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Legislation Hotline

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 European Commission welcomes agreement on improving transparency of certain financial transactions in the shadow banking sector

On 17 June 2015, the European Commission announced that it welcomed political agreement on the proposal for a regulation on reporting and transparency of securities financing transactions (known as SFTR). The agreement follows negotiations between the commission, the European Parliament and the Council of the European Union to find common ground on the regulation. The proposed regulation aims to increase the transparency of certain transactions in the shadow banking sector.

Securities financing transactions (SFTs) allow market participants to access secured funding, i.e. to use their assets to secure financing for their activities. This involves the temporary exchange of assets as a guarantee for a funding transaction (e.g. the lending or borrowing of securities, repurchase or reverse repurchase transactions, buy-sell back or sell-buy back transactions, or margin lending transactions).

The proposal contains three measures to improve the transparency of SFTs. First, all SFTs, except those concluded with central banks, will be reported to central databases known as trade repositories. Second, information on the use of SFTs by investment funds will be disclosed to investors in the regular reports and pre-investment documents of funds. Finally, minimum transparency conditions will need to be met on reuse of collateral, such as disclosure of the risks and the need to grant prior consent.

The formal adoption of the proposal is expected later in 2015.

Further information is available on the European Commission website.

1.2 IOSCO publishes report on credible deterrence approaches in securities market regulation

On 17 June 2015, the International Organization of Securities Commissions

(IOSCO) published the report *Credible Deterrence*, which identifies key enforcement factors that may deter misconduct in international securities and investment markets.

The report identifies key elements in the prevention of misconduct and financial crime from a range of international regulatory authorities and encourages regulators operating in both emerging and developed markets to consider how they might integrate credible deterrence into new or existing enforcement strategies.

The report identifies seven key elements for credible deterrence:

1. Legal certainty: Consequences for misconduct must be certain and predictable;
2. Detecting misconduct: Regulators must be well connected and obtain the right information;
3. Co-operation and collaboration: Safe havens must be eliminated by working together;
4. Investigation and prosecution of misconduct: Enforcement must be bold and resolute;
5. Sanctions: Strong punishments must be given to wrongdoers so as to stop them profiting from misconduct;
6. Public messaging: Public understanding, transparency and caution must be promoted; and
7. Regulatory governance: Good governance is necessary to deliver better enforcement.

The report is available on the IOSCO website.

1.3 Corporate reporting on workforce management

On 11 June 2015, the UK National Association of Pension Funds (NAPF) published the discussion paper *Where's the workforce in corporate reporting?*, highlighting the lack of reporting by companies on how they manage their workforces.

The report underlines the role of pension funds in the UK economy as long-term investors with a clear interest in promoting the long-term success of the companies in which they invest; but points out that NAPF members still often struggle to find any clear or consistent reporting with respect to an investee company's workforce. While there has been significant evolution in recent years of corporate reporting on governance and environmental matters, the workforce remains notable by absence in company reports.

The four areas the NAPF suggests as areas to be developed in corporate reporting the following:

- composition of the workforce;
- stability of the workforce;
- skills and capability of the workforce; and,
- motivation and engagement of the workforce.

The report is available on the NAPF website.

1.4 Financial market infrastructures report

On 11 June 2015, the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) published the second update to the Level 1 assessments of implementation monitoring of the Principles for Financial Market Infrastructures (PFMIs).

Level 1 assessments are based on self-assessments by individual jurisdictions on how they have adopted, within their regulatory and oversight frameworks, the PFMIs' 24 Principles for FMIs and four of the five Responsibilities for authorities.

The initial Level 1 assessments were conducted in mid-2013 and a report was published in August 2013. The current report is the second update to the Level 1 assessments and shows that good progress has been made by the 28 participating jurisdictions since the previous update in May 2014. In particular, the gap in the progress on implementation measures applicable to central securities depositories and securities settlement systems vis-à-vis other types of FMI has now closed.

The Second Update to Level 1 Assessment Report is available on the IOSCO website.

1.5 Superannuation Prudential Practice Guide SPG 223 Fraud Risk Management

On 10 June 2015, the Australian Prudential Regulation Authority (APRA) released the response package for *Superannuation Prudential Practice Guide SPG 223 Fraud Risk Management* (SPG 223). The response package includes the final SPG 223, plus a letter which outlines APRA's response to submissions about draft SPG 223 (released in October 2014). SPG 223 focuses on current and emerging fraud risk factors affecting the superannuation industry, while taking into account broader risk management-related matters raised in *Prudential Standard SPS 220 Risk Management* and *Prudential Practice Guide SPG 220 Risk Management*.

While SPG 223 provides guidance for the superannuation industry, the guidance may be of benefit for authorised deposit-taking institutions, general insurers and life insurers when considering matters related to fraud risk management.

The response letter and final SPG 223 are available on the APRA website.

1.6 Women joining but not leading boardrooms globally

On 10 June 2015, Deloitte Touche Tohmatsu Ltd (Deloitte Global) published the fourth edition of *Women in the Boardroom: A Global Perspective*. The report finds that representation of women on corporate boards continues to increase, but the number of women leading boards still remains low globally. Overall, women now hold 12% of seats worldwide with only 4% chairing boards.

The report outlines the efforts of 49 countries to increase the number of women occupying board seats. European countries continue to lead on gender diversity in the boardroom, with Norway, France, Sweden, and Italy all ranking high. Regionally, countries in the Americas and Asia Pacific region have progressed the least. According to the report the regional breakdown of women chairs is: EMEA (5%), the Americas (4%) and Asia-Pacific (4%).

The report is available on the Deloitte Global website.

1.7 UK: Fair and Effective Markets Review releases final report

On 10 June 2015, the Fair and Effective Markets Review (the Review) published its *Final Report*, which sets out 21 recommendations to help restore trust in the UK wholesale Fixed Income, Currency and Commodity (FICC) markets. The Review was established by the Chancellor of the Exchequer and Governor of the Bank of England in June 2014 to help to restore trust in those markets in the wake of a number of recent high profile abuses.

Recommendations to raise standards, professionalism and accountability of individuals include:

- encouraging IOSCO to consider developing a set of common standards for trading practices that will apply across all FICC markets;
- extending UK criminal sanctions for market abuse to a wider range of FICC instruments and lengthening the maximum sentence from seven to ten years' imprisonment; and
- mandating qualification standards to improve professionalism and disclosure requirements for references to avoid misconduct going undetected when individuals change jobs.

Recommendations to firms to improve the quality, clarity and understanding of FICC trading practices:

- creating a new FICC Market Standards Board with participation from a broad cross-section of firms and end users and, involving regular dialogue with the public authorities, to address areas of uncertainty in trading practices and promote adherence to standards.

Recommendations to the UK authorities to strengthen regulation of FICC markets include:

- extending elements of the Senior Managers and Certification Regimes to a wider range of regulated firms active in FICC markets; and
- creating a new statutory civil and criminal market abuse regime for spot foreign exchange, drawing on the international work on a global code.

Recommendations to the international authorities to raise standards in global FICC markets include:

- agreeing a single global FX code providing a comprehensive set of principles to govern trading practices around market integrity, information handling, treatment of counterparties and standards for venue - as well as stronger mechanisms to ensure market participants adhere to that code; and
- examining ways to improve the alignment between remuneration and

conduct risk at a global level.

The report is available on the Bank of England website.

1.8 IOSCO publishes good practices on reducing reliance on CRAs in Asset Management

On 8 June 2015, the International Organization of Securities Commissions (IOSCO) published its final report on *Good practices on reducing reliance on CRAs in Asset Management*, which provides a set of good practices for reducing over-reliance on external credit ratings in the asset management industry. The report stresses the importance of asset managers having the appropriate expertise and processes in place to assess and manage the credit risk associated with their investment decisions. To help managers avoid over-reliance on external ratings, the report lists eight good practices that they may consider when resorting to external ratings.

In the report, IOSCO notes that the use of external ratings by asset managers is mainly demand driven, as various forms of reliance on external credit ratings remain on the investor side. References to external credit ratings may derive from regulatory requirements or an investor's own internal rules. This may result in mechanistic reliance, which could trigger forced asset sales in the event of downgrades.

To address these concerns, IOSCO recommends considering potential ways to reduce possible investor overreliance on external ratings as a result of references in regulatory requirements. The good practices address national regulators, investment managers, and investors, where applicable. To identify these sound practices, IOSCO drew on the feedback received from various stakeholders, including asset managers and their representative trade bodies, institutional investors, and their associations as well as CRAs.

The report is available on the IOSCO website.

1.9 Stewardship Code report shows investors committed but room for improvement

On 3 June 2015, the UK Investment Association published the report *Adherence to the FRC's Stewardship Code*. The report found that five years on from the launch of the Financial Reporting Council's (FRC) Stewardship Code, investment managers, life companies and pension funds are committed to engagement, but that there is still room for improvement.

The report highlights that respondents increased the human resource dedicated to engagement by 19% in the year to 30 September 2014. Furthermore, over 80% of this increased resource is represented by portfolio managers and analysts, indicating a welcome increase in the integration of stewardship into the investment process.

Almost 90% of respondents are satisfied with the outcome of their engagement with the companies in which they invest. They welcomed companies' responsiveness and openness to dialogue, alongside their ability to effect change.

Respondents indicated that direct contact and one-to-one meetings are the most effective ways of engaging with investee companies. The report also shows that collective engagement is vital in certain circumstances, in order to attain critical mass, allow smaller investors access to companies and effect change. The effectiveness of collective engagement can, however, be compromised where there is no consensus on the course of action.

Other key findings show:

- an increase in the response rate to 45% - the highest in three years;
- a stable proportion of respondents - 78% - conduct all or some engagement in-house;
- that there is more engagement with overseas equities but less with other asset classes;
- a significant increase in voting activity with 84% voting all shares in UK companies; and
- a decrease in respondents that notify companies in advance of intention to vote against or abstain.

The report is available on the Investment Association website.

1.10 Joint Forum releases report on credit risk management across sectors

On 2 June 2015, the Joint Forum released its report *Developments in credit risk management across sectors: current practices and recommendations*. The report provides insight into the current supervisory framework around credit risk, the state of credit risk management at firms and implications for the supervisory and regulatory treatments of credit risk.

It is based on a survey that the Joint Forum conducted with 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. The report updates previous Joint Forum work on this topic, particularly *The management of liquidity risk in financial groups* (2006), and used the date of that report as the benchmark when analysing changes in the field of credit risk management.

The Joint Forum puts forward the following recommendations:

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 promote the monitoring and evaluation of 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.

Recommendation 4: Supervisors should consider whether firms are accurately capturing central counterparty exposures as part of their credit risk management.

The report is available from the IOSCO website.

1.11 FRC provides aid to audit committees in evaluating audit quality

On 29 May 2015, the UK Financial Reporting Council (FRC) issued a practice aid to assist audit committees in evaluating audit quality in their assessment of the effectiveness of the external audit process.

As well as setting a framework for the committee's evaluation, the aid sets out practical suggestions on how audit committees might tailor their evaluation in the context of the company's business model and strategy; the business risks it faces; and the perception of the reasonable expectations of the company's investors and other stakeholders.

The framework set out in the practice aid focuses on understanding and challenging how the auditor demonstrates the effectiveness of key professional judgments made throughout the audit and how these might be supported by evidence of the following critical auditor competencies:

- a mindset and culture that exhibits integrity and objectivity and is aligned with the expectations and interests of users of their reports;
- the skills and knowledge to develop a thorough understanding of the company's business and industry, the environment in which it operates and of the applicable legal and regulatory framework, and the strength of character to provide effective challenge in performing the audit; and
- the ability to establish effective quality control by putting in place the processes necessary to deliver a consistently high quality audit.

The practice aid is available on the FRC website.

1.12 Public consultation on amendments to OTC derivatives reporting requirements

The Australian Government has commenced consultation on proposed amendments to over-the-counter (OTC) derivatives reporting requirements. Consultation occurred in 2014 on a proposed central clearing mandate for OTC interest rate derivatives denominated in Australian dollars and four global currencies (US dollars, euro, Japanese yen and British pounds), limited to trades between internationally active dealers. In December 2014 the government announced that it would proceed with implementing the proposed central clearing mandate.

On 28 May 2015, drafts of a Ministerial Determination and a set of amendments to the Corporations Regulations 2001 (Cth) (the Corporations Regulations) implementing the proposed mandate were provided for public consultation.

In December 2014 the government also announced that it would provide relief from the trade reporting requirements by allowing "single-sided reporting" for entities with low levels of OTC derivatives transactions, provided they conclude the transactions with counterparties that are already required or have agreed to report the trade.

The announcement specified that this relief would be implemented by introducing single-sided reporting for Phase 3B entities as defined in the trade reporting derivative transaction rules made by the Australian Securities and Investments Commission. Phase 3B entities as defined in those rules have less than $5 billion gross notional OTC derivatives positions outstanding. Draft amendments to the Corporations Regulations containing this measure have been made available for public consultation.

The Ministerial Determination and other related documents are available on the Treasury website.

1.13 FSB publishes thematic review on supervisory frameworks and approaches for systemically important banks

On 26 May 2015, the Financial Stability Board (FSB) published a thematic peer review on supervisory frameworks and approaches for systemically important banks (SIBs).

The review, which was conducted in close collaboration with the Basel Committee on Banking Supervision (BCBS), assesses progress towards enhancing supervisory frameworks and approaches for SIBs since the financial crisis, in particular for global systemically important banks (G-SIBs). Increasing supervisory effectiveness is a key pillar of the FSB policy framework for reducing the moral hazard of systemically important financial institutions (SIFIs).

The peer review found that national authorities have taken significant steps to enhance supervisory effectiveness within their institutional frameworks. Authorities are using a broader and more sophisticated range of supervisory tools, which in turn contributes to a more forward-looking supervisory approach capturing both current and emerging risks. The scope of supervision has also been expanded to incorporate macroprudential and resolvability considerations. These changes are underpinned by enhanced dialogue between supervisors and the board and senior management of SIBs, both in terms of level of seniority and frequency. Corporate governance and the development of recovery and resolution plans are common areas of focus across many jurisdictions.

More work, however, is needed to further improve and assess supervisory effectiveness. In particular, a key finding from the review is the importance of strengthening cross-border supervisory cooperation and building the mutual trust that is needed - in good times, but even more so in difficult times. Effectiveness could also be strengthened by establishing and implementing clear and transparent supervisory strategies and priorities. Communication with firms on these priorities, as well as on the outcomes from supervisory activities, including data requests, needs to be strengthened. One of the outstanding challenges to further progress supervisory effectiveness is the need for authorities to effectively manage the volume of regulatory and supervisory changes, including by having sufficient budgetary resources and building and maintaining a skilled, capable, and experienced workforce.

The review is available on the FSB website.

1.14 Consultation on Corporate governance: Board responsibilities

On 21 May 2015, the UK Prudential Regulation Authority (PRA) released a consultation paper seeking views on a draft supervisory statement to identify some key issues for boards to consider, and to which the PRA pays close attention in the conduct of its supervision. It is not intended to be a comprehensive guide to good corporate governance. The consultation paper is relevant to all PRA-regulated firms.

The draft statement underscores the collective responsibilities shared by board members, and as such, complements the individual accountabilities which the PRA is introducing through the Senior Managers and Senior Insurance Managers Regimes.

It provides guidance on the PRA's expectations relating to:

- setting strategy;
- culture;
- risk appetite and risk management;
- board composition;
- the respective roles of executive and non-executive directors;
- knowledge and experience of non-executive directors;
- board time and resources;
- management information and transparency;
- succession planning;
- remuneration;
- subsidiary boards; and
- board committees

The consultation paper is available on the PRA website.

1.15 Productivity Commission releases draft report on business set-up, transfer and closure

On 21 May 2015, the Australian Productivity Commission released a draft report which found that governments can do more to reduce impediments to setting up and closing businesses.

The draft report proposes new recommendations that would improve the environment for setting up and closing businesses:

- financing options for new small businesses would be improved through the introduction of a crowd-sourced equity arrangement that balances the financing needs of business against the risk preferences of different types of investors;
- formal restructuring of companies through voluntary administration should be possible when a company is not yet insolvent;
- a simplified liquidation process should be introduced to reduce the time and expense of winding up businesses with recoverable assets of little value; and
- the exclusion period and restrictions on bankrupts should be reduced from three years to one year.

Where innovative new business models are disrupting established regulatory arrangements, the commission proposes a structured exemption period, to allow regulations and regulators to be flexible and adaptive. Regulators should be properly resourced for this task.

The report is available on the Productivity Commission website.

1.16 APRA statistical information on superannuation fund profiles and performance

On 20 May 2015, the Australian Prudential Regulation Authority (APRA) published *Superannuation Fund-level Profiles and Financial Performance (2014 interim edition)*.

The publication is available on the APRA website.

1.17 US Federal Reserve announces fines totalling US$1.8 billion against six major banks

On 20 May 2015, the US Federal Reserve announced it will impose fines totalling more than US $1.8 billion against six major banking organisations for their unsafe and unsound practices in the foreign exchange (FX) markets. The fines, among the largest ever assessed by the Federal Reserve, include: US$342 million each for UBS AG, Barclays Bank PLC, Citigroup Inc, and JPMorgan Chase & Co; US$274 million for Royal Bank of Scotland PLC (RBS); and US $205 million for Bank of America Corporation. The Federal Reserve also issued cease and desist orders requiring the firms to improve their policies and procedures for oversight and controls over activities in the wholesale FX and similar types of markets.

The Federal Reserve is requiring the firms to correct deficiencies in their oversight and internal controls over traders who buy and sell US dollars and foreign currencies for the organizations' own accounts and for customers. As a result of these deficient policies and procedures, the organizations engaged in unsafe and unsound conduct by failing to detect and address improper actions by their traders. These actions included the disclosure in electronic chatrooms of confidential customer information to traders at other organizations. Five of the banks failed to detect and address illegal agreements among traders to manipulate benchmark currency prices. Bank of America failed to detect and address conduct by traders who discussed the possibility of entering into similar agreements to manipulate prices. In addition, the Federal Reserve found UBS, Citigroup, JPMorgan Chase, and Barclays engaged in unsafe and unsound conduct in FX sales, including conduct relating to how the organisations disclosed to customers the methods for determining price quotes.

The Federal Reserve is requiring the six organizations to improve their senior management oversight, internal controls, risk management, and internal audit policies and procedures for their FX activities and for similar kinds of trading activities and is requiring four of the organisations to improve controls over their sales practices. The Federal Reserve is also requiring all six organisations to cooperate in its investigation of the individuals involved in the conduct underlying these enforcement actions and is prohibiting the organisations from re-employing or otherwise engaging individuals who were involved in unsafe and unsound conduct.

The Federal Reserve is taking action against UBS, Barclays, Citigroup, JPMorgan Chase, and RBS concurrently with the Department of Justice's criminal charges against these five organisations related to misconduct in the FX markets. Bank of America was not part of the actions taken by the Department of Justice and has not been charged by the Department of Justice in this matter.

Further information is available on the Federal Reserve website.

1.18 Global director network issues principles of good governance

In May 2015, the Global Network of Director Institutes (GNDI), the international network of director institutes, issued a new perspectives paper to guide boards in looking at governance beyond legislative mandates.

The Guiding Principles of Good Governance were developed by GNDI as part of its commitment to provide leadership on governance issues for directors of all organisations to achieve a positive impact.

The principles are available on the GNDI website.

2. Recent ASIC Developments

2.1 Updated guidance on collective action by investors

On 23 June 2015, ASIC released updated regulatory guidance for investors to help them in taking collective action to improve the corporate governance of listed entities.

The guidance, which follows ASIC consultation launched in February 2015 (15-027MR), is reflected in *Regulatory Guide 128 - Collective action by investors* (RG 128).

The guidance includes:

- illustrative examples of conduct which is unlikely or more likely to trigger

the takeover and substantial holding provisions;
- an outline of ASIC's approach to enforcement of these provisions in the context of collective action by investors, which includes considering whether the conduct is control seeking rather than simply promoting good corporate governance; and
- an overview of some other legal and regulatory issues that can arise in relation to investor engagement.

As part of this policy update, ASIC has also discontinued class order relief that facilitated voting agreements between institutional investors as it does not reflect the way institutional investors tend to engage with entities and has not been used for many years.

Regulatory Guide 128 is available on the ASIC website.

2.2 Changes of auditors

On 18 June 2015, ASIC announced a fundamental change to its approach to consenting to the resignation, removal and replacement of auditors.

ASIC will now generally consent to the resignation of an auditor at any time of the year, subject to some conditions. Previously, ASIC only consented to the resignation of an auditor of a public company to take place at an annual general meeting (AGM) unless there were exceptional circumstances.

ASIC will consent to the resignation of an auditor at any time if:

- there are no concerns in connection with the resignation, such as a concern where there is a disagreement between management and the auditor over an accounting treatment; and
- the change in auditor and the reasons for the change are communicated to members or in a disclosure notice, unless the change occurs at an AGM of a public company.

The new approach is outlined in a revised *Regulatory Guide 26 - Resignation, removal and replacement of auditors* and is broadly consistent with the approach in major jurisdictions around the world.

The revised RG 26 also sets out how to apply for ASIC consent to the resignation, removal and replacement of auditors of registered schemes, Australian Financial Services licensees and credit licensee trust accounts.

Regulatory Guide 26 is available on the ASIC website.

2.3 Consultation on remaking ASIC class orders on financial reporting

On 16 June 2015, ASIC released a consultation paper proposing to remake five class orders that are due to expire (sunset) in 2015 and 2016. The class orders affect the disclosures made in financial reports and the manner in which financial reports are presented to security holders.

It is also proposed to continue a limited, technical exemption from lodging financial reports afforded to some grandfathered large proprietary companies. This exemption cures some technical drafting anomalies in the law.

The class orders proposed to be remade are:

- Class Order [CO 05/638] Anomalies preventing certain large proprietary companies from being grandfathered;
- Class Order [CO 05/639] Application of accounting standards by non-reporting entities;
- Class Order [CO 05/642] Combining financial reports of stapled security issuers;
- Class Order [CO 05/644] Disclosing post balance date acquisitions and disposals; and
- Class Order [CO 06/441] Including different registered scheme financial reports in a single document.

ASIC proposes to remake these class orders as they are operating effectively and efficiently, and continue to form a necessary and useful part of the legislative framework. No significant changes are proposed.

Consultation Paper 233 - Remaking ASIC class orders on financial reporting (CP 233) outlines the class orders to be remade and ASIC's rationale for remaking them.

Consultation Paper 233 is available on the ASIC website.

2.4 Impairment of non-financial assets: The role of directors

On 10 June 2010, ASIC released an information sheet to assist directors and audit committees in considering whether the value of non-financial assets shown in a company's financial report continues to be supportable.

ASIC encourages directors to consider the need to impair non-financial assets such as goodwill, identifiable intangibles, and property, plant and equipment. Common issues include impairment calculations that use unrealistic cash flows and assumptions, and mismatches between the cash flows used and the assets being tested for impairment.

While calculations supporting impairment or valuation of significant assets can be complex, directors can review the cash flows and assumptions used in the calculations prepared by management or experts, using their knowledge and understanding of the business, the assets and the future prospects of the business.

Even though directors do not need to be accounting experts, they should seek explanations and expert involvement if needed and where appropriate, challenge asset values in the financial report.

ASIC's *Information Sheet 203 - Impairment of non-financial assets: The role of directors and audit committees* discusses matters including:

- the need for impairment testing
- the process for assessing impairment

common issues with impairment calculations
- questions that may be asked of external auditors.

The information sheet is available on the ASIC website.

2.5 Focus areas for 30 June 2015 financial reports

On 3 June 2015, ASIC announced its focus areas for 30 June 2015 financial reports of listed entities and other entities of public interest with many stakeholders.

(a) Asset values

ASIC encourages preparers and auditors of financial reports to carefully consider the need to impair goodwill and other assets. ASIC continues to find impairment calculations that use unrealistic cash flows and assumptions, as well as material mismatches between the cash flows used and the assets being tested for impairment. Fair values attributed to financial assets should also be based on appropriate models, assumptions and inputs. Particular focus should be given to assets of companies in extractive industries and mining support services, as well as asset values that may be affected by digital disruption.

(b) Accounting policy choices

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

(c) Material disclosures

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

(d) Role of directors

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

Further information can be found in ASIC's *Information Sheet 183 - Directors and financial reporting*, which is available on the ASIC website.

2.6 Improved credit card travel insurance disclosure

On 2 June 2015, ASIC announced that following an ASIC review, credit card issuers and insurers have made improvements to disclosure for travel insurance provided through credit cards.

ASIC's review of 17 credit card brands, issued by a range of credit card issuers, including the big four Australian banks, followed complaints made to ASIC from the general public and disputes data published by the Financial Ombudsman Service (FOS). These complaints included uncertainty around who was covered by the policy, the extent of exclusions and eligibility requirements.

Following the review, the credit card issuers and their insurers have agreed to make the following improvements:

- clarify when the insurance cover is "activated", particularly where a minimum spend threshold needs to be met to activate the insurance cover
- clarify if and when the use of reward points to pay for travel costs will activate the insurance cover
- clarify whether supplementary cardholders can benefit from the policy
- provide clearer and more prominent information about the documentation needed to make a claim.

Credit card issuers have also made improvements to their websites by making it easier to locate the insurance policy terms and conditions, and are now including direct links to the terms and conditions where none were provided previously.

Credit card issuers that also distribute standalone travel insurance have also made changes to their websites to clearly distinguish the standalone travel insurance policy from the credit card policy so that consumers do not mistakenly rely on the wrong policy.

Further information is available on the ASIC website.

2.7 Consultation on remaking of superannuation Class Orders

On 2 June 2015, ASIC released a consultation paper proposing to remake two class orders that are due to expire (sunset) in April and October 2016. ASIC proposes to remake these class orders without significant changes before they sunset, so that their ongoing effect will be preserved without any disruption to the entities who rely on them.

ASIC is proposing to remake class orders that broadly:

- provide relief to streamline the intra-fund transfer process [CO 04/1574] - Application form and cooling-off relief for certain transfers of members between financial products and interests within a superannuation fund, due to sunset on 1 April 2016; and
- provide relief to streamline the product disclosure statement regime for members who choose their own superannuation investment strategy [CO 06/636] - Superannuation: Delivery of product disclosure for investment strategies, due to sunset on 1 October 2016.

Consultation Paper 232 - Remaking ASIC Class Orders on Superannuation (CP 232) proposes both Class Orders be remade so that the substantive effect of the relief in each Class Order is continued beyond the expiration date in a new legislative instrument. For both Class Orders ASIC's preliminary position is that minor and technical changes be made to the terms of the relief. Drafts of the proposed new legislative instruments are attached to the consultation paper.

Consultation Paper 232 is available on the ASIC website.

2.8 Consultation on central clearing obligations for OTC derivatives

On 28 May 2015, ASIC proposed draft rules to implement mandatory central clearing requirements (clearing requirements) for certain over-the-counter (OTC) derivatives. The proposals are the next stage in Australia meeting its Group of Twenty (G20) commitments to reform OTC derivatives markets following the global financial crisis (GFC).

The government is consulting on a draft determination and regulations to implement a central clearing mandate in Australia (see Item 1.12 in this Bulletin). ASIC's draft rules would implement the government's proposed central clearing mandate, which would cover trades between internationally-active dealers.

Consultation Paper 231 - Mandatory central clearing of OTC interest rate derivative transactions (CP 231) and the Draft ASIC Derivative Transaction Rules (Clearing) 2015 (the Draft Derivative Transaction Rules (Clearing)) propose the mandatory clearing of certain classes of OTC interest rate derivative transactions through a licensed or prescribed clearing and settlement facility. CP 231 covers issues such as the entities which will be subject to the clearing requirements, the cross-border application of the Draft Derivative Transaction Rules (Clearing) and the transaction and asset classes subject to the clearing requirements.

Under ASIC's proposals:

- Australian and foreign clearing entities (financial entities with $100 billion or more gross notional outstanding in OTC derivatives measured on a rolling basis) will be subject to mandatory central clearing, for trades with each other and with foreign-internationally active dealers (swap dealers regulated by the CFTC or SEC);
- only certain OTC interest rate derivatives, namely fixed-to-floating swaps, basis swaps, overnight index swaps and forward rate agreements, will be required to be cleared; and
- the clearing requirements will start in April 2016, but there will be no obligation to backload open positions as at that date, subject to requirements applying to trades that are extended.

Consultation Paper 231 is available on the ASIC website.

2.9 Reports on relief applications - October 2014 to January 2015

On 28 May 2015, ASIC released its latest report outlining decisions on relief applications covering the period 1 October 2014 - 30 January 2015.

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 October 2014 and 30 January 2015, ASIC approved 542 relief applications.

Report 435 - Overview of decisions on relief applications (October 2014 to 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 following:

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

Report 435 also discusses the various relevant publications released by ASIC during the four months.

The report summarises examples of situations where ASIC has exercised, or refused to exercise, its exemption and modification powers under the Corporations 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 thinks 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.

Report 435 is available on the ASIC website.

2.10 Updated guidance for externally administered companies and registered schemes being wound up

On 27 May 2015, ASIC published an updated *Regulatory Guide 174 - Relief for externally administered companies and registered schemes being wound up* following consultation launched in August 2014.

ASIC has issued a new legislative instrument which provides companies with a liquidator appointed with an exemption from financial reporting and, if the company is also a public company, with AGM relief in certain circumstances. Companies in other forms of external administration with an uncertain future are permitted to delay preparing their financial reports under ASIC's relief. ASIC's new instrument also provides exemption relief from financial reporting to insolvent registered managed investment schemes.

To provide information to members of insolvent registered managed investment schemes, ASIC's instrument requires those in charge of the winding up to periodically report to members and creditors by making certain information available. For externally administered companies, the law already requires that members and creditors have access to certain public information that is prepared periodically by the external administrator and lodged with ASIC.

In addition, ASIC's instrument ensures that members of externally administered companies and registered managed investment schemes being wound up can obtain information by requiring the external administrator of the company or person having responsibility for winding up the registered managed investment scheme to have arrangements in place to answer any reasonable questions asked by a member without charge.

Regulatory Guide 174 is available on the ASIC website.

2.11 Consultation on addressing "sunsetting" banking and insurance class orders

On 26 May 2015, ASIC released a consultation paper proposing to remake three class orders that are due to expire (sunset) between 1 October 2015 and 1 October 2017.

ASIC proposes to remake these class orders without significant changes before they sunset, so that their ongoing effect will be preserved without any disruption to the entities who rely on them. ASIC also proposes to repeal one class order that is no longer required.

ASIC is proposing to remake class orders that:

- provide relief from the requirement for a licensee to appoint a distributor of a basic deposit product as its authorised representative (Class Order [CO 04/909] Agency banking), due to sunset on 1 October 2017;
- remove the requirements to include an interest rate in a Product Disclosure Statement and a termination value in a periodic statement for deposit products (Class Order [CO 05/681] Transitional relief for deposit product providers-PDSs and periodic statements), due to sunset on 1 October 2015; and
- provide relief from the requirement for a licensee to appoint a distributor of a general insurance product as its authorised representative (Class Order [CO 05/1070] General insurance distributors), due to sunset on 1 April 2016.

Consultation Paper 230 - Remaking ASIC class orders relating to banking and insurance (CP 230) outlines the minor changes that ASIC is proposing to make to these class orders, including:

- combining [CO 04/909] and [CO 05/1070] into a single instrument;
- updating the name, format, legislative references and definitions; and
- simplifying and modernising the drafting to make the new instruments easier to understand.

ASIC is proposing to repeal Class Order [CO 06/623] Relief for certain general insurers from s981B account requirements. The relief provided by this class order is otherwise available under the ordinary operation of the Corporations Act 2001 (Cth).

The Consultation Paper 230 is available on the ASIC website.

2.12 First licensing activity report

On 20 May 2015, ASIC published its first report on its approach to licence applications to help inform businesses and individuals wanting to provide financial services or credit, or register as a liquidator or auditor.

Report 433 - Overview of licensing and professional registration registration applications: July to December 2014 (REP 433) sets out recent regulatory outcomes achieved by ASIC in relation to Australian financial services (AFS) applications, Australian credit licence (credit licence) applications, liquidator registration applications, company auditor and approved SMSF auditor registration applications.

The report will also assist stakeholders to better understand the overall number and type of participants that ASIC licenses or registers across the financial services sector, the credit industry, auditors and liquidators and financial markets. It provides a picture of how this population is changing over time.

Key findings for 1 July to 31 December 2014:

- ASIC assessed approximately 1,660 applications, with 46% relating to a new licence application and the remaining 40% relating to variations to existing licence; 14% related to professional registration (liquidators and auditors);
- Of the total number of applications assessed, 27% of these related to an Australian financial services (AFS) licence and 14% related to an Australian credit licence;
- 49% of all applications assessed during this period were approved;
- 73% of those approved were in a form other than as requested by the applicant (with 68% of these relating to an AFS licence and 83% related to a credit licence);
- eight AFS licences were suspended, 120 AFS licences were cancelled and 172 credit licences were cancelled;
- ASIC assessed 235 applications for professional registration as liquidators and auditors; and
- ASIC also cancelled 426 SMSF auditors who failed to comply with their SMSF auditor competency examination by 30 June 2014.

Report 433 is available on the ASIC website.

2.13 Updated guidance for carbon market participants

On 20 May 2015, ASIC released updated regulatory guidance for carbon market participants.

ASIC's updated *Regulatory Guide 236 - Do I need an AFS licence to participate in carbon markets?* (RG 236) follows changes to the structure and regulation of carbon markets in Australia. The updated guidance will assist carbon market participants - in particular, carbon abatement project developers and aggregators - to operate their businesses in compliance with the financial services laws.

RG 236 has been updated to take into account:

- the end of the carbon pricing mechanism in February 2015;
- the startup of the Emissions Reduction Fund (ERF), including the broader scope of project types and new participants under the ERF;
- anticipated ERF project structures that involve multiple small-scale carbon abatement activities under a single project;
- competitive ERF reverse auctions for carbon abatement contracts; and
- the introduction of the emissions reduction safeguard mechanism in July 2016.

RG 236 has also been updated to reflect:

- that carbon units, European Union allowances and Australian-issued international units ceased to be financial products from the end of the carbon pricing mechanism; and
- the exemption of carbon abatement contracts from the definitions of "derivative" and "financial product" for the purposes of the Corporations Act 2001 (Cth).

This exemption means that a person is not required to hold an Australian financial services (AFS) licence to provide advice about, or enter into, a carbon abatement contract.

Regulatory Guide 236 is available on the ASIC website.

2.14 Online guide for small business directors

On 19 May 2015, ASIC released a new online resource to help small business owners understand their role and responsibilities as company directors.

ASIC's *Guide for small business directors* provides an overview of directors' duties under the Corporations Act 2001 (Cth) with a focus on small business directors.

The guide covers the following topics:

- what it means to be a company director;
- how to become a company director;
- directors' key responsibilities;
- directors' liabilities when things go wrong; and
- how to resign as a director.

The guide is available on the ASIC website.

3. Recent ASX Developments

3.1 AQUA and Warrant Rule and Procedure Amendments

ASX has amended the ASX Operating Rules, reflecting regulatory matters ASIC has sought and miscellaneous matters ASX has sought. The rule changes support the facilitation and growth of quotation, trading, clearing and settlement of financial products such as Warrants, ETFs, Managed Funds and Structured Products. The majority of the changes were flagged in the AQUA consultation papers of August 2010 and August 2012.

The amendments cover multiple areas including: enhanced disclosure requirements for issuers, additional requirements for products deemed to be synthetic, adhering to ASIC or ASX naming conventions, expanding the definitions of ETFs and Managed Funds, introducing a new concept of Fully Covered AQUA Products and expanding the existing concept of Fully Covered Warrants, expressly providing for revocation of admission at the request of the Issuer and other matters.

Further details are available at ASX.com.au.

3.2 Amendments to ASX Settlement and Listing Rules relating to share transfers under s. 444G of the Corporations Act

Subject to regulatory clearance and confirmation of effective date in a subsequent notice, the ASX Settlement and Listing Rules will be amended to enhance awareness of the impact on share holdings of a share transfer under s. 444G of the Corporations Act 2001 (Cth). The Rules will be amended to allow suspended financial products to remain on CHESS so that standard reconciliation of sponsored holdings can apply. The Rules will also specify the requirements prior to the recommencement of normal trading for entities that have been subject to a s. 444G transfer, which will include announcements required by the issuer, timing of despatch holding statements and recommencement of trading on a deferred settlement basis.

Further details are available at ASX.com.au.

3.3 Amendments to ASX Enforcement and Appeals Rulebook

ASX has announced it is making amendments to the ASX Enforcement and Appeals Rulebook (ASXEAR). ASXEAR is now in line with the current trade cancellation regime under the ASX and ASX24 operating rules and provides for appeals to be dealt with on an expedited basis.

Additional powers of sanction are being introduced to allow ASX to impose conditions or restrictions on an Issuer's participation in the settlement facility as a consequence of a rule contravention. Additional appeal rights are being introduced regarding ASX decisions to revoke CHESS approval of Issuers' products.

There have also been some minor amendments to clarify and improve drafting and remove obsolete references.

Further details are available at ASX.com.au.

3.4 Consultation Paper: Implementing a T+2 Settlement Cycle for the Cash Market: Draft Rule Amendments

Following an earlier consultation in February 2014, ASX is seeking feedback on the proposed rule changes required to implement a trade date plus two business day (T+2) settlement cycle for cash market trades in Australia in March 2016 and a consequential reduction in the ex period for corporate actions. Feedback is also being sought in relation to managing the implementation of T+3 to a T+2 settlement cycle.

The consultation paper is available at ASX.com.au.

3.5 Reports

On 3 June 2015 ASX released:

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

for May 2015.

4. Recent Takeovers Panel Developments

4.1 Mungana Goldmines Ltd - Panel Declines to Conduct Proceedings

On 9 June 2015, the Panel announced that it had declined to conduct proceedings on an application dated 1 June 2015 from Auctus Chillagoe Pty Ltd in relation to the affairs of Mungana Goldmines Ltd.

Mungana is currently the subject of an off-market takeover bid from Auctus.

Auctus submitted (among other things) that Mungana's investor presentation dated 25 May 2015 was misleading because it:

- overstated a production target in relation to Mungana's King Vol asset and
- understated its estimated pre-production capital expenditure.

On 5 June 2015, Mungana made a clarifying announcement retracting the production target and re-characterising it as an aspirational statement as it was "determined in the absence of sufficient certainty in respect of specific JORC modifying factors relevant to its achievement ... [and therefore] not based on reasonable grounds".

The Panel considered that Mungana's clarifying announcement dealt with any potential issues relating to disclosure of the production target. The Panel also considered that it was open to Auctus to put forward its own views to Mungana's shareholders in relation to Mungana's estimated pre-production capital expenditure.

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

Review Declined

On 18 June 2015, the review Panel declined to conduct proceedings on an application dated 9 June 2015 from Auctus Chillagoe Pty Ltd seeking a review of the initial Panel's decision in Mungana Goldmines Ltd 01.

Auctus submitted (among other things) that the initial Panel may have erred in concluding that statements made by Mungana in relation to pre-production capital expenditure for its King Vol project were not "material information to the valuation of Mungana's shares".

The review Panel considered that there was no reasonable prospect that it would come to a different conclusion to the initial Panel. Accordingly, the Panel declined to conduct proceedings.

Further information is available on the Panel website.

4.2 Panel Publishes Revised Guidance Note 2 and Guidance Note 4

On 27 May 2015, the Takeovers Panel published revised versions of *Guidance Note 2 - Reviewing Decisions* and *Guidance Note 4 - Remedies General*.

On 16 March 2015, the Panel issued consultation papers in relation to proposed changes to Guidance Note 2 and Guidance Note 4.

The main changes proposed were to clarify:

- in Guidance Note 2, the timing and process for an application for review, including an application to obtain the President's consent (if required); and
- in Guidance Note 4, that parties have the opportunity, at any point during the Panel's process, to offer a resolution to the unacceptable circumstances prior to the Panel making a declaration and orders.

Following consultation, the Panel has further amended Guidance Note 4 to make it clear that a resolution will be more favourably considered if it is provided earlier in the proceedings rather than later. No further amendments were made to Guidance Note 2 from the draft circulated with the Consultation Paper.

The consultation papers on Guidance Note 2 and on Guidance Note 4 are available on the Panel website.

5. Recent Research Papers

5.1 The Asia Region Funds Passport Initiative - Challenges for Regulatory Coordination

In the wake of the global financial crisis of 2008, global and regional coordination has become increasingly important in cross-border financial regulation. In addition to dealing with the general aspects of regulatory supervision and enforcement, coordination now has to deal with the challenges that arise in a range of specific areas. These include crisis management, the regulation of hedge funds, shadow banking activities, over-the-counter derivatives, bank resolution, Basel compliance and financial inclusion, to name a few. The critical question is how coordination should best be achieved. Although there are existing mechanisms for achieving coordination and cooperation in the context of general enforcement and supervisory activity, these mechanisms become more problematic when applied to specific areas such as those identified above. This is because most (if not all) of these areas involve coordination and cooperation between multiple regulators, operating in both a global and regional context, and bring into play a number of dynamics that have their roots in economic, political, financial, legal and other considerations.

The authors consider the challenges for regulatory coordination in relation to the proposed Asia Region Funds Passport (ARFP). The paper commences by providing background information on this initiative and the benefits that it is expected to achieve. Other regional initiatives are also discussed. Practical arrangements that are required to support the ARFP, including the need for coordination between the member economies are then discussed. The paper then explores the framework within which effective coordination might be achieved by reference to some of the literature in this field and also the issues and challenges that are specific to the ARFP. The paper concludes by discussing what effective coordination of this initiative might mean for regional coordination in the area of financial regulation generally.

The paper is available on the SSRN website.

5.2 A Quick Fix? Credit Repair in Australia

A poor credit history can preclude an individual from obtaining loans, credit cards and even access to basic utilities. Credit repair companies claim to assist people in this situation, by deleting adverse information from their credit histories. As financial hardship becomes more widespread, increasing numbers of Australians are turning to credit repair. Yet critics maintain that these companies charge high fees for services that are available for free through ombudsman schemes. In this way, they often increase their clients' financial hardship, while subverting the objectives of the ombudsman schemes. This article examines the Australian credit repair industry, including the regulatory context and the industry's attempts at self-regulation. It discusses several case studies from a Melbourne community legal centre, and describes the regulation of credit repair in the United States and the United Kingdom. It considers various law reform options that would address the problems posed by credit repair in Australia.

The paper is available on the SSRN website.

5.3 The Mythology of Salomon's Case and the Law Dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective

Salomon's case has for a long time been widely seen as a landmark case that is the keystone of modern company law. A mythology has developed around the case that has resulted in the Salomon principle exercising an iron grip on company law. The rigid application of the principle in Salomon's case to corporate groups has enabled corporate groups to structure themselves in ways that limit the tort liabilities of the group as a whole and so raises important social, economic and ethical questions regarding the allocation of risk that are not addressed by the application of the Salomon principle. This article suggests that given the importance of the social, economic and ethical issues raised in cases of mass torts that invariably involve corporate groups, it is preferable that these issues are resolved by tort law, which is concerned with the allocation of risk, thereby circumventing the dead hand of Salomon.

The paper is available on the SSRN website.

5.4 Are Judgments About Auditor Liability Influenced by Audit Committee Expertise and Independence?

The US *Sarbanes-Oxley Act 2002* required that firms disclose whether their audit committee has at least one independent financial expert. This study examines whether the independence and expertise of audit committee members lower the exposure of external auditors to legal liability. The authors use an experiment where potential jurors make judgments about auditor independence and legal liability for a case that involves an audit failure. They find that audit committee independence is associated with judgments of increased auditor independence and lower legal liability. Exposure to legal liability, however, is highest when audit committee financial expertise is high but independence from management is low, consistent with the perception that powerful audit committee members can use their influence opportunistically.

The paper is available on the SSRN website.

5.5 Direct Parental Negligence Liability: An Expanding Means to Hold Parent Companies Accountable for the Human Rights Impacts of Their Foreign Subsidiaries

In order to provide access to remedy for victims of human rights impacts and encourage parent companies to prevent future impacts by their foreign subsidiaries, there is a need for national courts to apply tort law duty of care obligations to parent companies. This paper argues that parent companies with high levels of control or supervision of their subsidiaries owe a direct duty of care to those whose risk of injury is foreseeable. When these parents act negligently - failing to meet this duty of care or exercise due diligence - in controlling the actions of their subsidiaries, they should be held directly liable. The paper aims to clarify why and how parent companies can be held liable for failing to exercise a requisite duty of care in controlling the acts of their subsidiaries when human rights impacts result.

The paper is available on the SSRN website.

5.6 Thirty Years of Shareholder Activism: A Survey of Empirical Research

The authors summarise and synthesise the results from 67 studies that examine the consequences of shareholder activism for targeted firms, and draw two primary conclusions. First, activism that adopts some characteristics of corporate takeovers, especially significant stockholdings, is associated with improvements in share values and firm operations. Activism that is not associated with the formation of ownership blocks is associated with insignificant or very small changes in target firm value. Second, shareholder activism has become more value increasing over time. Research based on shareholder activism from the 1980s and 1990s generally finds few consequential effects, while activism in more recent years is more frequently associated with increased share values and operating performance. These results are consistent with Alchian and Demsetz's (1972) argument that managerial agency problems are controlled in part by dynamic changes in ownership, and with Alchian's (1950) observation that business practices adapt over time to mimic successful strategies.

The paper is available on the SSRN website.

6. Recent Corporate Law Decisions

6.1 Compulsory acquisition not unfairly prejudicial to minority shareholders

(By Sarah Traviati and Tim Downing, King & Wood Mallesons)

Arbuthnott v Bonnyman [2015] EWCA Civ 536, England and Wales Court of Appeal, Lewison LJ and McCombe LJ, 20 May 2015

The full text of this judgment is available here.

(a) Summary

Mr Arbuthnott (Arbuthnott), a founding member of the Charterhouse Group, claimed that, among others, Mr Bonnyman (Bonnyman) had acted in a manner unfairly prejudicial to his interests as a member of Charterhouse Capital Ltd (the Company) by giving effect to the compulsory acquisition of his shares at a value he believed grossly undervalued the Company. The Court of Appeal dismissed all claims of unfair prejudice made by Arbuthnott on the basis that the compulsory acquisition was properly executed in accordance with all shareholder arrangements and that there had been no evidence of bad faith or improper motive.

(b) Facts

The Company, through various subsidiaries (Charterhouse Group), carried on a private equity business (the Business). A team of 16 investment managers (including Arbuthnott and Bonnyman) (the Founders) had acquired the Company and were the sole shareholders.

The Founders entered into a Shareholders' Agreement (the Agreement) and Articles of Association (the Articles) governing the Company. The Agreement contained provisions requiring that if a majority of the Founders agreed to pursue an exit transaction (excluding any Founder who is, or is connected to, the proposed purchaser (the Non-interested Members)), that each shareholder would sell their shares in the Company to the proposed purchaser provided that the terms of the sale are no less favourable than those being offered to any other shareholder of the same class (the Exit Provisions). In addition, the Articles contained provisions permitting a purchaser who makes an offer to all members to purchase their shares and acquires 50% or more of the voting rights in the Company to then require that any non-accepting shareholders sell their shares at the same price (the Drag Provisions).

The Agreement established a standing committee of the board (the Remuneration Committee) that was delegated with authority to determine all matters relating to the remuneration of employees and directors of the Company and the declaration of distributions to members of the Charterhouse Group (the Remuneration Model).

Charterhouse Capital Partners LLP (LLP) was the main operating entity of, and investment adviser to private equity funds managed by, the Charterhouse Group. Members of the management and investment team were granted an interest in the LLP. However, on retirement from active responsibilities an individual would cease to be a member of the LLP, but would retain any interest held in the Company. A deed was entered into, and later amended, between all the initial members of the LLP (including Arbuthnott) (the LLP Deed) establishing a mechanism whereby the Remuneration Committee of the Company (through a subsidiary which was the LLP's managing member) determined all matters relating to the distribution of the LLP's profits to its members (with the members of the LLP ultimately receiving almost all the fee income earned).

In December 2007, Arbuthnott informed Bonnyman that he intended to resign from membership of the LLP (the Meeting). Arbuthnott claimed that at the Meeting he and Bonnyman (acting on behalf of the Company) had orally agreed that there would be an independent valuation of the Company in connection with the sale of Arbuthnott's shares in the Company.

Following the retirement of Arbuthnott and other members of the Company (together with Arbuthnott, the Retiring Members), the Retiring Members held more than 50% of the shares in the Company. Subsequently the remaining active members (the Continuing Members) made a formal offer through Watling Street Ltd (WSL) of £15.15 million to all shareholders of the Company to acquire all their shares, subject to certain conditions (including amendments to the Articles) (the Offer). The Offer was accepted by all Non-interested Members except Arbuthnott.

In connection with the conditions of the Offer, amendments to the Articles were proposed, and approved by all members except Arbuthnott, to remove concepts which did not appear in the equivalent provisions of the Agreement and to introduce a new majority drag provision facilitating the compulsory acquisition of shares by a purchaser in connection with a change of control transaction (the CA Amendments).

Pursuant to s. 994(1) of the *Companies Act 2006 (UK)*, which confers jurisdiction on the court to grant relief for unfairly prejudicial conduct in the conduct of a company's affairs, Arbuthnott made various claims of unfair prejudice, including:

- that the Company had repudiated its agreement with Arbuthnott by failing to provide a suitable valuation in connection with the sale of his shares, causing him unfair prejudice - this was rejected by the trial judge; and

- that the Offer, the CA Amendments and the implementation of the Offer were carried out improperly for the purpose of expropriating shares held by Arbuthnott at a value he believed grossly undervalued the Company.

(c) Appeal decision

Lewison LJ noted the general proposition that members of a company cannot ordinarily succeed in a claim of unfair prejudice where the conduct in question is consistent with an arrangement agreed between shareholders of the company.

His Honour considered the role of directors in the context of a takeover offer; relevantly, that directors are required to conduct the affairs of a company in the way most likely to promote its success for the benefit of its members as a whole and not the benefit of individual shareholders with respect to the disposal of their shares.

(i) Compulsory acquisition - the CA Amendments

The CA Amendments permitting the majority to acquire the minority shareholdings were held not to be an improper expropriation of the minority interest held by Arbuthnott. Lewison LJ cited established principles noting that an amendment by a Company to its articles of association, which adversely affects certain shareholders while benefitting others, does not, of itself, invalidate the amendment.

Agreeing with the trial judge, Lewison LJ noted that the CA Amendments were a "tidying up exercise" and concluded that there was no basis for the challenge to the validity of the CA Amendments as there was no evidence of bad faith or improper motive. His Honour concluded that the CA Amendments were for the benefit of the Company (even if benefiting certain shareholders) as they aligned the Articles with the Agreement by extending the protective condition that a majority of Non-interested Members had to agree to the proposed sale and providing a mechanism for a prospective buyer to compulsorily acquire outstanding minority interests.

His Honour articulated that the test in determining whether conduct is unfairly prejudicial is not whether all reasonable people would have agreed that the CA Amendments were in the best interests of the Company. It is sufficient that a reasonable person could have thought that the CA Amendments were in the Company's best interests.

(ii) The Remuneration Model

His Honour also rejected Arbuthnott's claim that the Remuneration Model was unreasonable, unfair or improper in continuing to operate to provide the members of the LLP with the majority of the Business profits. Lewison LJ emphasised that Arbuthnott had agreed to this model as a shareholder and director of the Company. His Honour found that it was a reasonable and proper means of continuing to conduct the Business and the model could reasonably be regarded as critical to the Business.

(iii) The Exit Provisions

Lewison LJ rejected Arbuthnott's submission that the Exit Provisions required a majority of Founders to secure the best price for all shares in the same class and facilitate cooperation between shareholders.

Although Lewison LJ agreed that the Founders in the majority had an obligation beyond unconditional self-interest in considering the Offer, there was no implied term to secure the objective best possible price for the shares, taking into account all relevant matters and ignoring irrelevant matters, or to ensure that the non-purchasing shareholders received a proportionate part of the true value of the controlling interest being sold, noting that this would be "inconceivable" and "onerous". His Honour stated that by previously agreeing to the Exit Provisions in the Agreement, Arbuthnott had agreed to be bound by the price which the Founder majority was content to accept.

The appeal was unanimously dismissed.

6.2 Officers' entitlement to present indemnification for ongoing legal costs incurred in defending criminal proceedings

(By Marissa Bendyk and Robert Marsh, King & Wood Mallesons)

Note Printing Australia Ltd v Leckenby [2015] VSCA 105, Victorian Court of Appeal, Tate, Whelan and Ferguson JJA, 20 May 2015

The full text of this judgment is available here.

(a) Summary

The case before the Victorian Court of Appeal was concerned with two main issues:

- the correct construction of a deed of indemnity (the Deed) between Note Printing Australia Ltd (NPAL) and Mr John Leckenby (the former CEO of NPAL); and
- whether s. 199A(3)(b) of the Corporations Act 2001 (Cth) (the Act) prevented the Deed from providing that Mr Leckenby (Leckenby) had a present entitlement to be indemnified for ongoing legal costs incurred during the course of relevant criminal proceedings.

Tate J held, with Whelan and Ferguson JJA agreeing, that cl 2.2(b) of the Deed did confer a present entitlement on Leckenby to be paid by NPAL for his legal costs incurred in defending the relevant criminal proceedings, until and unless a guilty verdict was reached in those proceedings in which case there would be an obligation to repay the legal costs. Her Honour also held that such an entitlement is consistent with s. 199A(3)(b) of the Act.

(b) Facts

Leckenby was the CEO of NPAL from September 1998 to June 2004. Along with other former officers of NPAL, and the company itself, he has been charged with criminal offences relating to the bribing of foreign officials to secure certain printing contracts for the benefit NPAL (the Criminal Proceeding). It is expected that his trial in relation to these charges will take place in 2015.

On 27 July 2001, Leckenby and NPAL entered into the Deed. The Deed provided that NPAL agreed to indemnify Leckenby against certain liabilities, including liability for legal costs, which may be incurred as a result of Leckenby being an officer.

Relevantly cl 2.2 of the Deed provided:

> To the fullest extent permitted by law, NPAL hereby indemnifies [Leckenby] against each and every liability for legal costs and expenses [he] may incur or for which [he] may become liable in defending an action for a liability incurred as such an officer of NPAL unless such costs and expenses are incurred:
>
> b. in defending or resisting criminal proceedings in which [he] is found guilty.

Furthermore cl. 6.2 of the Deed provided:

> If it is established in relation to a Claim that:
>
> a. the Officer is not entitled to be indemnified under clauses 2.1 or 2.2, NPAL is thereupon relieved from each and every obligation under clauses 2.1 and 2.2 in respect of that Claim and the Officer must refund to NPAL all amount incurred by NPAL under this Deed in respect of that Claim within 30 days of NPAL providing to the Officer details of such amounts: ...

Leckenby called on the indemnity in cl 2.2(b) of the Deed on 15 March 2013 in respect of the criminal proceedings to which he was a party. NPAL refused, however, to indemnify Leckenby on the basis that it was not permitted, at law, to indemnify Leckenby until after the Criminal Proceedings were finalised without a finding of guilt.

Leckenby brought proceedings in the Supreme Court of Victoria seeking declaratory relief that, among other things, he was entitled to be presently indemnified for his current and ongoing legal costs in relation to the Criminal Proceedings.

At first instance, Sifris J found in favour of Leckenby. Sifris J's findings were identified by Tate J as resting on three propositions:

- the prohibition in s. 199A(3)(b) of the Act has no impact unless a guilty verdict is reached and it therefore allows for an agreement that provides for an advance from a corporation to one of its officers which requires a refund or repayment if the officer is found guilty and s. 212 of the Act confirms this;
- such an agreement is not a traditional indemnity because it does not hold someone harmless; requiring repayment is inconsistent with indemnifying someone; and
- cl. 2.2 is "no more than and no different to" an agreement that provides for an advance which requires repayment upon the reaching of a guilty verdict; it does not offend the prohibition in s. 199A(3)(b) and should be read according to its clear intent as giving rise to a present entitlement in Leckenby to payment by NPAL of any liability he incurs for legal costs and expenses prior to verdict.

NPAL appealed the first instance decision challenging all three propositions.

(c) Decision

Tate J agreed with the trial judge that on its proper construction cl 2.2(b) provided that NPAL has an obligation to indemnify Leckenby for all his legal costs and expenses prior to a guilty verdict in the criminal proceedings. As such, the focus of the appeal was whether cl 2.2(b) of the Deed was consistent with the prohibition under s. 199A(3)(b) of the Act.

Relevantly, s. 199A(3) provides:

> When indemnity for legal costs not allowed ...
>
> 3. A company or related body corporate must not indemnify a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against legal costs incurred in defending an action for liability incurred as an officer or auditor of the company if the costs are incurred:
>   b. in defending or resisting criminal proceedings in which the person is found guilty: ...

(i) The correct construction of s. 199A(3)(b) of the Act

The court held, consistently with the first instance decision, that a proper construction of s. 199A(3)(b) indicates that payments can be made up until, and unless, a guilty verdict is reached provided that there is also an obligation to repay any such payments in the event of a guilty verdict. In coming to this conclusion the court emphasised:

- that the prohibition in s. 199A(3)(b) is phrased in the future perfect tense meaning that until or unless a guilty verdict is reached, a person charged with an offence is not a person who has been "found guilty" and as such a prohibition on indemnification has not yet arisen;
- that this interpretation of s. 199A(3)(b) is consistent with the reasoning employed by the Full Federal Court of Australia in *Rickus v Motor Trades Association of Australia Superannuation Fund Pty Ltd* (2010) 265 ALR 112 (*Rickus*) when interpreting s. 199A(3)(a) of the Act; and
- the evidence surrounding the introduction of s. 199A(3)(b) clearly supported such an interpretation.

The court also emphasised the importance of taking a "businesslike approach" to the interpretation of commercial contracts in supporting the trial judge's findings in relation to the construction of the Deed. Ultimately, the court concluded that the Deed did confer a present entitlement on Leckenby to be paid by NPAL for his legal costs and expenses and that such an entitlement was consistent with the prohibition contained in s. 199A3(b) of the Act.

6.3 Examinees challenge of examination summonses fails

(By Lachlan Salt, Ashurst)

Whyte v McLuskie [2015] QSC 132, Supreme Court of Queensland, Burns J, 15 May 2015

The full text of this judgment is available here.

(a) Summary

Four individuals have unsuccessfully challenged examination summonses issued against them as part of the applicant receiver's commission to realise the property of a managed investment scheme which was being wound up.

(b) Facts

Four examinees (Examinees) sought the discharge of examination summonses issued to the applicant (Mr Whyte) under s. 569B of the Corporations Act 2001 (Cth) (the Act).

The Examinees had audited the LM First Mortgage Income Fund (the Fund) in August 2009 in their capacities variously as members or employees of Ernst & Young. The Fund's responsible entity at the time was LM Investment Management Ltd (LMIM), which subsequently went into voluntary administration. LMIM's winding up was halted until certain court applications had been determined by Dalton J.

On 8 August 2013, Dalton J determined those applications and ordered LMIM in its capacity as responsible entity to wind up the Fund, appointed Mr Whyte under s. 601NF(1) of the Act to ensure that the Fund was wound up in accordance with its constitution, and further appointed Mr Whyte under s. 601NF(2) as receiver of the property of the Fund. As part of his appointment as receiver under s. 601NF(2), Dalton J gave Mr Whyte the powers set out in s. 420 of the Act (Receiver's power to carry on corporations business during winding up) and empowered him to, among other things, take all steps necessary to realise the property of the Fund held by LMIM.

On 13 June 2014, ASIC approved Mr Whyte's application to be granted "eligible applicant" status for the purposes of the examination provisions contained in Division 1 of Part 5.9 of the Act. On 17 November 2014, Mr Whyte applied for the summonses against the Examinees, which were issued by Mullins J on 30 January 2015. The summonses were served on 12 February 2015.

The Examinees argued for the discharge of the summonses on the following grounds.

- First, the Examinees argued that Dalton J's orders did not allow Mr Whyte to conduct examinations because s. 601NF(2) of the Act did not empower the court to make an order affecting the rights of and imposing duties on third parties (such as conducting examinations).
- Second, it was argued that an examination under s. 569B is confined to an examination about a corporation's examinable affairs and that Mr Whyte's appointment did not extend over the affairs of any corporation as defined under the Act.
- Third, it was argued that the proper scope of the power conferred by s. 569B was confined to the investigation of the affairs of a corporation which is ancillary to the external appointment under Chapter 5 of the Act and that, accordingly, it would be collateral to and inconsistent with the purpose for the conferral of that power to deploy it in furtherance of an agreement to administer the affairs of the Fund. Essentially, it was submitted that such an improper purpose would be an abuse of the court's processes.
- Fourth, the Examinees alleged a failure to make full and frank disclosure of

material matters because it was inferable that certain authorities had not been drawn to the attention of Mullins J during the hearing of Mr Whyte's successful application to have the summonses issued.

Each of these grounds were rejected and the Examinees' challenge to the summonses' validity was unsuccessful.

(c) Decision

As to the Examinees' first submission, Burns J considered that it could be disposed of shortly by stating that the summonses were issued pursuant to s. 569B and not s. 601NF(2). *In obiter* Burns J considered, however, that the true scope of s. 601NF(2) is prescribed by its words, which confer a power "as wide as it needs to be to achieve its evident purpose - to give directions about how a registered scheme is to be wound up ...". Burns J stated that in this case "the power conferred by section 601NF(2) was used to appoint a receiver as the most appropriate mechanism to realise the scheme property. While the Examinees accept that as a proposition, they argue that the achievement of that object - the realisation of scheme property - is to proceed without the benefit of the full range of powers ordinarily conferred on a receiver. I do not accept that argument".

As to the Examinees' second submission, Burns J said it was "difficult to see how (this) argument sits comfortably" with a combined reading of ss. 9 and 53 of the Act.

These provisions make it clear that:

- any matters concerning the financial or business undertaking, scheme, common enterprise or investment contract to which the interests in the Fund relate; and
- any matters relating to, or arising out of, any audits conducted with respect to the Fund

are properly to be regarded as examinable affairs of a corporation, namely, LMIM.

In response to the Examinees' related argument that Mr Whyte was appointed as receiver of the property of the Fund, as opposed to the property of a corporation, Burns J questioned the correctness of this contention, distinguished the authority submitted in support of it, and made the point that even if the contention was correct it would not have made Mr Whyte ineligible to apply for the summonses because Dalton J by court order tasked Mr Whyte with realising the property of the Fund held by the corporation, LMIM, as its responsible entity.

The Examinees' third submission was not accepted because, although managed investment schemes (such as the Fund) are governed under Chapter 5C of the Act and not Chapter 5, Burns J considered that nothing in either chapter limits the extent to which a receiver appointed under Chapter 5C (such as Mr Whyte) can avail himself of the examination powers in Chapter 5. Indeed, Burns J noted that the inclusion in s. 53 of matters concerning managed investment schemes, the location of s. 420 (which empowers receivers) in Chapter 5 and the realisation that receiverships are a defined form of external administration "are strongly to the opposite effect".

Finally, as no substance was to be found in the Examinees' challenge to the validity of the summonses, no question of non-disclosure on the application before Mullins J could arise.

6.4 Effect of a deed of company arrangement limiting access to damages by creditors, and the subsequent effect on costs for parties and non-parties

(By Alex Moores, DLA Piper)

Central Queensland Development Corporation Pty Ltd v Sunstruct Pty Ltd [2015] FCAFC 63, Federal Court of Australia, Full Court, Besanko, Gilmour and Rangiah JJ, 14 May 2015.

The full text of this judgment is available here.

(a) Summary

The Full Court of the Federal Court of Australia (the Court) considered three issues relating to the effect of a Deed of Company Arrangement (DOCA) on the validity and quantum of damages and costs orders. The DOCA was relied on by the primary judge as it related to the Central Queensland Development Corporation Pty Ltd (Bluechip) and Mr Sidney Knell allegedly attempting to circumvent the position of Sunstruct Pty Ltd (Sunstruct) as a creditor.

Centrally:

- the Court agreed to a variation of the quantum awarded in Sunstruct's Counterclaim against Bluechip, reducing it from $343,319.13 to $172,467.88;
- the Court rejected the argument that the DOCA compromised Sunstruct's recovery of costs by classifying the costs order as a claim arising prior to the appointment of administrators, which would have the effect of invalidating the order; and
- the Court upheld the appeal by Mr Knell, who was a director and shareholder of Bluechip, that no costs should be awarded against him as a non-party on the grounds that procedural fairness had not been followed when the primary judge relied on evidence of conduct surrounding the DOCA that was not lead when the costs order was issued.

(b) Facts

The Court considered two separate issues on appeal; the first being the Bluechip (the previous name of the Central Queensland Development Corporation) appeal centred on the DOCA compromising the quantum of Sunstruct's claims, and the second being the Knell appeal disputing the apportionment of costs to non-parties.

(i) Bluechip DOCA Appeal

Bluechip and Sunstruct entered into a construction management agreement on 21 September 2007. Under this agreement, Sunstruct was to assist with a building development project. During this time, Bluechip claimed Sunstruct was negligent and had engaged in misleading and deceptive conduct, and sought damages on that basis. Sunstruct counterclaimed for the alleged outstanding management fees (the Counterclaim). In the Federal Circuit Court in primary proceedings, Bluechip's claims were dismissed and Sunstruct was formally awarded $343,319.13 on 28 November 2013.

Prior to the formal decision, Bluechip entered into a DOCA with its creditors on 10 March 2011 reporting that a voluntary administrator had been appointed on 3 February 2011. This occurred within two weeks prior to the final day of the primary trial. Separately, the sum of $324,556.72 had been paid into a trust fund on 31 July 2009 in anticipation of the outcome of the earlier proceedings, and on 20 October 2009 both parties consented to approximately half being transferred to Bluechip. By the time of the matter before the Court, there was $172,467.88 remaining.

In the costs judgment in November 2013, the primary judge held that all unsecured claims against Bluechip were compromised due to the DOCA. The primary judge held that the DOCA was binding on all secured and unsecured creditors, including Sunstruct, to not take further action in the primary proceedings, and that the money held in trust was not included due to the DOCA's exclusions. Contemporaneously, Bluechip argued that the fact the DOCA was compromised invalidated the costs order in favour of Sunstruct in the Counterclaim.

Bluechip therefore contended the primary judge erred and only the secured amounts should have been entered, having the effect that the DOCA excluded any unsecured amount and would therefore lower the quantum owed to Sunstruct.

(ii) Knell Costs Appeal

Mr Knell was ordered in the primary proceedings, as Bluechip's sole director, to contribute to the costs awarded, which would be paid in full by himself and Bluechip the company. Mr Knell submitted to the Court that the fact the DOCA was compromised insofar as Sunstruct's claim against Bluechip meant that it must also be compromised in relation to Sunstruct's claim against him. The primary judge held Mr Knell responsible for part of the payment of costs, largely due to his involvement with the DOCA and how his behaviour was cynical and directed to his self interest by using the DOCA to prevent valid recovery of Sunstruct's entitlements. The proximity of the DOCA agreement to the end of the primary trial was considered evidence that Mr Knell knew the outcome was likely to go against him and he thus attempted to use the corporate veil to shield Bluechip's assets. Removing Sunstruct as a creditor specifically was considered to be a driving motivator for the DOCA.

(c) Decision

(i) The effect of the DOCA on the quantum of damages

The Court held, in relation to whether the quantum of the Counterclaim was correct, that the primary judge erred when finding that all claims against Bluechip were compromised by the DOCA. More correctly, only the secured amount ought to have been entered and the Court varied the original order of $343,319.13 and substituted the amount of $172,467.88, being the amount held on trust. This excluded the costs incurred by Sunstruct, which Bluechip was also ordered to pay and which became the subject of the second part of the appeal.

(ii) The effect of the DOCA on costs in view of ss. 444D and 553 of the Act

Having established that the judgment amount in relation to the Counterclaim itself was incorrectly applied due to the misapplication of the DOCA, Bluechip argued that the cost order for the Counterclaim was also incorrect. For this, Bluechip relied on an interpretation of "claim" that would make not only the claims arising prior to the appointment of the administrators admissible under the DOCA, but also any claims the circumstances of which arose prior to appointment of the administrators, whether or not the claim had actually been made. If such an interpretation was followed, Sunstruct would be prevented by the terms of the DOCA from pursuing the claim. The question was whether costs awarded to Sunstruct on its Counterclaim constituted a "claim".

Bluechip contended that the claim did arise prior to the appointment of the administrators and, by the operation of ss. 444D and 552, the costs order could be used as proof against Sunstruct. In determining whether this construction was correct, the Court focused on contrasting the use of the phrase "debts or claims" in s. 553 of the Act as opposed to "debts and liabilities" in s. 82 of the Bankruptcy Act 1966 (Cth), finding that the classes of provable debts are broader under s. 553 because of the ability to include "circumstances giving rise to" the claim itself. Despite this, however, the Court concurred that an order for costs is at the discretion of the court to award, and the legal right to pursue a costs claim arises once the order has been made not at the point the ability to make the claim arises. Until the order is made and the legal right is enlivened, there is no claim under s. 553.

On the basis that the costs order is distinct from, and not incidental to, the result of a judgment against a losing party, Sunstruct's costs of prosecuting the Counterclaim against Bluechip were not compromised by the DOCA - despite variation of the Counterclaim's quantum - having regard to s. 444D of the Corporations Act 2001 (Cth) and similarly in respect of Sunstruct's costs in defending the claims brought by Bluechip. Thus, Bluechip's appeal was denied and the costs order in favour of Sunstruct upheld.

(iii) Awarding costs against a non-party

The Court rejected the submission by Mr Knell that the cost order against him personally could not be enforced due to the DOCA being compromised, but agreed that the matter should be re-examined on procedural fairness grounds. There would be nothing to preclude an action against Mr Knell simply because the DOCA invalidated Sunstruct's claim against a company of which Mr Knell was the director.

Mr Knell's claim was, however, ultimately upheld as the Court found he had been blind-sighted by the use of the DOCA as the basis for the costs order. Mr Knell was given no notice of the intention to use his drafting of the DOCA as evidence and when Sunstruct was invited to identify for the Court the specific objectionable behaviour that surrounded the drafting of the DOCA it did not. Therefore, the Court held, the decision to apportion costs to Mr Knell based on his conduct in relation to the DOCA was made by the primary judge without reference to argument from Sunstruct, and this was a denial of procedural fairness.

The Court ordered that the matter be remitted to the Federal Circuit Court for non-party cost applications to be considered in light of the upheld appeal.

6.5 Open for inspection - Federal Court looks beyond ancillary purposes to the dominant proper purpose of an application to inspect the company's books

(By Marlowe Mitchell, Herbert Smith Freehills)

Mighty River International Ltd v Mesa Minerals Ltd [2015] FCA 462, Federal Court of Australia, Barker J, 14 May 2015

The full text of this judgement is available here.

(a) Summary

In this case Barker J considered whether a minority shareholder, in applying to inspect a company's books and records, was acting in good faith and whether inspections on behalf of the shareholder would be made for a proper purpose, as required by s. 247A of the Corporations Act 2001 (Cth) (the Act).

(b) Facts

In 2010, Mineral Resources Ltd (MRL) commenced a takeover in respect of Mesa Minerals Ltd (Mesa) which ultimately resulted in MRL acquiring most of its current shareholding in Mesa (approximately 67% of Mesa's issued shares). In 2010, approximately 19% of the issued shares in Mesa were held by the applicant Mighty River International Ltd (Mighty River). Mighty River elected not to accept the MRL takeover bid, retaining its significant minority shareholding thereafter.

Following the takeover, Mighty River in April 2012 commenced proceedings against MRL and its directors in the Supreme Court of Western Australia on the basis of an alleged unwritten agreement concerning the acquisition by MRL of Mighty River's shares in Mesa. These proceedings were subsequently settled.

In July 2014, Mighty River's solicitors wrote to Mesa requesting documents for the purpose of considering whether to commence proceedings against Mesa for statutory oppression (under s. 232 of the Act) and winding up (s. 461 of the Act). In November 2014, Mighty River indicated to Mesa that it would instead pursue an application under s. 247A of the Act for the documents it required.

Section 247A of the Act provides in brief:

> On application by a member of the company or registered managed investment scheme, the Court may make an order authorising the applicant or another person to inspect the books of the company or scheme on behalf of the applicant, only if it is satisfied that the applicant is acting in good faith and that the inspection is to be made for a propose purpose. A person who is granted leave under s. 237, or applies for leave or is eligible to apply for leave under s. 237, may apply to the court for an order under s. 247A.

(c) Decision

Mighty River submitted that the documents the subject of the s. 247A application (which were in substance the same as the documents requested in the abandoned discovery application) were sought for the purposes of enabling Mighty River to determine the nature and scope of Mesa's port capacity and access rights and the terms upon which third parties were using the port rights and the general purpose mining lease (the Third Party Arrangements). Mighty River was particularly concerned with whether the Third Party Arrangements were on commercial terms, and submitted the purpose of the application was to enable it to make a decision on the exercise of its rights as a shareholder of Mesa and to protect its rights and interests as a shareholder.

Mesa submitted that the protracted hostilities between the parties was relevant, and that the purpose of the application was not to determine the Third Party Arrangements or to protect Mighty River's investment, and was rather to usurp the well-defined power of Mesa's Board of Directors and to extract a financial gain from MRL. Mesa pointed to Mighty River's continual purchase of shares in Mesa, contending that this indicated that Mighty River was not genuinely concerned in protecting its investment interests and was looking to increase "its influence and leverage as a significant shareholder" (at [41]).

Barker J held that he was satisfied in all circumstances that Mighty River, through its sole director Mr Xie, was acting in good faith in making the application and that the inspection would be for a proper purpose. An order was made allowing Mighty River access to the requested documents.

(i) General principles considered

In discussing the general principles associated with s. 247A, Barker J observed that these were generally understood by the parties.

Barker J noted that s. 247A required the application of an objective test and the onus is on the applicant to prove that he or she is acting in good faith and that the inspection is for a proper purpose being a "purpose connected with the proper exercise of rights of a shareholder as a shareholder": *Hanks v Admiralty Resources NL* [2011] FCA 891 (*Hanks v Admiralty Resources*) at [32]. Even if the applicant discharges its onus, Barker J noted that the Court still has the discretion whether or not to order inspection.

If the applicant's primary or dominant purpose is a proper purpose, Barker J confirmed it is immaterial that an inspection may be of benefit to the applicant for some other purpose. However the rights provided by s. 247A do not qualify the important company law principle that a shareholder will not normally have recourse to the Courts to challenge a management decision made by or with the approval of directors.

Barker J also noted it is no defence to an application under s. 247A that an applicant may acquire information not available to other shareholders, as any shareholder has a right to apply under the s. for an inspection order. Barker J also observed another principle to arise from the authorities being that an applicant "who has a significant shareholding and who has been a shareholder for some considerable time will more easily discharge the burden of showing good faith than one who has recently acquired a token holding": *Hanks v Admiralty Resources* at [32].

(ii) Success of the future claim not a consideration

Eligibility to apply for leave under s. 237 of the Act is a precondition to an application under s. 247A. Section 237 relates to the Court's power to grant leave for a party to bring, or intervene in, proceedings on behalf of a company.

Mighty River submitted that it was not necessary for it to prove that it will succeed in any future claim. The accuracy of this submission was reflected in Barker J's recount of the accepted principles to emerge from the authorities.

(iii) Existence of a collateral purpose did not defeat the application

The suggestion by Mesa's counsel that the application was brought so that MRL would make another offer to purchase Mighty River's shareholding in Mesa was rejected by Mighty River. Although Mr Xie admitted he would be pleased to accept an offer from MRL to buy the Mesa shares, he explained that Mighty River was not trapped as a shareholder and would be happy to hold the shares in Mesa. Barker J held that Mighty River's willingness to accept an offer from MRL did not preclude it from making the application to gain access to the nominated documents.

(iv) Previously available information

Mighty River submitted that there were insufficient details available regarding Mesa's Third Party Arrangements, including in Mesa's annual and interim reports, to satisfy itself that those arrangements were in the best interests of shareholders. While Mesa submitted that Mighty River had previously had access to documents the subject of the application, Mighty River submitted contrary evidence, and ultimately Barker J accepted Mighty River's submissions that the available information as to the Third Party Arrangements was ambiguous and incomplete.

(v) Usurping the powers of the Mesa Board of Directors

In their submissions, Mesa contended that Mighty River, having elected not to accept MRL's takeover bid, was now seeking to conduct itself as a de facto director of Mesa. Mesa referred to Mr Xie's oral evidence that Mighty River wanted to review the documents requested and then "engage a discussion with the...directors in the company ... on - what is commercial enough" so that Mighty River could then "talk about whether we need to get the court to get involved." Mesa submitted that this approach did not gel with Australian company law and was contrary to the constitutionally limited rights of Mesa's shareholders to interfere with the Board's decisions.

In response, Mighty River submitted that the s. of the constitution which restricted a shareholder from inspecting the books of the company without a resolution in favour from the directors was not relevant, as the application was being made pursuant to the Act. While Barker J did not refer to the constitution submissions, his Honour stated that he did not consider on the evidence that "requesting the required documents is impermissibly involving itself in the company's management." (at [106]).

Although the decision in this case was determined by the veracity of the evidence presented, and the well accepted principles espoused by Barker J and the parties, it serves as a timely reminder that the focus of a s. 247A application will be the ultimate dominant proper purpose, and not the associated ancillary benefits of such an application.

6.6 Application for leave under s. 459S to oppose a winding up application dismissed

(By Alexandria Hammerton, Minter Ellison)

Re Vangory Holdings Pty Ltd [2015] NSWSC 546, Supreme Court of New South Wales, Black J, 12 May 2015

The full text of this judgment is available here.

(a) Summary

This case considered an interlocutory application for leave under s. 459S(1)(b) of the Corporations Act 2001 (Cth) (the Corporations Act) to oppose a winding up application on a ground on which it could have relied, but did not, to set aside an earlier statutory demand. The plaintiff, First Debenture Ltd (FDL) had commenced proceedings to wind up the first defendant, Vangory Holdings Pty Ltd (Vangory) on the basis of a debt allegedly owed to FDL by Vangory. Vangory contended that there was a genuine dispute as to the existence of the debt, and commenced this proceeding for leave to oppose FDL's application on that basis.

(b) Facts

On 16 February 2015, FDL filed an Amended Originating Process in which it sought an order that the Vangory be wound up on the grounds of insolvency under s. 459A of the Corporations Act. FDL's application relied on a creditor's statutory demand for payment dated 26 September 2014 (the Demand). The Demand alleged that, in October 2012, First Debenture Project No 4 Pty Ltd (FD4) had given a loan of $527,000.00 to Vangory which was to be repayable on demand. It was accepted by all parties that the claimed debt was subsequently assigned from FD4 to FDL. Vangory made no application to set aside the Demand within 21 days of its service, under s. 459G of the Corporations Act, nor did Vangory take any action to comply with the Demand to FDL's reasonable satisfaction.

On 4 March 2015, Vangory applied for leave under s. 459S(1)(b) of the Corporations Act to oppose the winding up application on a ground on which it could have relied, but did not, to set aside the Demand, namely, that there was a genuine dispute as to the debt the subject of the Demand. Vangory contended that at no date was it indebted to FDL as claimed, and relied on an affidavit by one of its directors, Mr Jeffrey Dawson, and also an affidavit of Mr Greg Huxley, a consultant to Vangory.

The affidavit evidence from Mr Dawson admitted the receipt by Vangory of $572,000.00 on the settlement of the sale of a property by Gillieston Project No 1 Pty Ltd (GP1) to FD4. Mr Dawson denied that this amount was a loan however, and it was contended that GP1 directed FD4 to pay that amount to Vangory. Mr Dawson gave evidence that neither he nor any other representative of Vangory had had any discussion with FD4 or FDL regarding the loan. He also pointed to the absence of any loan agreement as well as the fact that, as a director of both FDL and Vangory, he would have needed to declare his personal interest to the board of FDL, something he had not done.

Vangory also relied on an affidavit sworn by Mr Huxley in other proceedings, in which he acknowledged the payment of $572,000.00 to Vangory from FD4 but, once again, denied the payment was a loan.

Finally, Vangory sought to raise an offsetting claim against FDL by relying on evidence in Mr Dawson's affidavit that Vangory had paid expenses on FDL's behalf by way of loan to FDL. Vangory had issued a creditor's statutory demand of their own to FDL in respect of the alleged loan, and FDL had commenced proceedings to set aside the demand. It was unnecessary to consider the offsetting claim in this proceeding, as lawyers for Vangory accepted that it would not be sufficient to avoid the presumption of insolvency arising unless a genuine dispute as to the debt claimed by FDL could be raised.

(c) Decision

Section 459S of the Corporations Act provides that:

> 2. In so far as an application for a company to be wound up in insolvency relies on a failure by the company to comply with a statutory demand, the company may not, without the leave of the Court, oppose the application on a ground:
>   a. that the company relied on for the purposes of an application by it for the demand to be set aside; or
>   b. that the company could have so relied on, but did not so rely on (whether it made such an application or not).
> 3. The Court is not to grant leave under subsection (1) unless it is satisfied that the ground is material to proving that the company is solvent.

Black J identified the relevant matters for an application for leave under this section at [10] as being: whether there is a serious question to be tried on the ground sought to be raised; the sufficiency of any explanation as to why that ground was not raised in an application to set aside the creditor's statutory demand, involving an evaluation of the reasonableness of the debtor's conduct at the time when the application might have been made; and whether the Court is satisfied that the relevant ground is material to proving whether the debtor is solvent.

(i) Serious question to be tried is established

In considering whether there was a serious question to be tried, Black J clarified that the question was directed to whether there was an arguable case that the debt was the subject of a genuine dispute. His Honour noted that there was no need to make a final determination of the existence of a genuine dispute.

His Honour held at [15] that a serious question existed as to the characterisation of the $572,000 as a loan for a number of reasons. He agreed with submissions put forward by Vangory that FDL did not produce any evidence in support of their assertion that the money paid by FD4 to Vangory was a loan. FDL produced no loan agreement, cash book, loan ledger or demand for repayment of the loan. Further, there was no evidence of discussions between the parties going to the existence or terms of the loan, and no reference to the loan in board meetings of FDL (at [14]). On this basis Black J agreed that there was at least an arguable case that the money paid by FD4 was not advanced as a loan to Vangory.

(ii) Sufficient explanation for the failure to apply to set aside the Demand

Vangory submitted that their failure to respond to the Demand came about because Mr Huxley, who received the company mail, was suffering from stress and psychiatric illness and, despite receiving the Demand, did not bring it to the attention of Mr Dawson as he normally would. Black J (at [16]) found difficulty with this as there was no evidence of an effective communication system in place between Mr Dawson and Mr Huxley, and he could not be certain that Mr Dawson would have taken responsibility for dealing with the Demand, given the limited responsibility he took for many of his other obligations as a director. Mr Huxley had also been able to respond to and deal with a second creditor's statutory demand despite his circumstances at the same time.

His Honour noted Wigney J's comments (at [21]) in *Soundwave Festival Pty Ltd v Altered State (WA) Pty Ltd (No 1)* [2014] FCA 466 that "inattention and inactivity cannot provide a satisfactory explanation for a failure to comply with or set aside a statutory demand". Black J stated at [22] that it would not have been difficult for Vangory to put in place a system where a creditor's statutory demand sent to its registered office would be addressed. His Honour was therefore not satisfied that there was a sufficient explanation given for Vangory's failure.

(iii) Materiality of claimed debt to Vangory's solvency

In determining whether the claimed debt was material to Vangory's solvency, Black J referred to the existing definitions of "materiality" given in a number of previous decisions (at [24]-[33]), considering both the "strict" or "narrow" approach as well as the "broad" approach to that definition. Without coming to a conclusion as to which approach was correct, he determined that, for a debt to be "material" to a company's solvency, a possibility must exist that without the debt the company might be found to be solvent. His Honour found that that possibility had not been established by Vangory (at [33]).

His Honour also held that the evidence led as to Vangory's solvency was not convincing. Although Vangory sought to rely on Mr Dawson's evidence, Black J found that such evidence should be given little weight (at [34]). Mr Dawson himself had little knowledge of the financial affairs of Vangory outside of what Mr Huxley had told him nor had he read some materials exhibited to his affidavit. Further, there were questions as to Vangory's tax liabilities and other significant costs it had incurred and there was serious doubt as to whether the draft accounts that had been prepared were correct. Black J held at [54] that the Court had no evidence on which to rely to establish Vangory's true financial position or its solvency.

Accordingly, Black J ordered that the application for leave by Vangory under s. 459S of the Corporations Act be dismissed with costs.

6.7 Insolvent, uncommercial, director-related transactions and the paramount nature of directors' duties

(By Daria Orjekh, Corrs Chambers Westgarth)

Kijurina (as liquidator of ET Family Pty Ltd) v Taouk [2015] FCA 424, Federal Court of Australia, Edmonds J, 8 May 2015

The full text of this judgment is available here.

(a) Summary

In this decision of the Federal Court of Australia, Edmonds J concluded that certain transactions transferring property to a "close associate" (the director's wife) were unreasonable director-related transactions, uncommercial transactions and insolvent trading transactions under ss. 588FDA, 588FB and 588FC of the Corporations Act 2001 (Cth) (the Corporations Act), respectively.

Additionally, the Court held that the transactions contravened the director's fiduciary duties and statutory duties of care and diligence, good faith, use of position and use of information under ss. 180(1), 181, 182 and 183 of the Corporations Act respectively.

This decision reinforces the paramount nature of observing statutory directors' duties and fiduciary duties owed to a company and the expansion of the duties, in insolvent trading situations, to include the interests of creditors.

(b) Facts

At all material times, Mr Edmond Taouk was the sole director, secretary and shareholder of ET Family Pty Ltd ACN 143 414 662 (ET Family) and MEA Group Pty Ltd ACN 159 812 870 (MEA Group) (together, the Companies). The main assets of ET Family and MEA Group were properties in Bankstown and Cowra, respectively (the Properties). At the date of the proceedings, Mr and Mrs Taouk were married, although separated.

In early September 2013, Mr Taouk and his wife, Mrs Taouk, entered into a Binding Financial Agreement (BFA) pursuant to s. 90C of the Family Law Act 1975 (Cth) which detailed how to deal with the property and financial resources of the couple in the event of a marriage breakdown. Annexure A to the BFA listed the assets and liabilities of Mr and Mrs Taouk. Annexure A of the BFA also listed assets and liabilities of the Companies, including significant tax debts owed to the ATO.

Listing the assets and liabilities of the Companies in the BFA demonstrated that Mr Taouk was aware that a total of $672,000 of tax was owed and he was discharging his personal financial obligations with assets of the Companies.

In late September 2013, the Properties were transferred to Mrs Taouk by way of undated transfers, for consideration "pursuant to s 90C Family Law Act 1975". At the date of the transfers the Properties had a combined market value of at least $3,160,000. Mrs Taouk subsequently mortgaged the Properties and paid $548,435 to Mr Taouk from the proceeds of the mortgage.

A number of monetary payments were also made from the Companies' bank accounts to Mr Taouk, his son and associated companies.

In October 2013, the first and second plaintiffs were appointed as liquidators pursuant to a voluntary winding up of both Companies. The Extraordinary General Meetings of both Companies at which the liquidators were appointed tabled a Report of Affairs containing a certification by Mr Taouk that creditors of ET Family totalled not less than $643,497 and creditors of MEA Group totalled not less than $72,090.

After numerous unsuccessful attempts by the liquidators to determine the basis of the transfers from the Companies to Mrs Taouk, the liquidators commenced proceedings.

(c) Decision

(i) Unreasonable director-related transactions: s. 588FDA

As the transfers of the Properties constituted a transfer or disposition of the land to a close associate - Mrs Taouk - the central issue before Edmonds J was whether a reasonable person in each Company's circumstances would not have entered into the transaction, having regard to the matters in s. 588FDA(1)(c) of the Corporations Act, being any benefits, detriments or other matters relevant to each Company or others.

Edmonds J accepted the liquidators' submissions and concluded that the transfers of the Properties were unreasonable director-related transactions, taking the following factors into account:

- reasonable market value of the Properties;
- substantial value of debts owing to the ATO;
- existence of other creditors;
- the transfer of the Properties leaving the Companies with no assets to pay its creditors, including a substantial tax liability to the ATO;
- transfers being to a close associate of Mr Taouk (his wife);
- no consideration being received for assets worth around $3,250,000;
- the Properties being used to discharge a personal debt;
- Mr Taouk's personal financial benefit from the subsequent mortgage over the same Properties; and
- transfers being an attempt by Mr Taouk to avoid payment of the ATO liability.

In reaching this conclusion, Edmonds J applied the test in *Slaven v Menegazzo* [2009] ACTSC 94 at [44]:

> In my judgment, it is clear that a reasonable person in the company's circumstances would not have entered into the transaction having regard to those matters. That is because, a reasonable person in the position of the company at the time of the transaction, would not have agreed to dispose of the property upon the terms upon which the company did so.

Edmonds J similarly concluded the monetary payments from the Companies' bank accounts were unreasonable director-related transactions, taking into account the payments being made to related persons, for no consideration, in respect of personal expenses and for amounts that were not *bona fide* debts.

(ii) Uncommercial and insolvent transactions: ss. 588FB and 588FC

In determining whether the transactions were uncommercial, the central issue before Edmonds J was whether a reasonable person in each Company's circumstances would not have entered into the transaction, having regard to the matters in s. 588FB of the Corporations Act. Applying an objective standard and taking into account identical considerations in relation to the transfers of the Properties and the monetary payments set out in s. (c)(i) above, Edmonds J held the transactions to be uncommercial.

Edmonds J also concluded the transactions were insolvent transactions by applying the relevant statutory question - whether the Companies became insolvent as a consequence of entering into the transaction, i.e. transferring the Properties. After the transfers, the Companies had no assets to pay their creditors, including substantial tax liabilities. Accordingly, the transfers had the effect of the Companies becoming insolvent because the Companies had deprived themselves of all assets from which they could meet their liabilities, and as such, were insolvent transactions.

(iii) Breach of fiduciary duties and statutory directors' duties: ss. 180, 181 and

182

The court affirmed Santow J's reasoning in *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253 (*ASIC v Adler*), in particular at [458] that "causing a company to enter into an agreement which confers unreasonable personal benefits on a director is a breach of sections 180, 181 and 182" of the Corporations Act.

Edmonds J held Mr Taouk had breached his statutory directors' duties by entering into the BFA and allowing the transfer of the Properties and extended the *ASIC v Adler* test, concluding the same conduct also to be a breach of the equivalent fiduciary duties.

(iv) Orders

Edmonds J accepted the liquidators' submissions, holding the transactions to be:

- unreasonable director-related transactions under s. 588FDA of the Corporations Act;
- uncommercial transactions under s. 588FB of the Corporations Act; and
- insolvent transactions under s. 588FC of the Corporations Act.

The court ordered:

- relief pursuant to ss. 588FF(1)(a) and (c) of the Corporations Act, which is restitutionary in nature, in respect of the unreasonable director-related transaction, uncommercial transaction and insolvent transactions;
- statutory compensation pursuant to s. 1317H of the Corporations Actfor breach of statutory directors' duties; and
- equitable compensation for breach of fiduciary duties.

The quantum of relief was the total market value of all Properties and the monetary payments.

The decision confirms that a BFA will not necessarily protect company assets even in family company contexts and can expose a director to various penalty and compensation provisions in the Corporations Act.

6.8 Court grants leave under s. 459S of the Corporations Act to oppose an application for winding up

(By Matt Hartsuyker, Ashurst)

Re Bulwinkel Enterprises Pty Ltd [2015] QSC 112, Supreme Court of Queensland, Martin J, 8 May 2015

The full text of this judgment is available here.

(a) Summary

The Supreme Court of Queensland granted leave to Bulwinkel Enterprises Pty Ltd (the Respondent) under s. 459S of the Corporations Act 2001 (Cth) (the Act) to allow the Respondent to oppose an application of winding up in insolvency. The application was made after the Respondent failed to comply with a statutory demand. The court held that the materiality threshold for granting leave contained in s. 459S(2) of the Act was satisfied because the ground which the Respondent sought to reply upon to oppose the application for winding up, namely the existence of particular debts, was "likely to influence the determination" of solvency.

(b) Facts

Ms Stephanie Roebuck (the Applicant) is the executor of the estate of her late mother, Suzanne Florence Bulwinkel (the Deceased). At the time of her death, the Deceased was married to Dr Kim Bulwinkel, a shareholder and former director of the Respondent, who was responsible for the day to day management of the Respondent.

In mid-2008, the Deceased separated from Dr Bulwinkel. At this time, an agreement was reached between Dr Bulwinkel and the Deceased whereby Dr Bulwinkel would cause an entity he controlled to purchase a property owned by the Deceased and pay a number of debts owed by her to third parties.

Dr Bulwinkel caused Bulrock Pty Ltd (Bulrock) as trustee for the Bulwinkel Development Trust (the Trust) to purchase the property from the Deceased. The property had a value of $1,050,000. A sum of $250,000 was deployed towards satisfying the debts of the Deceased, leaving an effective shortfall in what was received by the Deceased as consideration for the sale of the property of $800,000 (the Property Transaction). The Respondent subsequently replaced Bulrock as trustee of the Trust and assumed all of Bulrock's liabilities, including those related to the Property Transaction.

On 13 June 2014, the Applicant served the Respondent with a statutory demand for the payment of $990,377.63 (the Debt), comprised of:

- $771,336.84, being the loan related to the Property Transaction, adjusted to include a number of relevant deductions (the Property Loan); and
- $219,040.79, being alleged unpaid distributions from the Trust to the Deceased.

The Respondent did not comply with the statutory demand, nor did it file an application for the statutory demand to be set aside in accordance with s. 459G of the Act. The Applicant subsequently made an application for the Respondent to be wound up in insolvency. The Respondent sought leave from the court under s. 459S of the Act to oppose that application.

(c) Decision

(i) The statutory context

Under s. 459P of the Act, a creditor may apply to the court for a company to be wound up in insolvency. Where such application is based on the failure by a company to comply with a statutory demand, certain additional provisions of the Act apply.

The statutory demand process under the Act can be summarised as follows:

- under s. 459E, a creditor may serve a company with a statutory demand relating to a debt which is due and payable, provided both the debt and the form of the statutory demand satisfy the legislative criteria;

- subject to the company lodging an application to set aside the statutory demand under s. 459G, the company has 21 days from being served the demand to comply with it in accordance with s. 459F; and
- if the company does not comply with the statutory demand, the company is presumed to be insolvent under s. 459C(2)(a), unless it can prove otherwise.

The Respondent sought leave under s. 459S of the Act to oppose the winding up application and prove its solvency. Section 459S restricts the circumstances under which a party that failed to comply with a statutory demand can oppose an application for its winding up. The party must seek the leave of the court and may not oppose the application on a ground that the company relied on (or could have relied on) for the purposes of an application by it for the statutory demand to be set aside, regardless of whether it made such an application or not.

Under s. 459S(2), the court must not grant leave allowing a party to oppose the winding up application unless it is satisfied that the ground the company intends to rely upon is material to proving that the company is solvent. The Respondent submitted that the Debt was not valid and the disputed amount was material to determining the solvency of the Respondent.

(ii) Was the ground "material" for the purposes of s. 459S(2) of the Act?

In *Switz Pty Ltd v Glowbind Pty Ltd* (2000) 48 NSWLR 661 (*Switz v Glowbind*), the NSW Court of Appeal applied a strict interpretation of when the court may grant leave under s. 459S. The court in that instance held that the relevant debt in dispute must, in effect, be pivotal to the determination of solvency for leave to be granted to oppose a winding up application.

Martin J noted the body of authority (summarised in McPherson's Law of Company Liquidation) which expresses a more relaxed interpretation than in *Switz v Glowbind* as to what is required to satisfy the materiality threshold for granting leave under s. 459S(2) of the Act. The court did not consider individual cases in detail, rather, Martin J held that the authorities can be summarised in their collective approach such that a disputed debt is material to the determination of solvency if it is "likely to influence the determination of a cause rather than to be necessarily decisive of it". The court noted that several judges have stated that "material to proving" under s. 459S(2) is not the same as being "determinative of" solvency.

The court followed the less strict construction of s. 459S(2) and granted leave to the Respondent on the basis that the existence of the Debt was a ground which was "likely to influence the determination of the issue before the court."

After granting leave, the court considered the question of the solvency of the Respondent. Evidence was presented to the court showing that the Respondent's accounts consistently contained amounts corresponding with the Debt claimed in the statutory declaration as owing to the Deceased. It was also submitted that Dr Bulwinkel repeatedly acknowledged to the Applicant in correspondence that those amounts were owing to the Deceased in respect of the Property Loan and the unpaid distribution from the Trust.

The Respondent led evidence through an affidavit of its accountant that the entries on the financial statements of the Respondent in respect of the Property Loan and unpaid Trust distributions were for accounting purposes only and that no debts in respect of those amounts were owing to the Deceased. The court held that this accounting treatment had arisen after the application for winding up and was inconsistent with the way that those amounts have been consistently characterised prior to that. The court held that the Debt contained in the statutory demand was valid and, in conjunction with further analysis regarding the financial state of the Respondent, found that the Respondent was insolvent.

6.9 Leave for a unitholder of a unit trust to bring proceedings on behalf of the trustee required but not granted

(By Meagan Ryan, Minter Ellison)

Randa Lee Investments Pty Ltd v Ballan [2015] VSC 178, Supreme Court of Victoria, Sifris J, 8 May 2015

The full text of this judgment is available here.

(a) Summary

This judgment addressed whether or not a unitholder requires leave to bring proceedings against the directors of the former corporate trustee of a unit trust and the basis on which leave will be granted. Sifris J considered that leave is necessary to commence and continue such proceedings, and will be granted if there are special and exceptional circumstances. Leave was not granted in this case because:

- the plaintiff failed to demonstrate a case of sufficient strength or prospects of success;
- the plaintiff failed to demonstrate that the trustee had refused to take action;
- the pleading was defective; and
- there was another case progressing on the matter and multiplicity of proceedings should be avoided as far as possible.

(b) Facts

The first plaintiff, Randa Lee Investments Pty Ltd, (Randa Lee), a unitholder in the Marnong Unit Trust (Unit Trust), filed an application to bring proceedings in its own name against the directors of Marnong Pty Ltd (Marnong), the former trustee of the Unit Trust, and Morlend Finance Corporation (Vic) Pty Ltd (Morlend). The first and second defendants, Constantino Ballan (Con Ballan) and Sam Cimino, were directors of Marnong. Prior to the application, Marnong went into receivership and liquidation and was therefore disqualified from acting as trustee of the Unit Trust. Accordingly, Sifris J appointed Michael Carrafa (Carrafa) as the trustee (the New Trustee).

60% of the interests in the Unit Trust were held by the Chiavaroli family (the Chiavaroli Interests), including Randa Lee, and 40% of the interests were held by the Ballan and Cimino families (the Ballan and Cimino Interests). The groups had a significant falling out, so, to separate their interests, the unitholders entered into a Unitholders Agreement on 30 December 2013. That agreement provided that the unitholders agreed to subdivide the land held by Marnong and subsequently grant options to purchase parts of the land to the unitholders and Con Ballan.

Marnong was the registered proprietor of land described in six certificates of title following the subdivision. Marnong granted options to purchase the land described in three of those certificates to the Ballan and Cimino Interests and Con Ballan (the Call Option Deeds) and granted options to purchase the remaining land to the Chiavaroli Interests.

Marnong, as trustee for the Unit Trust, had a debt with the Commonwealth Bank of Australia (CBA). Peter Chiavaroli and two Chiavaroli-controlled entities were liable for 94.11% of that debt, the Ballan and Cimino Interests were responsible for the remaining 5.89% and Con Ballan and Sam Cimino were guarantors of the facility. On 31 December 2013, the Ballan and Cimino Interests paid out their 5.89% liability. The CBA facility was due to expire on 31 July 2014 and Con Ballan and Sam Cimino decided not to agree to the roll-over of Marnong's CBA facility unless they were released from their personal guarantees.

On 26 September 2014 the parties to the Unitholders Agreement and the Call Option Deeds entered into a Deed of Variation of Call Option Agreements which extended the timeframe for the Ballan and Cimino Interests to exercise their options under the Call Option Deeds. On 28 November 2014 the plaintiffs (except Empicato) and Con Ballan exercised their options under the Call Option Deeds. The Chiavaroli Interests refused to recognise the Deeds and the rights of the Cimino and Ballan Interests to exercise their respective option and, on 30 January 2015, the Ballan and Cimino Interests commenced proceedings seeking orders for specific performance of the Call Option Deeds. Orders and directions were given on 1 April 2015.

Randa Lee alleged that the Call Option Deeds were void, the Ballan and Cimino Interests were not entitled to specific performance and that the lots of land offered to the Ballan and Cimino Interests should remain with the Unit Trust. Further allegations included that Con Ballan and Sam Cimino breached their fiduciary and statutory duties to Marnong and that the financier, Morlend, knew of, and participated in, their breaches.

Randa Lee applied to commence proceedings in its own name alleging that Marnong and Carrafa were not desirous of running the case and that this constituted special circumstances which should permit it to commence proceedings without leave and as a matter of right. The defendants submitted that leave was required to commence proceedings, that a case had not been made out on the evidence for leave to be granted and that the pleading was fundamentally defective so that leave should not be granted.

The main issue for determination was whether or not Randa Lee, as a unitholder in the Unit Trust, required leave to commence proceedings and, if so, whether or not leave should be granted.

(c) Decision

Sifris J determined that leave was required to commence, and continue, proceedings and that leave should not be granted in this case. His Honour considered that leave was required due to "[l]ogic, principle and of course authority...". He observed that for an action to be commenced on behalf of another party, in this case the trustee, special and exceptional circumstances must be shown before a unitholder is permitted to proceed. Sifris J considered (at [37]) that issues of standing should be "established prior to the issue of proceedings, or at the time of issue, that the party that otherwise does not have standing should be permitted to proceed because the party that does have standing is unable or unwilling to do so".

Sifris J provided four reasons why he considered that leave should not be granted in this case.

(i) Randa Lee failed to demonstrate a case of sufficient strength or prospects of success

Sifris J looked at the evidence which included that the Call Option Deeds were agreed to by all unitholders, the options were validly exercised, there was no dissent at the time and the Chiavaroli Interests were also granted similar options.

Further, the directors of Marnong could not have breached their fiduciary or statutory duties, as they acted consistently with the executed agreements. Sifris J (at [59]) commented that, even if the directors of Marnong had breached their duties, it was questionable whether any action was available against the former directors for the alleged breach. The failure to roll-over the CBA facility was not a breach by the directors as there was no evidence that it was unconditional. His Honour considered it unsurprising that Con Ballan and Sam Cimino wanted to avoid responsibility for a default in the circumstances where the Chiavaroli Interests were wholly responsible for the debt.

His Honour therefore held that the evidence did not demonstrate that the case had reasonable prospects of success.

(ii) It had not been demonstrated that the Trustee had refused to take action

Randa Lee did not demonstrate to Sifris J's satisfaction that Marnong or the New Trustee were unable or unwilling to bring proceedings. There was no evidence that the Receivers and Managers appointed to Marnong were unable to proceed. The Receivers and Managers of Marnong and the New Trustee had not been contacted or approached by Randa Lee in relation to the relief sought in Randa Lee's application. Sifris J determined that it was too early to conclude that there was no one to look after all the unitholders, including Randa Lee.

(iii) The pleading was defective and should not be permitted to proceed

Sifris J described the pleadings (at [69]) as "self-evidently defective" and held that they could not proceed in that form. The two main issues identified by his Honour were that, as the pleadings did not contain any adequate particulars of knowledge or relevant matters, they were defective and, secondly, 'the rolled up nature of the pleading in various respects is deficient.'

(iv) Multiplicity of proceedings is, so far as possible, to be avoided

Sifris J considered that the Civil Procedure Act 2010 (Vic) encourages the continuation only of those cases with real prospects of success and that the matters be dealt with effectively and in a cost-effective manner. His Honour could see no reason why the matter should proceed.

Sifris J therefore struck out the statement of claim and stayed the proceedings until a further order. No permanent stay was granted.

6.10 Derivative action falls down on best interests requirement

(By Jack Quirk, DLA Piper)

J Huang v D Wang [2015] NSWSC 510, Supreme Court of New South Wales, Black J, 5 May 2015

The full text of this judgment is available here.

(a) Summary

This case involved a dispute between two dentists who were in practice together. In order to establish the practice, the dentists set up a trust company and trust which (among other things) leased the premises from a third party and through which the practice was conducted. The dentists and one family member of each dentist were the directors of the company. After a few years in practice, one of the directors facilitated the purchase of the practice premises by an entity she controlled, without the knowledge of the other dentist. The second dentist brought an application under ss. 236 and 237 of the Corporations Act 2001 (Cth) (the Act) seeking leave to bring substantive proceedings against the first dentist for breach of fiduciary and statutory duties owed to the company. Ultimately, Black J dismissed the application; while the other preconditions of s. 237 were satisfied, on the evidence before the Court it was not in the best interests of the company to grant leave.

(b) Facts

Dr Johnson Huang and Dr Di Wang worked together as dentists in the northern suburbs of Sydney in 2008 and, in August 2010, began looking for premises from which to practise together. The majority of the business of the dental practice was run by and through Ismile Pty Ltd as trustee of the Ismile Dental Unit Trust (Ismile) trading as Ismile Dental.

The directors of Ismile were Dr Huang and a member of his family and Dr Wang and a member of her family. The shares in Ismile were held in equal numbers by Dr Huang Enterprises Pty Ltd (DHE), a company controlled by Dr Huang, and WW Enterprises NSW Pty Ltd (WWE), a company controlled by Dr Wang. The units in the Ismile Dental Unit Trust were held equally by entities controlled by Dr Huang and Dr Wang.

In 2011, Ismile entered a lease with a third party over a property located at a development known as Q Central in Bella Vista, Sydney (the Premises), from which Ismile conducted its business. The dentists each kept separate bank accounts in respect of Ismile and each of them only took money from their own account. A third bank account was maintained for the payment of joint expenses such as rent, marketing and capital to pursue further opportunities should they arise.

In 2014, Dr Wang facilitated the purchase of the Premises by WWE without telling Dr Huang. Dr Huang and DHE (first and second plaintiff) sought leave under s. 237 of the Act to bring statutory derivative proceedings in the name of Ismile (third plaintiff) against Dr Wang and WWE (defendants) for, *inter alia*, breach of fiduciary and statutory duties Dr Wang owed to Ismile by virtue of her position as director.

By agreement by the parties, the application for leave to bring derivative proceedings and the substantive application were held together.

(c) Decision

Section 237 of the Act provides that a member of a company may apply for leave to bring proceedings in the name of the company if, in the opinion of the court: it is probable the company will not bring proceedings itself; the applicant is acting in good faith; it is in the best interest of the company for leave to be granted; there is a serious question to be tried; and the applicant has given written notice of the application to the company (or, if there is no notice, the court decides it is appropriate to grant leave based on the above factors).

His Honour stated that the court must be satisfied of all five matters before granting leave: *Maher v Honeysett & Maher Electrical Contractors* [2005] NSWSC 859. The plaintiff bears the onus of establishing that each of the five factors are satisfied on the balance of probabilities: *Swanson v RA Pratt Properties Pty Ltd* [2002] NSWSC 583 (*Swansson*). After setting out the requirements of s. 237, his Honour considered each, ultimately refusing to grant leave for reasons summarised below.

(i) Whether Ismile will bring the proceedings: Section 237(2)(a)

Because there were only two directors of Ismile (Dr Huang and Dr Wang), Black J felt this requirement was satisfied as it was unlikely that Dr Wang would authorise the commencement of proceedings against herself or WWE, particularly because Dr Wang denied any wrongdoing.

(ii) Whether Dr Huang and DHE were acting in good faith: Section 237(2)(b)

In considering this requirement, his Honour cited the *Swansson* case (above), in which Palmer J stated that this requirement had two components summarised as: whether the applicant honestly believes that a good cause of action exists, and that the application has reasonable prospects of success; and there is no collateral purpose or abuse of purpose by the applicant.

In Black J's opinion, the plaintiffs were acting in good faith based on the authorities. *Swansson* (among other authorities) indicates that it is relatively easy to satisfy this requirement if the application is made by a current shareholder (such as DHE), holding more than a token shareholding (DHE held 50% of the shares in Ismile), where the proceedings seek recovery of property so that the value of the shares would be increased. Furthermore, the plaintiff's conduct in the action (such as agreeing to have the leave application and substantive proceedings heard together), indicated to his Honour that there was no collateral purpose or abuse of process.

(iii) Whether there was a serious question to be tried: Section 237(2)(d)

Following on from *Swansson*, his Honour stated that this requirement had a relatively low threshold, and was the same as the test applied by the court in determining whether to grant an interlocutory injunction. His Honour then turned to each of the alleged breaches of duty by Dr Wang as a director of Ismile. This discussion was framed in the context of "corporate opportunity", which is that fiduciary duties will likely be breached where a director takes up an opportunity for profit where there is a "sufficient temporal and causal connection between the obligations and the opportunity": *SEA Food International Pty Ltd v Lam* (1998) 16 ACLC 552 at 57.

From this paradigm, his Honour accepted the defendants' submissions that Dr Wang had no positive obligation to pursue the purchase of the Premises, nor was there any suggestion that the opportunity to purchase the Premises arose by virtue of Dr Wang's position as Director. In his Honour's opinion, however, it did not seem that the earlier discussions between the parties as to the scope of the business foreclosed the possibility that it was in Ismile's interest to purchase the Premises and expand the business. As such, in his Honour's opinion, there was a serious question to be tried as to whether Dr Wang acted in conflict of interest to the extent that she did not draw the opportunity to acquire the Premises to Ismile's attention.

(iv) Whether it was in the best interests of Ismile that leave be granted: Section 237(2)(c)

On this requirement, his Honour cited Ball J in the case of *Re Gladstone Pacific Nickel Ltd* [2011] NSWSC 1235, who identified the relevant matters including the prospects of success of the action; the likely costs of the action; the likely recovery if the action is successful; and the likely consequences to the company if the action is unsuccessful.

His Honour considered the orders sought by the plaintiffs which were: a declaration as to Dr Wang's breach of duties; a constructive trust over the Premises; or, in the alternative, an account of profits from WWE for the profits obtained by ownership of the Premises. His Honour thought the orders sought were inappropriate on the balance of probabilities. On declaratory relief, his Honour felt that the costs outweighed the illusory benefit of any such order. On the constructive trust, his Honour felt that such an order was unlikely to be granted on the evidence before him. This was because there was little or no evidence to suggest that Ismile had intended (or had the funds) to purchase the Premises, nor had there been recent discussion between the dentists of this fact. Further, the weight of the authorities suggested that a constructive trust should only be granted where no other appropriate remedy is available: *Bathurst City Council v PwC Properties Pty Ltd* [1998] HCA 59. On the account of profits, his Honour found there was no evidence to suggest that any benefit had been obtained by WWE from its ownership of the Premises over a relatively short period, nor was likely to be obtained in the future.

His Honour was not persuaded that any of the orders sought, on the balance of probabilities, were in Ismile's best interests based on the evidence and the nature of the orders sought.

(v) Notice: Section 237(2)(e)

The required notice was given by Dr Huang to Ismile within the 14-day period prescribed by s. 237.

Because Black J refused to grant leave, his Honour was of the opinion it was undesirable to determine the substantive proceedings because of the interlocutory nature of the application.

6.11 Where to now for agreed civil penalty submissions following the CFMEU decision?

(By Ayman Guirguis, Richard Flitcroft and Asa Lam, Corrs Chambers Westgarth)

Director, Fair Work Building Industry Inspectorate v Construction, Forestry, Mining and Energy Union [2015] FCAFC 59, Federal Court of Australia, Dowsett, Greenwood and Wigney JJ, 1 May 2015

The full text of this judgment is available here.

(a) Summary

On 1 May 2015, the Full Court of the Federal Court delivered its decision in *Director, Fair Work Building Industry Inspectorate v Construction, Forestry, Mining and Energy Union* [2015] FCAFC 59 (*CFMEU*). The judgment overturned in excess of twenty years of authorities relating to the ability of parties, such as ASIC, the ACCC and the ATO, and those that are the subject of civil prosecutions from making joint submissions to the Court about the appropriate pecuniary penalty or range of penalties.

The Court, following the recent High Court decision in *Pasquale Barbaro v The Queen; Saverio Zirilli v The Queen* [2014] HCA 2 (*Barbaro*), which dealt with the position of recommendations of penalties in criminal matters, came to the view that:

- courts should have "no regard to the agreed figures in fixing the amounts of the penalties to be imposed, other than to the extent that the agreement demonstrates a degree of remorse and/or cooperation on the part of each respondent" (*CFMEU* at [3]); and
- the parties or the regulator was not permitted or required to provide the Court with their/its view as to the penalty or range of penalties that the Court may impose.

This is likely to lead to a significant chilling effect on the preparedness of parties to seek to resolve, rather than to contest, matters and the willingness of parties to take the benefit of ASIC's published approach concerning cooperation and its impact in resolving civil penalty proceedings. Commercially speaking, parties being investigated are generally interested in a final resolution of the matter - both on facts, findings of liability and quantum. The impact of this decision is that it leaves quantum in the air, and hence the attractiveness of admitting liability, without a high degree of comfort about the penalty outcome. Time will tell whether the view of the regulators about the chilling effect on the efficient resolution of litigious matters or the Court's view that its judgment will only cause short term inconvenience will hold true.

(b) Facts

In 2014, in *Barbaro*, the High Court held that the prosecution is not permitted or required to make submissions on sentencing ranges. It held that it was for the sentencing judge alone to decide what sentence will be imposed.

The High Court's view was that the prosecution's submission as to an available sentencing range is not a submission of law but rather, no more than a statement of opinion. Accordingly, it was not unfair for the sentencing judge to have refused to receive such a submission. It also held that this refusal did not amount to a failure to take into account a relevant consideration in sentencing the defendants.

The Court granted the Commonwealth leave to intervene in the CFMEU proceedings and was heard in relation to whether the position in respect of 'pleas', agreed statements of fact and joint submissions nominating a penalty or range in civil pecuniary cases can be made to the courts as a result of *Barbaro*. As part of the Commonwealth's intervention, ASIC, the ACCC, the ATO and the Fair Work Ombudsman provided evidence.

The ACCC's evidence, summarised by the Court at [159] was that:

- "the capacity for joint submissions as to penalty is, 'critical to its capacity to conduct effective negotiations with the parties and to efficiently resolve enforcement proceedings'";
- "a majority of respondents ... 'would not agree to resolve matters if the ACCC was not in a position to agree to put joint submissions to the Court on the recommended appropriate quantum of penalty' ... the ability to do so is "essential" to the ACCC's capacity to reach agreement in relation to the disposition of proceedings without the cost of a contested hearing"; and
- "without such ability 'the majority of matters would be likely to proceed to a contested hearing, at least in relation to penalty, and in many cases, flowing over to a contest in relation to liability (in full or in part) and other relief'. This would result in increased cost to both the ACCC and the respondents ... that such increased cost would result in its having to reduce the number of matters which it investigates and takes to litigation. Such reduction in enforcement proceedings would be likely to lead to a reduction in specific and general deterrence".

ASIC's position mirrored the ACCC's, the Court summarising its submission at [160]:

> if the parties were precluded from making joint submissions it would be less likely that matters would proceed by way of agreed facts. It submits that many respondents are only likely to agree to a statement of facts if there is an agreement as to the submissions to be made as to penalty, thus providing the respondents with some certainty as to outcome (while recognising that this is ultimately a matter for the Court to determine). Without this incentive ASIC anticipates that respondents would be less likely to accept liability for their contraventions and would require ASIC to prove its case on a fully contested basis. That situation would also result in significant delays in resolving matters. The overall effect would be the diversion of resources from other investigations ...

ASIC and the ACCC also stated (see [154] and [155]) that when they make submissions to the Court about an appropriate penalty range, they do not seek to indicate the outer bounds of the available range in the sense that higher or lower penalty amounts would involve appellable error.

(c) Decision

The judgment in *CFMEU* noted that there existed long-standing authorities, such as *NW Frozen Foods Pty Ltd v ACCC* (1996) 71 FCR 285 (*NW Frozen Foods*) that demonstrate that there has been a practice of government regulators and respondents making joint submissions as to an appropriate penalty and that there is a strong public interest in doing so. Even following *Barbaro,* this approach had been accepted in recent decisions, including by Jacobson J in *ASIC v GE Capital Finance Australia, in the matter of GE Capital Finance Australia* [2014] FCA

701.

The Court acknowledged the concerns of the regulators as to the importance of negotiations and agreements in the enforcement of various statutes pursuant to which pecuniary penalties may be imposed. However, the Court rejected submissions from Commonwealth regulators that the application of *Barbaro* may result in a material reduction in the likelihood of expedient resolutions of civil prosecutions and reiterated that many authorities establish that "the public interest in the imposition of pecuniary penalties also leads to the conclusion that the fixing of the amount of such a penalty is a matter for the Court, and that the parties cannot, by agreement, bind it" (at [145]).

Additionally, the Court found that as the High Court held in *Barbaro* that statements as to the ultimate outcome or range were merely expressions of opinion and therefore could not properly be advanced in submissions in the context of criminal sentences, there can be no justification for taking a different view in pecuniary penalty proceedings (given that such proceedings were penal in nature).

It is important to note that the judgment focuses on submissions as to penalty/range of penalties (i.e. matters of a penal nature). Therefore, regulators and parties can still come to an agreement as to the facts that are relevant to the matter as well as joint submissions concerning factors relevant to penalty, comparable cases (without being able to submit on the penalty itself) and even orders for declarations, injunctions, even arguably disqualification orders and obviously non punitive orders including orders for compliance.

In our view, however, *CFMEU* will result in a very significant rethink about the approach that regulators such as ASIC and the ACCC will have in their interactions with parties that are alleged to have contravened relevant legislation as well as the Court - it is already having an effect on matters that are presently before the Court or are in the midst of negotiations for discounts on penalties due to cooperation.

Special leave to appeal this decision to the High Court has been sought by the Commonwealth.

6.12 No penalty privilege for defendants; no inquisitorial inquiry for plaintiff

(By Andrew Wydmanski, Clayton Utz)

Oswal, in the matter of Burrup Fertilisers Pty Ltd (receivers and managers appointed) v Carson, McEvoy and Theobald (receivers and managers) (No 8) [2015] FCA 404, Federal Court of Australia, Siopis J, 30 April 2015

The full text of this judgment is available here.

(a) Summary

In a s. 423 proceeding into their conduct as receivers, the defendants opposed proposed directions that they file a response responding to the plaintiff's statement of facts and contentions and evidence they wished to rely upon at trial. They argued that penalty privilege protected them from providing evidence at that stage where the plaintiff was seeking that they be struck off as liquidators. They failed, with the judge noting that the privilege had been expressly abrogated by statute. An alternative submission that the Court should invoke penalty privilege as a matter of discretion also failed, with the judge citing contrary legislative intent, the benefits of applying standard adversarial procedures and the desire to avoid splitting the proceedings.

Not everything went the plaintiff's way. He had requested that the Court summon the defendants on its own motion to appear before it. The plaintiff argued that the Court could use its discretion to prescribe a procedure to conduct the inquiry consistently with the legislative purpose. The judge rejected this, citing two main objections. Firstly, the inquiry into the appropriateness of the liquidators' fees was essentially an adversarial process. Secondly, Chapter III Courts are poorly equipped to exercise inquisitorial powers.

(b) Facts

The defendants had been appointed by a creditor as receivers and managers of the company in which the plaintiff had been a director and shareholder. A series of court proceedings between the parties ensued. In the present matter, the plaintiff sought an inquiry into the defendants' conduct under s. 423 of the Corporations Act 2001 (Cth) (the Act), particularly in relation to their fees.

The parties disagreed on several directions proposed by the plaintiff, bringing two disputed legal issues brought before the Court:

- whether the defendants could rely on penalty privilege, and
- whether the nature of the proceeding allowed for the Court to act inquisitorially.

(c) Decision

Siopis J rejected the defendants' attempts to rely on penalty privilege while denying the plaintiff's request to conduct an inquisitorial investigation into the defendants' conduct.

(i) Could the defendants rely on penalty privilege?

The judge agreed that the plaintiff had sought the imposition of a penalty against the defendants, which included proposed orders that would have the effect of disqualifying the defendants from acting as liquidators for at least five years.

Siopis J refused the defendants' attempt to rely on the privilege in resisting the proposed directions that they file a response to the plaintiff's statement of facts and contentions, along with witness statements, expert reports and a list of documents which they wished to rely upon at trial.

His Honour cited s. 1349(1) of the Act which provides, among other things, that a person cannot refuse to provide documents or information in a proceeding under the Act on the grounds that they may potentially face cancellation or suspension of their registration under the Act.

The Court also rejected the defendants' alternative submission that it should make discretionary directions as if they were entitled to penalty privilege for three reasons:

- this would undermine the legislative intent expressed in s. 1349(1) of the Act, with no compelling reason to do so being demonstrated;
- fairness in this adversarial process would be achieved by requiring both sides to disclose their case to each other before trial. Although penalties were sought by the defendant, the true focus of the proceedings was to assess the level of the defendants' fees, which would be best served through standard adversarial procedures; and
- the defendants' approach could lead to an undesirable splitting of proceedings, with an adjournment required after the plaintiff's case to allow the defendants to file a response and evidence upon which they wished to rely.

(ii) Could the Court act inquisitorially?

The judge rejected the plaintiff's proposed direction requiring the defendants to present themselves to the Court for examination and attend until either they were excused or the proceedings had concluded.

His Honour emphasised the limits on the Court's ability to prescribe the procedure of the conduct of an inquiry, citing the observations of Campbell J in *Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd* [2002] NSWSC 16 at [147] and [148]. The precedents cited considered a s. 423 inquiry to be ultimately adversarial in nature, with a court being poorly equipped to "arrange the presentation of evidence, to investigate its availability or to effect the calling of witnesses."

The passage also noted that a court exercising the judicial power of the Commonwealth could not conduct "an inquiry analogous to a Royal Commission, the direction and agenda of which was dictated by the court itself".

The proposed direction was rejected as an impermissible departure from the ordinary conduct of an adversarial proceeding.

7. Contributions

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

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