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Bulletin No. 264

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1. Recent Corporate Law and Corporate Governance Developments

1.1 APRA strengthens rules to combat contagion risk within banking groups

20 August 2019 - The Australian Prudential Regulation Authority (APRA) has released a strengthened prudential standard aimed at mitigating contagion risk within banking groups.

The updated *Prudential Standard APS 222 Associations with Related Entities* (APS 222) will further reduce the risk of problems in one part of a corporate group having a detrimental impact on an authorised deposit-taking institution (ADI).

APRA received submissions from ten stakeholders to its consultation; most supported updating the requirements, however some raised concerns about the complexity of implementing certain proposed changes.

Responding to the consultation, APRA confirmed that APS 222 will be updated to include:

- a broader definition of related entities that includes board directors and substantial shareholders;
- revised limits on the extent to which ADIs can be exposed to related entities;
- minimum requirements for ADIs to assess contagion risk; and
- removing the eligibility of ADIs' overseas subsidiaries to be regulated under APRA's Extended Licensed Entity framework.

Additionally, APRA will require ADIs to regularly assess and report on their exposure to step-in risk - the likelihood that they may need to "step-in" to support an entity to which they are not directly related.

The new APS 222 will come into effect from 1 January 2021.

Copies of APRA's Response Paper, the updated prudential standard and reporting standards are available at Revisions to the related parties framework for ADIs.

1.2 Government publishes roadmap for implementation of the recommendations of the *Final Report of the Royal Commission into Banking, Superannuation and Financial Services Industry*

19 August 2019 - The government has released its *Financial Services Royal Commission Implementation Roadmap* (the Implementation Roadmap) setting out how the government will deliver on its response to the *Final Report of the Royal Commission into Banking, Superannuation and Financial Services Industry* (the Final Report), *Restoring trust in Australia's financial system*.

In the Final Report, Commissioner Hayne made 76 recommendations for reform. Of these, 54 recommendations were directed to the government, 12 to the regulators and 10 to the industry. Of the 54 recommendations directed to the government, over 40 require legislation.

In addition to the 76 recommendations, the government in its response announced a further 18 commitments to address issues raised in the Final Report.

Since the Final Report was received, the parliament has sat for 21 days and the government has implemented 15 of the commitments it outlined in response to the Final Report. This comprises 8 out of the 54 recommendations that were directed to the government and 7 of the 18 additional commitments the government made as part of its response. Significant progress has also been made on a further 5 recommendations with draft legislation either introduced to the parliament, released for comment or detailed consultation papers issued.

Excluding the reviews that are to be conducted in 2022, under the Implementation Roadmap:

- by the end of this year, more than 20 commitments, around one third of the government's commitments, will have been implemented or have legislation before the parliament;
- by mid-2020, more than 50 commitments, close to 90% of commitments, will have been implemented or have legislation before the parliament; and
- by the end of 2020, remaining Royal Commission recommendations requiring legislation will have been introduced.

An additional $9.3 million will be provided to the Treasury and the Office of Parliamentary Counsel this year to ensure that the government's timetable can be met, in addition to the $12.1 million that was already provided in this year's Budget.

It is anticipated that giving effect to the Implementation Roadmap will take up 75% of Treasury's legislative agenda over the next year with the Treasury legislative program typically representing 25% of the total government legislative program.

In three years' time, the government will establish an independent review to assess the extent to which changes in industry practices have led to improved consumer outcomes and the need for further reform.

There will be a similar review into the regulators' actions at the same time, which will be undertaken by the new financial regulator oversight authority, recommended by the Royal Commission and agreed to by the government.

The Implementation Roadmap is available on the Treasury website.

1.3 US Business Roundtable announces statement on the purpose of a corporation

19 August 2019 - The United States (US) Business Roundtable (the BRT) has announced the release of a new Statement on the Purpose of a Corporation (the Statement) signed by 181 Chief Executive Officers (CEOs). The BRT is an association of CEOs of major US companies. These CEO members lead companies with more than 15 million employees and more than US$7 trillion in annual revenues.

Since 1978, the BRT has periodically issued *Principles of Corporate Governance*. Each version of the document issued since 1997 has endorsed principles of shareholder primacy - that corporations exist principally to serve shareholders. With this announcement, the new Statement supersedes previous statements and outlines a modern standard for corporate responsibility.

The BRT Statement is below and the full list of signatories is available here.

Statement on the Purpose of a Corporation

"Americans deserve an economy that allows each person to succeed through hard work and creativity and to lead a life of meaning and dignity. We believe the free-market system is the best means of generating good jobs, a strong and sustainable economy, innovation, a healthy environment and economic opportunity for all.

Businesses play a vital role in the economy by creating jobs, fostering innovation and providing essential goods and services. Businesses make and sell consumer products; manufacture equipment and vehicles; support the national defense; grow and produce food; provide health care; generate and deliver energy; and offer financial, communications and other services that underpin economic growth.

While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders. We commit to:

- delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations;
- investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect;
- dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions;

- supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses; and
- generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.

Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country."

Response to the Business Roundtable's Statement by the Council of Institutional Investors

On 19 August 2019, the Council of Institutional Investors (the CII) issued a media release (the CII response) expressing concern about the BRT Statement. The CII is an association of US asset owners, primarily pension funds, state and local entities charged with investing public assets and endowments and foundations, with combined assets of US$4 trillion.

According to the CII, the BRT Statement undercuts notions of managerial accountability to shareholders.

The following is an extract from the CII response:

"The Council has a productive relationship with BRT that has included discussion on corporate 'stakeholder' obligations, but we respectfully disagree with the statement issued by the BRT earlier today. The BRT statement suggests corporate obligations to a variety of stakeholders, placing shareholders last, and referencing shareholders simply as providers of capital rather than as owners.

CII believes boards and managers need to sustain a focus on long-term shareholder value. To achieve long-term shareholder value, it is critical to respect stakeholders, but also to have clear accountability to company owners.

Accountability to everyone means accountability to no one. BRT has articulated its new commitment to stakeholder governance (which actually resurrects an older policy view) while (1) working to diminish shareholder rights; and (2) proposing no new mechanisms to create board and management accountability to any other stakeholder group.

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Much of the discussion on 'stakeholder' governance focuses on individual companies, and seems to downplay or ignore the role of markets. Shareholders have a very particular role in allocating (and re-allocating) equity capital. Public equity generally is highly liquid, and no doubt company managers often are frustrated by a sense that they are vulnerable to changes in company valuation that can be rapid, as investors reassess company prospects. While we appreciate that CEOs do not like to feel constrained and subject to market forces, nothing in the BRT statement will change this real-world dynamic of public equity markets.

While it is important for boards and management to have and articulate long-term vision, and sustain focus on the long-term strategy where they have strong conviction, a fundamental strength of the US economy has been and continues to be efficient allocation of equity capital. If 'stakeholder governance' and 'sustainability' become hiding places for poor management, or for stalling needed change, the economy more generally will lose out."

The full CII response is available here.

1.4 Government consultation on mandatory comprehensive credit reporting and hardship arrangements

15 August 2019 - The government has issued a consultation on mandatory comprehensive credit reporting and hardship arrangements.

In November 2017, the then Treasurer, Scott Morrison MP, announced that the government would introduce a mandatory comprehensive credit reporting regime, requiring the big four banks to participate fully in the credit reporting system.

On 25 June 2018, legislation to implement the regime (the National Consumer Credit Protection Amendment (Mandatory Comprehensive Credit Reporting) Bill 2018 (Cth) (the Bill)) passed the House of Representatives. However, the Bill did not pass prior to the dissolution of parliament due to the election.

The Bill, intended to mandate comprehensive credit reporting, has been updated to include the Attorney-General's recently announced changes to the reporting of hardship arrangements (the revised Bill).

Specifically, the revised Bill introduces a new category of information within credit reporting, enabling hardship information to be reported alongside repayment history information.

The government is seeking views on the exposure draft legislation and accompanying explanatory materials of the revised Bill, which implements this measure.

View the consultation package.

1.5 SEC proposes to modernise disclosures of business, legal proceedings, and risk factors under Regulation S-K

8 August 2019 - The US Securities and Exchange Commission (SEC) has announced that it has voted to propose rule amendments to modernise the description of business, legal proceedings, and risk factor disclosures that registrants are required to make pursuant to Regulation S-K. The proposed amendments are intended to update the rules to improve disclosures for investors and to simplify compliance efforts for registrants.

The proposed amendments would revise Items 101(a) (description of the general development of the business), 101(c) (narrative description of the business), and 105 (risk factors) to emphasise a more principles-based approach because businesses differ in terms of which aspects of these disclosures are material to them. Such a flexible approach, as opposed to prescriptive requirements, may elicit more relevant disclosures about these items. The proposed amendment of Item 103 (legal proceedings) would continue the current prescriptive approach because that requirement depends less on the specific characteristics of registrants.

In particular, the proposed amendment of Item 101(a) would:

- make it largely principles-based by providing a non-exclusive list of the types of information that a registrant may need to disclose, and by requiring disclosure of a topic only to the extent such information is material to an understanding of the general development of a registrant's business;
- include as a listed disclosure topic, to the extent material to an understanding of the registrant's business, transactions and events that affect or may affect the company's operations, including material changes to a registrant's previously disclosed business strategy;
- eliminate a prescribed timeframe for this disclosure; and
- permit a registrant, in filings made after a registrant's initial filing, to provide only an update of the general development of the business that focuses on material developments in the reporting period, and with an active hyperlink to the registrant's most recent filing that, together with the update, would contain the full discussion of the general development of the registrant's business.

The proposed amendment of Item 101(c) would:

- clarify and expand its principles-based approach, by including disclosure topics drawn from a subset of the topics currently contained in Item 101(c);
- include, as a disclosure topic, human capital resources, including any human capital measures or objectives that management focuses on in managing the business, to the extent such disclosures would be material to an understanding of the registrant's business, such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the attraction, development, and retention of personnel; and
- refocus the regulatory compliance requirement by including material government regulations, not just environmental provisions, as a topic.

The proposed amendment of Item 103 would:

- expressly state that the required information about material legal proceedings may be provided by including hyperlinks or cross-references to legal proceedings disclosure located elsewhere in the document in an effort to encourage registrants to avoid duplicative disclosure; and
- revise the US$100,000 threshold for disclosure of environmental proceedings to which the government is a party to US$300,000 to adjust for inflation.

The proposed amendment of Item 105 would:

- require summary risk factor disclosure if the risk factor section exceeds 15 pages;
- refine the principles-based approach of that rule by changing the disclosure standard from the "most significant" factors to the "material" factors required to be disclosed; and
- require risk factors to be organised under relevant headings, with any risk factors that may generally apply to an investment in securities disclosed at the end of the risk factor section under a separate caption.

The full text of the proposed rule is available on the SEC website.

1.6 ESG reporting by Australian listed companies

6 August 2019 - There has been an increase in environmental, social and governance (ESG) reporting by Australian listed companies but some gaps remain, according to the Australian Council of Superannuation Investors (ACSI).

New research on ESG reporting by ACSI reveals that the number of companies that comprehensively report on ESG matters has improved 19% over the past five years. Over half of Australia's largest listed companies now provide in-depth disclosure and assessment of their material ESG risks.

Key findings from the research include:

Safety performance

- 16 of 22 reported workplace fatalities were contractors, suggesting there is a disconnect between the safety practices of companies and the standards they require of contractors; and
- 67 companies disclosed no safety information, including 8 companies that pay executive bonuses based on safety outcomes. This lack of information is out of step with investor expectations.

Climate-related reporting

- the number of companies reporting against the Taskforce on Climate-related Financial Disclosures framework has doubled in 12 months, with over a quarter of ASX200 companies now committed to the framework;
- the wide range of climate scenarios used, and current levels of reporting, make comparisons between companies difficult; and
- few companies are disclosing long-term, emissions-reduction targets of net zero emissions by 2050.

Workforce reporting

- consequence management disclosure, which describes how companies deal with poor behaviour and breaches of conduct standards, is gaining prominence in the wake of the *Royal Commission into Banking, Superannuation and Financial Services Industry*;
- only 21% of executive leadership roles in the Australian Securities Exchange (ASX) 200 are held by women, and 32 companies still have all male leadership teams; and
- many companies are recognising the value of managing and retaining their workforces, disclosing outcomes of employee engagement surveys, voluntary turnover and training, although the lack of standardised reporting makes comparisons difficult.

1.7 Standing Economics Committee to expand inquiry into financial services sector and Royal Commission implementation

2 August 2019 - The government has asked the House of Representatives Standing Committee on Economics to inquire into progress made by relevant financial institutions in implementing the

recommendations of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (the Inquiry).

The Inquiry's remit has also been expanded to include other major relevant financial institutions and financial services associations. This Inquiry will complement the continuation of the broader inquiry into the four major banks which the government announced in 2016.

Of the 76 recommendations made by Commissioner Hayne, 10 were directed to the financial services industry.

The government has asked the Inquiry to commence as soon as possible.

1.8 AICD and Governance Institute statement on board minutes

1 August 2019 - The Australian Institute of Company Directors (AICD) and Governance Institute of Australia (GIA) have collaborated to outline their perspective on current issues in minute taking. The statement *Joint statement on board minutes* summarises key principles, provides views on matters to be included in minutes, and considers the approach to board papers and document retention policies.

AICD and GIA obtained feedback from members and also sought counsels' opinion on some particular issues related to minutes.

The legal opinion covers matters including:

- the purpose of minutes and detail to be included;
- drafts and notes;
- amendments to minutes;
- challenge and dissent;
- board papers and other supporting documents; and
- legal professional privilege.

1.9 Research report shows US federal class action securities fraud filings continue at near-record pace

31 July 2019 - According to a new report, *Securities Class Action Filings - 2019 Midyear Assessment*, released by Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse, plaintiffs continued the rapid pace of US securities fraud case filings with 198 new federal class actions in the first half of 2019. Plaintiffs have filed more than 1,000 securities class actions in the last two and a half years, accounting for more than 20% of the total number of cases filed since 1997.

The core filings increase is largely attributable to a delayed effect of market volatility in the last quarter of 2018 and to an uptick in filings in the consumer non-cyclical sector and against internet and high-tech firms.

The 126 core filings (those excluding merger and acquisition (M&A) claims) were just one shy of the record set in the first half of 2017. The number of filings involving M&A transactions, however, dropped below 90 for the first time since the second half of 2016. In the first half of 2019, M&A-related filings declined more than 20% to 72 from 91 in the second half of 2018.

Six mega dollar disclosure loss (DDL) filings (at least US$5 billion) and 11 mega maximum dollar loss (MDL) filings (at least US$10 billion) propelled aggregate market capitalisation losses to the highest and fourth-highest levels on record, respectively. The total US$180 billion DDL during the first half of 2019 was the highest on record. Total MDL increased by 17% to US$781 billion, a level more than double the historical average.

Key Trends:

- **non-US companies:** in the first half of 2019, core filings against non-US issuers as a percentage of all core filings remained relatively stable at 23% - the third-highest percentage on record. The number of core filings against European firms increased to its second-highest level on record for a semi-annual period, with 13 filings;
- **state and federal courts**: in March 2018, the US Supreme Court issued a unanimous opinion in *Cyan Inc. v. Beaver County Employees Retirement Fund* No. 15-1439 (*Cyan*) allowing plaintiffs to assert the *Securities Act of 1933* (the Securities Act) claims in state court. To date, 61 new Securities Act filings have appeared post-*Cyan*: 23 parallel filings, 12 filings in federal courts only, and 26 filings in state courts only;
- **industries**: the Consumer Non-Cyclical sector again had the greatest number of filings with 47. Of these, 32 were against biotechnology, pharmaceutical, and healthcare companies. The 19 filings in the Communications sector were all against internet and telecommunications companies.
- **S&P 500 firms**: core filings against S&P 500 firms in the first half of 2019 occurred at an annualised rate of 6.4%; and
- **cryptocurrencies**: there were three core filings involving initial coin offerings (ICOs) or cryptocurrencies in the first half of 2019. There was only one such filing in the second half of 2018, after a flurry of ICO and cryptocurrency filings at the end of 2017 and beginning of 2018.

1.10 Not-for-profit governance study

31 July 2019 - The AICD has released its annual not-for-profit (NFP) governance and performance study, which revealed that directors are spending more time on their governance role. The AICD's *Not-for-Profit Governance and Performance Study* (the Study) is in its tenth year.

This year the study found that 55% of directors surveyed spend one to five days a month on their NFP role and 23% spend more than five days a month on a single NFP.

The latest report identifies the factors that contribute to NFP board workloads which include rising governance expectations, community trust challenges for NFPs, the introduction of the National Disability Insurance Scheme, growing financial pressures, and changes in organisation complexity and regulation.

In addition to investigating the time directors spend on NFP board, this year's study explored directors' remuneration, succession planning, the sports sector, the slowdown in mergers, and financial performance.

Key findings of the Study:

- directors are devoting more time to each NFP board role with 23% of survey respondents spending more than five days per month on a single NFP (compared to 13% in 2013);
- NFP boards continue to comprise of mostly older directors with 77% over 50 and only 5% under 40 years old;
- the percentage of directors being remunerated has not fluctuated, with 19% remunerated this year;
- NFP directors are optimistic about their organisation's future but financial challenges persist with some inconsistency between profit expectations and actual profit;
- fewer organisations are engaged in or are considering merging with another NFP;
- directors are generally satisfied with the performance of their board; and
- key challenges for sports organisations are growth in revenue and membership, and facility improvements.

1.11 Global ethics board for accountants proposes changes to promote role, mindset expectations

31 July 2019 - The International Ethics Standards Board for Accountants (IESBA) has proposed changes to the *International Code of Ethics for Professional Accountants* (including International Independence Standards) (the Code) to promote the role and mindset expected of all professional accountants. The Exposure Draft, Proposed Revisions to the Code to Promote the Role and Mindset Expected of Professional Accountants, puts forward changes that further strengthen the Code.

The proposed revisions respond to stakeholder calls for the IESBA to explore whether and how the Code could contribute to strengthening the application of concepts underlying professional scepticism by all professional accountants.

Among other matters, the proposals:

- highlight professional accountants' wide-ranging role in society and the relationship between compliance with the Code and a professional accountant's responsibility to act in the public interest;
- include enhancements to the robustness of the fundamental principles of integrity, objectivity and professional behaviour;
- further strengthen the Code through requiring professional accountants to have an inquiring mind when applying the conceptual framework; and
- highlight the importance of being aware of bias and having the right organisational culture.

Related Resources

- 2018 Handbook of the International Code of Ethics for Professional Accountants;
- 2018 Roundtables;
- IESBA Webinar: The Revised and Restructured Code; and

- Preparing for the IESBA eCode.

1.12 APRA releases latest biennial stakeholder survey

31 July 2019 - APRA has published its *2019 Stakeholder Survey Report* (the Report).

The Report found more than 90% of regulated entities believe APRA's supervision helps to protect both their industry and the Australian community, a finding consistent with previous stakeholder surveys. A similar proportion of entities reported that APRA's supervision has had a positive impact on their risk management practices.

Other key findings include:

- 86% believe APRA's increased focus on risk culture has had a positive impact on their entity;
- 81% believe APRA is effective in identifying risks across their industry;
- 86% believe APRA's supervision enhances the financial and operational strength of their entity; and
- 92% agree that APRA's public communications are clear and effective.

The Report identified a slight downward trend in overall perceptions of APRA compared to the *2017 Stakeholder Survey Report*. The Report highlighted industry concern about the costs of regulatory compliance, identified that a third of respondents thought APRA collected too much statistical data, and indicated that entities were placing less importance on the harmonisation of the prudential framework across regulated industries.

The full 2019 Stakeholder Survey results can be found on the APRA website.

1.13 Extension of unfair contracts terms to insurance contracts

30 July 2019 - The government has released exposure draft legislation that extends the unfair contract term (UCT) regime to insurance contracts.

Recommendation 4.7 of the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (the Final Report) recommended extending the application of the UCTs regime to insurance contracts. In the government's response to the Final Report it agreed to implement this recommendation.

Consumer law currently protects consumers against UCTs that:

- would cause a significant imbalance in their rights and obligations under a contract;
- are not reasonably necessary to protect the business; and
- would cause detriment (financial or otherwise).

In his Final Report, Commissioner Hayne observed the considerations that render a UCTs regime appropriate for other contracts of financial products and services apply equally to insurance contracts, and there was no reason for the current exemption for insurance contracts to continue.

Removing the exemption for insurance contracts from the UCT regime will ensure consumers and small businesses have the same protections regardless of which financial service or product they are purchasing.

The exposure draft legislation is available on the Treasury website.

1.14 Legislation to ban grandfathered commissions for conflicted remuneration paid to financial advisers

30 July 2019 - The government has introduced into parliament legislation to ban the grandfathering of conflicted remuneration paid to financial advisers.

Conflicted remuneration is where the payment of a benefit to a financial adviser may incentivise them to recommend to a consumer a financial product that may not be in their best interests. Grandfathered conflicted remuneration can entrench clients in older products even when newer, better and more affordable products are available on the market.

One of the key recommendations of the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (the Final Report) was to end the payment of grandfathered conflicted remuneration to financial advisers.

The Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019 (the Bill) implements the government's response to the Final Report, to end the grandfathering of conflicted remuneration by 1 January 2021.

The government is also including in the Bill a power to make regulations to establish a scheme that will provide that those people paying conflicted remuneration rebate clients for any remuneration that would be paid after 1 January 2021.

To ensure that the benefits of industry renegotiating current arrangements to remove grandfathered conflicted remuneration ahead of 1 January 2021 flow through to clients, the government has commissioned the Australian Securities and Investments Commission (ASIC) to monitor and report on the extent to which product issuers are acting to end the grandfathering of conflicted remuneration.

1.15 Financial services: European Commission sets out its equivalence policy with non-EU countries

29 July 2019 - The European Commission (the Commission) has published its updated approach to equivalence in the area of financial services. The European Union (EU) assesses to what extent the regulatory regimes of a given third country achieves the same outcomes as its own rules. A positive equivalence decision allows EU authorities to rely on third country rules and supervision,

allowing market participants from third countries who are active in the EU to comply with only one set of rules. This Communication sets out how recent updates to EU legislation will ensure even greater effectiveness of the EU single rulebook, supervision and monitoring, while also fostering cross-border business in global markets. The Commission has to date taken over 280 equivalence decisions with regard to over 30 countries.

More information:

- Communication from the Commission: Equivalence in the area of financial services (29/07/2019);
- Recognition of non-EU financial frameworks (equivalence decisions); and
- Commission Staff Working Document EU equivalence decisions in financial services policy: and assessment (27/02/2017).

1.16 Gender diversity on ASX 200 boards

25 July 2019 - The AICD latest *Gender diversity progress report* reveals that, as at the end of June 2019, women represented 29.7% of directors on ASX 200 boards.

In 2015, the AICD called for ASX 200 companies to achieve 30% women on boards by the end of 2018. In that time gender diversity climbed more than ten percentage points but the target of 30% has not yet been reached.

1.17 Share repurchases, executive pay and investment

19 July 2019 - The United Kingdom (UK) Department for Business, Energy and Industrial Strategy has published a research paper titled *Share repurchases, executive pay and investment*. The research was commissioned by the UK government following share repurchases receiving growing prominence in recent years, in particular the suggestion that repurchases may be contributing to excessive executive pay and/or crowding out investment.

The research had two aims:

- examine the relationship between executive remuneration and motivations to undertake share repurchases. More specifically, to understand whether buybacks are being used to meet earnings per share (EPS) targets in CEO remuneration packages and/or to inflate the value of their share awards rather than to create long-term value for the company; and
- examine the relationship between share buybacks and corporate investment in the UK and to understand whether there is any evidence that share buybacks are having a detrimental impact on company investment, growth and productivity.

Over the period of the research (2007-2017) the analysis found no significant relationship between share repurchases and either the existence of an EPS condition or the proportion of an incentive award linked to that condition within executive pay incentives and share repurchases. In addition, the analysis found no relationship between share repurchases and investment. This is consistent with the survey findings that investment decisions are taken independently of share

repurchase decisions. Repurchases are then driven by factors (for example, excess cash and undervalued equity) which are largely unrelated to investment opportunities. It is stated in the report that "the evidence does not suggest that repurchases are being used systematically to artificially hit EPS targets, or crowd out investment".

1.18 FRC consults on enhanced Ethical and Auditing Standards

15 July 2019 - The UK Financial Reporting Council (FRC) has issued a consultation proposing changes to the UK's *Ethical and Auditing Standards*. The FRC proposes to set more stringent ethical rules for auditors, in response to findings from recent audit enforcement cases and from audit inspections. In response to feedback from investors, the FRC also proposes to enhance the quality and content of auditor's reports in order to improve transparency about what is found in the course of an audit.

Key changes proposed include:

- a clearer and stronger "objective, reasonable and informed third party test" which requires audit firms to consider whether a proposed action would affect their independence from the perspective of public interest stakeholders rather than another auditor. This is supported by additional material to encourage a wide-ranging assessment, which considers both the spirit and the letter of the standard;
- enhancing the authority of the Ethics Partner function within audit firms, in order to ensure firm wide focus on ethical matters and the public interest, and to require reporting to those charged with governance where an audit firm does not follow the Ethics Partner's advice;
- the list of prohibited non-audit services that auditors of Public Interest Entities can provide to audited bodies has been replaced with a much shorter list of permitted services, all of which are "closely related" to an audit or required by law and/or regulation. No other services can be provided; and
- the requirement for the auditors of all UK listed entities to include in their published auditor's reports the performance materiality threshold used in the audit.

Further detailed amendments to individual standards clarify the auditor's responsibilities when considering whether the bodies they have audited are compliant with relevant laws and regulations, and when checking there are no material misstatements in the "other information" companies include in their annual financial reports (other than the financial statements which are subject to audit).

Related documents:

- Consultation on Revisions to Ethical and Auditing Standards 2019;
- Revised Ethical Standard 2019 - Exposure Draft;
- Changes to the International Standards on Auditing (UK) (ISAs (UK)) and International Standard on Quality Control (UK) (ISQC (UK)) - Exposure Drafts; and
- Glossary of Terms (Auditing and Ethics) - Exposure Drafts.

2. Recent ASIC Developments

2.1 Proposed ban on the sale of binary options to retail clients, and restrictions on the sale of CFDs

22 August 2019 - ASIC has released a consultation paper, *CP 322 Product intervention: OTC binary options and CFDs* (CP 322) on proposals to use its product intervention power to address significant detriment to retail clients resulting from over-the-counter (OTC) binary options and contracts for difference (CFDs).

A binary option is an "all or nothing" bet on the outcome of an event. A CFD is a contract on the difference between the opening and closing price of an asset.

Accompanying CP 322 is *REP 626 Consumer harm from OTC binary options and CFDs*, which provides a snapshot of the binary options and CFD market, describes the harm to consumers ASIC has observed and outlines ASIC's proposed product intervention orders.

The Australian market for binary options and CFDs is growing rapidly, with the number of clients more than doubling in the past two years to one million clients (99% are retail clients and the majority are based offshore). Licensed issuers of these products conducted 675 million trades with clients last year and earlier this year held $2.9 billion of client money for trading.

ASIC is concerned that retail investors have suffered, and are likely in future to suffer, significant detriment from binary options and CFDs.

During 2018:

- licensed issuers received gross trading revenue of $490 million from binary options and $1.5 billion from CFDs-which can largely be attributed to a combination of net client losses and fees and costs charged to clients;
- CFD issuers automatically closed out 9.3 million client CFD positions in margin call; and
- over 41,000 clients' CFD trading accounts went into negative balance, totalling $33 million (that is, clients owed money to the CFD issuer).

A review (*REP 579 Improving practices in the retail OTC derivatives sector*) conducted by ASIC in 2017 found that:

- 80% of clients who trade binary options lose money;
- 72% of clients who trade CFDs lose money; and
- 63% of clients who trade CFD over currency pairs lose money.

Complex product features, such as the high leverage offered in CFDs - as high as 500-to-1 for foreign exchange CFDs - or the high likelihood of cumulative losses inherent in binary options, have contributed to retail clients' financial losses and can often be misaligned with their needs, expectations and understanding.

In CP 322, ASIC proposes to:

- ban the issue and distribution of OTC binary options to retail clients; and
- impose conditions on the issue and distribution of OTC CFDs to retail clients.

ASIC's proposed restrictions on the offer of CFDs to retail clients include:

- imposing leverage limits, which are set out in Section F of CP 322;

- implementing a standardised approach to automatic close-outs of client's CFD positions in margin call;
- protecting retail clients against the risk of negative CFD trading account balances;
- prohibiting certain trading inducements; and
- enhancing transparency of CFD pricing, execution, costs and risks.

ASIC's proposals are broadly consistent with measures implemented in many overseas markets.

2.2 Review of industry transition towards ending grandfathered remuneration for financial advice

21 August 2019 - ASIC is investigating the progress of transition away from grandfathered conflicted remuneration arrangements for financial advisers.

The investigation, directed by the Treasurer following the government's commitment to end the practice by 1 January 2021, will review the steps taken by industry participants from 1 July 2019 until the 2021 deadline.

ASIC will also investigate any impediments to this transition, and the extent to which benefits are being passed on to affected clients.

ASIC will conduct both quantitative and qualitative reviews. For the quantitative study, ASIC will conduct a survey of entities known to pay grandfathered conflicted remuneration to Australian financial services (AFS) licensees or their representatives and require them under notice to provide data:

- initially for a 12 month period (from 1 July 2018 to 30 June 2019); and
- thereafter on a quarterly basis for the review period (for example, reporting for the period from 1 July to 30 September 2019 will be in October 2019).

The first notice to entities has been issued and they will be required to provide their responses via a web portal. The qualitative review will include a smaller sample of entities that pay and receive grandfathered remuneration. This will involve more detailed engagement and analysis during the review period.

ASIC will analyse the information from both reviews and report to the Treasurer by 30 June 2021. The report will also be released publicly. ASIC expects to provide an update on its investigation to the Treasurer and industry as appropriate during the review period.

2.3 ASIC enforcement update January to June 2019

18 August 2019 - ASIC has released its enforcement update report for the period 1 January 2019 to 30 June 2019.

REP 625 ASIC enforcement update: January to June 2019 (REP 625) outlines key actions taken over the past six months to enforce the law and support ASIC's enforcement objectives. It is

stated in Report 625 that between July 2018 and June 2019 ASIC increased the number of ASIC enforcement investigations by 20%, enforcement investigations involving the big six financial firms (or their officers or subsidiary companies) by 51% and wealth management investigations by 216%.

View:

- REP 625;
- REP 615 ASIC enforcement update: July to December 2018;
- REP 585 ASIC enforcement outcomes: January to June 2018; and
- REP 568 ASIC enforcement outcomes: July to December 2017.

2.4 Updated guidance on climate change related disclosure

12 August 2019 - ASIC has published updates to clarify the application of ASIC's existing regulatory guidance to the disclosure of climate change related risks and opportunities.

The updates are contained in:

- *RG 228 Prospectuses: Effective disclosure for retail investors* (RG 228); and
- *RG 247 Effective disclosure in an operating and financial review* (RG 247).

ASIC reviewed its guidance following the recommendations of a Senate Economics References Committee report on Carbon Risk and the government's response which encouraged ASIC to consider whether its high-level guidance on disclosure remained appropriate.

While ASIC's review found that its existing, principles-based regulatory guidance remains fit for purpose, to help stakeholders to comply with their disclosure obligations, ASIC has updated its guidance to, amongst other things:

- incorporate the types of climate change risk developed by the G20 Financial Stability Board's Taskforce on Climate Related Financial Disclosures (TCFD) into the list of examples of common risks that may need to be disclosed in a prospectus appearing in Table 7 of Regulatory Guide 228;
- in Regulatory Guide 247, RG 247.66, highlights climate change as a systemic risk that could impact an entity's financial prospects for future years and that may need to be disclosed in an operating and financial review (OFR);
- in RG 247.66, reinforce that disclosures made outside the OFR (such as under the voluntary TCFD framework or in a sustainability report) should not be inconsistent with disclosures made in the OFR; and
- make a minor update to *Impairment of non-financial assets: Materials for directors* (INFO 203) to highlight climate change and other risks that may be relevant in determining key assumptions that underlie impairment calculations.

Regulatory Guide 247 has also been updated to clarify ASIC's general view that the risk of directors being found liable for a misleading or deceptive forward-looking statement in an OFR is minimal provided the statements are based on the best available evidence at the time, have a reasonable basis and there is ongoing compliance with the continuous disclosure obligations when events overtake the relevant statement made in the OFR.

ASIC's review of regulatory guidance follows last year's publication of *REP 593 Climate risk disclosure by Australia's listed companies (*REP 593). High-level recommendations set out in Report 593 included to:

- adopt a probative and proactive approach to emerging risks, including climate risk;
- develop and maintain strong and effective corporate governance which helps in identifying, assessing and managing risk;
- comply with the law where it requires disclosure of material risks; and
- disclose meaningful and useful climate risk related information to investors - the voluntary framework developed by the TCFD has emerged as the preferred standard in this regard and ASIC strongly encourages listed companies with material exposure to climate change to consider reporting voluntarily under the TCFD framework.

In the coming year, ASIC will conduct surveillances of climate change related disclosure practices by selected listed companies. ASIC will also continue to participate in the Council of Financial Regulators' working group on climate risk and participate in discussions with industry and other stakeholders on these issues.

View:

- RG 228;
- RG 247;
- INFO 203; and
- REP 593.

2.5 Findings from 31 December 2018 financial reports

8 August 2019 - ASIC has announced the results from a review of the 31 December 2018 financial reports of 125 entities (*19-206 Media Release: Findings from 31 December 2018 financial reports* (the Review)).

The Review covered 85 full year financial reports and 40 half-year reports. The Review of half-year reports focused on the application of major new accounting standards on revenue and financial instruments.

Arising from the Review, ASIC has made inquiries of 26 entities on 40 matters. The largest number of inquiries continue to relate to impairment of non-financial assets and inappropriate accounting treatments.

ASIC states that directors and auditors need to focus on impairment of non-financial assets in financial reports to ensure that the market is properly informed about asset values and the expected future performance implied by those values. ASIC continues to find instances where companies have made unrealistic and unsupportable assumptions about future cash flows. ASIC issued INFO 203 in June 2015 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.

Directors and auditors should also focus on the impact of the new accounting standards on revenue and financial instruments, which can materially affect reported financial position and results.

ASIC's risk-based surveillance of the financial reports of public interest entities for reporting periods ended 30 June 2010 to 30 June 2018 has led to material changes to 4% of the financial reports of public interest entities reviewed by ASIC. The main changes related to impairment of assets, revenue recognition and expense deferral.

View further information.

2.6 Consultation on new guidance for companies on whistleblower policies

7 August 2019 - ASIC has published its proposed guidance on the new legal obligation on companies to implement a whistleblower policy (*Consultation Paper 321: Whistleblower policies* (Consultation paper)).

Public companies, large proprietary companies and corporate trustees of registrable superannuation entities must implement a whistleblower policy and make it available to their officers and employees by 1 January 2020. This requirement was introduced as part of the reforms to the corporate sector whistleblower regime that commenced on 1 July 2019.

The proposed *Regulatory Guide Whistleblower Policies* (the draft Regulatory Guide) explains how companies can establish, implement and maintain a policy. It covers the information that companies must include in their whistleblower policy, including how they will support and protect whistleblowers and handle and investigate whistleblower disclosures.

ASIC also seeks feedback about exempting public companies that are small NFPs or charities from the requirement to have a whistleblower policy. ASIC is seeking views on whether this would minimise the risk of a disproportionate regulatory burden on these small NFPs and charities.

View the Consultation paper and draft Regulatory Guide.

2.7 Updated guidance on the Markets Disciplinary Panel's policies and procedures

7 August 2019 - ASIC has updated its regulatory guidance on the operation of the Markets Disciplinary Panel (MDP).

The MDP, which acts through a Division of ASIC, is a peer review panel that makes decisions about whether infringement notices should be given for alleged contraventions of the market integrity rules.

ASIC has updated *RG 216: Markets Disciplinary Panel* (RG 216) to simplify and streamline the MDP's policies and procedures, with the benefit of over eight years' experience of the MDP model.

The key changes include:

- the consolidation of Regulatory Guide 216 and *RG 225: Markets Disciplinary Panel practices and procedures* into a single, shorter guide;
- using any published infringement notice as the main communication vehicle by which the MDP's reasons are explained to the market participant, as well as for the benefit of market participants generally
- removing the tables of factors going to penalty and replacing them with four key factors, being (1) the character of the conduct; (2) the consequences of the conduct; (3) compliance culture; and (4) remediation
- excluding market operators from the MDP's remit.

Regulatory Guide 216 has also been updated to reflect the amendments to penalties made by the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 No. 17 (Cth). For conduct wholly occurring on or after 13 March 2019, the penalty that can be specified in an infringement notice can be as high as $3.15 million for each alleged contravention of any market integrity rule.

View:

- RG 216;
- *CP 306 Markets Disciplinary Panel*; and
- *REP 624 Response to submissions on CP 306 Markets Disciplinary Panel*.

2.8 Consultation on sunsetting class order for changing scheme constitutions

2 August 2019 - ASIC has released a consultation paper proposing to remake *ASIC Class Order [CO 09/552]* (*CP 320 Remaking ASIC class order on changing scheme constitutions: [CO 09/552]* (CP 320)), which is due to expire (sunset) on 1 October 2019.

[CO 09/552] provides relief in certain situations to vary how the constitution of a registered scheme may be modified, or repealed and replaced with a new constitution.

ASIC proposes to remake [CO 09/552] because it is operating effectively and continues to form a necessary and useful part of the legislative framework. The fundamental policy principles underpinning the class order have not changed.

The new instrument would continue the relief currently given by [CO 09/552] so that the relief will be preserved without any disruption to the entities that rely on it.

CP 320 outlines ASIC's rationale for proposing to remake the instrument.

2.9 Superannuation trustees warned about influencing employers through improper inducements

31 July 2019 - ASIC has issued guidance to superannuation trustees, reminding them that using improper inducements to influence employers in their choice of default fund is illegal.

The guidance set out in *INFO 241: Prohibition on influencing employers' superannuation fund choice: section 68A of the SIS Act* (INFO 241), draws attention to the recently amended s. 68A of the Superannuation Industry (Supervision) Act 1993 No. 78 (Cth). It also illustrates how s. 68A applies in common scenarios to ensure that superannuation trustees understand their legal obligations.

Section 68A prohibits a trustee, or its associates, from using goods or services to influence employers to nominate a default superannuation fund for employees, or to encourage employees to choose or retain a particular superannuation fund. This section changed in scope and penalty on 6 April 2019, enhancing ASIC's powers to take action in relation to employer inducements by superannuation trustees.

Earlier this year, the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* found that some large superannuation trustees were spending significant amounts to maintain or establish good relationships with employers or their officers responsible for nominating the default fund for employees. Reducing improper influences on employer decision-making is critical to addressing potential consumer harms.

INFO 241 is available on the ASIC website.

2.10 Review of Australian equity market's cleanliness

31 July 2019 - *REP 623 Review of Australian equity market cleanliness: 1 November 2015 to 31 October 2018* examines market cleanliness for the period from 1 November 2015 to 31 October 2018, with a focus on insider trading and information leaks ahead of material market announcements. It extends work in *REP 487 Review of Australian equity market cleanliness*, which found an overall improvement in market cleanliness over the ten years to 31 October 2015.

In a clean market, prices react immediately after new information is released through the proper channels. Abnormal price movements and unusual trading patterns ahead of material announcements may indicate an "unclean market".

The overall cleanliness of the market fluctuated between 2015 and 2018 - despite a deterioration in 2016, market cleanliness improved in 2017 and 2018 to settle around 2015 levels. During the period ASIC found that:

- on average, 0.6% of accounts that traded before material price-sensitive announcements were deemed suspicious;
- suspicious accounts profitably traded on average 5.1% of the volume before each announcement;
- while the percentage of suspicious trading accounts remained stable, the volume traded by these accounts increased;
- there was more suspicious trading before M&A announcements than other announcements;
- there was more suspicious trading and abnormal price movements before unscheduled announcements than scheduled announcements; and
- announcements by smaller companies were more likely to be unclean. Many of these smaller companies were in the materials sector.

Going forward, ASIC will use historical trading behaviour before material announcements to enhance market supervision work and inform regulatory priorities. ASIC will also increase monitoring of:

- trading ahead of M&As;
- brokers with high levels of unusual order flow; and
- clients that repeatedly exhibit unusual trading behaviour.

2.11 ASIC implements pause on admission of managed funds with internal market makers

30 July 2019 - ASIC has requested that exchange market operators do not admit any managed funds that do not disclose their portfolio holdings daily and have internal market makers while it undertakes a review during the remainder of this calendar year.

Internal market making occurs when a managed fund's responsible entity acts as the market maker for its own fund on the fund's behalf, either by submitting bids and offers itself or by engaging a transaction agent that executes its instructions. Funds using this model generally do not disclose their portfolio holdings daily. They are usually actively managed funds. Internal market making funds represent approximately 6% of exchange traded products by funds under management.

The market for exchange traded managed funds has changed materially as follows:

- substantial recent market growth in actively managed funds;
- continued innovation in fund structures and investment strategies among actively managed fund proposals, particularly those with internal market making;
- changes to the composition of market makers for exchange traded managed funds and the nature of the pricing models they use; and
- recent international developments, including regulatory approval in the US and Hong Kong of alternative frameworks.

On that basis, ASIC intends to review the regulatory settings for exchange traded managed funds that use internal market makers. The findings from the review will inform its next steps.

The pause on new admissions of these products by market operators (including funds whose admission applications are currently being considered) will remain in place until further notice. This will allow ASIC to consider the appropriate regulatory settings and will involve further consultation with the relevant sections of the industry during the second half of this year.

Existing actively managed exchange traded managed funds are not impacted. There is also no impact on other investment products that do not use internal market makers or on warrant products.

View *19-195 Media Release ASIC implements pause on admission of managed funds with internal market makers*.

2.12 Consultation on securities lending and "substantial holding" disclosure

29 July 2019 - ASIC has published *CP 319: Securities lending by agents and substantial holding disclosure* (CP 319) on securities lending by agents, and subsequent disclosure of a substantial holding in a listed entity.

CP 319 explains how the relevant interest provisions in ss. 608 and 609 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) apply to agent lending and therefore ASIC's expectations for compliance with s. 671B of the Corporations Act. CP 319 also seeks feedback on proposed legislative relief that aims to improve substantial holding disclosure by these intermediaries, while also reducing red tape. The proposed relief is consistent with ASIC's policy in RG 222 Substantial holding disclosure: Securities lending and prime broking and *ASIC Class Order [CO 11/272]*.

ASIC is consulting on the role played by agent lenders in securities lending and the market's view of any exemption from substantial holding disclosure.

3. Recent ASX Developments

3.1 Public consultation: changes to Guidance Note 1 and Guidance Note 10 relating to business continuity and cyber resilience

On 5 August 2019, the ASX released its response to submissions on the ASX's 8 March 2019 Consultation Paper (*Consultation on Guidance Note changes for ASX Clear, ASX Settlement, ASX Clear (Futures) and Austraclear participants*) proposing changes to *Guidance Note 10 Business Continuity and Disaster Recovery* (GN 10) and *Guidance Note 1 Admission as a Participant* (GN 1) to address cyber resilience.

The changes to GN 1 clarify the risk management framework obligations to incorporate cyber risk as a key consideration for participants in ASX Clear, ASX Clear (Futures) and ASX Settlement (other than specialist settlement participants).

The changes to GN 10 are relevant to participants in ASX Clear, ASX Clear (Futures), ASX Settlement (other than specialist settlement participants) and Austraclear (other than collateral manager special purpose participants, foreign currency settlement bank participants and special purpose participants permissioned for cash only transactions).

For existing participants, the proposed reduction in the recovery time objective (RTO) in GN 10 will be phased in over a three year period. For all other changes in GN 10, existing participants will have six months from the date of publication of the revised GN 10 to comply with them.

All new applicants for admission as participants will be expected to comply fully with revised GN 1 and 10, including the proposed reduction in RTO, as a condition of being admitted.

3.2 Monthly Activity Reports

On 6 August 2019, the ASX released the ASX Monthly Activity Report for July 2019.

4. Recent Research Papers

4.1 Theory, evidence, and policy on dual-class shares: A country-specific response to a global debate

Dual-class shares have become one of the most controversial issues in today's capital markets and corporate governance debates around the world. Namely, it is not clear whether companies should be allowed to go public with dual-class shares and, if so, which restrictions (if any) should be imposed.

Three primary regulatory models have been adopted to deal with dual-class shares:

- prohibitions, existing in countries like the UK, Germany, Spain, Colombia, or Argentina;
- the permissive model adopted in several jurisdictions, including Canada, Sweden, the Netherlands, and particularly the US; and
- the restrictive approach recently implemented in Hong Kong and Singapore.

This paper argues that, despite the global nature of this debate, regulators should be careful when analysing foreign studies and approaches, since the optimal regulatory model to deal with dual-class shares will depend on a variety of local factors. Namely, it is argued that, in countries with sophisticated markets and regulators, strong legal protection to minority investors, and low private benefits of control, regulators should allow companies going public with dual-class shares with no restrictions or minor regulatory intervention (for example, event-based sunset clauses).

By contrast, in countries without sophisticated markets and regulators, high private benefits of control, and weak legal protection to minority investors, dual-class shares should be prohibited or subject to higher restrictions (for example, time-based sunset clauses and stringent corporate governance rules). Intermediate solutions should be adopted for countries with mixed features.

Therefore, the key question to be addressed from a policy perspective is not whether companies should be allowed to go public with dual-class shares, as many authors and regulators seem to be discussing, but whether dual-class class shares should be allowed and, if so, under which conditions, taking into account the particular features of a country.

View *Theory, Evidence, and Policy on Dual-Class Shares: A Country-Specific Response to a Global Debate*.

4.2 Committing to human rights in Australia's corporate sector

This paper draws on data collected from the ASX 50 with a focus on policy commitment to human rights. As the *United Nations Guiding Principles* make clear a visible and accessible policy commitment is the most basic form of recognition that corporations should afford to human rights.

The paper takes the position that this policy commitment offers corporations a chance to declare a positive relationship with human rights. Therefore the presence or not of a policy statement, and the form that the statement takes, tells us much about the relationship between the corporate sector and human rights. The data reveals that there is generally a low compliance with the policy commitment requirement.

The most significant factor amongst a range of variables examined for predicting whether compliance will occur or not is membership of human rights engaged Business and Industry Non-Governmental Organisations.

View *Committing to Human Rights in Australia's Corporate Sector*.

4.3 Toward a mission statement for mutual funds in shareholder litigation

This paper analyses the conduct of mutual funds in shareholder litigation. The authors begin by reviewing the basic forms of shareholder litigation and the benefits such claims might offer mutual fund investors. They then investigate, though an in-depth docket review, whether and how the ten largest mutual funds participate in shareholder litigation.

They find that although shareholder suits offer potential benefits, the largest mutual funds have essentially forfeited their use of litigation. This finding is particularly striking given that index funds and other long-term oriented mutual funds generally cannot sell their shares when they are dissatisfied with company performance, leaving them with only two levers in corporate governance - voting and suing. Mutual funds vote, but they do not sue.

View *Toward a Mission Statement for Mutual Funds in Shareholder Litigation*.

4.4 The future or fancy? An empirical study of public benefit corporations

The public benefit corporation (PBC) is one of the most hyped developments in corporate law. The reason is the PBC's potential social purpose. PBC directors are required under their fiduciary duties to consider purposes other than profits in decision-making. These new forms are hailed by their champions as offering a new hope for a reformed capitalism. Critics have assailed them as unworkable, and a thin disguise for ordinary corporate profit-seeking behaviour.

What has been lacking in this debate is evidence. The authors aim to fill this gap by conducting an empirical study of early-stage investment in PBCs. Early-stage investment, consisting of venture capital and similar funds, presents an interesting test case for PBC funding, because the investors often have profit-maximising incentives and fiduciary duties of their own. Using a novel dataset, the authors can discern whether for-profit investment is occurring in PBCs, and if so, whether it is different in kind from ordinary early stage investment.

The authors find that PBCs are receiving investment at significant rates, and that investment is coming from typical sources of venture capital including traditional, profit-seeking venture capital firms - Sequoia Capital, Andreessen Horowitz, and others. They also find that venture

capital funds are investing in more consumer-facing industries, as well as investing smaller amounts than traditional investments.

The authors conclude that PBCs are attracting for-profit investment, supporting arguments that these new forms may be able to earn an acceptable rate of return while serving various purposes. We use these results to develop a theory of future PBC development, which asserts that investment in PBCs is likely to remain siloed in smaller, newly-formed firms. They conclude that widespread adoption of the form will take time, as network effects build and experience with the form becomes embedded within the entrepreneurial ecosystem. The PBC is not a failure. But it is in its infancy and any full embrace will take a significant period of time.

View *The Future or Fancy? An Empirical Study of Public Benefit Corporations*.

4.5 Australia's Modern Slavery Act: Towards meaningful compliance

Australia's recently enacted federal Modern Slavery Act 2018 No. 153 (Cth) (the Modern Slavery Act) forms part of a growing global trend towards mandated corporate disclosures in respect of modern slavery risks. This article argues that meaningful compliance with the Modern Slavery Act can only be achieved when businesses commit to implementing a comprehensive human rights due diligence program.

The authors aim to provide practical guidance on what this means in the Australian context by outlining the Guiding Principles concept of human rights due diligence, explaining how its key elements correspond with the Modern Slavery Act's reporting requirements, and applying internationally recognised good practice to these requirements.

View *Australia's Modern Slavery Act: Towards Meaningful Compliance*.

5. Recent Corporate Law Decisions

5.1 Brothers (up) in arms: Oppressive conduct in the context of a family business

(By Andrew Hay and Samuel Higgs, Clayton Utz)

BAM Property Group Pty Ltd as trustee for BAM Property Trust v Imoda Group Holdings Pty Ltd [2019] FCA 1192 (2 August 2019) Federal Court of Australia, Derrington J

(a) Summary

A shareholder in a family business was granted relief under s. 232 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) after another shareholder engaged in oppressive conduct towards the aggrieved shareholder.

The shareholders in the business were three brothers, two of whom were involved in the management of the business. The third brother was a silent partner with no involvement in the business.

Over the course of a few years, the offending brother excluded the aggrieved brother from the business, and also diverted commercial opportunities (and a substantial part of the business) to companies controlled by the offending brother.

This amounted to "oppressive conduct" by the offending brother under s. 232 of the Corporations Act, with the Federal Court (the Court) granting relief by ordering that the offending brother purchase the aggrieved brother's shares in the relevant family business entities.

(b) Facts

In 2013, an informal agreement was reached between three brothers - Brett, Jay and Chad McAlister - to engage in the business of developing land, erecting dwellings on sub-divided portions and selling the resulting house-and-land packages.

Brett and Jay were to participate jointly in the management of the business, and Chad would be a silent partner and remain largely uninvolved in the management of the business.

Imoda Group Holdings Pty Ltd (IGH) was incorporated as the ultimate holding company for the entities involved in the business. On the basis of initial capital contributions made by each brother, it was agreed that the shareholdings in IGH would be as follows:

- Brett: 47% - held by an entity controlled by Brett, BAM Property Group Pty Ltd (BAM);
- Jay: 47% - held by an entity controlled by Jay, Imoda Realty Pty Ltd (Imoda Realty); and
- Chad: 6% - held by an entity controlled by Chad, CRM Property Venture Pty Ltd (CRM).

Another two entities were incorporated as part of the business:

- Imoda Properties Pty Ltd (Imoda Properties), a wholly-owned subsidiary of IGH; and
- Imoda Land Holdings Pty Ltd (Imoda Land), a wholly-owned subsidiary of Imoda Properties.

A further entity, Yaroomba Holdings Pty Ltd (Yaroomba), was established to undertake a separate business, being the establishment of a bank of rental properties by purchasing vacant lots of land, constructing houses on them and renting the completed houses to third parties. The shareholding in Yaroomba was the same as in IGH, except that the shares were held by the brothers as individuals.

The value of the consolidated business was held predominantly by IGH.

The business thrived for a number of years, but Brett and Jay subsequently had a falling out, following which Jay took numerous actions to remove Brett from the business and divert corporate opportunities away from the business to companies solely owned by or associated with Jay. These included:

- Jay unilaterally appointing a friend of his as the general manager of the family business, despite Brett's opposition to the engagement;
- Jay informed Brett that the business would no longer have any meetings, but then proceeded to convene meetings without inviting Brett or immediately cancelling any meetings scheduled which Brett had become aware of;

- Jay unilaterally changed the business bank accounts and removed Brett's access to them;
- Jay caused the business to use the general manager's building licence to construct houses for the business, despite the original agreement that Brett's building licence would be used;
- Jay informed Brett that he was "not allowed to give directions to the staff";
- Jay unilaterally paid to himself or to entities associated with him hundreds of thousands of dollars and, additionally, made loans to himself as a director;
- Jay incorporated a new company, Imoda Homes, which was set up to act as a direct competitor of the business. Jay used funds from Imoda Properties to pay the expenses for Imoda Homes' competing business; and
- Jay allowed Imoda Homes to retain the profits that it made from the competing business which it operated with the use of funds from Imoda Properties.

As a result of the above actions, Brett and BAM claimed that Jay and Imoda Realty caused each of IGH and Yaroomba to be operated in a manner which favoured Jay's interests. The question for the Court was whether such conduct was oppressive within the meaning of s. 232 of the Corporations Act. If this could be established, the relief sought was that Jay and Imoda Realty should be jointly and severally liable to acquire BAM's and Brett's shares in IGH and Yaroomba respectively.

(c) Decision

Derrington J found that the actions taken by Jay and Imoda Realty amounted to oppressive conduct within the meaning of s. 232 of the Corporations Act - such actions included the exclusion of Brett from participation in the management of the companies, the diversion of corporate opportunities from IGH and Imoda Properties to Imoda Homes, and the diversion of money from the business to Jay as remuneration for his work.

In making this finding, Derrington J considered the principles for oppression, noting in particular that whether conduct is unfair or oppressive in a commercial company is assessed objectively through the eyes of the commercial bystander. In this instance, the unfairness in the operation of the companies was patent and engaged in deliberately to advance the interests of Jay and Imoda Realty to the detriment of the interests of Brett and BAM in the two operating companies.

The findings are best summarised at [85] of Derrington J's judgment, as set out below:

"The transfer by Jay of the business of Imoda Properties to Imoda Homes was an egregious breach of the fiduciary duty by Jay to Imoda Properties. He was prepared to use his control of the central company, IGH, which he had obtained by sidelining Brett, to further his own ends at Brett's expense. There is no doubt that his action in doing so falls well within the scope of the concept of being 'commercially unfair' or oppressive. That necessarily was conduct which contravened s. 232 of the Corporations Act. The mere act of excluding Brett from the management of IGH also falls within that category of conduct. The diversion of funds from IGH only compounded that act of oppression. It follows that the plaintiffs have established that the companies, IGH and Yaroomba, were operated oppressively or unfairly prejudicially to Brett and BAM."

As such, the relief sought by Brett and BAM was awarded, with Derrington J commenting that no relief other than the purchase of shares is appropriate given the conduct of Jay had substantially damaged the businesses of IGH and Yaroomba, and he had sought to transfer the benefit of those companies to himself.

5.2 Court makes orders appointing a Special Purpose Liquidator to two companies in liquidation

(By Patrick Hall, Herbert Smith Freehills)

In the matter of Walton Construction (Qld) Pty Ltd (in liq) [2019] FCA 1201 (2 August 2019)
Federal Court of Australia, Reeves J

(a) Summary

Upon the application of two unsecured creditors, the Federal Court (the Court) has made orders that a Special Purpose Liquidator (SPL) be appointed to two companies in liquidation under Division 90 s. 90-15 of the Insolvency Practice Schedule (Corporations) in Schedule 2 to the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). The SPL intends to conduct investigations and, if appropriate, commence and pursue any claims, and take any steps in relation to conduct which preceded the companies' eventual liquidation, against a director of each of the companies, and the National Australia Bank Limited (NAB).

(b) Facts

The first and second defendants, Walton Construction (Qld) Pty Ltd and Walton Construction Pty Ltd respectively (the Walton companies) owed various sums to the first plaintiff, Williams & Kersten Pty Ltd and to the second plaintiff, Page Steel Fabrications Pty Ltd, amongst other creditors. In a previous judgment, Derrington J found that from April to October 2013, shortly before the Walton companies were placed into liquidation, various schemes involving the Walton companies were implemented. The schemes involved:

- first, a number of bank guarantees issued by NAB in relation to various construction projects were replaced with surety bonds issued by Assetinsure Pty Ltd. The plaintiffs contended that this relieved Mr Walton (who was a director of the Walton companies) and his associated companies from liability; and
- second, the Walton companies were restructured whereby a significant debt owed by the second defendant to the first defendant was transferred to corporate entities connected with a firm of restructuring advisers.

Administrators were appointed to the Walton companies in October 2013 and it was resolved that the companies be wound up in November 2013. Derrington J held that the Walton companies were insolvent from at least the end of April 2013.

The plaintiffs sought that Mr Michael Caspaney be appointed as a SPL in order to, *inter alia*, conduct investigations and if appropriate, commence and pursue any claim in relation to:

- whether any of the appointed directors or officers of the Walton companies breached the statutory or fiduciary duties (or both) that they owed to the Walton companies in connection with advice received from the firm of restructuring advisers;
- whether NAB (and its officers, agents or employees) were involved in any breaches of statutory or fiduciary duties (or both) owed to the Walton companies; and
- whether any of the directors or officers of the Walton companies breached their duty to prevent insolvent trading under s. 588G of the Corporations Act.

The liquidators (who together were the third defendant) did not consent to nor oppose the appointment of the SPL (albeit subject to certain conditions). The liquidators did not consider

there was a viable claim against NAB and did not intend to commence litigation against NAB nor did they have the funds for such proceedings.

(c) Decision

(i) Questions for the Court

The Court was required to consider whether a SPL should be appointed to the Walton companies under s. 90-15 of Schedule 2 to the Corporations Act. Section 90-15(1) provides that "the Court may make such orders as it thinks fit in relation to the external administration of a company". Section 90-15(3)(c) provides that these orders may include "an order that another registered liquidator be appointed as the external administrator of the company".

(ii) The Court's decision and reasoning

The Court made orders under s. 90-15 of the Schedule to the Corporations Act that a SPL be appointed to the Walton companies. His Honour considered the relevant principles applicable to the appointment of a SPL from the decision of Gleeson JA in *In the matter of ACN 152 546 453 Pty Ltd (in liq)* [2018] NSWSC 1002. His Honour's reasons included:

- first, it was not necessary to make a rigorous assessment of the prospects of any proceeding the SPL may bring. His Honour did not consider the liquidators' opinions concerning the alternative courses available;
- second, it was necessary to consider whether there is a reasonable basis for the plaintiffs' belief that the matters warrant further investigation and the obtaining of a second opinion; and
- third, any expense of the SPL's investigations and any potential proceedings will be borne by the plaintiffs. There were further conditions which required the SPL to report to the Walton companies' creditors and the liquidators.

Further, his Honour stated that he had particular regard to the fact that:

- the plaintiffs have levelled no criticism of the liquidators' conduct nor their decision not to commence proceedings;
- the liquidators' decision to not pursue a viable claim is partly affected by the lack of funding available to them; and
- the SPL's fees and expenses will not be deducted from the property of the Walton companies and the activities of the SPL will not cut across any actions that the liquidators are currently pursuing or anticipate pursuing.

Accordingly, his Honour ordered the appointment of a SPL to the Walton companies. This order was subject to the parties submitting further draft orders to reflect various matters of form that had been discussed during the hearing.

5.3 Transfer of shares under deed of company arrangement permitted where members not unfairly prejudiced

(By Bradley Heath, DLA Piper)

Cussen, in the matter of Big Un Ltd (Subject to Deed of Company Arrangement) [2019] FCA 1162 (26 July 2019) Federal Court of Australia, Jagot J

(a) Summary

The case concerned an application under s. 444GA(1)(b) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) by Neil Robert Cussen and Mathew James Donnelly in their capacity as joint and several administrators of Big Un Limited (subject to deed of company arrangement) ACN 106 399 311 (the Plaintiffs) seeking leave to transfer 80% of the shares of Big Un Limited (Big Un) to WOW World Digital Pty Ltd (WOW). The Federal Court (the Court) may only give leave under s. 444GA(1) of the Corporations Act if it is satisfied that the transfer would not unfairly prejudice the interests of the members of the company.

To determine this, Jagot J considered the legal principles recently set out by Banks-Smith J in *Tucker, in the matter of Black Oak Minerals Ltd (subject to DOCA) (in liq)* [2019] FCA 293, that the Court must consider whether there is any residual value in the company as the issue involves comparing the circumstances in the event of a transfer of shares with the circumstances which would prevail in a liquidation.

(b) Facts

Big Un, an ASX listed company, went into administration on 24 August 2018.

On 20 December 2018, the creditors of Big Un unanimously resolved at a second meeting of creditors that a deed of company arrangement (DOCA) be entered into, under which WOW was to acquire 80% of the shares of Big UN for $350,000. The DOCA was conditional on the Court granting the Plaintiff's application for leave and the obtaining of relief from ASIC under s. 655A of the Corporations Act so as to permit WOW to acquire 80% of the shares in Big Un without being in breach of s. 606 of the Corporations Act (ASIC Relief).

(i) Creditors' claims

Creditors' claims against Big Un were dealt with under the DOCA as follows:

- secured creditors, related parties of WOW and those who have an insured claim against Big Un maintain their existing rights and are excluded from the DOCA;
- the remaining unsecured creditors (Trust Creditors) are grouped into two classes;
- the $350,000 contribution amount and a GST refund of $133,502 will go into the deed fund to be transferred to the Creditor's Trust Deed fund, the net proceeds of which is to be distributed to Trust Creditors; and
- a third party claims fund which is to hold any proceeds of claims made by the Deed Administrators against third parties, the net proceeds of which are to be distributed to the Trust Creditors, and then to the shareholders of Big Un in proportion to their shareholdings prior to the transfer of 80% of the shares to WOW.

(ii) Assets available in liquidation

The assets of Big Un that would be available in a liquidation but not under the DOCA are as follows:

- shares in three private companies (valued at a range of $16,000 to $225,000 on a liquidation basis);

- a licence between Big Un and its wholly owned subsidiary (valued at $0 in a liquidation, on the basis it is not transferable or capable of sublicence); and
- claims against third parties available to a liquidator (Third Party Claims), but not available to deed administrator, valued by Mr Cussen at between 0 to $658,339.

Against the loss of these claims in a liquidation, under the DOCA the contribution amount of $350,000 is to be provided by WOW. It was noted that the shareholders of Big Un voted unanimously in favour of the DOCA and there was no apparent objection by shareholders to the DOCA or to the transfer of 80% of the shares to WOW. It was noted that ASIC granted the ASIC Relief in principle, subject to a formal instrument of relief being executed.

The plaintiffs relied on a valuation of Big Un to conclude that it had no residual value.

(c) Decision

Jagot J agreed with the Plaintiff's submissions that:

- the only (very unlikely) recovery by the shareholders is Third Party Claims, which require an excess of at least $3.5 million and that the liquidators of Big Un's wholly owned subsidiary do not bring a claim for liability for the company's insolvent trading. In that circumstance, Big Un's shareholders would share in the surplus distribution in proportion to their existing shares in the company, i.e. excluding WOW;
- the only possible "down side" for the shareholders under the DOCA is the loss of the liquidator's claims, with an uncertain return estimated to range from 0 to $658,000, weighted against the certainty of the $350,000 contribution amount and the fact that the shareholders will retain 20% of their existing shareholding in a company which is free to re-start its previous operations in Australia relieved of its existing unsecured liabilities;
- in all likelihood, the shareholders will receive no dividend from the liquidation; and
- by voting unanimously in favour of the DOCA, the creditors took the view that "this was a reasonable commercial outcome for them - and not "unfairly prejudicial".

Accordingly, the Plaintiffs were granted leave to transfer 80% of the existing shares of Big Un to WOW pursuant to s. 444GA(1)(b) of the Corporations Act and in accordance with the DOCA. The Plaintiffs' costs of this application were to be costs in the administration of the DOCA.

5.4 Court refuses to frame buy-out order to improve tax position of shareholders

(By Katrina Sleiman, Corrs Chambers Westgarth)

Estera Trust (Jersey) Ltd v Singh [2019] EWHC 2039 (Ch) (26 July 2019) England and Wales High Court, Fancourt J

(a) Summary

After obtaining taxation advice, two shareholders applied for an alternation of a proposed order for the buy out of their shares following a finding that the company's affairs had been conducted in an unfairly prejudicial manner.

While the England and Wales High Court (the Court) determined that it had jurisdiction to make the order sought by the shareholders, it refused to do so. The Court considered that the tax

scheme sought to be implemented by the shareholders could reasonably be regarded as aggressive tax avoidance and that considerations of fairness, simplicity and finality far outweigh the interests of the shareholders in avoiding all risk of paying tax on the purchase price.

(b) Facts

In an earlier judgment, Fancourt J ordered that two shareholders (the petitioners) should have their shares bought out by the company and another shareholder (the respondents), following the finding that the company's affairs had been conducted in an unfairly prejudicial manner within s. 994 of the *Companies Act 2006 (UK)* (the *Companies Act*).

At a subsequent trial, the purchase price and the time for payment were determined. Fancourt J ordered that an initial sum of £22,500,000 on account of the full price be paid no later than 28 days after judgment and that the balance be paid no later than six months after judgment. His Honour left it to the parties to agree the wording of an order reflecting the terms of the judgment and ordered that all other consequential matters should be adjourned to be heard on a date to be fixed.

The petitioners subsequently appreciated the tax consequences of the proposed order: purchase by the company of their shares would be regarded as an income distribution and taxed more heavily than a capital transaction. If treated as a capital transaction, the gain arising to the first petitioner (Estera), which held the majority of the shares in question, would have been treated as a trust gain, liable to capital gains tax (at a rate of 20% currently) as and when distributed to on-shore beneficiaries. The appropriate rate of income tax for Estera would be the dividend trust rate, namely 38.1%, and would be payable immediately. The petitioners wanted to seek to avoid being subject to any - or certainly the 38.1% - immediate tax liability.

The petitioners made an application requesting a change in the proposed order. They wanted a company structure to be created the aim of which was to minimise their tax liability. The petitioners submitted that Fancourt J should conclude that there was nothing unlawful (or in that sense improper) about the proposed tax scheme; that the worst that will happen is that it will not succeed and that the petitioners will be subject to tax; that any risk of harm resulting to the respondents is very small compared with the possible adverse consequences to the petitioners of not adopting it and potentially being liable for 20% or 38.1% tax; and that as an exercise of the broad discretion that Fancourt J has under s. 996 of the *Companies Act* his Honour should make an order requiring the scheme to be implemented.

(c) Decision

Fancourt J held that while he had the jurisdiction to make the order, this was not an appropriate case in which the Court should exercise its discretion.

His Honour considered that the proposed scheme could reasonably be regarded by Her Majesty's Revenue and Customs (HMRC) and others as aggressive tax avoidance. Looked at in context rather than in the abstract, it is an artificial scheme conceived at the last minute for the sole purpose of avoiding a substantial income tax bill. If HMRC did form the view that the scheme amounted to aggressive tax avoidance, the scheme would be likely to be challenged and, if HMRC were proved right, it would be ineffective. But, in addition, the respondents could be regarded by HMRC as persons who are engaged in aggressive tax avoidance, or, even if HMRC's challenge failed, "creative" tax avoidance.

The petitioners submitted that the simple answer to any risk of potential harm to the respondents is that they are able to say to HMRC that the Court ordered them to enter into the scheme and so it is not aggressive tax avoidance. Fancourt J considered that while that might succeed, it only

raised another difficulty for the petitioners' argument, namely whether the Court should be willing to make such an order if the effect of it would be for something that would otherwise be treated as aggressive tax avoidance to be regarded more leniently by HMRC and possibly not challenged on that basis. Fancourt J determined that the Court should not do so, otherwise it is potentially assisting a party to engage in what may be inappropriate tax avoidance.

The effect of the order that the petitioners sought is to substitute for the intended sellers of the shares and the recipient of the price a different company, Jersey NewCo, and an entirely different purchase structure and timetable. Jersey NewCo does not exist and is not a party to the claim and will not be subject to the order that the petitioners sought. Fancourt J considered such relief, on any view, is wholly out of the ordinary - if not unprecedented - for the Court to grant on a section 994 petition, despite the breadth of the jurisdiction to grant relief.

Further, his Honour considered that the respondents were entitled to say that there should be an end to the process of buying out the petitioners. Having made arrangements with its bankers, the company was ready and able to proceed to complete, but completion was delayed by the petitioners' application. Now the petitioners propose a scheme that cannot be fully implemented until June 2020, and possibly longer if the Court has to be involved in any disagreements that arise in future.

In all of the circumstances, Fancourt J determined that considerations of fairness, simplicity and finality far outweigh the interests of the petitioners in avoiding all risk of paying tax on the purchase price.

5.5 Confirmation of ASIC's prescriptive approach to the registration of business names under the Business Names Registration Act 2011

(By James Samartzis, Ashurst)

Australian Appaloosa Association Ltd and Australian Securities and Investments Commission [2019] AATA 2195 (25 July 2019) Administrative Appeals Tribunal, Tribunal Member Frost

(a) Summary

Australian Appaloosa Association Ltd (the Applicant) sought review of the decisions of ASIC to register two business names on the basis that those names were "identical or nearly identical" to its name, and therefore not available to be registered under the Business Names Registration Act 2011 No. 126 (Cth) (BNR Act). The Administrative Appeals Tribunal (the AAT) held that ASIC's decisions were correct, and its decision reinforces that the prescriptive approach that ASIC takes when registering business names under the BNR Act is the correct approach.

The result of this decision is that even business names that have the potential to mislead, deceive, confuse, or pass off because of similarities with an existing business name can still be registered by ASIC in accordance with the BNR Act. The decision also confirms the use of ASIC's automated systems for determining whether business names are available for registration.

(b) Facts

The Applicant is an incorporated company and NFP organisation which maintains the national database and official records for Appaloosa horses, organises events, and arranges insurance and sponsorship for riders and horses.

On 2 April 2017, there was an attempt to spill the Board of the Applicant at its Annual General Meeting (AGM).

On 3 April 2017, the day after the AGM, a former director of the Applicant, Ms Debrah Ebbett registered two business names on ASIC's business name register:

- Appaloosa Association of Australia; and
- Appaloosa Australia

(each, a Business Name, and together, the Business Names).

The Business Names are the registered business names which are the subject of the review.

ASIC conducted an internal review following an application lodged by the Applicant. On 19 July 2017, ASIC affirmed its decisions to register the Business Names.

(c) Decision

The Tribunal held that, while a particular business name might be misleading or confusing, ASIC must still register it if it is "available" within the meaning of the BNR Act.

In particular, in order to determine whether a business name is "identical or nearly identical" to existing company or business names, ASIC must ensure that it complies with the rules outlined in s. 7 of the *Business Names Registration (Availability of Names) Determination 2015 (Cth)* (the Determination) and Part 1 of Schedule 6 to the Corporations Regulations 2001 No. 193 (Cth) (the Corporations Regulations).

(i) Statute and regulatory guidance

The Tribunal held that the legislative regime, pursuant to the BNR Act, the Corporations Regulations and the Determination is prescriptive and exhaustive. The Applicant argued that the Business Names were not "available" within the meaning of s. 24(1) of the BNR Act. Section 25 of the BNR Act states that a business name will be "available" if it is "not identical or nearly identical" to an existing business name. The Determination and Corporations Regulations provide a list of matters which are to be taken into account to determine whether a business name is "identical or nearly identical". Accordingly, to determine whether a business name is "available" under the BNR Act in this context, the relevant test is to apply:

- the rules for determining whether names are identical that are set out in the Corporations Regulations; then
- the Determination, which states that a business name is identical or nearly identical "if and only if, the names are the same".

The Tribunal also confirmed the approach in ASIC's *Regulatory Guide 235 Registering your business name*, which provides guidance on the registration of business names, and is consistent with the approach adopted by the BNR Act, the Corporations Regulations and the Determination.

(ii) Common law

The AAT noted several previous decisions which held that ASIC does not have any discretion over the registration of business names outside of the strict legislative regime. In particular, those decisions similarly confirmed that the Determination and Corporations Regulations that sit alongside the BNR Act are prescriptive and exhaustive. As a result, there may be instances where two or more business names might be so similar that they lead to confusion or deception but would still be registrable under the BNR Act. Under s. 24(1) of the BNR Act, ASIC must register a business name if it is satisfied that the business name is available. The use of the word "must" confirms that ASIC has no discretion to make judgments in relation to whether a business name is identical, or nearly identical, or whether it was registered for a malignant purpose.

(iii) Conclusion

After considering the applicable legislation and authorities, the AAT held that the BNR Act is a "prescriptive regime" that does not provide ASIC with any discretion to refuse registration if a business name is deemed available by the business name register maintained by ASIC, and all relevant legislative requirements are met.

Accordingly, the Business Names were available business names within the meaning of s. 24(1)(c) of the BNR Act, and the AAT affirmed the initial decision of ASIC to register the Business Names on 3 April 2017.

5.6 Jockeying for control and improper purposes

(By Thomas Cleeve, King & Wood Mallesons)

Hui v Champion [2019] FCA 1111 (23 July 2019) Federal Court of Australia, Jagot J

(a) Summary

In a recent decision of the Federal Court, Jagot J considered whether the action of the respondents in transferring shareholdings in, and removing directorships of, certain Australia companies held by the applicants was invalid on the basis that it was made for an improper purpose, contravened the company's constitution or was in breach of directors' duties.

Jagot J confirmed the approach in *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109 (*Permanent Building Society*), that an improper purpose must be the "substantial purpose" for which the impugned conduct was carried out. Jagot J found that, in this case, the purpose pleaded by the applicants (though capable of being categorised as improper) was not the substantial purpose of the impugned conduct. However, her Honour ultimately held that the transfer of shares was invalid on the basis that the transfer did not comply with the companies' constitutions, and that the applicants were entitled to relief under s. 1324(1) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).

(b) Facts

The proceedings are part of a broader dispute between two groups of Chinese investors in cattle stations in Western Australia, described by Jagot J as "the Shimao interests" (the applicants) and the "Dechang interests" (the respondents). The two groups are part of a joint venture arrangement that owns and operates the relevant cattle stations. In short, the structure of the arrangement is:

- certain pastoral leases are held by Consolidated Australian Pastoral Holdings Pty Ltd (CAPH), which are subleased to Argyle Cattle Company Pty Ltd (ACC);
- ACC entered into a management agreement with Australian Standard Agriculture Pty Ltd (ASA) (a company owned by Mr Champion, the first respondent) to manage the cattle stations. This agreement was subsequently terminated by a resolution of ACC on 18 December 2018;
- ACC's sole shareholder is Consolidated Australian Pastoral Holdings No. 2 Pty Ltd (CAPH2);
- CAPH2 is the trustee for ACP Holding Trust, and the sole unit holder of ACP Holding Trust is Shimao Aoya Holding Pty Ltd (HoldingCo);
- the shareholders of CAPH and CAPH2 are: Ms Hui (the first applicant, who is aligned with the Shimao interests), Mr Zhang (the second respondent, who is also aligned with the Shimao interests) and Mr Champion (who was, in part, aligned with the Dechang interests), who each hold two ordinary shares in each of CAPH and CAPH2 as bare trustee for HoldingCo; and
- HoldingCo's three directors are Mr Xue (the second respondent, who is aligned with the Dechang interests), Mr Champion and Ms Hui.

At the time of judgment, an arbitration concerning the control of the entire venture between the two groups was being conducted in China.

This proceeding concerned a more distinct issue relating to the removal of certain shareholdings in, and directorships of, CAPH and CAPH2 held by the Shimao interests. In January 2019, Mr Xue (of the Dechang interests) and Mr Champion signed a resolution of HoldingCo resolving that it issue written directions to Ms Hui and Mr Zhang (of the Shimao interests) to transfer all shares that they held in CAPH and CAPH2 on trust for HoldingCo to Mr Champion to hold on trust for HoldingCo. Importantly, the trust deed included a clause that required the trustees to transfer shares to the beneficiary (HoldingCo) or its nominee upon request.

Ms Hui and Mr Zhang did not act in accordance with the direction. On 12 January, Mr Champion, as a director and authorised representative of HoldingCo (the beneficiary of the shares held on trust), executed a standard share transfer form, signing both as transferor and transferee. The transfer form included the following notation that Mr Champion was acting "as director and an authorised representative of Shimao Aoya Holdings Pty Ltd [HoldingCo]", the beneficiary of the shares. Mr Champion, as the sole shareholder of CAPH and CAPH2, then passed resolutions of the companies that removed Ms Hui and Mr Zhang as directors of the companies.

(ii) Issues

The Shimao interests contended that the impugned conduct:

- was carried out for an improper purpose;
- contravened the constitutions of the companies; and/or
- involved breaches of directors' duties.

On these bases, the Shimao interests submitted that the removal of the shareholdings and directorships were invalid and sought orders under s. 1324(1) of the Corporations Act that would have the effect of reinstating the shareholding and directorships to the position they were in before the actions of the respondents in January 2019.

The respondents also made a cross-claim seeking a declaration that the impugned conduct was valid under s. 1322(4) of the Corporations Act, notwithstanding any procedural irregularity or contravening conduct.

(c) Decision

(i) The alleged improper purpose

The Shimao interests asserted that the resolution directing Ms Hui and Mr Zhang to transfer their shares in CAPH and CAPH2 was for an improper purpose, and as a result the transfer was invalid and they were entitled to relief under s. 1324(1) of the Corporations Act. The improper purpose pleaded by the Shimao interests was that the resolution was made by Mr Xue and Mr Champion "in direct response to and only because of the notice terminating [the Management Agreement] and for the purpose only of preserving, protecting and extending ASA's management rights".

Jagot J found that although this purpose was capable of being an improper purpose, there was not a sufficient factual basis for a finding that it was the substantial purpose for the resolution: *Permanent Building Society*. Rather, Jagot J determined that the substantial purpose for which the resolution was passed was so that HoldingCo could enter into a loan agreement with Westpac to deal with a lack of liquidity in ACC. Shimao had previously offered a loan to HoldingCo to address this lack of liquidity, and in this context, Jagot J found that it was readily apparent that Mr Xue wanted to solve the liquidity problem without "further empowering the Shimao interests by agreeing to HoldingCo taking a loan from them". However, the applicants did not identify this purpose as one of the improper purposes in their pleadings, which precluded them from relying on this purpose in establishing their claim.

(ii) Breach of constitution

Clause 20(c) of both the CAPH and CAPH2 constitutions provided that an instrument of transfer of shares must be "executed by or for both the transferor and the transferee". The relevant question to be determined was whether Mr Champion, as authorised representative of the beneficiary of the shares (HoldingCo), could sign the transfer "for" Ms Hui and Mr Zhang in circumstances where Mr Champion was neither their agent nor their attorney.

Jagot J found that the fact that the shares were held on trust for HoldingCo did not mean that HoldingCo could authorise Mr Champion to sign the transfer forms. This is because of the operation of cl. 11 of CAPH's and CAPH2's constitutions, which provided that: "Except as required by law or this constitution, the Company need not recognise: (a) that a person holds a share on trust.". Jagot J found that "for", in the context of the transfer of "legal ownership", should be given its ordinary and natural legal meaning of "on behalf of", meaning that legal authority must be given by the legal owner (Ms Hui and Mr Zhang) to an agent or attorney to execute the transfer. Further, Jagot J found that, in any event, the resolution itself did not authorise Mr Champion to execute the share transfer forms for Ms Hui or Mr Zhang. As a result, the share transfer forms were not proper instruments of transfer within the meaning of s. 1071B(3) of the Corporations Act, and were executed in contravention of cl. 20(c) of CAPH's and CAPH2's constitutions, meaning that the applicants were entitled to relief under s. 1324(1) of the Corporations Act.

(iii) Breach of director's duties

Jagot J found that Mr Xue, in entering into the Westpac loan agreement in preference to the unsecured loan offered by the Shimao interests on more desirable terms, fell short of the standard of reasonable care and diligence provided for in s. 180(1) of the Corporations Act, and that Mr Xue also breached his duty to act in good faith in the best interests of the company under s. 181(1)(a) of the Corporations Act. Importantly, entering into the Westpac loan agreement (which required security) meant that there was and remains a risk that HoldingCo is in breach of its agreement with China Merchant Bank (CMB), and an ongoing risk CMB will call in the loan as a

result - meaning that the principal amount would be immediately payable. This risk would not have eventuated if the unsecured loan offered by Shimao was accepted.

However, notwithstanding these breaches, Jagot J determined that Ms Hui and Mr Zhang could not bring an action for breaches of director's duty because, as former directors of CAPH, CAPH2 and ACC, they did not have a legitimate interest to enable them to obtain relief under s. 1324(1) of the Corporations Act. His Honour did, however, find that breaches of these director's duties were relevant to the respondent's cross claim seeking validation (see (iv) below).

(iv) The cross-claim seeking validation

The respondents cross-claimed, seeking an order declaring that the share transfer was valid under s. 1322(4) of the Corporations Act. Jagot J, in considering the requirements for granting an order (set out at s. 1322(6)(a) of the Corporations Act) refused to make an order validating the share transfers for the following reasons:

- the execution of the share transfer form by a person without authority to do so cannot be described as an act, matter or thing that is of a procedural nature: s. 1322(6)(a)(i) of the Corporations Act;
- Mr Xue did not act honestly. Rather, his conduct manifested a preference for his own interests over and above the interests of HoldingCo. In coming to this conclusion, Jagot J placed significant weight on Mr Xue's conduct in causing HoldingCo to enter into the loan agreement with Westpac in preference to the loan with the Shimao interests. Notably, this conduct was not *directly* related to the share transfer itself. Jagot J also found that it was not necessary to establish whether Mr Champion was acting honestly - it was sufficient that one of the two directors that signed the resolution was not acting honestly: s. 1322(6)(a)(ii) of the Corporations Act.
- in circumstances where Mr Xue was determined to re-assert control over the Australian operations, including through his refusal to accept the Shimao interests loan offer, it was not just and equitable to make the order sought: s. 1322(6)(a)(iii) of the Corporations Act.

5.7 Electronic execution of guarantee held to be invalid

(By Andrew Fong, King & Wood Mallesons)

Bendigo and Adelaide Bank Ltd v Pickard [2019] SASC 123 (16 July 2019) Supreme Court of South Australia, Stanley J

(a) Summary

Kenrop Pty Ltd (Kenrop) invested in a managed investment scheme operated by the Great Southern Group. Kenrop was offered a loan to fund its investment, provided Kenrop's directors agreed to act as Kenrop's guarantor. Kenrop applied for the loan through a Loan Application. The Loan Application was executed by Kenrop's directors, both in their personal capacity and on behalf of Kenrop. Under the Loan Application, both Kenrop and its directors appointed a company in the Great Southern Group (GSF), as their respective attorney to execute the formal loan and guarantee deed (Loan Deed) on their behalf.

The Loan Deed was then purportedly executed by GSF in that capacity at a later date.

The case centred around whether the attorney, GSF, had validly executed the Loan Deed on behalf of Kenrop's directors. The trial judge found that the purported execution was not valid, because the signatures of GSF's signatories had been electronically placed on the Loan Deed without the relevant signatories personally authenticating the signatures.

(b) Facts

As noted above, Kenrop was an investor in an agribusiness managed investment scheme operated by the Great Southern Group. A lender provided Kenrop with a loan to fund its investment. The loan was purportedly guaranteed by Kenrop's directors. The investment scheme ultimately failed, and the lender sued the directors under the purported guarantee.

The directors, in their personal capacity and as directors of Kenrop, had executed the Loan Application in February 2007. The Loan Application provided for the directors to give a personal guarantee on the terms set out in the attached pro forma Loan Deed. The Loan Application also provided for Kenrop and its guarantors to grant a power of attorney to GSF to execute the Loan Deed on their behalf. GSF electronically executed the Loan Deed as attorney for Kenrop and its guarantors in November 2008. In 2009, the directors, in their capacity as guarantors, executed a Mortgage and Amendment Deed, which varied the Loan Deed.

The directors resisted the lender's claim on the following grounds:

- the directors did not appoint GSF as their attorney in the Loan Application to sign the Loan Deed;
- the Loan Deed was not validly executed by GSF as the directors' attorney;
- if not effective as a deed, the Loan Deed was also not effective as a contract; and
- the directors did not ratify the Loan Deed when they executed the Mortgage and Amendment Deed.

(c) Decision

Stanley J held that the guarantee was invalid. The Loan Deed was not properly executed by GSF as attorney for the directors, and therefore it could not be ratified by the directors when they executed the Mortgage and Amendment Deed. The Loan Deed also failed as a binding contract for want of consideration.

(i) Directors' execution of power of attorney

Contrary to the directors' argument, Stanley J found that the power of attorney executed by the directors in the Loan Application was valid. A power of attorney authorising an attorney to execute a deed can only be conferred by deed. The Loan Application expressly provided that the power of attorney would be executed as a deed; the wording of the clauses displayed the solemnity required for a deed; the Loan Application was signed by each director and witnessed, meeting the statutory execution requirements; and the intention of the parties that the Loan Application be executed as a binding deed satisfied the delivery requirements.

In addition, the directors' signatures had the dual effect of binding Kenrop as principal, and also the directors personally as guarantors. This was based on: the express wording of the Loan Application; the fact that the directors had to provide a statement of personal assets; and that neither of the terms "applicant/guarantor" had been struck out in the signature clauses.

(ii) Attorney's electronic execution of Loan Deed

However, Stanley J held that the Loan Deed, containing the guarantee, was not validly executed as a deed by the attorney, GSF. Here, the signatures of two GSF officers were electronically affixed to an electronic version of the Loan Deed. While s. 127 of the [Corporations Act 2001 No. 50 (Cth)](#) (the Corporations Act) extinguished the common law paper requirement for a deed, an effective signing required the deed to either be physically signed, or for the person to "authenticate personally the mark appearing on the document as his or her signature". A "copying and pasting of a facsimile signature by a person unknown" was insufficient. Stanley J noted that authentication may possibly have been achieved by a board resolution which authorised the placement of the officers' electronic signatures on the Loan Deed. However, the relevant GSF board resolution in this case only authorised the acceptance of the loan applications.

Stanley J further considered that there should be a "single, static document rather than a situation where two electronic signatures are sequentially applied to an electronic document". In addition, "it is insufficient that two signatures appear on different counterparts" under s. 127 of the Corporations Act.

(iii) Contract instead of deed

Stanley J continued to find that the purported deed failed as a binding contract since the funds were advanced to Kenrop in June 2007, but the guarantee in the Loan Deed was executed in November 2008, meaning that the guarantee was executed for past consideration.

(iv) Ratification

Lastly, because the Loan Deed was "void at its inception because it was not validly executed", there was no act which could be ratified by the directors. Ratification cures only the lack of power or authority, but does not "transform something that has not been done into something else".

5.8 Construction of priority regimes within convertible instruments

(By Andrea Farrell, MinterEllison)

In the matter of ACN 150 567 098 Pty Ltd (in liquidation) (formerly known as Organic Response Investors Pty Ltd) [2019] NSWSC 869 (11 July 2019) Supreme Court of New South Wales, Black J

(a) Summary

Pursuant to s. 90-15 of the Insolvency Practice Schedule (Corporations) of Schedule 2 to the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) or former s. 511 of the Corporations Act (pursuant to transitional provisions), the liquidators of Organic Response Investors Pty Ltd (ORI) and Organic Response Pty Ltd (OR) sought declarations to justify their ability to pay a dividend where, as a matter of contractual construction, the liquidators argued that ORI's obligations under:

- a convertible note deed were subordinated to the claims of ordinary creditors; and
- two subsequent convertible loan agreements were not subordinated to the claims of ordinary creditors.

Black J found in favour of the construction contended for by the liquidators and requested to hear the parties on the form of the orders.

(b) Facts

ORI and its wholly owned subsidiary, OR, operated a smart lighting control system business. ORI sourced capital which it then transferred to OR to fund its operations. In the course of conducting its business, ORI obtained funding via three convertible loan agreements, being:

- a note deed under which ORI issued 80,000 notes valued at $10 per note to a variety of noteholders (Note Deed);
- a convertible unsecured loan agreement with E.ON Beteiligungen GmbH (E.ON Loan Agreement); and
- a convertible unsecured loan agreement with Constellation NewEnergy Inc (Constellation Loan Agreement).

(c) Decision

Black J found that ORI's obligations under the E.ON Loan Agreement and Constellation Loan Agreements were not subordinated to the claims of ORI's ordinary creditors, though its obligations under the Note Deed were.

(i) Applicable principles

Black J was required to consider the construction of the Note Deed, the E.ON Loan Agreement and the Constellation Loan Agreement and the interaction between them in the context of the liquidation.

Black J summarised the relevant contractual principles as follows (at [10]):

"[t]he construction of a contract is determined objectively, by reference to its text, context and purpose and, in determining the meaning of the terms of a commercial contract, it is necessary to ask what a reasonable businessperson would have understood those terms to mean, and that that task requires consideration of the language used by the parties in the contract, the circumstances addressed by the contract and the commercial purpose or objects to be secured by the contract."

(ii) Note Deed

Black J declared that ORI's obligations to the noteholders under the Note Deed were subordinated debt obligations for the purposes of s. 563C of the Corporations Act, which provides:

"(1) Nothing in this Division renders a debt subordination by a creditor of a company unlawful or unenforceable, except so far as the debt subordination would disadvantage any creditor of the company who was not a party to, or otherwise concerned in, the debt subordination.

(2) In this section:

debt subordination means an agreement or declaration by a creditor of a company, however expressed, to the effect that, in specified circumstances:

(a) a specified debt that the company owes to the creditor; or

(b) a specified part of such debt;

will not be repaid until other specified debts that the company owes are repaid to a specified extent."

The Note Deed described the convertible notes issued under it as "direct, unsecured and subordinated debt obligations". It contained a priority regime as follows:

"Each Convertible Note ranks for payment in a Winding Up of [ORI]:

- after all Senior Ranking Obligations;
- equally with each other Convertible Notes and all Equal Ranking Obligations; and
- ahead of all Junior Ranking Obligations."

Problematically, the concept Senior Ranking Obligations was defined in the Note Deed as "any obligation in relation to claims of any creditors (including subordinated creditors) of [ORI], the Holders, the holders of Equal Ranking Obligations and the holders of Junior Ranking Obligations". Effectively, the drafting of Senior Ranking Obligations did not exclude "Equal Ranking Obligations" and convertible notes, which impacted on the priority regime contained therein. Relying on *Fitzgerald v Masters* (1956) 95 CLR 420 and *Noon v Bondi Beach Astra Retirement Village Pty Ltd* [2010] NSWCA 102, decisions which permit addition of words to a contract to correct obvious errors, Black J accepted (at [24]) that, on its proper construction, the definition of Senior Ranking Obligations should have read "any obligations in relation to claims of any creditors (including subordinated creditors) of the Issuer, **excluding** the Holders, the holders of Equal Ranking Obligations and the holders of Junior Ranking Obligations".

(iii) E.ON Loan Agreement and Constellation Loan Agreement

Black J found that, as a matter of construction, the E.ON Loan Agreement and the Constellation Loan Agreement were not subordinated debt obligations.

The E.ON Loan Agreement and the Constellation Loan Agreement contained identical priority regimes as follows:

"a) The Convertible Loan is a convertible and unsecured loan constituted by this Agreement.

b) The Convertible Loan ranks for payment in a Winding Up of [ORI]:

1) after all Senior Ranking Obligations;

2) equally with all Equal Ranking Obligations; and

3) ahead of all Junior Ranking Obligations."

Relevantly, the concepts of Senior Ranking Obligations and Equal Ranking Obligations assumed the following definitions:

"**Senior Ranking Obligations:** any obligation in relation to claims of any senior creditors of [ORI]

Equal Ranking Obligations: any obligation in relation to claims of an unsecured creditor of [ORI], or claims of any holder of a preference share in the capital of [ORI], which claims are

expressed to rank equally with [ORI's] obligations under the Convertible Loan and includes the Convertible Notes."

Black J found that the E.ON Loan Agreement and the Constellation Loan Agreement were not subordinated debt obligations, meaning each ranked equally with the claims of ordinary creditors. In making that finding, Black J was influenced by the following factors:

- unlike the Note Deed, the E.ON Loan Agreement and the Constellation Loan Agreement were not described as subordinated debt obligations;
- each Loan Agreement made limited provision for subordination of the debts, which militated against a finding that the debts were *prima facie* subordinated to the claims of ORI's ordinary creditors; and
- ordinary debts were more likely captured within the definition of "Equal Ranking Obligations" than "Senior Ranking Obligations" because ORI warranted that it would not incur any future Senior Ranking Obligations, which, if inclusive of ordinary debts, would effectively prevent ORI from trading.

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