mr Smallbone, made an application for appointment as senior counsel to the NSW Bar Association. His application was late and as a result, the President of the Bar Association Ms Needham SC rejected the application.

The plaintiff challenged the validity of the President's decision not to extend time, seeking an order extending the time for his application to be made, directing the President to consider it on its merits, or requiring her to reconsider his application for an extension of time.

The Supreme Court of New South Wales rejected the plaintiff's application, finding that all of his grounds failed. As a result, Mr Smallbone was denied consideration for appointment as senior counsel in 2014.

(b) Facts

The plaintiff is a practising barrister, member of the Bar Association and "member of the Outer Bar".

On 15 May 2014, the Bar Council addressed a circular "to all members of the Outer Bar" entitled "Appointment of Senior Counsel - 2014", by which the President invited applications for appointment as senior Counsel for 2014 (the Invitation).

The Invitation outlined the selection process and specified that:

> before 5pm on 25 July 2014, applicants should inform me, in writing, of their intention to seek appointment ... Any application received by the Bar Association after 5.00pm on 25 July 2014 will not be considered.

The plaintiff's application was received by hand delivery at 5.12pm on 25 July 2014. By email on the same evening, the Bar Association's Executive Director communicated to the President of the Bar Association that the plaintiff's application was late. The President consequently made a decision not to accept the plaintiff's application (the President's Decision) and this was communicated to the plaintiff via various items of correspondence.

The plaintiff challenged the existence and legality of the "5.00pm Rule", the legality of the President's discretionary decision not to consider his application under cl. 17 of The Protocol (which refers only to "the last Friday in July", rather than to a 5.00pm deadline) notwithstanding that it was late, and the Bar Council's failure or refusal to review the President's Decision.

Specifically, the plaintiff contended that:

- The 5.00pm rule did not exist because it had not been duly authorised by the Bar Council, or, if it had been made, the time was not essential;
- If it had purportedly been made, it was void or of no effect by reason that it was not made for any proper constitutional object of the Bar Association, and/or it was contrary to the Legal Profession Act 2004 (NSW), s. 81(2), and/or it was an unreasonable restraint of trade, and/or it was oppressive or unfairly discriminatory within the meaning of the Corporations Act 2001 (Cth) (the Corporations Act), s. 232;
- The President's decision was an unreasonable restraint of trade and/or oppressive;
- The Bar Council's failure to reconsider and review the President's decision was an unreasonable restraint of trade and/or oppressive; and
- The 5.00pm rule fixed a period for doing an act or taking a proceeding in relation to a corporation, and the Court should extend time pursuant to the Corporations Act, s. 1322(4)(d).

(c) Decision

(**i) Existence and essentiality of the rule**

The plaintiff submitted that there was no 5.00pm deadline, and alternatively, if there was, it was not essential. He argued that the governing document was the Protocol (which was adopted by the Bar Council), which contained no 5.00pm deadline, and the Bar Council never resolved to adopt such a deadline.

The Court referred to statements in the various documents released by the Bar Council stipulating the 5.00pm deadline, and found that these statements "went far beyond mere warnings for the benefit of applicants". These statements included categorical statements that applications received after that time would not be considered. The statement in the Invitation that "any application received by the Bar Association after 5.00pm on 25 July 2014 will not be considered" was categorical and plainly conveyed that time was essential.

(ii) Validity of the 5.00pm rule

As to the validity of the"5.00pm rule, the Court found that it is not invalid as *ultra vires* the Bar Council. Brereton J accepted that establishing a scheme for the selection and appointment of senior counsel is within the Bar Association's powers. His Honour consequently accepted that specification of a time by which applications must be made is incidental thereto and is valid, even if it does not directly promote the administration of justice or the interest of all local practising barristers.

(iii) The President's decision, oppression and restraint of trade

Brereton J held that the 5.00pm rule cannot be characterised as oppressive, unfairly prejudicial or unfairly discriminatory to the plaintiff as he had not been treated differently from any other candidate. His Honour considered that any detriment or prejudice to the plaintiff from being excluded from consideration for silk in 2014 was not caused by any oppression or unfairness; rather, such detriment or prejudice was caused by "the consistent application of a reasonable deadline".

According to Brereton J, it follows from the conclusion that the 5.00pm deadline is not a restraint of trade (or if it is, a reasonable one), that the President's decision under cl. 17 could not be an unreasonable restraint. The President's decision was not "oppressive to, unfairly prejudicial to, or unfairly discriminatory against" the plaintiff. It was held that a reasonable decision not to give the plaintiff especially favourable treatment by relieving him of compliance with a deadline with which all other applicants had to comply "cannot remotely be characterised as oppressive, unfairly prejudicial or unfairly discriminatory".

The conclusion that the President's decision was not an unreasonable restraint of trade, nor oppressive, led the Court to the same conclusion in respect of the Bar Council's non-intervention. In any event, the Bar Council had no relevant review function to perform.

The Court ultimately decided that all of the plaintiff's grounds failed and therefore rejected the plaintiff's application. The plaintiff was denied consideration for appointment as senior counsel in 2014.

5.11 Liquidator's litigation funding agreement is retrospectively approved

(By Andrew Wydmanski, Clayton Utz)

Pascoe, in the matter of Brentwood Village Limited (in liquidation) [2014] FCA 1295, Federal Court of Australia, Gleeson J, 27 November 2014

The full text of this judgment is available here.

(a) Summary

The liquidator successfully applied for the retrospective approval of a litigation funding agreement entered on behalf of the insolvent company Brentwood. The judge found that the liquidator's decision to pursue the agreement in preference to an indemnity offered by the largest unsecured creditor (the Australian Taxation Office (ATO)) was not imprudent or unreasonable.

The liquidator had been able to secure favourable terms from a funder which the ATO had not offered to match. The ATO's concerns about the level of funding premium sought by the funder were insufficient, and it had not suggested any lack of good faith or prudence on the part of the liquidator. After considering that the recovery proceedings had a likelihood of success, that no third party was likely to be prejudiced by the agreement's approval and that the recovery proceedings were unlikely to be protracted or complex, the Court approved the agreement.

The Court also made orders allowing documents relating to the discussions between the ATO and liquidator, such as affidavits, to remain confidential, but published the reasons for judgment after giving the liquidator an opportunity to make submissions about any parts which should be subject to a confidentiality order under s. 37AF of the Corporations Act 2001 (Cth) (the Corporations Act).

(b) Facts

The liquidator was appointed pursuant to winding up orders made on the application of Brentwood's largest creditor, the ATO. Initially, the liquidation was unfunded, with the liquidator, his staff and legal representatives acting on a speculative basis.

The liquidator subsequently identified two viable proceedings for the recovery of:

- two nursing homes that had been transferred to associated entities, and
- a substantial loan made to one of the associated entities.

He requested funding from creditors in May 2014 to continue his investigations, with no formal response received. Between May and October 2014, he sought funding from six potential funders.

The liquidator believed that the associated entities were planning to transfer the nursing homes to unrelated third parties. On 11 September 2014 he sought an indemnity from the ATO to seek urgent freezing orders against the associated entities, which was narrower than his request to the litigation funders.

The "exhaustive" funding negotiations with the ATO failed, and the liquidator then entered into a funding agreement with a funder for the freezing proceedings, recovery proceedings and examination proceedings under Part 5.9 of the Corporations Act. He considered the funding agreement to be superior to the ATO's offer in eight respects.

The liquidator informed the ATO of the funder's offer and its indicative terms, together with reasons why the liquidator considered it to be a superior offer. Expressing his view that it was in the interest of all creditors, he sought the ATO's consent to enter into the agreement.

The ATO responded with disappointment that the liquidator had decided to "shop elsewhere" and stated it would "neither support nor oppose" the application for approval of the funding agreement.

The liquidator entered into a litigation funding agreement on Brentwood's behalf on 31 October 2014 to fund the proceedings. He commenced the recovery proceedings on the same day.

He subsequently sought the Court's approval for the funding agreement, which would terminate on 30 November 2014 if the Court withheld its approval.

(c) Decision

Justice Gleeson noted that s. 477(2B) of the Corporations Act (which prevents liquidators entering into agreements lasting more than three months without the approval of the Court, committee of inspection or creditors' resolution) allows for retrospective approval of an agreement in appropriate circumstances.

(i) Key considerations in approving a funding agreement

Justice Gleeson noted that the Court's role under s. 477(2B) is not to conduct a full merits review of the liquidator's decision, nor to second-guess the liquidator's commercial judgment. Rather, the Court has to be satisfied that it was a proper exercise of power and not ill-advised or improper.

Factors that are relevant to assessing the good faith or prudence of a proposed litigation funding agreement include:

- The liquidator's prospects of success in the litigation;
- The nature and complexity of the cause of action;
- The extent to which the liquidator has canvassed other funding options;
- The level of the funder's premium;
- The liquidator's consultation with creditors; and
- The risk involved in the claim (including the amount of costs likely to be incurred in the proposed litigation, the extent to which the funder is to contribute to those costs, and the extent to which the funder is to contribute to the defendant's costs if the action is not successful, or towards any order for security for costs).

(ii) Should the funding agreement be approved?

The judge concluded that the liquidator's refusal to accept the ATO's funding terms were not imprudent or unreasonable. The ATO did not offer to match the terms offered in the funding agreement to the liquidator.

While acknowledging the ATO's concerns that the litigation funder sought a substantial funder's premium, which would reduce the amount paid out to unsecured creditors, Gleeson J noted that it was within the range of premiums typically sought and that the ATO was not suggesting any lack of good faith or prudence on the liquidator's part.

There was a likelihood of success in the recovery proceedings. Further, they were not unduly complex or likely to be protracted. There was also no identifiable prejudice to third parties arising from the funding agreement's approval. Bearing these factors in mind, Gleeson J approved the agreement.

5.12 Benefits paid "in connection with" retirement: Clarifying the scope of s. 200B(1) of the Corporations Act in the absence of shareholder approval

(By Laura Ravanello, Herbert Smith Freehills)

Renshaw v Queensland Mining Corporation Limited [2014] FCAFC 172, Federal Court of Australia, Full Court, Rares, Griffiths and Gleeson JJ, 26 November 2014

The full text of this judgment is available here.

(a) Summary

This case considered whether certain payments were made in connection with the termination of the first appellant as managing director of the respondent company. The main question for the Full Federal Court was whether the payments made to the appellants by the respondent were in contravention of s. 200B(1) of the Corporations Act 2001 (Cth) (the Corporations Act).

Under s. 200B(1) of the Corporations Act, an entity:

> ... must not give a benefit in connection with a person's retirement from an office ... if:
>
> a. the office or position is a managerial or executive office; or
> b. the retiree has, at any time during the last 3 years before his or her retirement, held a managerial or executive office in the company;
>
> unless there is member approval ...

Ultimately, the Full Court upheld the primary judge's decision and held that the payments made to the appellants were in contravention of the Corporations Act. This case demonstrates the importance of shareholder approval when giving benefits in connection with a person's retirement from a managerial or executive office.

(b) Facts

(i) Background

Between 8 July 2004 and 23 October 2012, Howard Renshaw was the managing director and sole executive director of the respondent company, Queensland Mining Company Limited (QMCL). Mr Renshaw resigned as managing director on 23 October 2012 but continued as a non-executive director of QMCL. Mr Renshaw's resignation was in accordance with an agreement (the Settlement Deed) between himself, QMCL, and a company owned and controlled by Mr Renshaw: Butmall Pty Ltd (Butmall).

Under the Settlement Deed, the following payments were provided for:

- Under cl. 1.1, QMCL agreed to terminate a Management/Service Contract dated 27 November 2011 (the November Agreement) and agreed to pay Mr Renshaw and Butmall a termination sum. Pursuant to this Clause, on 23 October 2012, payments were made by QMCL to Mr Renshaw, his accountant's trust account and Butmall.
- Pursuant to cl. 2.2, Mr Renshaw could be paid a termination benefit of 2 million fully paid ordinary shares in QMCL or, if not issued, $110,000. This benefit was never paid.

(ii) First instance judgment

At first instance, Perry J found that the various payments made to Mr Renshaw and Butmall were in contravention of s. 200B(1) of the Corporations Act. Termination payments had been made in connection with Mr Renshaw's resignation as managing director and no general meeting of QMCL was called to consider a resolution to approve the payments.

Mr Renshaw and Butmall were ordered to pay 80% of QMCL's costs, on the basis that QMCL had freely entered into the Settlement Deed and had made payments pursuant to cl. 1.1 of the Deed. In doing so, QMCL had breached s. 200B of the Corporations Act and had contributed to the situation requiring recovery of the payments made to Mr Renshaw.

(iii) Key questions and arguments before the Full Court

On appeal, the Full Court considered the central question of whether the payments to Mr Renshaw and Butmall constituted a benefit connected with Mr Renshaw's retirement as managing director.

The appellants (Mr Renshaw and Butmall) contended that the primary judge erred in not construing cll. 1.1 and 2.2 of the Settlement Deed as involving distinct and separate obligations. The appellants contended that:

- cll. 1.1 and 2.2 of the Settlement Deed should be read separately. The payment under cl. 1.1 of the Settlement Deed was not a payment connected to Mr Renshaw's resignation but rather, a means by which QMCL paid out its obligations under the November Agreement. Clause 2.2 alone related to Mr Renshaw's loss of office; and
- The November Agreement was terminated by the Settlement Deed.

The cross-appellant (QMCL) argued that the primary judge erred in the exercise of discretion that Mr Renshaw and Butmall pay only 80% of QMCL's costs.

QMCL argued that her Honour failed to take into account that the cause of proceedings was:

- Mr Renshaw and Butmall's refusal to repay the payments made pursuant to cl. 1.1 of the Settlement Deed;
- Mr Renshaw and Butmall's contravention of s. 200D of the Corporations Act in receiving a benefit; and
- Mr Renshaw being involved in the board's decision.

(c) Decision

(i) Meaning of "in connection with"

The Full Court first considered the meaning and purpose of the phrase "in connection with" which repeatedly appears in Division 2 of Part 2D.2 of the Corporations Act. The overarching purpose of Division 2 of the Corporations Act was also considered. The Full Court held that the purpose of the division is to bring transparency to transactions commonly referred to as "golden handshakes".

The Full Court concluded that the expression "in connection with" demonstrates that Parliament intended to create a "broad nexus" between the benefit and the termination of a person, in order to protect shareholders' rights and interests to know of, and approve, expenditure of the company's money.

(ii) A benefit given in connection with retirement

Using a broad construction of Division 2 of Part 2D.2 of the Corporations Act and particularly the expression "in connection with", the Full Court rejected the appellant's argument that payment under cl. 1.1 of the Settlement Deed was not a benefit given in connection with Mr Renshaw's cessation as managing director or loss of position under the November Agreement.

The Full Court reasoned that cl. 1.1 expressly stated that QMCL would terminate the November Agreement and pay Mr Renshaw's termination sum upon signing of the Deed. Clause 2.1 outlined Mr Renshaw's agreement to resign as managing director upon receipt of the termination sum. Therefore, the termination of the November Agreement and Mr Renshaw's resignation depended entirely on QMCL paying the termination sum following Mr Renshaw's signing of the Settlement Deed. There was a sufficient connection between these events and the Full Court upheld the primary judge's conclusion that the termination sum was given in connection with Mr Renshaw's retirement as managing director.

Given the Court's finding of a contravention of s. 200B(1) of the Corporations Act, the Full Court did not decide the other matters argued by the appellants. The appeal was dismissed, with costs set off.

(iii) Consideration of the cross-appeal

The Full Court rejected the argument that the primary judge failed to take into account that the appellant had contravened s. 200D of the Corporations Act by receiving a benefit. The Full Court considered that before the primary judge explained why QMCL's recovery of costs was limited to 80%, her Honour had referred to the appellant's failure to comply with their obligation under s. 200J of the Corporations Act to repay the benefit. By having regard to the primary facts in finding the breach of s. 200J, her Honour had, by extension, considered whether the appellants had contravened s. 200D, even if her Honour had not explicitly referred to s. 200D.

The Full Court also detailed the broad discretionary power to order costs under s. 43 of the Federal Court of

Australia Act 1976 (Cth) and that there is no automatic rule that costs are always awarded in favour of the successful party. Ultimately, the Full Court was satisfied that the primary judge did not make any of the errors argued by QMCL and the cross-appeal was dismissed, with costs set off.

5.13 Shareholders can't effectuate a capital reduction but can spill a Board

(By Chantalle Toussaint and Will Heath, King & Wood Mallesons)

In the matter of Molopo Energy Ltd; Molopo Energy Ltd v Keybridge Capital Ltd [2014] NSWSC 1864, Supreme Court of New South Wales, White J, 19 December 2014

The full text of this judgment is available here.

(a) Summary

ASX-listed Molopo Energy Limited (the Plaintiff) is the ultimate holding company of Molopo Energy Canada Limited (MECL). Keybridge Capital Limited (the Defendant) became a substantial shareholder in the Plaintiff.

The Defendant served two requisitions for a general meeting of the Plaintiff's shareholders.

The first requisition proposed shareholder resolutions to amend the Plaintiff's Constitution and to effect a substantial reduction of the Plaintiff's capital which was not supported by the Plaintiff's directors. The second requisition proposed the removal of a number of directors and their replacement by the Defendant's nominees.

The Plaintiff challenged the requisitions.

The court held that the directors of the Plaintiff were not required to submit the resolutions proposed in the first requisition to a general meeting, but were required to comply with the second requisition and convene a shareholders' meeting to consider the proposed resolution to replace the directors.

(b) Facts

The Plaintiff, MECL and some former MECL employees became defendants or cross-defendants in certain proceedings commenced in Canada between 2011 and 2014.

On 2 September 2014, the Plaintiff released an announcement to the Australian Securities Exchange describing how the Plaintiff was proposing to deal with its cash reserves. The announcement stated that approximately one-third of the cash reserves would be set aside for "capital management initiatives in the form of a proposed return of capital to shareholders, subject to legal advice as to whether and to what extent the litigation to which [the Plaintiff] is a party allows [it] to reduce its capital".

On 27 October 2014, the Defendant became a substantial shareholder in the Plaintiff. Shortly after, the Defendant served requests on the Plaintiff's directors calling for a general meeting.

(i) 11 November Requisition

On 11 November 2014, the Defendant served a requisition under s. 249D of the Corporations Act 2001 (Cth) (the Corporations Act) for a general meeting encompassing two resolutions (the 11 November Requisition). The first resolution proposed that the Plaintiff's Constitution be amended so that "the right, power or capacity of the company to reduce its share capital" could be "exercised by the company in general meeting". The aim of the first resolution was to empower the company in general meeting to initiate a capital reduction without the support of the Board. The second resolution proposed a capital reduction of approximately $54 million.

The Plaintiff challenged the 11 November Requisition on two grounds. First, it argued the proposed amendment to the Plaintiff's constitution was invalid because the company's power to undertake a capital reduction is vested in the directors, and the function of shareholders is only to approve a proposal advanced by the directors. Second, it argued the Defendant's second proposed resolution was invalid because if it was passed and implemented, the capital reduction would or might materially prejudice the company's ability to pay its creditors contrary to ss. 256B and 256D(1). In particular, four of the Plaintiff's directors were concerned that the capital reduction proposed by the Defendant might affect the Plaintiff's ability to pay its creditors, particularly if the litigation in Canada was determined adversely.

(ii) 18 November Requisition

The Defendants submitted a second s. 249D request for a general meeting on 18 November 2014, proposing a resolution that three of the current five directors be removed and that two persons nominated by the Defendant be appointed (the 18 November Requisition). The 18 November Requisition stated that the proposed resolutions did not need to be considered if both of the resolutions in the 11 November Requisition were passed by the required majorities.

The Plaintiffs challenged the validity of the 18 November Requisition on the basis that (1) its conditionality caused it to be invalid; and (2) the appointment of new directors was only for the purpose of bringing about the proposed capital reduction and it would not be a proper purpose to appoint directors who may seek to effect a capital reduction that might be unlawful.

(c) Decision

Justice White of the Supreme Court of New South Wales held that the directors of the Plaintiff were not required to submit the resolutions in the Defendant's 11 November Requisition to a general meeting but they were required to convene a general meeting to consider the resolutions proposed in the 18 November Requisition.

(i) Shareholders have no power to effectuate a capital reduction

Justice White held that a company's power to undertake a capital reduction is vested in the directors and the shareholders only function is to approve or reject a capital reduction proposed by the directors. His Honour's reasons in reaching this conclusion included:

- Section 256B of the Corporations Act requires that shareholders 'approve' a capital reduction. "Approve" in this context means to confirm or sanction a decision or proposal by another. The decision to effectuate a capital reduction is one for the Board and the power to approve or reject it is vested in the shareholders.
- It would lessen the protection provided to creditors if the decision to effect a reduction of capital were put solely in the hands of shareholders.
- Where the decision to undertake a reduction lies with the directors (subject to shareholder approval), creditors are protected by sanctions that could be available against directors if the reduction materially prejudiced the company's ability to pay its creditors. Conversely, if directors could be required by shareholders to implement a capital reduction which they did not support, they might be forced to incur liability under s. 588G of the Corporations Act for insolvent trading. Shareholders could therefore unfairly expose directors to liabilities against their volition.
- Additionally, it would be difficult for directors to discharge the requirement to provide information to shareholders under s. 256C(4) in circumstances where shareholders were initiating a capital reduction against the Board's wishes.

Justice White accepted the Plaintiff's further submission that, on the evidence adduced, the litigation against the Plaintiff was not without substance and accordingly the proposed capital reduction might materially prejudice its ability to pay its creditors.

(iii) 18 November Requisition to remove directors

Justice White refused to grant the Plaintiff relief in respect of the 18 November Requisition to replace the directors. His Honour reasoned:

- the resolution to replace the directors was not invalid because of its conditionality with the 11 November Requisition; and
- there was no substance to the assertion that the directors proposed by the Defendant would not act in accordance with their duties as directors in relation to any proposed capital reduction.

5.14 The distinction between a non-executive and executive director

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

AIG Australia Ltd v Jaques [2014] VSCA 332, Supreme Court of Victoria, Court of Appeal, Warren CJ, Neave and Hansen JJA, 16 December 2014

The full text of this judgment is available here.

(a) Summary

AIG Insurance Limited (AIG) issued an Investment Management Insurance Policy (the Policy) to Australian Property Custodian Holdings Limited (Holdings) in respect of claims for wrongful managerial acts. Mr Jaques (the Respondent) was a director of Holdings and an insured person under the Policy. Under the

Policy, non-executive directors were entitled to extended cover under a special excess limit. AIG denied extended cover to the Respondent in respect of certain claims on the basis that he was an executive director at the relevant time.

The Respondent commenced proceedings against AIG and won at trial. AIG appealed.

The Court of Appeal (the Court) dismissed AIG's appeal and confirmed that the Respondent was a non-executive director for the purposes of the Policy. In doing so, the Court considered the factors which determine whether a person is a "non-executive director".

(b) Facts

Holdings was the responsible entity for, and trustee of, a property unit trust (the Trust). The Respondent was a director of Holdings from 1 March 2001 until 6 January 2011. He was initially appointed a non-executive director of Holdings in 2001 and was appointed an executive director on 26 June 2007.

Claims were made against the Respondent for various wrongful managerial acts over a period including 2006 and 2007. The Respondent notified AIG of the claims. He sought extended cover under the Policy's special excess limit in respect of the period ending 26 June 2007 when he accepted appointment as an executive director. AIG refused to provide extended cover on the basis that, although the Respondent was not formally appointed as an executive director of Holdings until 26 June 2007, he was in fact performing the role of an executive director from 6 April 2004.

AIG relied on various circumstances in support of its argument that the Respondent was in fact an executive director at the relevant time and so fell outside the scope of the extended cover for non-executive directors.

These included:

- Holdings structured its affairs so that it did not operate the Trust, and used other entities to manage the business of operating the Trust properties (the Managing Group). From 6 April 2004, the Respondent commenced full time employment as general manager of an entity in the Managing Group. As part of his employment, the Respondent worked for other entities within the Managing Group in respect of the Trust. AIG alleged that, from the date of his appointment as an employee of the Managing Group, the Respondent also became an executive director of Holdings.
- The Respondent was also described as an "executive director" in the Trust's product disclosure statements.

The Respondent commenced proceedings against AIG seeking declaratory relief that he was a non-executive director during the relevant period and therefore covered under the Policy. The trial judge granted the relief. AIG appealed.

(c) Decision

The Court delivered a unanimous judgment dismissing AIG's appeal. It confirmed the trial judge's factual findings that the Respondent was a non-executive director of Holdings during the relevant period for the purposes of the Policy. In doing so, it considered the factors which determine whether a person is a non-executive or executive director.

(i) Distinction between non-executive and executive director

The Court found that the essential element in distinguishing between a non-executive and executive director under the Policy was whether the director was performing executive functions in the management and administration of the company.

The Court considered the factors relevant to distinguishing between an executive and non-executive director including:

- The subjective views of the board or the director as to the director's status are of limited relevance in determining whether a person is an executive or non-executive.
- While contemporaneous records kept by the company will often be relevant in determining a director's status, such records are relevant to the extent they provide evidence of the roles and tasks undertaken by the director or of a delegation of authority to perform such functions.
- Except to the extent they provide evidence of the roles and tasks undertaken by a particular director, the way in which a person's status is represented to investors is of limited relevance.
- While independence from key management personnel and guiding and monitoring management may be desirable attributes for a non-executive director, a finding that these attributes were not present would be insufficient to alter a conclusion based on a finding that the director performed executive functions for the company and that the company gave the director the authority to do so. In this respect, the duty to exercise independent judgment rather than simply defer to the judgment of others is a duty of all directors.

Whether the director is involved in the operations of the company and performs work in connection with the company is relevant to whether the director is an executive or not. These are matters of degree and fact.
- In the absence of some further authority conferred on a director by the company under a contract of employment, services agreement, delegation or acquiescence in exercise of powers, a director should generally be treated as a non-executive director. The mere fact of appointment does not normally give a director any executive powers.

(ii) Factual findings

The Court upheld the trial judge's factual findings that the Respondent was a non-executive director of Holdings during the relevant period. Key facts included:

- The Respondent was employed full time by the Managing Group rather than Holdings itself.
- The Managing Group determined and allocated the Respondent's duties.
- The Respondent performed work for Holdings under management agreements between Holdings and the Managing Group.
- Holdings did not delegate executive responsibility to the Respondent under the arrangements.

It was of limited relevance that the Respondent had been represented to investors as being an executive.

6. Contributions

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