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**Sent:** Friday, December 18, 2020 7:34 PM
**To:** Ian Ramsay
**Subject:** SAI Global Corporate Law Bulletin No. 280

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Bulletin No. 280

Legislation Hotline

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Published by SAI Global on behalf of Centre for Corporate Law, Faculty of Law, The University of Melbourne with the support of the Australian Securities and Investments Commission, the Australian Securities Exchange and the leading law firms: Ashurst, Clayton Utz, Corrs Chambers Westgarth, DLA Piper, Herbert Smith Freehills, King & Wood Mallesons, Minter Ellison.


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## Detailed Contents

## 1. Recent Corporate Law and Corporate Governance Developments

### 1.1 APRA releases information paper on BEAR implementation at three large ADIs

11 December 2020 – The Australian Prudential Regulation Authority (APRA) has released an information paper detailing the findings from its review of the implementation of the Banking Executive Accountability Regime (BEAR) by three of Australia's largest authorised deposit-taking institutions (ADIs). The BEAR establishes accountability obligations for ADIs and their senior executives and directors. The regime also establishes, among other things, deferred remuneration, key personnel and notification obligations for ADIs.

APRA completed its implementation review of the BEAR at Australia and New Zealand Banking Group Limited (ANZ), Commonwealth Bank of Australia (CBA) and National Australia Bank (NAB). Westpac Banking Corporation was not included due to an ongoing investigation into potential breaches of the Banking Act 1959 No. 6 (Cth).

APRA's review found that all three of the large ADIs had designed adequate frameworks to implement the BEAR and that this has helped to deliver:

- greater clarity and transparency of individual accountabilities at ADIs;
- sharpened challenge by boards on actions taken by accountable persons to meet their obligations; and
- more targeted engagement between APRA and ADIs to deliver prudential outcomes.

As at the date of completion of the review, APRA considered that CBA had the most developed approach to implement the BEAR, but that all of the ADIs had further work to achieve clearer and more transparent accountability practices.

All of the ADIs have taken actions and made commitments to address the feedback received. This includes actions and commitments to increase support for implementation of the BEAR, to enhance the use of scenario testing to clarify roles and responsibilities, and to further integrate their breach and consequence management framework with their remuneration frameworks.

The information paper is available on the APRA website.

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### 1.2 Parliament passes legislation to implement further recommendations of the Banking, Superannuation and Financial Services Royal Commission

10 December 2020 – The Australian Parliament has passed legislation (the Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 (Cth)) that implements 20 recommendations of the Royal Commission into Misconduct in the Banking, Superannuation

and Financial Services Industry. It was reported in the November 2020 issue of the Corporate Law Bulletin that the Bill had been introduced into Parliament. The legislation adds to earlier legislation implementing other recommendations of the Royal Commission.

The legislation:

- strengthens the unsolicited selling (anti-hawking) provisions, including for superannuation and insurance products, to prevent pressure selling to consumers;
- introduces a deferred sales model for add-on insurance products, to promote informed purchasing decisions and prevent inappropriate sales of add-on insurance;
- makes the handling and settlement of insurance claims a "financial service", which will require insurers to behave honestly, efficiently and fairly and comply with other licensing obligations, to improve claims handling practices;
- prohibits the trustee of a superannuation fund from having a duty to act in the interests of another person, other than those arising from their duties as trustee of a superannuation fund; and
- allows provisions in financial services industry codes to be enforceable, with breaches attracting civil penalties, ensuring better adherence by industry and certainty for consumers.

These changes are complemented by providing further clarity regarding the role of the regulators and enhancing the requirements of financial institutions reporting breaches of the law.

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### 1.3 Governance of financial market infrastructures

10 December 2020 - The Reserve Bank of Australia (RBA) has published its most recent quarterly bulletin, and in this bulletin the RBA has published an article titled "Governance of Financial Market Infrastructures". Financial market infrastructures (FMIs) provide a broad range of services that underpin well-functioning financial markets. These services include the timely clearing and settlement of obligations between counterparties, assisting institutions in the management of risks and helping to coordinate actions in the event of a market participant's default. FMIs typically process large volumes of transactions and have strong interconnections with banks and other financial institutions, helping to bring networks of counterparties together. FMIs are often considered systemically important in the markets in which they operate. According to the RBA, good governance is critical to delivering effective risk management outcomes. Several high-profile reports have underscored this point in recent years, finding governance issues to be at the heart of poor compliance and risk management outcomes in the financial industry. Given the key role that FMIs play in supporting efficient and stable markets, the RBA has a strong interest in promoting good governance within these entities. The article explores aspects of FMI governance and how governance arrangements can help promote the safe and effective delivery of FMI services.

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### 1.4 Insolvency reforms passed by Parliament

10 December 2020 - The Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Cth) has been passed by the Commonwealth Parliament. In an earlier media release, the Australian Treasurer stated that key elements of the reforms include:

- the introduction of a new debt restructuring process for incorporated businesses with liabilities of less than $1 million, drawing on some key features of the Chapter 11 bankruptcy model in the United States;
- moving from a one-size-fits-all "creditor in possession" model to a more flexible "debtor in possession" model which will allow eligible small businesses to restructure their existing debts while remaining in control of their business; and
- a new, simplified liquidation pathway for small businesses to allow faster and lower cost liquidation.

The reforms will commence on 1 January 2021.

Further information about the Bill was provided in item 1.3 of the Corporate Law Bulletin No 278, October 2020.

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### 1.5 Report on governing company culture

9 December 2020 - Directors overwhelmingly believe greater boardroom focus on culture will lead to better long-term company performance, according to research from the Australian Council of Superannuation Investors (ACSI) and the Australian Institute of Company Directors (AICD).

The research - Governing company culture: Insights from Australian directors - is a collaboration between investors and directors to understand how culture is overseen, assessed and influenced in Australian Securities Exchange (ASX) listed companies.

The research draws on interviews with experts and senior directors of ASX 50 companies to provide perspectives on company culture from inside the boardroom supplemented by desktop analysis of public disclosures. It also provides directors with practical guidance about overseeing, assessing and influencing company culture.

Report conclusions include:

- **Culture is the responsibility of directors, not just senior management** - Directors can use a range of practical methods to exert significant influence over the company, while recognising that management must take the day to day lead in delivering the boards expectations;
- **Company culture is an increasingly high priority** - There has been a significant shift in the focus on culture over recent years, with it now firmly in the spotlight for directors;
- **Directors see the link between culture and long-term performance** - Directors feel that culture is extremely important to the long-term performance of a company;

- **Effective oversight of culture requires active and curious directors** – Data and metrics relating to culture can be made widely available, but in order to be effective, individual directors must be curious, persistent and willing to synthesise the many formal and informal sources of information. Directors must be alert to an overly optimistic picture of culture from management; and
- **There is limited public disclosure on culture** – Investors would value greater disclosure to discern companies' cultural strengths and weaknesses. Yet practices amongst ASX 50 companies shows wide variance in public disclosure and there is a lack of market consensus regarding the most valuable metrics to report against. This is an area where there should be further dialogue between directors and investors.

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### 1.6 Strengthening and streamlining oversight of the financial advice sector

9 December 2020 – The Australian Government has moved to implement further reforms to strengthen the financial advice sector and provide consumers with better access to affordable and high quality financial advice.

The Financial Sector Reform (Hayne Royal Commission Response No. 2) Bill 2020 (Cth) was introduced into the Parliament that addresses four recommendations from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry relating to financial advice. These reforms:

- strengthen and simplify the ongoing fee arrangement framework in the Corporations Act 2001 No. 50 (Cth) to minimise the risk that these types of arrangements give rise to fee for no service conduct (rec. 2.1);
- amend disclosure requirements to ensure that financial advisers disclose whether they are independent (rec. 2.2); and
- ensure that only fees for one-off financial advice can be deducted out of MySuper accounts (rec.s 3.2 and 3.3).

Following consultation on these recommendations, the Government has streamlined the approach to implementation to avoid duplication with existing requirements, minimise compliance costs for financial advisers and their clients and ensure all superannuation members are able to access financial advice and pay for that advice from their superannuation.

#### Simplifying the regulatory framework applying to financial advisers

Recommendation 2.10 of the Financial Services Royal Commission (FSRC) called for a single, central disciplinary body to be established for financial advisers. The Government will give effect to this recommendation by expanding the operation of the Financial Services and Credit Panel (FSCP) within the Australian Securities and Investments Commission (ASIC). The FSCP currently supports ASIC in the exercise of its regulatory functions with respect to the making of banning orders against individuals for misconduct. According to the Government, expanding the role of the FSCP will leverage its extensive expertise and existing governance structures, avoiding the need to establish a new body to perform this role.

Consolidating this new function within ASIC will also avoid regulatory overlap and minimise the possibility of multiple investigations by multiple agencies into the same conduct related to the provision of financial advice.

The Government will also move the standard-making functions of the Financial Adviser Standards and Ethics Authority (FASEA) to Treasury, with the standards to be set by legislative instrument. Remaining elements of FASEA's role, including administering the adviser examination, will be incorporated into the FSCP's expanded mandate. These reforms will further streamline the number of bodies involved in the oversight of financial advisers, resulting in FASEA being wound up.

Legislation implementing these reforms is intended to be introduced into Parliament in the first half of next year.

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### 1.7 IMF report on cyber risk and financial stability

7 December 2020 - The International Monetary Fund has published a report titled "Cyber Risk and Financial Stability: It's a Small World After All". According to the report, the ability of attackers to undermine, disrupt, and disable information and communication technology systems used by financial institutions is a threat to financial stability and one that requires additional attention.

Attackers have broad access to technology, allowing them to operate across borders and to attack financial firms and central banks either for profit or simply to disrupt. An increase in the incidence of attacks, rising losses, and the recognition of the potential for serious disruption to the functioning of the financial system has elevated cyber risk from a concern of IT departments to a central risk management issue for all financial institutions and a risk to system-wide stability. Attackers are universal in their reach-targeting large and small institutions, rich countries and the less well-off alike. The COVID-19 crisis has only heightened awareness of the vital importance of protecting digital systems and connectivity to ensure the continuity of economic and financial activity. Financial systems are at varying states of readiness to manage such attacks, and the international response is fragmented.

The report suggests there are six major gaps that, if addressed, could considerably reduce cyber risk and help safeguard global financial stability. These build on the need to pay greater attention to prevention, mitigation, measurement, and recovery. Addressing the gaps will require a collaborative effort by standard-setting bodies, national regulators, and industry associations, as well as by international financial institutions and other capacity development providers.

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### 1.8 Canadian securities regulators seek comments on activist short selling

3 December 2020 - Canadian Securities Administrators (CSA) have published a consultation paper to facilitate discussion about activist short selling.

Activist short selling involves an individual or entity that takes a short position in a security and then publicly shares information that is expected to negatively impact a company's stock price. If the value of the security declines, the short seller realises a profit.

The consultation paper summarises stakeholder concerns about activist short selling, outlines the Canadian and international regulatory frameworks for this activity and sets out CSA Staff's findings regarding the nature and extent of activist short selling in Canada.

The CSA's research and analysis began in 2019 and consisted of an empirical analysis of activist short seller campaigns targeting Canadian issuers based on available data as well as an academic literature review.

Key findings include:

- In general, activist short sellers tend to gravitate towards the securities of issuers and sectors where there is perceived overvaluation;
- Between 2010 and September 2020, a total of 73 Canadian issuers have been the target of 116 activist short seller campaigns. Among them, 16 campaigns (including all 12 campaigns from 2020) are still active;
- While there have been years with increased activity since 2015, annually there have been no more than five Canadian targets for every 1,000 Canadian listed issuers. In comparison, the United States (US) issuers are more frequently targeted by activist short sellers, seeing an average of 21 US targets annually for every 1,000 US listed issuers;
- Canadian campaigns tended to focus on larger issuers (median market capitalisation of $867 million and average market capitalisation of $4.5 billion);
- Approximately 75% of the Canadian campaigns analysed experienced a negative price impact on the day of the first campaign announcement and up to one month after the first campaign announcement. However, the extent of the short-term price impact varied across targets and also over time; and
- Across all 116 Canadian campaigns, approximately 40% involved allegations of some type of fraud at the issuer, the most common being a stock promotion scheme.

CSA Consultation Paper 25-403 Activist Short Selling can be found on CSA members' websites.

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### 1.9 IOSCO consults on issues and concerns regarding market data

3 December 2020 – The Board of the International Organization of Securities Commissions (IOSCO) is seeking feedback on a consultation report on issues relating to access to market data in secondary equity markets.

Market data is an essential element of fair and efficient markets. More specifically, market participants need information on quotations and trades in order to make informed and competitive trading decisions and to comply with certain regulatory requirements. However, participants in many jurisdictions have raised concerns about the content, costs, accessibility, fairness and consolidation of market data.

The IOSCO consultation report on Market Data in the Secondary Equity Markets describes these concerns and asks for industry views on both the issues and possible regulatory responses to them. The report identifies and describes the issues and concerns relating to:

- the market data necessary to facilitate trading in today's markets;
- fair, equitable and timely access to market data;
- the interchangeability of market data;
- fees for market data;
- the need for and extent of data consolidation; and
- additional products and services related to accessing market data.

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### 1.10 Reporting on the new UK Corporate Governance Code is a mixed picture

26 November 2020 – The revised United Kingdom (UK) Corporate Governance Code (the Code) provides an opportunity for companies to report to their stakeholders in a way that allows them to communicate high-quality information about the way in which their governance functions to deliver a company's purpose and strategy. Although some companies have embraced the opportunities the revised Code offers, the UK Financial Reporting Council (UK FRC) has found in its Review of Corporate Governance Reporting that this was not consistent across the board.

According to the UK FRC, some companies continue to treat the Code as a box-ticking exercise. Where this happens, reporting is formulaic and companies do not seize the opportunity to meaningfully explain why they do not comply with its provisions.

The Code was revised to emphasise the wider benefits of good governance for the economy and society. It calls on companies to establish a purpose which is aligned with its culture and strategy, and forge strong relationships with key stakeholders. The UK FRC's review found that corporate governance reporting failed to live up to stakeholder expectations. For example, many companies stated the importance of diversity at board level and in the succession pipeline but offered little explanation to set out what they are doing to deliver that.

There was better reporting on stakeholder engagement, but the UK FRC is concerned that some companies continue to rely on the reporting process rather than substance. The review highlights the need to demonstrate consideration of feedback to the board and outcomes, such as the influence on decision-making. In many cases, it was not clear how issues were raised to the board level, and how that then affected decision-making.

The review has allowed the UK FRC to set out expectations for improvement in the following areas:

- companies should provide clear and meaningful explanations of how they achieve good governance standards in line with the flexibility offered by the Code;

- companies should clearly show the impact of engagement with stakeholders, including shareholders, on decision-making, strategy and long-term success;
- companies should provide better assessment and monitoring of culture, including consideration of methods and metrics used; and
- companies should demonstrate commitment to diversity and inclusion through actions, such as improved succession planning and recruitment from diverse talent pools.

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### 1.11 BIS research paper on stablecoins

24 November 2020 – The Bank for International Settlements has published a research paper titled Stablecoins: Potential, Risks and Regulation. Both the emergence of distributed ledger technology and rapid advances in traditional centralised systems are moving the technological horizon of money and payments. These trends are embodied in private "stablecoins": cryptocurrencies with values tied to fiat currencies or other assets. The research paper examines market developments, how they might be monitored, the potential role of stablecoins and what this implies for their regulation.

The paper reviews market developments for existing stablecoins and describes their potential for embedding a robust monetary instrument into digital environments. It then assesses "global stablecoin" proposals, including Facebook's revised Libra 2.0 project and discusses discuss potential regulatory responses, including focusing on the necessity of a balanced proportional approach. Stablecoins raise the option to embed supervisory requirements into stablecoin systems themselves, allowing for "embedded supervision". The paper concludes with a discussion of whether central bank digital currencies or other initiatives could provide more effective solutions to fulfil the functions that stablecoins are seeking to address.

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### 1.12 Report on the implications of climate change for financial stability

23 November 2020 – The Financial Stability Board (FSB) has published a report that discusses the implications of climate change for financial stability.

Building on the FSB Stocktake of financial authorities' experience in including physical and transition climate risks as part of their financial stability monitoring, this report assesses the channels through which physical and transition risks could impact the financial system and how they might interact. Particular focus is on the potential amplification mechanisms and cross-border effects, and on the channels that could materialise in the short-to-medium term.

Current central estimates of the impact of physical risks on asset prices appear relatively contained but may be subject to considerable tail risk. The manifestation of physical risks could lead to a sharp fall in asset prices and increase in uncertainty. A disorderly transition to a low carbon economy could also have a destabilising effect on the financial system.

Climate-related risks – physical and transition risks – may also affect how the global financial system responds to shocks. They may give rise to abrupt increases in risk premia across a wide range of assets. This could alter asset price (co-)movement across sectors and jurisdictions; amplify credit, liquidity and counterparty risks; and challenge financial risk management in ways that are hard to predict. Such changes may weaken the effectiveness of some current approaches to risk diversification and management. This may in turn affect financial system resilience and lead to a self-reinforcing reduction in bank lending and insurance provision.

There are various actions that financial institutions can take – and are taking – to reduce or manage their exposure to climate-related risks. However, the efficacy of such actions taken by financial firms may also be hampered by a lack of data with which to assess clients' exposures to climate-related risks, or the magnitude of climate-related effects. Robust risk management might be supported by initiatives to enhance information with which to assess climate-related risk.

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### 1.13 IOSCO reviews money market funds recommendations and events arising from the March 2020 market turmoil

20 November 2020 – IOSCO has published a diagnostic report analysing the events that occurred in the Money Market Funds (MMFs) sector during the market turmoil in March 2020. Simultaneously, IOSCO published a thematic review assessing the implementation of selected IOSCO recommendations issued in 2012 to strengthen the resilience of MMFs globally.

The Thematic Review was conducted by the IOSCO Assessment Committee (AC), and is based on IOSCO's assessment of the legislative and regulatory frameworks of the nine largest MMF domiciles, in relation to the implementation of the 2012 IOSCO recommendations. The participating jurisdictions represent approximately 95% of the total net assets managed by MMFs worldwide. The assessment under this review is generally based on information as of end of August 2019.

The Diagnostic Report was conducted by the Financial Stability Engagement Group (FSEG) to focus on the effects of the market dislocations related to the COVID-19 events on MMFs and seek to characterise the behaviour of MMFs of varying types and of currencies across the main MMF jurisdictions.

Given its considerable size, the MMF industry plays an important role in the real economy by supporting the short-term funding needs of banks and non-financial corporations. In response to the severe stress experienced during the 2008 global financial crisis, IOSCO published recommendations in 2012, aimed at strengthening the resilience of MMFs globally. The recommendations assessed in the Thematic Review focus on valuation; liquidity management; and MMFs that offer a stable Net Asset Value.

The Thematic Review found that the participating jurisdictions have generally implemented MMF reforms in line with the 2012 IOSCO recommendations, taking into account the heterogeneity and specificities of their local MMF markets. Liquidity requirements in most of the assessed jurisdictions are in line with the recommendations for MMFs to hold a minimum amount of liquid assets with some variation on the type of eligible assets and amount. All jurisdictions (except for very limited types of funds in one jurisdiction) systematically require the use of stress tests. In line with the 2012 recommendations, all assessed jurisdictions allow for the use of certain liquidity management tools and require specific pre- or post- sale disclosures to investors regarding the use of these tools.

Nevertheless, the March market turmoil impacted the functioning of the short-term funding markets and led to significant strains in the MMF sector, raising questions about its resilience. Against this backdrop, the Diagnostic Report provides a factual description of events across jurisdictions in March 2020. The Diagnostic Report describes how impacts - driven by a combination of cash needs and "flight-to-safety" behaviours - varied considerably by MMF type, structure and currency. Outflows from MMFs holding primarily non-public, mostly USD denominated debt were significant. In contrast, the market saw historic inflows into MMFs holding primarily US government instruments.

Central bank interventions in money markets - some of them targeted specifically at MMFs - as well regulatory relief measures introduced by securities and prudential regulators, helped ease the financial strains. All non-government MMFs honoured redemptions and none were forced to apply liquidity management tools such as fees, gates or suspensions.

Nevertheless, the March market turmoil highlighted continuing vulnerabilities in certain types of non-public MMFs and the need for further reform. The Diagnostic Report highlights areas that merit further consideration, such as the broader ecosystem and the functioning of the money markets, the behaviour of MMF investors and elements of regulatory frameworks that may have played a role in accelerating flows out of certain types of non-public MMFs.

IOSCO has contributed this analysis of MMFs during the March market turmoil to the FSB's Holistic Review of the March Market Turmoil and is continuing to work closely with its member authorities and the FSB on this and other aspects of the role of non-bank financial intermediation.

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### 1.14 Payments system review publishes issues paper

20 November 2020 - The Payments System Review has published an issues paper that provides an overview of Australia's payments system and calls for responses to 11 consultation questions. The issues papers states that the "payments system" refers to the collection of laws, regulations, protocols and infrastructure that governs and administers the way that payments in all forms are sent and received. It is noted in the issues paper that developments in technology and broader structural changes to the economy are driving new forms of payments that better serve the needs of end-users - whether they are consumers, businesses, governments, or community groups. According to the issues paper: "Australia's regulatory architecture should encourage and foster innovative developments while minimising the risks that arise from these changes. This issues paper poses questions around how Australia's regulatory architecture can best serve end users by creating a framework that encourages competition and innovation, ensuring payments can be made in an efficient, low-cost and secure manner without compromising the stability of the system".

The issues paper has two main sections:

- regulatory architecture of Australia's payments system (the role of regulatory architecture, current regulatory architecture and a regulatory architecture for the future); and
- developments in the payments system (the evolving landscape and international comparisons).

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### 1.15 Climate risk disclosure by the largest global and Australian companies

19 November 2020 - KPMG has published two reports on climate risk disclosure by the largest global and Australian companies. KPMG developed 12 criteria for good corporate reporting on climate risk disclosure grouped under four themes: governance, identification, and impacts climate-related risks and reporting on a net zero transition.

For the first report, "Towards net zero: How the world's largest companies report on climate risk and net zero transition", KPMG examined disclosure by the world's largest 250 companies. Overall, the data paints a picture in which most large companies in most countries have the basics of climate risk reporting in place. They have acknowledged climate change as a financial risk and are reporting, to some extent, on both the physical and transitional climate risks their businesses face. However, only one in five is following the Task Force on Climate-related Financial Disclosures (TCFD) recommendation to apply scenario analysis to assess and disclose the potential impacts of these risks and even fewer are doing a good job of it. With regard to reporting on decarbonisation and net zero transition, an encouraging number of companies have set carbon reduction targets that are aligned with what the climate science tell us is needed. This is a significant improvement from the situation five years ago when KPMG research showed that the carbon reduction targets being set by the world's biggest businesses were largely arbitrary and unexplained. On the other hand, the G250 as a group still has a lot of work to do to improve the way they report their decarbonisation strategies and progress.

For the second report, "Towards net zero: How the top Australian companies report on climate risk and decarbonisation", KPMG examined climate risk disclosure by the ASX100. The research shows that climate risk reporting by Australian companies has improved significantly over the last three years. The ASX100 are more likely to report climate-related risks, and more likely to report using the TCFD recommendations than the G250. However, Australia is falling behind the G250 in reporting on the transition to net zero.

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### 1.16 UK review of listings

19 November 2020 - The UK Government has announced a review of the listings regime that will "propose a range of recommendations for how to boost the UK as a destination for Initial Public Offerings (IPOs) and optimise the capital raising process for companies seeking to list

on the main UK market". There are currently over 1,100 companies listed on the London Stock Exchange's Main Market with a capitalisation of around £3 trillion.

The review will consider:

- whether current rules around free floats, dual class share structures, and track record requirements strike the correct balance between corporate governance and market integrity on the one hand, and the requirements of companies seeking to list on the other;
- whether the requirements for when a prospectus has to be produced (which are currently harmonised at European Union (EU)-level), are appropriate for the UK market – including whether companies that are already listed should be able to more easily raise new capital, and whether other triggers and documentation required for offers to the public and admission to trading venues are optimal for the UK market;
- whether there are specific non-regulatory, non-legislative actions which the government could take to boost the UK as a destination for IPOs and optimise the capital raising process for large and small companies on UK markets; and
- other issues, including whether there is a case to introduce differentiated entry requirements for the UK's premium listing segment in respect of companies which already have a primary equity listing on markets in other countries that are assessed to have high standards of corporate governance.

The Call for Evidence, which has a series of questions on which submissions are requested, can be viewed on the UK Government website.

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### 1.17 NZ: FMA seeks feedback on industry guidance for advertising financial products

18 November 2020 – The New Zealand (NZ) Financial Markets Authority (FMA) has opened consultation on proposed guidance about advertisements for financial products.

The guidance focuses on how "fair dealing" requirements in the Financial Markets Conduct Act apply to advertisements for financial products. Fair dealing provisions apply broadly to conduct relating to anyone (regardless of where they are based) offering financial products to the New Zealand public. They prohibit:

- misleading or deceptive conduct, including conduct which is likely to mislead or deceive;
- false, misleading or unsubstantiated representations; and
- offers of financial products in the course of unsolicited meetings.

As well as traditional advertising mediums in print, broadcast, digital and outdoor formats, the guidance also applies to mobile apps, product brochures and promotional fact sheets, direct mail (e.g. written letters or email), group presentations and seminars, and advertorials.

The guidance sets out that advertisements should:

- be truthful and accurate;

- take care when comparing different products;
- balance risk and reward;
- take care with phrasing and jargon;
- ensure forecasts are based on reasonable and supportable assumptions;
- not overemphasise performance;
- prominently display warnings and disclaimers;
- clearly disclose fees and costs;
- not claim to be endorsed, approved or regulated;
- be discernible from other content (such as sponsored content); and
- identify offers that are made only to wholesale investors.

The guidance complements existing information published by the FMA, including the crowdfunding and peer-to-peer lending guidance, regulatory response guidelines and website content on the FMA's approach to the fair dealing and stop order provisions.

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### 1.18 IAASB publishes key takeaways on fraud and going concern

17 November 2020 – The International Auditing and Assurance Standards Board (IAASB) has published a key takeaways report following three recent virtual roundtables with experts and leaders exploring issues and challenges related to fraud and going concern. These roundtables focused on:

- the impact of technology advancements on fraud perpetration and detection;
- the "expectation gap", or differences between public perceptions and the auditor's responsibilities for fraud and going concern; and
- fraud and going concern in audits of less complex entities.

The publication details the roundtables and what was discussed. The input from these roundtables comprise one aspect of the IAASB's broader information-gathering activities related to fraud and going concern that will be considered in determining possible future actions.

The full roundtable recordings, including individual breakout sessions, are available on the IAASB's YouTube channel:

- Fraud Technology Roundtable;
- Expectation Gap Roundtable; and
- Fraud and Going Concern Procedures in Less Complex Entities Roundtable.

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### 1.19 Implementation and effects of the G20 financial regulatory reforms: 2020 Annual report

13 November 2020 – The Financial Stability Board 2020 Annual Report finds that the G20 reforms after the 2008 financial crisis have served the financial system well during the COVID-19 pandemic. Greater resilience of major banks at the core of the financial system has allowed the system largely to absorb, rather than amplify, the macroeconomic shock. Bold

and decisive actions by authorities sustained the supply of credit to the real economy and helped maintain global financial stability.

Given the pandemic, there has been limited additional progress implementing the G20 reforms during the last year. Regulatory adoption of several core Basel III elements has generally been timely to date, but there have been delays in implementing other Basel III standards. Substantial work remains to operationalise resolution planning for systemically important banks and to implement effective resolution regimes for insurers and central counterparties.

The FSB and standard-setting bodies (SSBs) have extended implementation deadlines for certain international reforms to provide additional capacity for firms and authorities to respond to the COVID-19 shock. In addition, authorities in many jurisdictions have taken regulatory and supervisory measures to alleviate the economic impact of COVID-19 on the financial system.

The pandemic represents the first major global test of the post-crisis financial system, and an opportunity to examine whether reforms have worked as intended. The FSB and SSBs will carry out further work to identify potential lessons learned for international standards.

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### 1.20 ESMA tells fund managers to improve readiness for future adverse shocks

13 November 2020 - The European Securities and Markets Authority (ESMA), the EU's securities markets regulator, has published a Report on the preparedness of investment funds with significant exposures to corporate debt and real estate assets, for potential future adverse liquidity and valuation shocks. The Report identifies five priority areas for action which would enhance the preparedness of these fund categories.

The priority areas identified to enhance the preparedness of the funds are the following: ongoing supervision of the alignment of the funds' investment strategy, liquidity profile and redemption policy; ongoing supervision of liquidity risk assessment; fund liquidity profile reporting; increase of the availability and use of Liquidity Management Tools; and supervision of valuation processes in a context of valuation uncertainty.

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### 1.21 Parliamentary Committee final report on the regulation of auditing

11 November 2020 - The Parliamentary Joint Committee on Corporations and Financial Services has published its final report titled Regulation of Auditing in Australia. It follows the publication of the Committee's interim report in February 2020. The final report is brief compared to the interim report. The interim report did the following:

- provided an overview of Australia's legislative and regulatory framework for audit;
- reviewed matters relevant to the state of audit quality in Australia;
- discussed threats to auditor independence, as a key component of audit quality, as well as potential solutions to these threats; and

- examined the gap that exists between the regulatory requirements pertaining to audit and the public's expectations of the functions of an audit, as well as proposals to expand the scope of audit to better meet user needs.

The Committee also made 10 recommendations in the interim report.

In its final report, the Committee endorses the 10 recommendations in its interim report. These recommendations are as follows.

**Recommendation 1** – The Committee recommends that ASIC:

- formally review the manner in which it publicly reports the periodic findings of its audit inspection program, giving appropriate consideration to approaches used internationally; and
- based on this review, develop and implement, by the end of the 2020-21 reporting period for its audit inspection program, a revised framework for reporting inspection findings, with a focus on the transparency and relative severity of identified audit deficiencies.

**Recommendation 2** – The Committee recommends that the Australian Government introduce, by the end of the 2020-21 financial year, through appropriate legislation, a requirement that ASIC publish all future individual audit firm inspection reports on its website once ASIC has adopted a revised reporting framework referred to in Recommendation 1.

**Recommendation 3** – The Committee recommends that the FRC, in partnership with ASIC, by the end of the 2020-21 financial year, oversee consultation, development and introduction under Australian standards of:

- defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and
- a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.

**Recommendation 4** – The Committee recommends that the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) be amended so that an auditor's independence declaration is expanded to require the auditor to specifically confirm that no prohibited non-audit services have been provided.

**Recommendation 5** – The Committee recommends that the Australian Professional and Ethical Standards Board consider revising the APES 110 Code of Ethics to include a safeguard that no audit partner can be incentivised, through remuneration advancement or any other means or practice, for selling non-audit services to an audited entity.

**Recommendation 6** – The Committee recommends that the FRC, by the end of the 2020-21 financial year, oversee the revision and implementation of Australian standards to require audited entities to disclose auditor tenure in annual financial reports. Such disclosure should include both the length of tenure of the entity's external auditor, and of the lead audit partner.

**Recommendation 7** – The Committee recommends that the Corporations Act be amended to implement a mandatory tendering regime such that entities required to have their financial reports audited under the Corporations Act must:

- undertake a public tender process every ten years; or
- if an entity elects not to undertake a public tender process, the entity must provide an explanation to shareholders in its annual report as to why this has not occurred.

The Committee further recommends that the government consider a staged implementation of this recommendation (in its interim report, the Committee recommended that the tender process be implemented by 2022 for any entity that has had the same auditor for a continuous period of ten years since 2012).

**Recommendation 8** – The Committee recommends that the FRC oversee a formal review, to report by the end of the 2020-21 financial year, of the sufficiency and effectiveness of reporting requirements under the Australian standards in relation to:

- the prevention and detection of fraud; and
- management's assessment of going concern.

**Recommendation 9** – The Committee recommends that the Corporations Act be amended such that entities required to have their financial reports audited under the Corporations Act must establish and maintain an internal controls framework for financial reporting. In addition, such amendments should require that:

- management evaluate and annually report on the effectiveness of the entity's internal control framework; and
- the external auditor report on management's assessment of the entity's internal control framework.

**Recommendation 10** – The Committee recommends that the Australian Government take appropriate action to make digital financial reporting standard practice in Australia.

The Australian Greens published a dissenting report in which they make two recommendations:

- any firm that provides audit services for a significant proportion (for example, more than 5%) of companies capitalised or operating in Australia be prevented from providing non-audit services; and
- the regulatory regime for auditing be simplified, with a single body being responsible for accounting, auditing and assurance standards; and another body being responsible for enforcement, currently ASIC.

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### 1.22 AFCA releases 2019-20 Annual Review

6 November 2020 – The Australian Financial Complaints Authority (AFCA) has released its 2019-20 Annual Review, revealing the number of complaints received and closed, the amount

awarded to consumers in compensation and refunds, and the ombudsman's approach to the COVID-19 pandemic.

According to the AFCA Annual Review, between 1 July 2019 and 30 June 2020 AFCA received 80,546 complaints from consumers and small businesses, which is a 14% increase in the monthly average compared to the last financial year.

The ombudsman resolved 76,681 complaints during the 2019-20 financial year, and awarded or obtained $258.6 million in compensation or refunds to complainants.

A majority of complaints (58%) lodged with AFCA in this period related to banking and finance, followed by general insurance (24%), superannuation (9%), investments and advice (6%) and life insurance (2%).

Credit cards were the most complained about product (with 11,628 complaints), followed by home loans (7,608), personal loans (5,722) and motor vehicle comprehensive insurance (4,104).

Despite the increase in complaints, AFCA was able to resolve the majority of complaints quickly, with complaints taking an average of 73 days to reach an outcome.

AFCA's Annual Review also outlines how the ombudsman approached the COVID-19 pandemic and worked with industry and regulators to support those with financial disputes.

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## 2. Recent ASIC Developments

### 2.1 ASIC report explores how to measure "value for money" in default insurance in superannuation

14 December 2020 - ASIC has released a report on measuring the value for money that Australians receive from default insurance provided by their superannuation funds. Superannuation trustees must offer default death and permanent incapacity insurance benefits on an opt-out basis to most members in a MySuper product. Many trustees also choose to offer default insurance to members in Choice superannuation products.

Report 675 Default insurance in superannuation: Member value for money (REP 675) explores metrics that can help superannuation trustees analyse the value for money of default insurance and deliver better outcomes for members.

In producing REP 675, ASIC considered publicly available data on default insurance offered by 20 large MySuper products, which at 30 June 2020, covered 82% of MySuper member accounts. ASIC also used its compulsory information gathering powers to obtain more granular data from a sample of 11 mostly large superannuation trustees for a six-year period

(FY 2013–14 to FY 2018–19). These trustees held an estimated 40% of superannuation accounts with insurance at 30 June 2019. ASIC engaged directly with a range of trustees to understand their insurance arrangements and how they measure the outcomes their members receive from default insurance.

REP 675 compares some measures of value for money, with a focus on outcomes for members, across superannuation trustees and for distinct member cohorts. Each of the measures of value for money has its own strengths and weaknesses, and trustees will need to consider a range of indicators to measure value for members.

The report highlights that:

- **There is wide variation in default cover offered** – Across MySuper products, ASIC found a large amount of variation in the types and level of default cover. For example, some large MySuper products offered over 20 times as much default cover as others. The premiums members paid for default cover also varied widely. Differences in price are partly due to different levels of cover, but also other factors including the average risk level of the membership and the generosity of terms and conditions;
- **Different cohorts of members can receive different outcomes** – ASIC's analysis of detailed insurance claims data provided by trustees identified that some cohorts of members with default insurance, such as younger members and those in insurance policies with more restrictive terms and conditions, may be receiving relatively low value. Such outcomes raise questions about the appropriateness of the default insurance design and fairness between groups of members; and
- **Trustees found providing member insurance data challenging** – Some trustees were unable to properly identify which members had default insurance, and some struggled to explain patterns in the data they provided to ASIC. Those with the most complicated insurance designs and product structures tended to face the most issues.

According to ASIC's analysis of the claims data from the larger superannuation trustees, insurers estimated that superannuation members with default insurance, as a whole, will be paid up to 79 cents in claims for each dollar of insurance premiums they were charged over the six year period to FY 2018–19.

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**2.2 Consultation on the treatment of lease assets in satisfying AFS licence requirements**

11 December 2020 – ASIC has issued Consultation Paper 336 Financial requirements: Treatment of lease assets (CP 336). CP 336 seeks industry feedback on ASIC's proposal to change the treatment of lease assets in the calculation of financial requirements applicable to Australian financial services (AFS) licensees.

Following the introduction of accounting standard AASB 16 Leases (AASB 16), some AFS licensees may face difficulty in complying with their financial requirements because intangible assets, excluding deferred tax assets, are not included in satisfying such requirements.

ASIC's proposal will allow AFS licensees to include a right-of-use lease asset in their calculation of net tangible assets, adjusted surplus liquid funds and surplus liquid funds.

The proposal provides a solution to an impediment that some AFS licensees face in meeting their financial requirements. This will give licensees the regulatory certainty they need when it comes to meeting their licence conditions.

The proposal involves changes to:

- ASIC Class Orders [CO 13/760] – *Financial requirements for responsible entities and operators of investor directed portfolio services*,
- [CO 13/761] – *Financial requirements for custodial or depository service providers;*
- [CO 12/752] – *Financial requirements for retail OTC derivative issuers;*
- the standard conditions in ASIC Pro Forma 209 – *Australian financial services licence conditions;* and
- the existing conditions of each AFS licence.

Download

- Regulatory Guide 166 Licensing: Financial requirements;
- [CO 13/760];
- [CO 13/761];
- [CO 12/752]; and
- PF 209.

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**2.3 Updated regulatory guide on time-sharing schemes**

11 December 2020 – ASIC has released an updated Regulatory Guide 160 Time-sharing schemes (RG 160). The updated RG 160 contains guidance on the existing regulation of time-sharing schemes, as well as some new requirements, and is accompanied by an updated legislative instrument.

This release follows the earlier publication of Consultation Paper 272 Remaking ASIC class orders on time-sharing schemes (CP 272). It also takes into account the findings from ASIC's review of advice, consumer experience and financial value research, summarised in Report 642 Timeshare: Consumers' experiences (REP 642).

Industry generally has until 30 September 2021 to implement the new requirements set out in the updated RG 160. The transition periods will allow firms to implement the new requirements during a period when fewer sales are taking place due to COVID 19.

While ASIC remains concerned about the time-sharing sales practices, it is appropriate to give industry some time to implement the new requirements in the updated RG 160 and the new design and distribution obligations (DDO), which commence in October 2021.

ASIC will review the sales practice in early 2022 and if pressure selling conduct leading to poor consumer outcomes is identified, ASIC will consider further measures to address this harm.

### New requirements

In addition to the updated guidance on the current regulation, RG 160 contains the following new requirements:

- **a new "subject to finance" obligation** to allow consumers to withdraw their application for interests in a time-sharing scheme, even after the end of the cooling-off period, where their application is "subject to finance" and they do not proceed with the finance before the loan is provided;
- **new hardship withdrawal arrangements** so operators can allow time-sharing scheme members, who meet hardship criteria, to withdraw where the scheme constitution has been amended to provide for hardship withdrawals;
- **new compliance and audit requirements** for points-based programs to reduce the potential for dilution of members' interests;
- **amended disclosure requirements** to ensure operators and promoters provide consumers with clear and prominent information about the key features and risks of time-sharing, both verbally and in writing, at sales presentations; and
- **amended fees and costs disclosure requirements** tailored to the different types of time-sharing schemes and requiring clear disclosure of the upfront and ongoing costs involved in time-sharing.

### Transition to new requirements

Under the transitional arrangements outlined in RG 160, the current requirements will generally continue to apply until 30 September 2021 unless operators put in place arrangements for the application of new requirements before this date. Operators of registered time-sharing schemes must comply with the new requirements by 1 October 2021.

Issuers of products disclosure statements for time-sharing schemes will have until 30 September 2022 to implement the new fees and costs disclosure requirements (consistent with changes to fees and costs disclosure more generally in RG 97 Disclosing fees and costs in PDSs and periodic statements).

The updated RG 160 is based on ASIC Corporations (Time-sharing Schemes) Instrument 2017/272 as amended by ASIC Corporations (Amendment) Instrument 2020/1064 and ASIC Corporations (Amendment) Instrument 2020/1065 (Timeshare Instruments).

### Legacy schemes

ASIC will also review the individual relief provided to state-exempt time-sharing schemes, title-based time-sharing schemes and member-controlled clubs (legacy schemes). ASIC will look to amend this relief to reflect the new requirements under the Timeshare Instruments after consultation with these legacy scheme operators.

View:

- More about time-sharing schemes.

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### 2.4 Regulatory guide on product design and distribution obligations

11 December 2020 – ASIC has released a new Regulatory Guide 274 Product design and distribution obligations (RG 274). The design and distribution obligations require firms to design financial products to meet the needs of consumers, and to distribute their products in a more targeted manner. The obligations were passed by Parliament in 2019 following a recommendation of the Financial System Inquiry.

RG 274 addresses demand from industry for ASIC guidance as they prepare for the obligations to take effect on 5 October 2021. This follows a two year transition period and a six month deferral of commencement provided by ASIC due to the impacts of COVID-19.

The guidance in RG 274 is principles-based, reflecting Parliament's intent that industry is best placed to implement the obligations in the context of their existing operations and product offerings. It also reflects the fact that the design and distribution obligations cover most financial products across all sectors of the financial services market.

RG 274 sets out:

- the financial products to which the design and distribution obligations apply;
- ASIC's interpretation of the obligations; and
- ASIC's administration of the obligations.

View:

- Feedback report; and
- submissions.

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### 2.5 Technical updates to RG 246

10 December 2020 – ASIC has released technical updates to Regulatory Guide 246 Conflicted and other banned remuneration (RG 246) to reflect recent changes to the law.

The updates to RG 246 reflect:

- the end of the grandfathering of conflicted remuneration for financial product advice from 1 January 2021; and
- the extension of the ban on conflicted remuneration to stamping fees paid in relation to listed investment companies and listed investment trusts (excluding real estate investment trusts) that took effect on 1 July 2020.

The ban on conflicted remuneration for financial product advice applies to all benefits given on or after 1 January 2021. Product issuers are required to provide rebates to clients for all previously grandfathered benefits that they remain legally obliged to pay on or after 1 January 2021.

The updated RG 246 also clarifies that the law does not prescribe a timeframe for repaying commissions that are being clawed back where a life insurance policy has been cancelled or reduced in the first two years. This is consistent with the guidance previously published on the ASIC website.

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**2.6 Extension of relief from portfolio holdings disclosure**

8 December 2020 – ASIC has deferred the first reporting date for superannuation funds to disclose their portfolio holdings because the regulations supporting the requirements have not yet been made.

The relief from portfolio holdings disclosure was originally set to expire on 31 December 2020, with disclosure of information about a fund's holdings required on its website no later than 90 days from its reporting date (either 31 December or 30 June). ASIC's deferral allows additional time for the Government to make the regulations.

ASIC has implemented the deferral by amending the first reporting day in ASIC Class Order [CO 14/443] for superannuation funds to disclose their portfolio holdings to 31 December 2021.

Depending on when regulations are made, ASIC may shorten the period of the relief by a further legislative instrument. In doing so, ASIC will take into account the fact that industry will need an appropriate transition time to implement the regime.

ASIC supports greater transparency about funds' portfolio holdings and welcomes the move by some funds to proactively increase transparency about their portfolio holdings in the absence of legislative obligations.

View:

- ASIC Corporations (Amendment and Repeal) Instrument 2020/921.

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**2.7 Trustees to improve occupational classification practices in insurance in superannuation**

3 December 2020 – An ASIC review of default occupational categories in life insurance held through superannuation has identified ways for trustees to improve member outcomes and better meet legal obligations. ASIC reviewed the "occupational default" practices of a sample of 21 trustees who were using a high-risk occupational category as the default in their

MySuper products. This review was part of ASIC's ongoing work on insurance in superannuation.

Trustees often have limited data about members' occupations. As a result, most superannuation trustees allocate their MySuper product members a particular occupational category for the purpose of life insurance cover (occupational default) unless the member or employer provides additional information about the member's occupation.

What occupational category is chosen as default is important because a high proportion of members generally end up in the default category. Funds often select the highest risk category as their default to ensure all members are covered regardless of their occupation. However, this means the premiums are comparatively high.

In the products ASIC looked at, on average the price of default insurance for the highest risk occupational category was approximately double that of the lowest risk category. In five out of 20 cases, the price difference was between three and four times.

ASIC undertook the review in 2019 and 2020, choosing trustees that used a high-risk occupational default and that were more likely to have a membership with white collar or broad-based mix of occupations. The review explored a range of issues such as the assumptions trustees made about their members when setting their fund's occupational default, the factors trustees considered, and how they determined that the default was appropriate for their membership.

Trustees were also asked what they told members about the occupational categories, particularly the default, and how easy it was for members to update their occupational category to ensure that they are paying the correct insurance premiums.

**Key findings**

ASIC's review found:

- significant variation in the sophistication of trustees' assumptions and in the factors they took into consideration when designing their default category;
- poor disclosure by some funds, including about the relative cost of premiums in different categories and, in the case of 15 trustees, the use of a generic labels (such as "standard" or "general") for the most expensive category; and
- the process for members to update their occupational category was generally not readily apparent or accessible.

Following ASIC's engagement, most trustees using a generic label for their occupational default have updated their product disclosure statements (PDSs) and/or website disclosures to include clearer information about their occupational default categories.

**Areas for improvement**

Trustees may be contravening their legal obligations if they fail to ensure that insurance premiums charged to members are based on appropriate statistical assumptions. They can enhance outcomes for members with default insurance by ensuring that:

- effort is made, through engagement with members and employers, to gather better occupation data about individuals and cohorts so that default settings are based on appropriate statistical assumptions and are fair and reasonable;
- occupational default labels are meaningful, promote understanding of the level of risk and associated cost of the category, and trustees take prompt action to address any mis-categorisation; and
- disclosures clearly state a member's occupational category, the meaning of the category, the cost of the insurance in that category, whether the member may be eligible for an alternative category that is less expensive or provides a greater level of cover, and that members can easily amend their profile so that premiums are charged based on accurate information.

**Background**

In [Report 591 Insurance in superannuation](), ASIC raised concerns about the practice of trustees defaulting their fund members into high-risk occupational categories in the absence of member data.

Most super funds group occupations into categories such as "Blue Collar", "White Collar" and "Professional" to reflect the different levels of risk and the cost of cover associated with different occupations.

ABS data suggests that 50% or more of the Australian workforce is employed in primarily administrative or office-based work (i.e. lower risk, white collar work). In those funds not targeted to high-risk occupations, it is plausible that many members may be paying too much for their insurance if substantially more than 50% of the membership is in the high-risk occupational category by default.

The industry has recognised that this issue needs to be addressed. The Insurance in Superannuation Voluntary Code of Practice requires that trustees must not include members in higher risk categories than the general membership due to occupation *without relevant evidence*. In line with Recommendation 4.15 from the FSRC, APRA is updating SPS 250 to strengthen trustees' obligation to ensure that "any status attributed to default members (affecting the premium to be charged for insurance) is fair and reasonable".

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**2.8 Consultation on consumer remediation guidance**

3 December 2020 - ASIC has released a consultation paper on proposed updates to [Regulatory Guide 256: Client review and remediation conducted by advice licensees]().

Consultation Paper 335 Consumer Remediation: Update to RG 256 (CP 335) includes clarification of RG 256's application to all financial services licensees, credit licensees and superannuation trustees.

ASIC has been involved in many consumer remediations across insurance, superannuation, wealth and banking since releasing RG 256 in 2016. These range from Fee for No Service remediations affecting all of the major banks (highlighted at FSRC) to smaller remediations arising out of systems errors and failures by licensees to deliver on their contractual promises to consumers.

ASIC is currently monitoring over 100 remediations that could see the return of at least another $3.55 billion in total to over 3.6 million consumers upon finalisation. There are many other remediations that are dealt with by firms without any ASIC involvement.

While ASIC has seen some good practices by licensees, ASIC has also seen many remediations caused – or blown out – by ongoing systems failures, ultimately resulting in significant costs to licensees and further harm to consumers.

CP 335 gives industry and stakeholders the opportunity to provide feedback about the challenges they face in designing and executing remediations. It includes real-life case studies based on remediations in which ASIC has been directly involved.

ASIC has also released Making it Right: how to run a consumer centred remediation, a resource that offers immediate help to licensees with the day-to-day design and execution of consumer-centred remediations. This customer-centred field guide draws on ASIC's on-the-ground experience with remediations and lessons from behavioural science. It does not set new legal obligations.

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### 2.9 Information sheet on managing conduct risk during LIBOR transition

30 November 2020 – ASIC has published Information Sheet 252: Managing conduct risk during LIBOR transition (INFO 252) on practical guidance that Australian entities can adopt to manage conduct risk during the London Interbank Offered Rate (LIBOR) transition. LIBOR is expected to cease after the end of 2021. Although entities in Australia have made substantial changes to date, additional effort is required to ensure an orderly transition.

The guidance sets out regulatory expectations and clarifications on key transition issues. It aims to assist entities in establishing necessary arrangements to mitigate conduct risk associated with the discontinuation of LIBOR.

INFO 252 sets out:

- frameworks, practices, and recommendations on fair treatment of clients, representation of product performance, and client communication strategies;
- ASIC's expectation of the industry, including what ASIC considers to be best practices; and

- buy-side entity specific guidance and recommendations.

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### 2.10 Draft information sheet for insurance claims handling

27 November 2020 – ASIC has released a draft information sheet on insurance claims handling and settling.

This follows the introduction of the Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 ("the Bill") into Parliament on 12 November 2020. On passage of the Bill, persons providing claims handling and settling services will need to be covered by an AFS licence, and the general conduct obligations under s. 912A of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) will apply.

Industry participants that will need to get an AFS licence for claims handling and settling or be authorised by another AFS licensee are:

- insurers;
- insurance claims managers;
- tradespersons (referred to as "insurance fulfilment providers") who can reject claims on behalf of an insurer;
- insurance brokers who handle claims on behalf of an insurer;
- financial advisers who handle claims on behalf of an insurer; and
- people that carry on a business of representing people to pursue insurance claims for reward (referred to as "claimant intermediaries").

Entities that already hold an AFS licence will need to apply for a variation to their licence so it covers the new financial service of claims handling and settling.

To assist industry to comply with the timeframes in the Bill, ASIC has released the information sheet in draft form now. This will help give industry participants as much time as possible to consider whether they need to obtain (or vary) an AFS licence, and if so, what they will need to do.

The draft information sheet:

- sets out who needs to be authorised to provide claims handling and settling services for insurance products and who can act on an AFS licensee's behalf;
- explains how and when to apply for an AFS licence, or variation to an existing AFS licence, including materials that are needed to support an application; and
- refers to existing regulatory guidance on how to meet the general obligations under s. 912A of the Corporations Act, and indicates how the obligations may be tailored to claims handling.

ASIC has also released a draft version of C12 Proof: Claims Handling and Settling Service Statement. Applicants seeking an AFS licence authorisation for claims handling and settling services will be required to supply this statement as part of their application.

ASIC will issue the final information sheet and proof document, incorporating any changes to the legislation during passage of the Bill, ahead of the commencement of the reforms.

ASIC expects to start taking applications for AFS licences, and variations to existing licences, from 1 January 2021 (subject to the Bill's passage before the end of this year). Applicants are strongly encouraged to submit their applications as soon as possible because:

- during the transition period between 1 July 2021 and 31 December 2021 claims handing and settling services can only be provided if a complete application was lodged by 30 June 2021, and it has either been granted or is still pending; and
- from 1 January 2022 claims handling and settling services can only be provided if the application has been granted.

View:

- Draft INFO 000 Claims handling and settling; and
- Draft C12 proof on insurance claims handling and settling.

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### 2.11 Consumer research on insurance in super

20 November 2020 – ASIC has released an independent research on the experiences of superannuation fund members who directly engaged with their fund about insurance held through superannuation.

Report 673 Consumer engagement in insurance in super (REP 673) presents findings from research exploring the experiences of superannuation fund members, who were not using a financial adviser and directly contacted their fund to make enquiries about or make changes to their insurance arrangements.

There are over 20 million superannuation accounts and around half of these have life insurance attached. While some members have life insurance recommended by a financial adviser or arranged by their employer, most hold the default cover offered by their fund trustee.

Insurance in superannuation is complex and it is widely acknowledged that members' awareness and understanding of it is relatively low. ASIC's consumer research has highlighted that a number of fund members who directly engage with their insurance found the process challenging and were not always able to achieve what they set out to do.

The research found that the process of gaining information about insurance arrangements from their super fund or making changes to the insurance presented several potential hurdles to many members. Limited knowledge and understanding of insurance in superannuation and a relative lack of confidence among members because of the complexity of web-based information were some of the issues identified.

A number of participants in the research engaged with their insurance for fact-finding or to address lack of knowledge about the level of cover they had and how much they should have.

Most members expected this to be a simple self-service process, but found that was not the case. Many wanted more than factual information.

After interacting with their fund, about a third of the participants spontaneously reported that they felt confused, overwhelmed or uncertain. They found insurance complex and difficult. Some discovered information they did not understand or did not know how to respond to. This often caused them to delay in engaging further with their fund on insurance after their initial interaction.

The research highlights some challenges for trustees, such as those associated with providing more tailored information for members. At the same time, there is an opportunity for trustees to significantly improve their members' experience by improving communication to members about insurance, including on their websites. Many of the problems members experienced may have been reduced or avoided if the information they sought was easy to find, clear and balanced.

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### 2.12 Consultation on reference checking and information sharing protocol

19 November 2020 – ASIC has released a consultation paper seeking feedback on a new reference checking and information sharing protocol for financial advisers and mortgage brokers. Mandating reference checking for financial advisers and mortgage brokers was a recommendation of the FSRC (see Background).

The Government accepted the FSRC recommendations on reference checking and, on 12 November 2020, introduced the Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 (the Bill) into Parliament.

The Bill includes obligations on Australian financial services (AFS) licensees and Australian Credit (credit) licensees to comply with an ASIC reference checking and information sharing protocol (ASIC Protocol).

ASIC has developed a draft ASIC Protocol, which sets out obligations for licensees in relation to undertaking a reference check on an individual seeking to be employed or authorised as a financial adviser or mortgage broker. ASIC has also prepared a draft information sheet to help licensees understand their reference checking and information sharing obligations.

ASIC is now consulting on both the draft ASIC Protocol and the accompanying information sheet through Consultation Paper 333 Implementing the Royal Commission recommendations: Reference checking and information sharing (CP 333).

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### 2.13 Consultation on promoting access to affordable advice for consumers

17 November 2020 – ASIC has issued Consultation Paper 332 Promoting access to affordable advice for consumers (CP 332). CP 332 seeks input from industry participants and relevant stakeholders to help ASIC understand:

- the issues and impediments relating to the supply of good quality affordable personal advice; and
- the practical steps that can be taken by ASIC and industry to improve consumer access to good quality affordable advice.

This consultation is part of a broader piece of work by ASIC to understand how to improve access to personal advice for consumers.

A particular focus of this paper is on promoting access to quality "limited advice". All personal advice can be scaled up and down to cover all areas relevant to the client, or one or some of the areas relevant to the client. "Limited advice" is personal advice that does not cover all areas that are relevant to the client. It is also known as "scaled", "piece-by-piece", "single issue", "modular" or "episodic" advice.

ASIC knows from previous research that consumers want better access to limited and affordable advice, but that many industry participants find it challenging to provide this type of advice. ASIC is keen to receive feedback on the impediments to providing affordable and limited advice that ASIC and industry are able to address.

ASIC is inviting feedback from the financial advice industry and others with an interest in making affordable advice more accessible to consumers. Feedback on industry's experience in providing limited, digital and strategic advice is of particular interest.

As part of this consultation, ASIC is also seeking input on what can be done to make the example statements of advice (SOAs) in Regulatory Guide 244 Giving information, general advice and scaled advice and Regulatory Guide 90 Example Statement of Advice: Scaled advice for a new client more helpful.

View:

- ASIC's previous consumer research Report 627 Financial advice: What consumers really think; and
- Report 224 Access to financial advice in Australia, which identified that consumers want access to affordable advice and, in particular, limited advice.

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## 3. Recent ASX Developments

### 3.1 Public consultation – Proposed Listing Rule changes: online forms, notification of security issues and corporate action timetables

On 30 November 2020, ASX released a consultation paper on proposed changes to the ASX Listing Rules to facilitate the introduction and operation of the next round of new and updated online forms that ASX will be releasing in the New Year.

ASX is also taking the opportunity to propose:

- changes to the rules dealing with notifications of security issues in Listing Rules 3.10.3 – 3.10.3D to make them clearer and easier to follow;
- amendments to Listing Rules 3.21 and 3.22 and a new Listing Rule 12.13 addressing the cancellation or deferral of previously announced dividends, distributions and interest payments;
- an amendment to Listing Rule 2.8.3 to reduce the deadline for applying for quotation of securities issued as a consequence of the conversion of unquoted convertible securities from 10 business days to 5 business days;
- clarifying amendments to the definition of "employee incentive plan" in Listing Rule 19.12; and
- changes to the timetables for corporate actions in Appendices 6A and 7A, in particular to allow an additional 2 business days for an entity to announce the results of certain corporate actions.

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### 3.2 Public consultation – Proposed ASX Clear Operating Rules, Procedures and Guidance Note: trust and client segregated account

On 30 November 2020, ASX released a consultation paper on proposed amendments to the ASX Clear Operating Rules and Procedures and ASX Clear Operating Rules Guidance Note 12 (Trust and Client Segregated Accounts) to provide an improved framework and additional guidance to assist participants to comply with their client money obligations.

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## 4. Recent Takeovers Panel Developments

### 4.1 Webcentral Group Limited 02R – Panel declines to conduct proceedings

25 November 2020 – The review Panel has declined to conduct proceedings on an application dated 30 October 2020 from Keybridge Capital Limited in relation to the affairs of Webcentral Group Limited ("Webcentral"). The application sought a review of the initial Panel's decision in Webcentral Group Limited (see TP20/66).

The application concerned an off-market takeover bid from 5G Networks Limited ("5GN") for Webcentral. The review Panel agreed with the initial Panel that it is conceivable that Webcentral shareholders were coerced into accepting the 5GN bid prior to the waiver of the 50% acceptance condition to the 5GN funding, in particular during the period after 5GN declared its bid free of conditions.

However, the review Panel considered it unlikely it would find any coercion relating to the 50% acceptance condition in the 5GN funding unacceptable in light of other factors that may have influenced acceptances into the 5GN bid at the time.

The review Panel also considered it unlikely that it would second guess the decision of the Webcentral directors to recommend the 5GN bid and provide intention statements to accept the 5GN bid in the circumstances.

The review Panel concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances, affirming the initial Panel's decision not to conduct proceedings.

The Panel will publish its reasons for the decision in due course on its website.

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#### 4.2 Excelsior Capital Limited – Panel declines to make declaration

23 November 2020 – The Panel has declined to make a declaration of unacceptable circumstances in response to an application dated 29 October 2020 from Mr Warwick Sauer in relation to the affairs of Excelsior Capital Limited ("Excelsior"). The application concerned acquisitions of Excelsior shares resulting in Ms Leanne Catelan's relevant interest in Excelsior increasing from 47.8% to 50.2% (see TP20/68).

The Panel considered (among other things) that:

- there was insufficient material to establish that the acquisitions were unacceptable. The Panel was not satisfied the market was uninformed to any material extent when the acquisitions occurred; and
- Ms Catelan was required to lodge a substantial holder notice in relation to acquisitions on market on 10 and 12 March 2020, but did not lodge a substantial holder notice until 9 November 2020 (after the Applicant made his application). Ms Catelan should have ensured she complied with the substantial holding notice requirements in a timely manner. However, given that a notice has now been provided, in the circumstances of this matter, further action by the Panel is not necessary or appropriate.

The Panel considered that it is not against the public interest to decline to make a declaration of unacceptable circumstances.

On the basis of the above, the Panel decided not to make a declaration of unacceptable circumstances.

The Panel will publish its reasons for the decision in due course on its website.

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### 4.3 Cardinal Resources Limited 03, 04, 05 and 07 – Panel declines to conduct proceedings

#### Cardinal Resources Limited 03 and 04

17 November 2020 – The Panel has declined to conduct proceedings in relation to applications dated 30 October 2020 by Samson Rock Capital LLP and Cardinal Resources Limited (ASX/TSX: CDV) in relation to the affairs of Cardinal (see TP20/69 and TP20/71 respectively).

Cardinal is the subject of competing takeover bids from Nord Gold S.E. ("Nordgold") and Shandong Gold Mining (Hong Kong) Co., Limited ("Shandong"). On 19 October 2020, Shandong made an announcement that its $1.00 per share offer price under its unconditional off-market takeover bid for Cardinal was best and final in the absence of a higher competing offer.

On 21 October 2020, Nordgold increased the price under its unconditional on-market takeover bid for Cardinal from $0.90 to $1.00 per share. On 26 October 2020, Nordgold made an announcement that its $1.00 per share offer price was best and final in the absence of a higher competing offer.

The applications concerned whether the effect of the above-mentioned circumstances (among others) is that the auction for control of Cardinal has hit an impasse, "with neither bidder able to increase its offer, and the very real prospect that neither will be able to be successful, so that control of the company will not be resolved through the bids". The applicants submitted that there has ceased to be an efficient, competitive and informed market for control of Cardinal shares.

Each of the applicants sought final orders, including that both Nordgold and Shandong be permitted to increase their offer price under their respective takeover bids above $1.00 per Cardinal share.

Among other matters, the Panel considered the following circumstances important to its decision:

- ASIC's "truth in takeovers" policy contained in RG 25 has been endorsed by the Panel as a "fundamental tenet" of Australia's takeover regime and requiring "persons to act in accordance with statements that they have made to the market concerning their intentions in the context of a takeover bid under Chapter 6 promotes the principle set out in s. 602(a)" (see Breakfree Limited 03 and 04 [2003] ATP 38 & 39 at [110]-[111]);
- the Panel has had regard to that policy in considering the question of whether the circumstances here are unacceptable; and
- it considered there was no reasonable prospect that it would find the current situation between Shandong and Nordgold in respect of their bids for Cardinal unacceptable, including because: Shandong's qualification in its last and final statement made on 19

October 2020 (i.e. "in the absence of a higher competing offer") was not ambiguous; Nordgold matching the Shandong offer and seeking to hold Shandong to its last and final statement was not a misuse of the "truth in takeovers" policy; and notwithstanding that the auction between Shandong and Nordgold has been stalled, there is no material to suggest that the market is inefficient or uninformed.

The Panel concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances. Accordingly, the Panel declined to conduct proceedings. The reasons for the decision are available on the Takeovers Panel website.

**Cardinal Resources Limited 05**

The Panel also declined to conduct proceedings on an application dated 30 October 2020 from Shandong Gold Mining (HongKong) Co., Limited ("Shandong") in relation to the affairs of Cardinal Resources Limited (ASX/TSX: CDV) (see TP20/72).

Cardinal is the subject of competing takeover bids from Nord Gold S.E. ("Nordgold") and Shandong. The application concerned, among other things, whether Nordgold and MM Asset Management Inc. ("MMAM") had come to an agreement, arrangement or understanding that MMAM would accept into the Nordgold bid in consideration for Nordgold increasing the offer price under its on-market bid for Cardinal on 2 September 2020 from A$0.66 to A$0.90 per share ("MMAM Arrangement").

Shandong submitted that by virtue of the MMAM Arrangement, Nordgold had acquired a relevant interest in MMAM's Cardinal shares prior to MMAM accepting into the Nordgold bid, which resulted in Nordgold's voting power in Cardinal exceeding 20% in breach of s. 606.

The Panel considered (among other things) that:

- Shandong did not provide sufficient probative material to justify the Panel making further enquiries as to whether Nordgold had acquired a relevant interest in MMAM's Cardinal shares prior to MMAM accepting into the Nordgold bid; and
- MMAM's conduct in relation to the on-market disposal of its Cardinal shares following Nordgold announcing an increase in its offer price on 2 September 2020 was not economically irrational, including because the Shandong offer continued to be subject to a 50.1% minimum acceptance condition at that time.

The Panel concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances. Accordingly, the Panel declined to conduct proceedings. The reasons for the decision are available on the Takeovers Panel website.

**Cardinal Resources Limited 07**

The Panel also declined to conduct proceedings on an application dated 20 November 2020 from Cardinal Resources Limited in relation to its affairs (ASX/TSX: CDV) (see TP20/80).

On 18 November 2020, Nordgold made an announcement extending the closing date for its on-market bid for Cardinal to 7 December 2020 ("Nordgold Announcement"). The Nordgold Announcement contained statements, including that:

- "Nordgold's on-market offer has been extended by seven days and will now close on Monday 7 December 2020, ahead of results being determined for the 2020 Ghanaian General Election which is scheduled to take place on the same day.;
- . the Takeovers Panel has determined not to consider the applications made by Cardinal and Shandong, announced on 30 October and 2 November 2020, respectively.[1] Therefore the offers made by Shandong and Nordgold are determined best and final.;
- . Nordgold's on-market offer therefore provides shareholders with the quickest and most expedient route to securing the full cash payment for tendered shares.;
- . Nordgold also intends to provide an off-market alternative for shareholders who prefer this option. The terms of this alternative will be commercially the same as those offered by Shandong and will have expedited payment terms. Nordgold received approval from ASIC to conduct the simultaneous off-market bid on 18 November 2020.; and
- . With both Nordgold and Shandong's offers best and final, we hope that the takeover can now be concluded successfully.".

Footnote 1 to the Nordgold Announcement stated that "Cardinal has applied to the Takeovers Panel seeking a review of the Takeovers Panel's determination in relation to the applications made on 30 October 2020.".

Cardinal submitted (among other things) that the Nordgold Announcement had resulted in an uninformed market and that it was made at a time in which undertakings given in notices of appearance lodged by Nordgold in relation to Cardinal Resources Limited 03 & 04 ("Notices of Appearance") still applied.

The Panel considered (among other things) that it was not persuaded that any of the statements made in the Nordgold Announcement were misleading or in contravention of the undertakings given in the Notices of Appearance and, in any event, those statements had been overtaken by events.

The Panel concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances. Accordingly, the Panel declined to conduct proceedings. The reasons for the decision are available on the Takeovers Panel website.

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## 5. Recent Research Papers

### 5.1 The future of the corporation and the economics of purpose

This article examines the economic underpinnings of the concept of corporate purpose, which has gained increasing attention from business academics, practitioners and policymakers. It argues that there are fundamental reasons for reconceptualising the purpose of business in the future which derive from the changing nature of business and the market failures to which it gives rise. It suggests that regulation is proving increasingly inadequate at correcting market failures, and the traditional separation between economic efficiency and distribution that underpins policy formulation is untenable. Instead, the article sets out how appropriately defined notions of corporate purpose can help to promote not only better social outcomes but also enhanced functioning of firms and markets. It describes a set of principles that provide a comprehensive framework for reforming business around credible commitments to corporate purpose. The reformulation of the corporation has profound implications for the macroeconomic performance of economies as well as the microeconomics of firms and markets.

The Future of the Corporation and the Economics of Purpose

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### 5.2 Making ″stakeholder capitalism″ work: Contributions from business & human rights

For the first time in four decades, leading business associations, corporations, and the corporate law and governance community are seriously debating the social purpose of the corporation. The idea of stakeholder governance – moving beyond shareholder primacy toward some form of ″stakeholder capitalism″ – is in play. But the question of how to do this unveils significant differences of opinion, as well as difficulties. Some advocates place their bet on enlightened voluntary cooperation between corporations, large institutional investors, and other stakeholders. Yet considering the financial incentives that the current system affords corporate directors and executives, especially in the Anglo-American system, driven by equity-based compensation, voluntarism by itself is unlikely to move the needle far enough. Others provide long and detailed lists of a dozen or more bodies of law and regulations that should be reformed to ensure that accountability to wider stakeholders is established. But that inevitably poses multiple political impediments and therefore takes time. For their part, critics of ″stakeholderism″ posit what amounts to an impossibility theorem, contending that corporate leaders simply are unable to identify ex ante who the relevant stakeholders are, or to devise a formula regarding how to weigh and balance their conflicting interests – let alone how their concerns would be represented at board levels.

In contrast, the authors focus on a pathway that reflects the ambition of stakeholder capitalism, but which current reform proposals have largely overlooked. They draw on practical experience in the field of business and human rights, where leading companies are increasingly embedding human rights due diligence processes into their strategic decision-making. As human rights due diligence is made mandatory for companies, which it is in a growing number of jurisdictions – with debate centred in but not limited to Europe – risks to stakeholders become a significant corporate governance issue. It makes it necessary that their concerns are addressed and requires demonstration that indeed they are. Such changes by themselves may not constitute a full-blown system of multi-fiduciary obligations, but they mark substantial strides on the path toward it, and they are doing it in the relatively near-term.

Making "Stakeholder Capitalism" Work: Contributions from Business & Human Rights

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### 5.3 Crypto-enforcement around the world

The blockchain revolution in capital and financial markets attracted the attention of enforcement agencies in many jurisdictions. This article elaborates the results of an international enforcement survey of the Blockchain and Fintech Research Program of the Rutgers Center for Corporate Law and Governance. It provides a detailed analysis of enforcement in major crypto-market jurisdictions. The data suggest that, despite an extended network of agreements facilitating international cooperation, the US Securities and Exchange Commission (US SEC) maintains its historically active enforcement posture. The US SEC brings more enforcement actions against cryptoasset issuers, broker-dealers, crypto-exchanges, and other digital-asset market participants than most other major crypto-jurisdictions, as well as the US Commodity Futures Trading Commission. SEC enforcement results in considerably more serious penalties.

The data raise theoretical questions on regulation via enforcement, its effect on financial innovations, and regulatory competition. The US does not have a separate regulation designed for the decentralised ledger technology industry and related financial markets, which effectively creates a pure regulation via enforcement environment. To the extent that the US agencies pursue actions not only against domestic companies but also foreign firms, which raise only part of their capital from US investors, their actions impact global crypto-markets and raise regulatory competition concerns.

Crypto-Enforcement Around the World

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### 5.4 Shareholder primacy and the moral obligation of directors

The fiduciary obligations of corporate directors is one of the most written about and important topics in corporate law. Increasingly, critics of American capitalism have urged that corporations, and implicitly corporate directors, act in a more socially responsible fashion and thus eschew the notion of shareholder primacy. On this view, directors must consider the effect of their actions on "stakeholders" other than shareholders and be guided by morality – do the right thing – when making business judgments. When directors move away from shareholder primacy, however, decision-making becomes more difficult and problematic. This article analyses the arguments that underpin a rejection of shareholder primacy, alternatives to shareholder primacy, and the utility of morality as a guide for directors making business judgments.

Shareholder Primacy and the Moral Obligation of Directors

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### 5.5 "Legitimate expectations" and the oppression remedy

Should a shareholder's legitimate expectations form part of the test employed by courts to decide if the shareholder has been oppressed? The term "legitimate expectations" was first used by an Australian court in an oppression claim more than 40 years ago. Yet there remains disagreement among courts regarding whether the use of the term assists or impedes them in deciding oppression claims. This is an important issue given that the oppression remedy is widely used by shareholders. To advance the debate, the authors examined the 51 Australian judgments in which there is substantive discussion of the term. The analysis undertaken reveals five different approaches to the use of the term in these judgments and no consistent approach adopted by the courts. The evaluation by the authors leads to the conclusion that use of the term "legitimate expectations" has not aided the analysis by courts of whether oppression has occurred, its use has been inconsistent, and therefore it should not be used in cases where oppressive conduct is alleged.

"Legitimate expectations" and the oppression remedy

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### 5.6 A "Damaging Loophole" "Long Overdue" for closing: Extending consumer protections against unfair contract terms to insurance

As part of the Australian Consumer Law reforms of 2010, unfair contract terms protections were implemented nationwide across most sectors that use standard form contracts in their dealings with consumers, including financial services. However, until recently, these protections did not apply to general insurance contracts covered by the Insurance Contracts Act 1984 No. 80 (Cth). Consumer groups, as well as a series of government and independent inquiries and reviews, have long called for reforms to bring insurance within the ambit of the unfair contract terms protections contained in the Australian Securities and Investments Commission Act 2001 No. 51 (Cth). In February 2020, legislation was passed to remedy the situation. In this article, the authors examine the history that paved the way to these reforms, and evaluate their impacts for consumers and insurers. They argue that this legislation indicates a move away from the view of insurance contracts as having a "unique character" that renders them "unsuited" to the consumer protections that apply to other financial products and services. The authors suggest that the application of unfair contract terms protections to insurance contracts has potential to address consumer harm without resulting in prohibitive costs for the insurance industry.

A "Damaging Loophole" "Long Overdue" for Closing: Extending Consumer Protections Against Unfair Contract Terms to Insurance

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### 5.7 Cause to complain? Consumer experiences of internal and external dispute resolution in the context of general insurance

The provision of "fair, timely and effective" mechanisms for the resolution of consumer complaints is "a central part" of the regulatory framework for financial services including general insurance in Australia. Insurers are required to have in place internal dispute resolution ("IDR") processes through which policyholders can complain if their insurance claim is subject to delays, or if they are unhappy with its outcome. Insurers must also be members of the recently established Australian Financial Complaints Authority, to which policyholders may escalate complaints that are not resolved through IDR. This article draws upon the findings of a survey of building, home contents and comprehensive car insurance policyholders to shed light on the experiences of consumers who make or escalate complaints in relation to their claims; issues with compliance with the regulatory frameworks governing complaints; and the barriers that can deter consumers from making use of these complaints mechanisms.

[Cause to Complain? Consumer Experiences of Internal and External Dispute Resolution in the Context of General Insurance]

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## 6. Recent Corporate Law Decisions

### 6.1 Business interruption insurance for COVID-19: First Australian test case

*(By Kemsley Brennan, James Stanton, Kathryn Rigney, Nina Newcombe, MinterEllison)*

*HDI Global Specialty SE v Wonkana No. 3 Pty Ltd trading as Austin Tourist Park* [2020] NSWCA 296 (18 November 2020), Supreme Court of New South Wales, Court of Appeal, Bathurst CJ, Bell P, Meagher JA, Hammerschlag and Ball JJ.

#### (a) Summary

On 18 November 2020, the NSW Court of Appeal delivered its decision in *HDI Global Specialty SE v Wonkana No. 3 Pty Ltd trading as Austin Tourist Park* [2020] NSWCA 296. The decision was highly anticipated for both insureds and insurers seeking clarity from the Court in relation to certain exclusion clauses which reference the Quarantine Act 1908 No. 3 (Cth) (the Quarantine Act) as amended, and whether those references encompass the Biosecurity Act 2015 No. 61 (Cth) (the Biosecurity Act) and, if so, the timing of the application of the exclusion.

The NSW Court of Appeal was only required to rule on the primary question before it, being whether the words "declared to be quarantinable diseases under the Quarantine Act" appearing in the HDI Disease Benefit and the Hollard Disease Cover should be read as "determined to be listed human diseases under the Biosecurity Act 2015". The secondary question as to timing of the exclusion was not required, given the Court's primary findings.

In short, the Court unanimously rejected the insurers' arguments that the words "and subsequent amendments" to the Quarantine Act should be construed so broadly so as to encompass the Biosecurity Act. The Court did not accept that a reasonable person would have understood the words "and subsequent amendments" to include a reference to the Biosecurity Act, and as a matter of construction, the references to the Quarantine Act could not be construed as references to a replacement statute.

Subject to a possible appeal, the expected effect of this would be that many insureds whose policies feature that specific exclusionary wording will not be barred from cover for COVID-19 losses by that exclusion. Cover for those insureds will, however, be dictated by the terms of those policies and the circumstances of each case.

### (b) Facts

#### (i) Insurance claims

In the midst of the global COVID-19 pandemic, the global insurance market saw, and is still seeing, numerous notifications of loss to businesses due to the disease, interruption to trade, and government-mandated closures. Insurers have also worked to respond to those notifications, with varying effect. As a consequence, the Insurance Council of Australia ("ICA") agreed with the Australian Financial Complaints Tribunal ("AFCA") to prepare and run a test case to resolve questions relating to the coverage available under certain exemplar insurance wordings.

The exemplar wordings contained an extension for certain occurrences of disease in or near the location of the relevant insured business, but contained an exclusion for certain serious communicable diseases. The Court of Appeal was asked to determine whether the mechanism by which the exclusion operated would encompass COVID-19 losses.

#### (ii) Business interruption policies

The business interruption policies in question were issued by insurers to small, medium and large businesses. Such policies are ordinarily intended to cover damage and loss to business premises, as well as the consequential loss of profit and any additional expense consequent upon that physical loss.

Classically, the business interruption cover in those policies would trigger following incidents such as floods, fires and building collapses. However, a large number of those policies also extend to cover other incidents which do not strictly result from damage to the property. Those types of cover were directly called into question by COVID-19 and examined by the Court.

#### (iii) Background facts

The first, second and third defendants were insured against interruption to their tourist park business for the period 28 February 2020 to 28 February 2021 under a business interruption policy issued by the first plaintiff, HDI Global ("HDI"). The retail business of the fourth defendant was insured under a similar policy for the period 11 May 2019 to 11 May 2020 issued by the second plaintiff, the Hollard Insurance Company Pty Ltd ("Hollard").

Each of the policies provided cover for interruption or interference caused by outbreaks of certain infectious diseases within a 20km radius of the insured's premises, but subject to an exclusion for diseases declared to be quarantinable diseases under the Quarantine Act and subsequent amendments.

The Quarantine Act had been repealed on 16 June 2016 and replaced by the Biosecurity Act, which did not provide for declarations of quarantinable diseases by the Governor-General, but provided for determination of "listed human diseases" by the Director of Human Biosecurity. COVID-19 was not declared to be a quarantinable disease under the Quarantine Act before it was repealed, but it was determined to be a listed human disease under the Biosecurity Act on 21 January 2020.

The defendant insureds claimed indemnity from HDI and Hollard for business interruption caused by COVID-19, which were declined. The insurers then commenced proceedings seeking declarations that on the proper construction of each clause in the HDI and Hollard policies, the words "declared to be quarantinable diseases under the Quarantine Act" should be read as "determined to be listed human diseases under the Biosecurity Act".

### (c) Decision

#### (i) Quarantine Act did not mean Biosecurity Act

The insurers argued, *inter alia*, that the exclusion was intended to carve out all serious infectious diseases, including those under the former Quarantine Act and current Biosecurity Act. To deprive the clause of that meaning would lead to absurdity, since the Quarantine Act was no longer in force. Particularly since the exclusion was intended to be ambulatory (to exclude diseases as and when they were listed or declared), the insurers argued that the commercially sensible interpretation of the clause was to allow the reference to the Quarantine Act to also be reference to the Biosecurity Act. All five judges sitting in the Court of Appeal reached the same practical conclusion: the wording of the insurance policies should stand without forcing the insurers' intended meaning upon them. In short, the reference to the Quarantine Act in those policies would not be read as incorporating the Biosecurity Act because it was a meaning inconsistent with the orthodox canons of interpretation.

Hammerschlag J emphasised that rules of contractual construction are uncontroversial and, by applying those, the exclusion wording was given the meaning on its face. That is, the exclusion would only operate for those diseases declared under the repealed Quarantine Act. Those diseases, such as SARS and influenza remained diseases which would be excluded. However COVID-19 was listed under the Biosecurity Act and, therefore, the exclusion would not apply to that disease notwithstanding the insurers' intent that it would.

His Honour approached the issue on the basis that absurdity is more than just a lack of genuine commercial good sense. It entails commercial nonsense, to the point where it is obvious that the parties did not mean what they said and obvious what they meant to say. Although his Honour accepted that it may have made better commercial sense for the parties to have referred to a current Act rather than one repealed four years earlier, the words used are not a clear mistake and, if they were, do not rise to the level of absurdity. Although he suspects that the insurers made a mistake, suspicion is insufficient and anyway there was no basis to suspect that the insureds overlooked anything.

Bathurst CJ and Bell P agreed with the reasoning of Hammershlag J. Meagher JA and Ball J reached the same conclusion but via slightly differing reasons. Among other things, Meagher JA and Ball J referenced the English authority of *Impact Funding v AIG Europe* [2016] UKSC 57, which provides that an exclusion clause must be read in the context of the contract of insurance as a whole, consistent with and not repugnant to the purpose of the policy.

Their Honours focused further on the fact that the bargaining positions of insurer and insured were not such as an ordinary commercial contract. That position was also accepted in Australian laws of contractual construction. Insurance policies are written by insurers and generally issued as standard form wordings, with little input from the insured in most cases. Given the policies in question fell into that "standard form" category, their Honours determined that the meaning was sufficiently plain on the face of the contract as a whole: the exclusion would operate (and not be infected by absurdity) with reference to specific diseases, either a named disease or other diseases declared under the Quarantine Act, and this was not ambiguous.

They also made the valid point – somewhat common in disputes with insurers – that the outcome could have been avoided by more careful drafting by underwriters, noting that elsewhere in the policy there is a reference to the Insurance Contracts Act 1984 No. 80 (Cth) "or any subsequent legislation".

The distinction in the Court's approach is a fine one. As Bathurst CJ and Bell P stated:

"The question is one of construction, and of the proper limits and extent to which a contractual document, here the policies of insurance, may be construed in a way which involves a departure from the actual words used by the parties, on their ordinary grammatical meaning. Both Hammerschlag J and Meagher JA and Ball J conclude that orthodox principles of contractual construction are not so flexible as to admit of the insurers' second argument. We are of the same view".

**(ii) Key takeaways**

It is currently anticipated the insurers may seek leave to appeal the Court of Appeal's decision. In order to obtain that leave under s. 35A of the Judiciary Act 1903 No. 6 Cth) the High Court will have regard *inter alia* to whether the proceedings involve a question of law that is of public importance, whether because of its general application or otherwise. At this stage it seems that such an application has a reasonable chance of being granted given the exclusion appears in a number of policies in the market, and the sheer impact felt by Australian businesses following COVID-19.

While the legal principles applied in the judgement are not novel in themselves, the key takeaway is that the Court of Appeal will apply the orthodox canons of interpretation to exclusions in insurance contracts, rather than force a meaning. That is the case even if the result is one which is not necessarily commercially optimal or even, in some cases, intended.

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**6.2 Making payments under a DOCA: What's your authority?**

*(By Claire Taylor, Lin Ma and Cynthia Anandajayasekeram, Ashurst)*

*Commissioner of Taxation v Yeo as Liquidator of Ready Kit Cabinets Pty Ltd (in liq)* [2020] FCAFC 1999 (18 November 2020), Federal Court of Australia, Full Court, Jagot, Davies and Markovic JJ.

(a) Summary

The Commissioner of Taxation ("the Commissioner") brought proceedings, on appeal, against Ready Kit Cabinets Pty Ltd ("RKC") for payments made by RKC to the Australian Taxation Office ("ATO") ("the Payments").

The sole issue in the case was whether the Payments were entered into or done on behalf of RKC "by, or under the authority of the administrator(s)" of a deed of company arrangement ("DOCA") as per s. 588FE(2B)(d)(i) of the Corporations Act 2001 No. 50 (Cth) ("Corporations Act"). The consequence of being categorised as not authorised as such was that the Payments would be set aside as voidable transactions that unfairly favoured the ATO as a creditor.

The Federal Court of Australia ("FCA"), agreeing with the Primary Judge at first instance, held that the Payments were not made "by, or under the authority of the administrators". The FCA did find that the DOCA vested control and management in the director of RKC for making the payments in compliance with taxation laws and the administrators were parties to the DOCA. However, the FCA held that such authorisation was general in nature and did not imply that making the Payments was especially by, or under the authority of, the administrators. Therefore, the FCA found the Payments should be set aside as voidable transactions as the Primary Judge correctly held.

(b) Facts

RKC entered into the DOCA with its creditors and the respondents, Mr Yeo and Mr Rambaldi, who were appointed as deed administrators ("Administrators"). Clause 4.1(a) of the DOCA provided for the management and control of RKC to return to the director for the term of the DOCA. During the DOCA term, RKC made payments to the ATO in compliance with taxation laws as covenanted and undertaken by the director of RKC in cl. 6.1(d) of the DOCA.

Later after the termination of the DOCA, the Administrators were appointed as liquidators of RKC and challenged the Payments as a voidable transaction, relying on s. 588FE(2B)(d)(i) of the Corporations Act, which states the following:

"The transaction is voidable if: .

(d) the transaction, or the act done for the purpose of giving effect to it, was not entered into, or done, on behalf of the company by, or under the authority of:
(i) the administration of the deed.".

(c) Decision

### (i) The Payments were not made under the authority of the administrators of the DOCA

The Commissioner contended that making the Payments by the director was specifically contemplated under and required by the DOCA, as the DOCA itself vested control and management of RKC in its director during the period of DOCA. The Commissioner argued this meant that the Payments were made on behalf of RKC by or under the authority of the Administrators who authorised entry into the DOCA.

The Administrators, however, argued that cl. 4.1(a) of the DOCA returned control and management of RKC to the director. Therefore, the Payments were made by the director under his own authority in managing RKC.

The FCA made its decision by distinguishing between the Payments being made as required by the DOCA, and being made by or under the authority of the Administrators.

The FCA found cl. 6.1(d) of the DOCA required the director to make the Payments pursuant to the director's own control and management of RKC re-vested in him by cl. 4.1(a). The DOCA did not empower the Administrators to manage RKC, nor make the Payments that were meant to be made by the director. The Administrators were not required to do anything to give effect to RKC and the director's obligations to comply with taxation laws as per cl. 6.1(d) of the DOCA.

Despite the Payments being made during the currency of, and as contemplated under and required by the DOCA to which the Administrators were a party, it was found that the director made the Payments on behalf of RKC without any involvement by the Administrators. By virtue of this difference, the FCA concluded the Payments were not made by, or under the authority of, the Administrators.

### (ii) Source of authority

The FCA agreed that management and control of RKC only reverted to the director by reason of cl. 4.1(a) of the DOCA and that the Payments could only be made by the director as a result of cl. 6.1(d) of the DOCA.

Further, the FCA accepted that by entering into the DOCA, the Administrators authorised the control and management of RKC to revert to the director and RKC and its director were required to comply with all taxation laws and make the Payments. In that sense, the Administrators "authorised" those subclauses.

However, the FCA went further to state that authorising the provisions of the DOCA is not the same as authorising the acts done to give effect to making the Payments. Once control and management had reverted to the director by operation of the DOCA, the source of authority for making the Payments was within the director who exercised his powers of control and management re-vested in him by the DOCA.

### (iii) Conclusion

The FCA highlighted that where a company is subject to a DOCA, it is the terms of that agreement and the provisions of the Corporations Act that bind and define the rights, obligations and powers of the parties. In this case, it was held that the director was exercising his powers of management and control in the making of the payments because of the DOCA, but not by or under his own authority, not by or under the Administrators.

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### 6.3 Court clarifies liquidators' liabilities when both liquidators and receivers are appointed

*(By Cjay Aksoyoglu, King & Wood Mallesons)*

*Joiner (Liquidator), in the matter of CuDeco Limited (Receivers and Managers Appointed) (in liq)* [2020] FCA 1661 (17 November 2020), Federal Court of Australia, Banks-Smith J.

#### (a) Summary

The Federal Court of Australia has clarified whether joint liquidators ("Liquidators") would be exposed to personal liability with respect to the environmental obligations of CuDeco Limited ("CuDeco"). The Liquidators argued that since CuDeco's assets were controlled by the receivers and managers ("Receivers"), they should not incur liability for any regulatory burdens under the environmental legislation.

Banks-Smith J held that:

- the Liquidators were not subject to the same obligations as imposed on "related persons" within the meaning of s. 363AB of the Environmental Protection Act 1994 No. 62 (Qld) ("EPA"). Unlike the Receivers, the Liquidators had, at all material times, little control over the company's assets. The Liquidators have limited liability and were justified in bringing a proceeding on this basis;
- the Liquidators were "executive officers" within the meaning of Schedule 4 of the EPA and s. 412 Mineral Resources Act 1989 No. 110 (Qld) ("MRA"); and
- the Liquidators may renew their application for relief under s. 545 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) if the hypothetical risk of personal liability materialises in the future.

The Court was also concerned that there was no contradictor in this matter, neither through the relevant government departments nor ASIC. The Court was nonetheless satisfied that the Liquidators had taken all reasonable steps by issuing disclaimers and notices to interested parties.

#### (b) Facts

CuDeco is currently in liquidation and operates the Rocklands open cut copper mine near Mt Isa in Queensland. On 1 July 2019, the Receivers were appointed under a general security agreement. These assets include substantial infrastructure such as a processing plant and tailings dam. CuDeco, being a mining company, is exposed to risks and liabilities relating to environmental protection under the relevant State legislation. The Liquidators, appointed on 5 July 2019, sought a declaration as to whether they could be personally liable for potential environmental risks, rehabilitation costs or civil and criminal liability.

The Liquidators sought broad relief by way of declarations to act, as reassurance that they are protected from personal liability against hypothetical and generalised risk. This would comfort the Liquidators to continue with the liquidation without the potential for a decrease in the amounts available for distribution to creditors.

### (c) Decision

### (i) Whether liquidators are "related persons"

Banks-Smith J found that the Liquidators were justified in seeking a declaration that they are not a "related person" of CuDeco. Banks-Smith J emphasised that at all relevant times, the Receivers had control of CuDeco's interests and assets, leaving the Liquidators with no influence or control over any aspect of the Rocklands mine operations. The Receivers also gave evidence that they have full control over the assets of CuDeco. They have also been responsible for working with the relevant departments to adhere to environmental obligations.

The Court cautioned that this question is not exclusively one of statutory construction and that the decision-maker has discretion to decide whether they are satisfied as to the matter. To determine whether the Court is satisfied that a person has a relevant connection in the case of concurrent appointments, Banks-Smith J stated non-exhaustive considerations such as:

- the relationship between receivers, liquidators and the company;
- the terms of the appointment of the receivers;
- the respective specific roles, powers and responsibilities of the receivers and liquidators during the relevant time in question; and
- any relevant evidence the liquidators seek to produce.

The Liquidators did not benefit financially from the carrying out of any relevant activity, had no control in the management of the assets, and any prior dealings they had with CuDeco were limited to the performance of their statutory duties as liquidators. Banks-Smith J ultimately held that the Liquidators had no decision-making control and so fell outside of the definition on this basis as a matter of fact.

### (ii) Whether liquidators are "executive officers"

Banks-Smith J stated that the definition of "executive officer" under Schedule 4 of the EPA and s. 412A(5) of the MRA is broad and includes the Liquidators in this case. The Court supported the authority in *Linc Energy Ltd (in Liq) v Chief Executive, Department of Environment and Heritage Protection* [2017] QSC 53 ("*Linc Energy*") that a liquidator is an "executive officer". Banks-Smith J noted at [160] that

"The role of the Liquidators in this case is not to be assessed in a vacuum, devoid of the content of that role that arises from their position as liquidators."

The facts were not distinguishable from *Linc Energy* as the Liquidators hold some powers relating to CuDeco, particularly with respect to its creditors. The Court noted that although there is no bar on the number of persons who may be executive officers at any given time, the Liquidators here still retain some power and so fall within the broad definition of "executive officer".

### (iii) Whether liquidators are liable to pay "expenses"

The Court declined to make a declaration with respect to s. 545 of the Corporations Act. Section 545 allows liquidators to avoid incurring any expense in the winding up of a company unless there is sufficient available property. Banks-Smith J did, however, note that should the hypothetical arise and there are expenses incurred, s. 545 should be available to protect the Liquidators. If a more defined risk of personal liability arises in the future, the Liquidators can renew their application for relief at that time.

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## 6.4 Reinstating deregistered companies and retrospectively validating proceedings under the Corporations Act

*(By Angus Lane, King & Wood Mallesons)*

*In the matter of Austral Bronze Pty Limited; In the matter of John Darlington Pty Limited; In the matter of John Darlington Pty Limited (No 2)* [2020] NSWSC 1633 (17 November 2020), Supreme Court of New South Wales, Rees J.

### (a) Summary

On 17 November 2020, Rees J ordered the reinstatement of deregistered companies Austral Bronze Pty Ltd and John Darlington Pty Ltd ("the Companies"). Rees J further ordered that prior proceedings commenced in the Dust Diseases Tribunal ("the Tribunal") by the claimants against the deregistered Companies were validly commenced. The cumulative effect of these orders was to enable the claimants to pursue claims for general damages against the deregistered Companies relating to the contraction of mesothelioma in the course of the claimants' employment with the Companies. In making these orders, the Court considered the nature of its power under s. 601AH of the Corporations Act 2001 No. 50 (Cth) ("Corporations Act") to reinstate deregistered companies and make orders ancillary to that reinstatement.

### (b) Relevant legislation

Section 601AH(2) of the Corporations Act provides that the Court may make an order that ASIC reinstate the registration of a company (a) upon an application by a person aggrieved by the deregistration; and (b) if the Court is satisfied that it is just that the company's registration be reinstated. Section 601AH(3) allows the Court to make ancillary orders to the reinstatement that it considers appropriate, including validating anything done during the period of deregistration.

Further, s. 12B of the Dust Diseases Tribunal Act 1989 No. 63 (NSW) ("Dust Diseases Tribunal Act") provides that the estate of a person whose death has been caused by a dust-related condition may recover damages for non-economic loss provided that "proceedings commenced by the person were pending before the Tribunal at the person's death." The key issue the Court faced when considering this legislation was whether the Tribunal proceedings were in fact "commenced. [and] pending" against the Companies despite them being deregistered at the time the proceedings were commenced.

### (c) Facts

Barry Fletcher and John Viksne had previously been employed by Austral Bronze Pty Ltd and John Darlington Pty Ltd respectively. During their employment with the Companies, they were both exposed to asbestos which lead them to contract mesothelioma and die in 2019. Prior to their deaths, they each commenced proceedings in the Tribunal for general damages against the Companies. However, at the time that the proceedings were commenced, both of the Companies were deregistered. The estates of Mr Fletcher and Mr Viksne ("the Claimants") initiated proceedings seeking orders for the reinstatement of the Companies and the retrospective validation of the Tribunal proceedings. The insurer for the Companies, Allianz Australia Insurance Limited ("the Insurer"), objected to the orders sought by the Claimants.

The Court had to determine (1) whether it had the power to make an order for reinstatement under s. 601AH given that one of the Companies had been deregistered prior to the commencement of the Corporations Act; and (2) whether it had the power to make ancillary orders under s. 601AH validating the previous proceedings commenced by the Claimants in the Tribunal.

### (d) Decision

Rees J dealt with several issues in reaching the conclusion to reinstate the Companies and retrospectively validate the Tribunal proceedings. These are summarised below.

#### (i) Power to reinstate companies deregistered prior to commencement of s. 601AH

One of the Companies – Austral Bronze Pty Ltd – had been deregistered prior to the commencement of s. 601AH of the Corporations Act. The Insurer argued that the Court had no power to reinstate companies pursuant to the Corporations Act that had been deregistered prior to the Act's commencement. This argument relied upon the text of the provision which stated it was only exercisable in respect of "companies", which is defined under the Corporations Act as companies registered pursuant to the Act. Rees J rejected this argument, determining that the Court had such power. Her Honour relied upon Barrett J's judgment in *Shaw v Goodsmith Industries Pty Ltd* [2002] NSWSC 406. Barrett J held that s. 1408 of the Corporations Act – the transitional provision – had the effect of preserving the Court's power of reinstatement under the legislation preceding the Corporations Act, such that the Court could make an order under s. 601AH to reinstate a company that was deregistered prior to the commencement of the provision. Rees J outlined that this interpretation was consistent with Parliament's intention.

#### (ii) Were the Tribunal proceedings "commenced. [and] pending before the Tribunal at the person's death"?

The Insurer argued that the Tribunal proceedings were not validly commenced and pending at the time of the Claimants' deaths pursuant to s. 12B of the Dust Diseases Tribunal Act. This was because the named defendants in the proceedings did not exist by reason of their deregistration. Rees J agreed with this argument. Pursuant to s. 601AD of the Corporations Act, upon deregistration a company "ceases to exist". As all proceedings must identify a proper defendant, then the Tribunal proceedings were a nullity. As such, s. 12B of the Dust Diseases Tribunal Act did not apply to allow the Claimants to claim damages. Further, simply reinstating the Companies under s. 601AH would not retrospectively validate the proceedings.

#### (iii) Could an ancillary order be made under s. 601AH to retrospectively validate the Tribunal proceedings?

Despite holding that the Tribunal proceedings were not validly commenced pursuant to s. 12B, Rees J held that the proceedings could be retrospectively validated by an ancillary order made under s. 601AH(3). Her Honour focused her analysis on the plain wording of the provision allowing the court to "validate anything done" during the period of deregistration. This language did not impliedly limit the Court's power to only allow the Court to remove anomalies or impediments arising out of reinstatement. The section should not be interpreted as imposing limitations not found in its express terms. On this basis, Rees J held that the Court had the power to retrospectively validate the Tribunal proceedings upon reinstatement of the Companies.

#### (iv) Did the Court have jurisdiction to retrospectively validate the proceedings?

Lastly, the Insurer argued that the Court had no jurisdiction to retrospectively validate the Tribunal proceedings even if it had the power to make an ancillary order to that effect under s. 601AH(3). This was because the Tribunal proceedings related to the recovery of damages in respect of a dust-related condition, a subject matter over which the Tribunal had exclusive jurisdiction pursuant Dust Diseases Tribunal Act. Again, Rees J rejected this argument. The proceedings before the Court were not proceedings for the recovery of damages. Rather, they were for the reinstatement of the Companies, as well as for orders retrospectively validating the Tribunal proceedings. These were matters ancillary to the claims for damages. On this basis, the present proceedings did not fall within the exclusive jurisdiction of the Tribunal. The Court therefore had federal jurisdiction over the matter.

#### (v) Orders made

Rees J ordered the reinstatement of the Companies pursuant to s. 601AH. This was firstly because the Claimants were clearly "person[s] aggrieved" by the deregistration of the Companies as they could no longer pursue their claims for damages because of the deregistrations. The reinstatements were "just" and did not unfairly prejudice the Companies because the Claimants had undertaken to enforce any damages awarded to them against the Insurer, rather than the Companies themselves.

In addition, Rees J ordered that, pursuant to the Court's power to make ancillary orders in s. 601AH(3), the proceedings commenced by the Claimants in the Tribunal be retrospectively validated. This was on the condition that any award of damages in those proceedings be enforced against the Insurer, rather than the Companies.

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### 6.5 A small win for creditors; shares of no economic value and a global pandemic not cause for unfair prejudice to stall the sale of Virgin and its subsidiaries any longer

*(By Morgan Hartley-Marschner, DLA Piper)*

*Strawbridge, in the matter of Virgin Australia Holdings Ltd (administrators appointed) (No 9)* [2020] FCA 1652 (10 November 2020), Federal Court of Australia, Middleton J.

#### (a) Summary

Leave was granted to the first plaintiffs, the administrators of the second plaintiff, Virgin Australia Holdings Ltd ("Virgin") and its subsidiaries ("the Virgin Companies"), to transfer all existing shares of Virgin to BC Hart Aggregator, L.P. ("Bain Capital"), pursuant to the Deed of Company Arrangement dated 25 September 2020 between the administrators, Bain Capital and certain companies including Virgin (order made under s. 444GA(1)(b) of the Corporations Act 2001 No. 50 (Cth) ("Corporations Act")). A second order was made to allow the administrators to execute all documents to affect the share transfer pursuant to s. 447A(1) of the Corporations Act.

#### (b) Facts

In April 2020, the administrators were appointed and began the process for the sale of the business and assets of the Virgin Companies. Bain Capital's offer was accepted, and the execution of several binding transaction documents were entered into on 26 June 2020 (Bain Transaction). The Bain Transaction comprised two alternate completion pathways for the sale and restructure; by way of an asset sale agreement ("ASA") or pursuant to approving a number of interrelated deeds of company arrangement that had been proposed by Bain Capital at the second meeting of creditors ("Bain DOCA Proposal").

On 25 August 2020 the administrators issued their report to the creditors of the Virgin Companies and convened the second meeting of creditors ("Second Meeting"). The report recommended that the creditors vote in favour of the Bain DOCA Proposal at the Second Meeting on the basis that it provided the greatest return to creditors. This is what occurred on 4 September 2020 at the Second Meeting. On 25 September the administrators, Bain capital and the Virgin Companies executed the various deeds of company arrangement.

As Virgin is listed on the ASX, it is subject to prohibitions on certain acquisitions subject to s. 606 of the Corporations Act. On 24 September it applied to ASIC to provide relief from s. 606 to facilitate the transfer of all the issued shares in Virgin to Bain Capital or its nominee. This application was also a condition precedent to effectuation of one of these deeds ("the Primary DOCA"). On 16 October 2020, ASIC made an in-principle decision to provide the relief.

If the Primary DOCA was not effectuated, the Bain Transaction through the transfer of shares could not proceed and instead would be completed through the asset sale agreement which would complicate the path to completion and provide smaller returns to creditors. A feature of both transaction options is the nil value of the Virgin shares. This outcome was supported by an independent expert, expressed in their report. Importantly, the expert went further to say that in a liquidation or going concern scenario, the shares in Virgin are likewise of no value.

### (c) Decision

The legal onus on proving that the share transfer should be exercised in their favour fell on the Applicants, while the shareholders have an evidentiary onus to establish any prejudice or unfair prejudice they may suffer.

Middleton J considered what the effect was on shareholders if the transfer of shares was not approved. This required attention to the valuation of the assets and liabilities of Virgin by reference to a liquidation scenario. Given the shares held no value in the liquidation, which was also the only alternative to the proposed transfer of the shares, there was no prejudice in giving leave under s. 444GA(1)(b) of the Corporations Act. The fact that the shares held no economic value did not establish unfair prejudice. While the COVID-19 pandemic and consequent travel restrictions have affected the airline industry globally and contributed to the insolvency of the Virgin Companies, Middleton J was not persuaded that future uncertainties of the industry were sufficiently short-lived so as to justify not granting the application or putting it off any further.

Given that the shareholders do not experience a financial difference on account of which Bain Transaction is completed, the decision came down to the benefit the creditors receive under the transfer of shares scenario. On this basis, Middleton J was strongly inclined to permit the share transfer to proceed and orders pursuant to s. 444GA(1)(b) and s. 447A(1) of the Corporations Act were made.

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## 6.6 Broad creditor rights and the failure to limit "examinable affairs"

*(By William Chaffey, Corrs Chambers Westgarth)*

*In the matter of GVE Hampton Pty Ltd (In Liq)* [2020] FCA 1577 (30 October 2020), Federal Court of Australia, Beach J.

### (a) Summary

Shangri-La Construction Pty Ltd ("Shangri-La"), a creditor of GVE Hampton Pty Ltd (in liquidation) ("GVE"), was granted the status of "eligible applicant" by ASIC per Div 1 of Pt 5.9 of the Corporations Act 2001 No. 50 (Cth) ("Corporations Act") to examine the affairs of GVE. The former directors of GVE ("the examinees") applied to discharge their examination summonses or be granted a stay on the basis that the summonses were originally issued for an improper purpose. Failing this, the examinees sought to limit the scope of the summonses.

In rejecting the examinees' application, the Court considered the scope of "examinable affairs" for an authorised creditor and indicated that creditors have broad examination rights.

### (b) Facts

On 26 October 2017, the County Court of Victoria issued a judgment against GVE for the sum of $200,000 ("the judgment debt"), in favour of Shangri-La, following a construction dispute. On 4 December 2017, GVE went into liquidation following a creditors' voluntary winding up. Joint and several liquidators were appointed. The liquidators' statutory report highlighted that GVE had made related party loans of $5.2 million to entities owned by the examinees. This gave rise to eight examinable affairs as the liquidators' were of the view that the loans appeared to be to the detriment of GVE and to the benefit of company directors potentially in breach of their directors' duties.

Shangri-La applied for the summonses for examination to investigate whether the transactions were shams to avoid paying creditors or whether they were voidable under s. 588FF of the Corporations Act as uncommercial transactions, unreasonable director-related transactions, or unfair preference payments. On 18 December 2019, the Federal Court made orders to issue the summonses for examination of the directors pursuant to ss. 596A and 596B of the Corporations Act.

The examinees applied to discharge the summonses or be granted a stay. The examinees argued Shangri-La sought the summonses for an improper purpose, the proposed examination was too broad and the scope of the documents sought too wide for a creditor to request.

The examinees argued that a creditor, such as Shangri-La, is only entitled to conduct an examination into the affairs of a company that related to its own debt. Thus the scope of Shangri-La's examination should be limited and not as expansive as if they were a liquidator or an administrator.

### (c) Decision

#### (i) Discharge the summonses on the basis of an improper purpose

The examinees firstly argued that an "improper purpose" is one where creditors seek documents that go beyond the scope of their own unsecured debt. Citing *Re New Tel Ltd (in liq) ("Re New Tel"); Evans v Wainter Pty Ltd* (2005) 145 FCR 176, the examinees contended that examinations can only be "for the purpose of obtaining information in relation to a debt owed to the creditor". Thus, the examinees were of the belief that Shangri-La was seeking documents to inquiry into the affairs of GVE and not for the purpose of obtaining information about its debt. The examinees argued this is an improper purpose as Shangri-La is acting as if it were a liquidator or administrator, not a creditor.

In rejecting this argument, Beach J was satisfied that since Shangri-La had already been issued a judgment debt, the examination would be without purpose if Shangri-La could not inquire beyond its own debt. Further, once authorised as an "eligible applicant" by ASIC, the Court will place any limitations at the issuance of the summons. His Honour held that a court may limit the scope of an examination based on the legitimate purpose of the inquirer under ss. 596A and 596B of the Act if necessary at the time the order is made.

The examinees then argued that *Re New Tel* requires an examination to be for the benefit of the company, its contributors or its creditors as a whole. The examinees said this is because *Re Excel Finance Corporation Ltd (receiver and Manager Appointed) ("Re Excel"); Worthy v*

*England* (1994) 52 FCR 69 established that an examination that does not benefit "the corporation, its contributories or its creditors" is an abuse of process.

The examinees stated that Shangri-La's summonses were an abuse of process and thus issued for an improper purpose because the breadth of the summonses implied the examination would not be beneficial to GVE, but would be used to gather information about the affairs of GVE which may benefit the eligible applicant in future litigation. The examinees contended that this was a personal advantage, limited to Shangri-La, and thus an examination for an improper purpose. They relied on *ACN 004 410 833 Ltd (formerly Arrium Limited) (in liq) v Michael Thomas Walton* [2020] NSWCA 157 which stated that a private purpose is one which benefits a limited group of persons and is therefore an abuse of process.

If the Court was satisfied there could be a private purpose, the examinees suggested the private purpose could only be satisfied if Shangri-La identified a potential source of funds available in the winding up that would reduce GVE's indebtedness to Shangri-La whilst not diminishing the funds available to other creditors.

His Honour was not satisfied with the examinees argument, noting that in any examination there may exist a "separate subsidiary purpose" whereby a creditor can use the examination procedure to investigate the transactions that will ultimately be recoverable by a liquidator and ensure its debt is repaid. Justice Beach confirmed that a separate subsidiary or "private purpose for the examination is not disqualifying so long as that private purpose is not the dominant purpose".

His Honour held Shangri-La's dominant purpose was aimed towards "recouping funds to allow both the satisfaction of the judgment debt and to benefit GVE and its creditors as a whole". The fulfilment of this purpose by recovering $5.2 million leads to two benefits. First, the benefit to Shangri-La making it substantially more likely the judgment debt would be satisfied. Second, the benefit to GVE, its contributories and creditors, as recovery would make it more likely GVE can satisfy its liabilities.

Thus, Shangri-La's examination was for the purposes of fulfilling the judgment debt. The fulfilment of this purpose demonstrates a benefit to GVE and the creditors by recovering $5.2 million and did not constitute an abuse of process.

His Honour explained that "examinable affairs" are of a "very broad amplitude" and can encompass relevant company dealings with third parties and related entities. The examinees failed to have regard to this breadth of scope in their argument. The argument on improper purpose therefore failed.

**(ii) Limiting the extent of the proposed examinations**

His Honour was not satisfied that the authorised examination should be limited per s. 596F(1)(a) of the Corporations Act. In *Lamb (in his capacity as Liquidator of Redcastle Estate Pty Ltd) v Mentha* [2010] FCA 695, the Court confirmed it had discretion to give directions about an examination "at any time" and define "the matters to be inquired into at examination" at the Court's discretion under s. 596F(1)(a).

The examinees argued that Shangri-La was not entitled to "stand in the shoes of the liquidator" and thus the scope of the proposed examination should be limited to Shangri-La's debt only. His Honour held this suggestion misconstrued the purpose of the terms falling within the summonses. Since the summonses were issued for a proper purpose, "no such limitation of the type" contended by the examinees should be authorised.

Further, his Honour dismissed the argument that Shangri-La's "eligible applicant" status had changed since ASIC's approval. Justice Beach stated that ASIC's authorisation of Shangri-La as an "eligible applicant" was an administrative decision; it did not in terms confine the boundaries of the examinations themselves. Nonetheless, his Honour noted that Shangri-La is confined to asking questions that are for a proper purpose or the Registrar may be required to limit or disallow questioning. The examinees' argument for limiting the proposed examinations thus failed.

#### (iii) Limiting the extent of the documents produced

His Honour did however limit the production of documents requested by Shangri-La. His Honour stated that document descriptions need to be specific. For example, phrases such as "any other person or entity that is related to the above companies" are not acceptable, as they require the examinees to make a judgment call on relevance. Consequently, this line was repealed from the summonses.

However, his Honour did not limit the breadth of documents requested. The Court explained that ss. 596F and 597 of the Corporations Act confer extensive powers on courts to determine how the examinations will be conducted and the nature of the documents that must be produced. If any argument is made to limit the scope of document production, the convenient time to do so is when the Registrar is making such an order.

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### 6.7 Directors that will benefit from collateral arrangements contingent on approval of a scheme of arrangement may recommend the scheme to shareholders

*(By Christopher Portway, Herbert Smith Freehills)*

*DWS Limited, in the matter of DWS Limited* [2020] FCA 1590 (30 October 2020), Federal Court of Australia, Beach J.

#### (a) Summary

The decision in this case relates to an application made by DWS Limited to approve the calling of a shareholder meeting to consider a scheme of arrangement under s. 411(1) of the Corporations Act 2001 No. 50 (Cth) ("Corporations Act") . The Court considered whether DWS's Managing Director, who was set to receive a collateral benefit on approval of the scheme of arrangement, should be permitted to formally recommend DWS's shareholders approve the scheme. Beach J considered the two prevailing views of the Courts that exist on this issue. First, that collateral arrangements of this kind should not disqualify directors from putting a recommendation to shareholders. Second, that collateral arrangements of this kind should, if sufficiently prejudicial, result in the director being disqualified from recommending approval of the scheme to shareholders. The Court adopted and endorsed the first approach, ultimately ordering a shareholder meeting to consider the scheme of arrangement.

### (b) Facts

DWS Limited ("DWS") was a publicly listed Australian company that sought to enter into a scheme of arrangement with HCL Australia Services Pty Limited ("HCL") to provide for the acquisition of all of DWS's issued shares by HCL ("the Scheme"). After entering into a scheme implementation agreement ("SI Agreement") with HCL, DWS applied for an order under s. 411(1) of the Corporations Act to approve the calling of a shareholder meeting to consider the Scheme. The Scheme booklet included a unanimous recommendation of the Scheme from all of DWS's directors, including the Managing Director. Separate to the terms of the Scheme was a collateral agreement under which the Managing Director of DWS would take on a paid consulting role with HCL upon approval of the Scheme ("the Collateral Agreement").

### (c) Decision

#### (i) Nature of discretion

In considering whether the Managing Director should be permitted to include in the Scheme Booklet a recommendation to shareholders on whether to approve the Scheme, Beach J noted that, at the first hearing, the Court should generally restrict its considerations to ensuring procedural and substantive requirements have been met, with limited consideration to be given to issues related to fairness. However, his Honour noted that it is appropriate for the Court to consider fairness where a proposed scheme appears to be "so blatantly unfair or otherwise inappropriate that it should be stopped from going any further".

#### (ii) Blatant unfairness

Beach J considered five separate categories within which issues related to the unfairness of schemes of arrangement typically arise, being:

- performance risk;
- shareholder warranties;
- the break fee;
- the exclusivity arrangements; and
- directors' interests.

#### General items

The first four categories were disposed of quickly by the Court. Beach J stated that:

- the relevant performance risk was acceptable. The terms of the Scheme prevented any transfer of shares to HCL until consideration was issued. Further, HCL executed a deed poll ensuring performance (including a covenant to provide consideration to Scheme shareholders);
- shareholder warranties were acceptable because they were in the usual form and sufficiently disclosed in the explanatory memorandum distributed to shareholders;

- the break fee was acceptable because it was not disproportionate to the value of the bid consideration and it had been agreed to in circumstances where it was a condition precedent to HCL entering into the SI agreement; and
- the exclusivity arrangements were acceptable because they were reasonable and in the usual form.

Directors' interests

The fifth category, directors' interests, attracted more substantive analysis. Beach J considered in depth the consequence of the Managing Director's Collateral Agreement which was contingent on scheme approval. His Honour first established that the Collateral Agreement was not class creating because it did not make it impossible for the Managing Director and other DWS shareholders to consult together in their common interest. His Honour then examined whether a director who is set to receive a collateral benefit if a scheme of arrangement is approved should be permitted to give a recommendation to shareholders about whether to vote in favour of the scheme of arrangement. Here, Beach J explored two conflicting approaches.

The first approach was expressed in *Re Villa World* (2019) 139 ACSR 550. In that case, Black J opined that a director who was set to receive an additional financial benefit if a scheme was approved should not be disqualified from giving a recommendation in the scheme booklet. This conclusion was supported by three assertions. First, it would be inconsistent for a director to support a scheme of arrangement when the board resolves to put the scheme to shareholders and then take the position in the scheme booklet that they are not justified in making a recommendation. Second, there is no general rule that a director should not make a recommendation on the basis that they have an interest in the outcome. Third, there will be many cases where an executive who has an interest in the outcome of a scheme would properly participate in the board's decision to go through with the scheme distinct from any decision about personal interests.

The second approach was expressed in *Re Wellcome Group Limited* [2019] FCA 1655. In that case, O'Bryan J opined that there may be circumstances in which a director of a company should not make a voting recommendation to shareholders about a proposed scheme because of the nature and extent of additional benefits that will be received by the director if the scheme is implemented. Here, O'Bryan J criticised the analysis of Black J above. He asserted a boundary condition that the decision by a director to support a scheme is "no more and no less than a decision to put the scheme to shareholders for their consideration." It followed that a board's opinion that a scheme is worthy of consideration by shareholders was not an endorsement of that scheme and was wholly distinct from a board's opinion on whether that scheme should be accepted by shareholders. And therefore there was no inconsistency in a director supporting a scheme when resolving to put the scheme to shareholders and then taking a position in the scheme booklet that they were not justified in making a recommendation.

Beach J expressed his support for the first approach, stating that the latter pays insufficient attention to commercial realities. Critically, his Honour asserted that the boundary condition articulated by O'Bryan J is empirically inaccurate. To illustrate this, Beach J highlighted that schemes of arrangement were usually:

- used for "friendly" takeovers;
- accompanied by a scheme implementation agreement which receives the unanimous resolution of the target board; and
- accompanied by standard terms which require the target board to take reasonable steps to promote the scheme (subject to fiduciary carve out).

His Honour noted that, in these circumstances, it could not be said that a board's decision to put a scheme to shareholders carries no endorsement with it. And therefore Bryan J's "boundary condition" could not hold. Having concluded that Black J's approach was to be preferred, Beach J found that the Managing Director's recommendation to shareholders did not contaminate the fairness of the Scheme notwithstanding the additional financial benefit he would receive if the Scheme were to be approved. His Honour held that a director who is set to receive a collateral benefit if a scheme of arrangement is approved should be permitted to give a recommendation to shareholders about whether to vote in favour of that scheme.

### (d) Conclusion

Beach J was satisfied with the Scheme and the accompanying explanatory memorandum. His Honour ordered a meeting of DWS's shareholders to consider the Scheme.

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### 6.8 Finding of oppressive conduct entitles plaintiff to winding up relief order

*(By Andrew Hay and Maggie Skow, Clayton Utz)*

*Anthony Shear as trustee for the Links Field Trust v Campbell* [2020] WASC 391 (28 October 2020), Supreme Court of Western Australia, Master Sanderson.

### (a) Summary

The plaintiff, Anthony Shear as trustee for The Links Field Trust ("Plaintiff") sought orders that the sixth defendant, Odyssey Mortgage and Finance Pty Ltd ("OMF"), be wound up pursuant to either s. 233(1)(a), s. 461(1)(f) or s. 461(1)(k) of the Corporations Act 2001 No. 50 (Cth) ("Corporations Act") and for the sale of the business of OMF to the fifth defendant, Ocean Life (WA) Pty Ltd ("Ocean Life"), to be void and set aside pursuant to s. 233 of the Corporations Act on the basis of oppressive conduct.

It was determined that the first and second defendants had engaged in oppressive conduct and breaches of their fiduciary duties. An order was made for the unwinding of the sale of OMF to Ocean Life and for the winding up of OMF.

### (b) Facts

OMF, a mortgage broking business, was owned and operated by the Plaintiff and by Mr Paul Campbell and Mr Michael Ryding (together, the First and Second Defendants), as a sideline to their financial advisory business ("OFS proceedings").

In 2018 the Plaintiff and the First and Second Defendants fell into a significant dispute regarding the conduct of the affairs of OFS proceedings. As a result, the Plaintiff sought a winding up order for OFS proceedings. The OFS proceedings settled, however, by this point there was a complete breakdown of the relationship between the Plaintiff and the First and Second Defendants.

In March 2019 the First and Second Defendants properly convened a shareholder meeting at which the Plaintiff was removed as a director of OMF. The First and Second Defendants then initiated a proposed buyout of the Plaintiff from OMF, obtaining a valuation of the OMF business, of which the Plaintiff had no knowledge or input and put in an offer to purchase the Plaintiffs shares in OMF. Whilst still in negotiations with the Plaintiff, the First and Second Defendants incorporated Ocean Life as a vehicle for the acquisition of OMF and in December 2019, sold OMF to Ocean Life without the Plaintiff's knowledge.

OMF was represented by the same law firm as the First and Second Defendants and did not receive independent legal advice in relation to the sale.

**(c) Decision**

Section 232 of the Corporations Act provides that the Court may make an order under s. 233 of the Corporations Act if the conduct of a company's affairs is oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members.

Master Sanderson held that there had been a clear breach of fiduciary duties to OMF and to the Plaintiff by the First and Second Defendants that justified a finding of oppressive conduct. The oppressive conduct included:

- the combined effect of removing the Plaintiff from the board of OMF and then running OMF in a manner which entirely ignored the Plaintiff's views; and
- selling OMF to Ocean Life, an entity controlled by the First and Second Defendants without the knowledge of the Plaintiff and without OMF obtaining independent legal advice or obtaining an independent arm's length valuation of OMF.

It was held that it was appropriate to make an order that the sale of OMF to Ocean Life be set aside and that OMF be wound up on the basis of the oppressive conduct and the breach of fiduciary duties, which entitled the Plaintiff to the relief sought.

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### 6.9 Illegal phoenix activity? Court confirms it's difficult to identify – and plead

*(By Rachael King and Pilar Adams, Corrs Chambers Westgarth)*

[*Australian Securities and Investments Commission v Bettles* [2020] FCA 1568](#) (28 October 2020), Federal Court of Australia, Greenwood ACJ.

### (a) Summary

- There is no such thing, per se, as "illegal phoenix activity" and there is inherent difficulty in attributing content to that phrase;
- The dramatic allegory of the phoenix dying in flames and being reborn from the ashes is well understood. When determining whether conduct in relation to a business operation reborn from the ashes of a liquidated company constitutes "illegal phoenix activity", the starting point is to identify the alleged conduct and demonstrate how it contravenes the Corporations Act 2001 No. 50 (Cth) ("Corporations Act"). Only then can such conduct be described as "illegal phoenix activity"; and
- An allegation that a person is "involved in" a contravention of the Corporations Act requires precise identification of the particular conduct of a person alleged to be involved in a contravention of the Corporations Act, and how that conduct aided or abetted a contravention of the Act by others.

### (b) Facts

In the case of *Australian Securities and Investments Commission v Bettles* [2020] FCA 1568, ASIC contended that the controllers of a group of companies (the MA Group) engaged in "illegal phoenix activity". ASIC further contended that the liquidator, Mr Bettles, knew about this activity, and that Mr Bettles "aided and abetted the controllers in designing and implementing that strategy", and therefore was a person involved in a contravention of provisions of the Corporations Act.

On this basis, ASIC sought orders that Mr Bettles' registration as a liquidator be cancelled and that he be prohibited from acting as a liquidator for a period of time.

Mr Bettles brought an interlocutory application to strike out ASIC's Concise Statement and Supplementary Concise Statement (Statements) on the grounds that the two documents failed to make clear the precise conduct by Mr Bettles which was said to be conduct rendering him a person involved in a contravention of the Corporations Act pursuant to s. 79.

By its Statements, ASIC alleged that the controllers of the MA Group engaged in eight classes of conduct that constituted "illegal phoenix activity", including developing a strategy to transfer the income and assets of the MA Group companies to a new group of companies, selectively placing companies in the MA Group into liquidation, transferring staff from the MA Group to the new group, and redirecting income and entering into an uncommercial sale of the client book.

ASIC alleged that the "illegal phoenix activity" was conducted in contravention of ss. 180, 181 and 182 of the Corporations Act, which require directors and other officers to discharge their duties with care and diligence, in good faith for the best interests of the corporation and for a proper purpose, and to not improperly use their position to gain an advantage for themselves or someone else or cause detriment to the corporation.

ASIC alleged that Mr Bettles, a liquidator for some of the companies in the MA Group, was a person ″involved in a contravention″ pursuant to s. 79 of the Corporations Act, in that he aided or abetted the alleged contraventions.

Mr Bettles argued that the facts set out in ASIC's Statements inadequately connected the alleged conduct to the claimed contraventions and should be struck out.

(c) Decision

(i) Meaning of ″illegal phoenix activity″

In considering Mr Bettle's application, Greenwood ACJ reviewed papers by the Commonwealth Treasury Department and academics on the meaning of ″fraudulent″, ″unlawful″ or ″illegal″ phoenix activity. The effect of this consideration was to observe that there is a distinction between a legitimate use of the corporate form and ″unlawful' phoenix activity (where a corporate entity accumulates debts without an intention to repay the debt and then liquidates to avoid payment of the debt).

While that might be easy to identify in its more basic form, alleged ″illegal phoenix activity″ is often significantly more complex.

So when does the rebirth of an operation from the ashes of a liquidated company become ″illegal″ or ″fraudulent″?

Businesses getting into a position of doubtful solvency, or actual insolvency, as a result of poor business practices – and legitimately using the corporate form to restructure – is to be distinguished from ″fraudulent″ phoenix activity. This type of activity involves the deliberate and systematic liquidation of corporate trading entities with the intention of avoiding tax or other liabilities, and the continuation of the operation of that business through other trading entities, debt-free. The key feature of ″fraudulent phoenix activity″ is the intention to exploit the corporate form to the detriment of unsecured creditors.

Greenwood ACJ observed that there is inherent difficulty in attributing content to the phrase ″illegal phoenix activity″. His Honour explained that the question of whether the conduct described by the phrase ″phoenix conduct″ is, as a matter of law, ″unlawful phoenix activity″ is entirely determined by whether proof of the facts of the conduct makes good a contravention of a provision of the Corporations Act.

His Honour stated that identifying conduct, and attaching a label of ″illegal phoenix activity″ to it, jumps a step in the analysis. There is no such thing, per se, as ″illegal phoenix activity″. Rather, the analysis is to identify the impugned conduct and explain why that conduct satisfies elements of a particular provision of the Corporations Act, therefore demonstrating contravention of the Corporations Act. Such analysis establishes a conclusion that the particular conduct is unlawful.

Greenwood ACJ observed that, ″it is not sufficient to set out a collection of facts over a period of time and describe the conduct falling within that large matrix of fact as ″illegal phoenix activity″ on the footing that the matrix of fact engages contraventions of ss. 180, 181 and 182.″ Alleging that someone was involved in a contravention of the Corporations Act involves identifying, with precision, the facts demonstrating conduct contravening the Corporations Act, and the facts which demonstrate that the relevant person is a person "involved in" that contravention because the person aided or abetted that conduct.

(ii) Decision

Greenwood ACJ found that the Statements "did not . [identify] a sequence of facts which, if made good, demonstrate a contravention by particular persons of ss. 180, 181 or 182 of the Corporations Act leading to a pleading that the defendant was involved in a relevant contravention in the sense of aiding and abetting that conduct."

For example, ASIC alleged that the controllers of MA Group devised a plan to engage in "illegal phoenix activity" and that Mr Bettles knew of this activity and aided and abetted the controllers, in that Mr Bettles attended a meeting at which the matters were discussed. Those allegations of fact did not engage, by specific paragraphs of a pleading, conduct falling within the elements of ss. 180, 181 or 182 on the part of the controllers, nor with a pleading that Mr Bettles aided and abetted a contravention by the controllers.

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**6.10 Applicant in unsuccessful shareholder class action fails to establish misleading or deceptive conduct by company making, repeating and maintaining its guidance representations**

*(By Beverley Newbold, David Taylor, Rafael Aiolfi, Jacky Wong, Ben McLachlan. MinterEllison)*

*Crowley v Worley Limited* [2020] FCA 1522 (22 October 2020), Federal Court Australia, Gleeson J.

(a) Summary

On 22 October 2020, a single judge of the Federal Court dismissed a shareholder class action against Worley Limited ("Worley") in *Crowley v Worley Limited* [2020] FCA 1522 (*Crowley v Worley*). This is the first shareholder class action won by a respondent in Australia, and only the second shareholder class action to go to judgment after trial.

Key points:

- aggressive, stretch, or optimistic targets set in budgets and forecasts do not, in and of themselves, mean that representations to the market regarding the achievability of those optimistic targets lack a reasonable basis. Companies are more likely to succeed in defending shareholder class actions if they can establish that budgets and forecasts were set following a comprehensive, robust and detailed budgeting process;
- errors discovered in hindsight (which contributed to the miss of those optimistic targets) do not necessarily undermine the reasonable basis of the forward-looking representations at the time they were made. A post-event review by senior management following Worley's downward revised forecast and significant share price drop contained a number of observations about a "culture of optimism" within Worley and insufficient allowance for downside risks. The Court accepted that while those

observations were a candid and genuine description of what had gone wrong with the budgeting and forecasting processes, the post-event review did not mean that the FY14 Budget, which underpinned the forecast, lacked a reasonable basis;

- unexpectedly poor results that emerge over the course of a financial year do not automatically require a company to immediately revise its earnings guidance. The Court recognised that companies have the capacity to turn things around, engage in cost-cutting exercises, and experience negative or positive variability in earnings over the course of a year – all of which may preserve the reasonableness of the original earnings guidance;
- the Court's analysis repeatedly had regard to the application of the onus of proof. As Worley raised credible evidence showing that the Board and the Chief Executive Officer (CEO) had reasonable grounds for making the guidance representations (those reasonable grounds being the FY14 Budget), and demonstrating that the process by which the FY14 Budget was developed was also reasonable, the onus of proof shifted to the applicant to prove the unreasonableness of the FY14 Budget. The applicant repeatedly failed to do this and, therefore, the Court found that Worley did not engage in misleading or deceptive conduct by making, repeating and maintaining its guidance representations;
- though materiality needs to be assessed on a case by case basis, a variance of 5% to guidance may be sufficiently material to require a corrective disclosure to the market.
- it is unclear whether directors or senior management should have regard to market views (particularly if those views are sufficiently divergent) as to the expected performance of their company, and be required to make a corrective disclosure if they became aware of information that was materially different to those market views. On the facts of this case, views held by Credit Suisse, Deutsche Bank, Morgan Stanley, Macquarie and Citibank analysts did not give rise to a consensus market expectation that Worley would deliver FY14 NPAT of $354-$368m, by reference to which Worley was required to disclose any material information; and
- companies should nevertheless remain vigilant as, although in this case Worley demonstrated that the process by which its budgets were developed was reasonable, there remains some uncertainty about how doubts held by senior management about a budget, even if not held by or capable of being known by the board, might ultimately undermine a contention that the budget, and thus guidance, was reasonable.

(b) Facts

Worley is an ASX-listed company. On 14 August 2013, Worley represented to the market that it anticipated Net Profit After Tax (NPAT) of $322m in the 2014 financial year (FY14 Guidance). Worley advised that its expectation rested on a "solid foundation". That foundation was an internal FY14 budget approved by Worley's board of directors in August 2013 (FY14 Budget).

On 9 October 2013, Worley announced that its first-half result in FY14 would be lower than the previous year. Despite this, Worley reaffirmed its FY14 Guidance. Worley's FY14 Guidance was also repeated on 10 and 15 October 2013.

However, on 20 November 2013, Worley downgraded its FY14 Guidance to between $260–$300m. Following the announcement, Worley's share price fell by $5.59 per share (an approximately 26% decline).

On 27 October 2015, Larry Crowley commenced a shareholder class action on behalf of shareholders who purchased shares in Worley in the period between 14 August and 20 November 2013 ("the Relevant Period"). Mr Crowley alleged that he and other shareholders had suffered loss by reason of Worley's alleged misconduct in the Relevant Period, namely that:

- Worley failed to comply with its continuous disclosure obligations under s. 674 of the Corporations Act 2001 No. 50 (Cth) ("Corporations Act"); and
- Worley engaged in misleading or deceptive conduct in contravention of s. 1041H of the Corporations Act, s. 12DA of the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) ("ASIC Act") and/or s. 18 of the *Australian Consumer Law* ("ACL").

Mr Crowley advanced three arguments in respect of Worley's alleged misconduct. These were:

- the FY14 Budget, which underpinned the FY14 Guidance, lacked reasonable grounds when it was approved by the Board;
- Worley lacked reasonable grounds for maintaining its FY14 Guidance between 21 September and 15 October 2013, at which stage it should have been clear that assumptions in the FY14 Budget were failing; and/or
- Worley was aware of a market consensus expectation that it would deliver FY14 NPAT of $354–368m (which was above its FY14 Guidance) and Worley ought to have corrected the market consensus expectation when it became aware that its earnings would fall materially short of it.

Mr Crowley sought to rely upon the market-based causation theory and a share price inflation to allege his loss. Put another way, Mr Crowley asked the Court to determine whether Worley's FY14 Guidance substantially inflated Worley's share price over its true value.

### (c) Decision

#### (i) When does guidance or a budget lack reasonable grounds?

Mr Crowley's argument that Worley's FY14 Guidance lacked a reasonable basis on 14 August 2013 rested on several critiques of Worley's budgeting process. In particular, Mr Crowley critiqued the following aspects of Worley's FY14 Budget:

- Worley "required" its locations to adopt Worley's overall FY14 growth strategy, as determined by senior management of the company without regard to regional market conditions;
- senior management "demanded" adjustments to operational Earnings Before Interest and Tax (EBIT) in the amount of $88.6m;

- it was inappropriate for Worley to include a stretch target of $12m EBIT in the FY14 Budget;
- Worley's performance in its major markets was deteriorating;
- the FY14 Budget did not include a contingency against underperformance;
- Worley's blue sky revenue figures, which referred to estimated revenue from projects not identified at the time of forecasting, were insufficiently scrutinised;
- the FY14 Budget projected an unreasonable amount of blue sky revenue; and
- Worley had a historical track record of underperforming against its internal budget.

Criticisms made by Mr Crowley in respect of Worley's requirements or demands of its locations ((a) and (b) above) were, in large part, drawn from a post-event review into Worley's budgeting processes by Worley's then CFO, Simon Holt ("Holt Memorandum"). The Holt Memorandum recounted Worley's culture of growth expectation, that blue sky targets might have been premised on the hope of materialisation rather than on a sound basis, and that management assumed that regional markets were "sandbagging" their budget estimates. Mr Crowley described the Holt Memorandum as a "damning assessment" of Worley's "high pressure budgeting culture".

At a general level, the Court observed that Worley's FY14 Budget, with the benefit of hindsight, may have been "overly optimistic". However, the Court did not find that Worley's FY14 budgeting processes and its FY14 Guidance lacked reasonable grounds at the time they were approved and made. Key to the Court's decision was evidence from Worley's management showing a rigorous process of building up the budget by soliciting input from regions/locations. The fact that senior management imposed stretch targets on the regions, and/or that there was debate about the budget, including commentary about it being "aggressive", did not necessarily mean that senior management did not believe that the budget was achievable and reasonable. The Court considered that there was an adequate review of the budget's inputs when the budget was prepared, and the fact that FY14 Budget was revised down three months later did not mean it lacked a reasonable basis at the time it was formulated and approved.

In respect of the Holt Memorandum, while the Court accepted that Mr Holt's criticisms represented a candid and genuine assessment of the errors in Worley's budgeting methodology, it did not mean that the FY14 Budget lacked a reasonable basis at the time it was approved. Rather, the Holt Memorandum represented a retrospective analysis of Worley's errors leading up to the FY14 Budget that was made with the benefit of hindsight. Relevantly, Gleeson J found that Mr Crowley's attempted portrayal of the Holt Report as a "damning assessment" was an "exaggeration".

**(ii) Unexpected results do not necessarily undermine the reasonable basis for guidance**

Mr Crowley argued that even if Worley's FY14 Budget was reasonable on 14 August 2013, the unreasonableness of Worley's FY14 Guidance became increasingly apparent to the Board and senior management between 14 August 2013 and 20 November 2013, when Worley's performance fell below the expectations set out in the FY14 Budget. To that end, Mr Crowley noted that despite recording declines in its first-quarter results, Worley reaffirmed its FY14 Guidance on 9, 10 and 15 October 2013.

Mr Crowley also pointed to Board packs which, among other things, downgraded the yearly estimated FY14 NPAT range and noted that all financial contingencies had been deployed two months into the financial year. Likewise, Mr Crowley drew attention to Worley's commencement of an "EBIT improvement program" in September 2013, which was accompanied by emails referring to a "major reset". In light of these facts, amongst others, Mr Crowley argued that Worley had "relinquished" elements forming the grounds of its FY14 Budget, and therefore ought to have reasonably recognised it was likely to fall short of its FY14 Guidance.

Her Honour dismissed Mr Crowley's arguments as unpersuasive, noting that the applicant failed to demonstrate or set out any evidence that would meaningfully call into question the reasonableness of Worley's FY14 Guidance up to the point that it downgraded guidance on 20 November 2013. While the Court accepted that there were concerns about Worley performance against the FY14 Budget, it did not accept that a "cost reduction program" could not have turned things around and that Worley should not, therefore, be taken as knowing that the FY14 Budget was unreasonable or unachievable. Similarly, analysis undertaken prior to Worley's October AGM indicating that Worley would be more dependent on the second half of the financial year than it had historically been, did not, by itself, amount to knowledge or awareness about the lack of a reasonable basis for the FY14 Budget and FY14 Guidance.

### (iii) Onus of proof

In respect of Mr Crowley's misleading or deceptive conduct case, the Court rejected Worley's argument that its FY14 Guidance constituted a present expectation of its views, rather than a representation with respect to a future matter. Her Honour held that Worley's use of the words "expect" with the qualification "uncertainties in world markets" did not sufficiently render the FY14 Guidance as not being made with regard to the future.

The onus of proof, therefore, fell on Worley to establish in evidence a reasonable basis for its FY14 Guidance by operation of s. 12BB(2) of the ASIC Act and s. 4(2) of the ACL, as a person is taken not to have had reasonable grounds for making the representation unless evidence is adduced to the contrary.

Gleeson J held that the reasonableness of Worley's FY14 Guidance was to be assessed by asking whether its Board and its CEO (the only executive director) had reasonable grounds for the FY14 Guidance based on their knowledge/state of mind at the time the FY14 Guidance was given. Her Honour assessed this by considering the state of mind of the Board collectively and the state of mind of the CEO individually. Her Honour found that the Board and the CEO individually held reasonable grounds for giving, repeating and maintaining its FY14 Guidance at all relevant times as:

- "the evidence does not show that particular integers or portions of the FY14 Budget were overstated or understated so as to be unreasonable or unjustifiable"; and
- "nor does the evidence demonstrate that a more sceptical approach would probably have led the Board to conclude that the FY14 Budget should not be approved".

Once Worley adduced evidence accordingly, the applicant was required to demonstrate the FY14 Budget's unreasonableness. As noted in ss. 2 and 3 above, Mr Crowley repeatedly failed to do so. The Court observed that the evidence put forward by Mr Crowley fell "well short of proving on the balance of probabilities that the FY14 Budget did not provide reasonable grounds for the August 2013 earnings guidance statement".

(iv) Information and materiality

Pursuant to s. 674(2) of the Corporations Act, Worley was obliged to notify the market of information that a reasonable person would expect to have a *material effect* on the price or value of Worley's shares if the information were generally available in the Relevant Period. A similar obligation exists in r 3.1 of the ASX Listing Rules. The relevant questions for the Court to answer were: (i) what standard of materiality was to be applied; and (ii) when did Worley become aware of information that was sufficiently material?

Mr Crowley submitted that a market consensus view existed that Worley would deliver FY14 NPAT in the range of \$354–\$368m (which Worley was aware of) and Worley was obliged to correct once Worley became aware of information suggesting that it would fall materially short of the market consensus view. To establish that a market consensus view existed, Mr Crowley relied upon a variety of analyst projections issued after Worley's FY14 Guidance expressing optimism regarding Worley's FY14 NPAT, including those published by Credit Suisse, Deutsche Bank, Morgan Stanley, Macquarie, Citibank and UBS.

In relation to the materiality threshold, Mr Crowley submitted that a material change was likely to connote a change of between 5% and 10%. The Court accepted this argument, explicitly adopting Beach J's approach in *Myer*, in which his Honour concluded that "materially lower" meant at least 5% lower.

On the facts of this case, her Honour did not consider that there was a market consensus view that Worley would deliver FY14 NPAT of \$354–\$368m (as was pleaded by Mr Crowley). Accordingly, it could not be said that a single consensus expectation of professional analysts existed in the Relevant Period, against which Worley was required to assess its performance and disclose any material effects pursuant to s. 674(2) of the Corporations Act. While not stated expressly, her Honour appears to have rejected Mr Crowley's argument that various separate analyst views as to Worley's expected financial performance could be aggregated together to form a single consensus view in respect of which Worley was required to disclose material information. Gleeson J reached this conclusion despite evidence from Worley's board packs indicating that the Board assessed its performance by reference to an aggregated range of analyst figures.

Even if a consensus expectation did exist, her Honour did not consider that it was likely that Worley's FY14 results would have fallen materially short of the (assumed) consensus expectation during the Relevant Period. In concluding so, her Honour adopted Beach J's threshold of materiality in *Myer* and applied a 5% reduction to this (assumed) consensus expectation on each of the pleaded dates, for the purpose of evaluating Mr Crowley's case. As a result, there was no continuous disclosure obligation on Worley to communicate any information to the market to correct the (assumed) consensus expectation.

Since the Court did not consider that Worley's conduct gave rise to any contraventions, it was not necessary to make findings in relation to causation and loss. As a result, Beach J's decision in Myer remains the only authority in support of market based causation.

### (v) Companies should nevertheless remain diligent

Gleeson J's judgment in *Crowley v Worley* turned largely on the individual facts of the case, although it should give comfort to companies who engage in rigorous budget preparation processes. Several questions remain unanswered from the judgment that are relevant for listed companies issuing market guidance:

- it is unclear, but it appears that Gleeson J considered that the Board and senior executives need to be "aligned in their expectation" in order for the company to have reasonable grounds for the guidance. This suggests that the Board (as a collective) and the CEO (as an individual), based on the information available to them, must all have had reasonable grounds for approving and giving the guidance, and that if one or other of them did not, then the company may not; and
- it is also unclear whether a company will have reasonable grounds for its guidance given in circumstances where its Board approves guidance based on a budget submitted to it by senior executives, but unbeknown to the Board (and the CEO), the budget in fact included some unreasonable elements or assumptions, or contained material errors of which the CFO and/or senior executives were aware or should have been aware. There is a risk that a court may find that if the budget is unreasonable or contained material errors, then the company may not have reasonable grounds for any guidance based on that budget.

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## 6.11 Application for relief under s. 1322 of the Corporations Act 2001 (Cth) in relation to share issues made without the requisite disclosure

*(By Joshua McKersey, MinterEllison)*

*Metalicity Ltd* [2020] WASC 387 (16 October 2020), Supreme Court of Western Australia, Hill J.

### (a) Summary

The plaintiff company, Metalicity Ltd ("Company"), brought proceedings in relation to 17 separate share issues, in respect of which the company had failed to comply with its disclosure obligations under pt 6D.2 of the Corporations Act 2001 No. 50 (Cth) ("Corporations Act"). The Company sought orders under s. 1322(4)(a) and s. 1322(4)(d) of the Corporations Act to validate the issues. Hill J made the orders sought by the Company. In so deciding, it was plainly material to her Honour that, by and large, the Company's contraventions of the Corporations Act were due to inadvertence rather than the wilful disregard of its obligations.

### (b) Facts

Between January 2016 and September 2020, the Company undertook 17 share issues that did not comply with the requirements of ch 6D of the Corporations Act. Following separate share issues on 9 and 11 September 2020, the Company was advised by its solicitors that it had not lodged a cleansing notice in relation to these issues. The Company subsequently commenced a review of all share issues since October 2015, and uncovered the other 15 transactions.

On 9 October 2020, the Company lodged a cleansing prospectus and cleansing notices in relation to the September issues. On the same day, the Company also announced its intention to commence the present court proceedings and alerted shareholders and other parties who may have purchased shares from sales after the impugned issues to potential issues with the transactions.

On 13 October 2020, the Company commenced these proceedings.

(c) Judgment

Hill J dealt first with the orders sought by the company under s. 1322(4)(d) of the Corporations Act for an extension of time to lodge the cleansing notices in relation to the September issues (the statutory time period for lodgement under s.708A(6) of the Corporations Act had expired by about four weeks when the notices were lodged on 9 October 2020).

Her Honour considered it necessary to determine first, having regard to the circumstances of the case and the general objects of the Corporations Act, whether it was appropriate to grant the extension of time, and then to determine whether any substantial injustice had been or was likely to be caused by the extension, in light of s. 1322(4)(d) and the precondition for relief in s. 1322(6)(c) of the Corporations Act respectively. Her Honour was satisfied that it was appropriate to grant the extension and that there had not been and was not likely to be any substantial injustice caused by the extension, because:

- first, if the orders were not made, the Company would be unable to lift the suspension of trading in its shares on the ASX, which would prejudice current and prospective shareholders, and there was a risk that the Company would be delisted from the ASX if the suspension continued;
- secondly, the Company provided an explanation for its non-compliance, being that it was a consequence of "inadvertence or misunderstandings" and was "honest and not intentional";
- thirdly, granting the extension of time was consistent with the purpose and policy of the Corporations Act, including by facilitating commerce generally;
- fourthly, the Company acted promptly in bringing the application and putting it on for urgent hearing;
- fifthly, both the ASX and ASIC indicated that they did not support or oppose the application nor intended to appear; and
- sixthly, the proposed orders sought by the Company allowed any potentially affected person to apply to court in respect of the orders.

Her Honour then turned to s. 1322(6)(a)(ii) of the Corporations Act, a precondition for relief under s. 1322(4)(a) of the Corporations Act, which requires that the persons concerned in or party to the contravention acted honestly. Apart from the share issues on 17 February 2016, 13 June 2016, and 9 March 2017, her Honour found that each impugned transaction resulted from "inadvertence or an incorrect assessment of whether a cleansing notice or prospectus was required to be lodged rather than any deliberate disregard by the plaintiff or its officers of the obligations under ch 6D of the Corporations Act". Her Honour also found that there had not "been a failure of Metalicity's directors to take an active interest in the company's compliance with the Corporations Act or to properly define roles of company officers", and that "the directors had delegated this function to an experienced and professional company secretary". Accordingly, Hill J held that s. 1322(6)(a)(ii) of the Corporations Act was satisfied in respect of 14 share issues.

As for the issues of 17 February 2016, 13 June 2016, and 9 March 2017, Hill J held that the condition for relief under s. 1322(4)(a) in s. 1322(6)(a)(iii) of the Corporations Act was satisfied in respect of these issues; that is, that it was just and equitable to make the orders sought. Her Honour reasoned that, without the orders, people who were issued or who had purchased (and had possibly on-sold) shares in the impugned transactions might suffer prejudice because, if those people on-sold those shares, any such sales may be void or voidable and would have occurred without the requisite pt 6D.2 disclosure. In the case of the Company and its shareholders, her Honour thought that the Company might suffer prejudice for the same reason while the shareholders might suffer substantial injustice by reason of not being able to trade their shares on the ASX unless the restriction was lifted.

In relation to s. 1322(6)(c) of the Corporations Act, which is also an essential condition for relief under s. 1322(4) of the Corporations Act and requires that no substantial injustice has been or is likely to be caused to any person, her Honour held that section to be satisfied for the same reasons supporting her Honour's conclusion on s. 1322(6)(a)(iii) of the Corporations Act.

Hill J also considered whether there were any other discretionary reasons to withhold relief, and held that there were not. In this connection, her Honour noted that there was no evidence of substantial misconduct or that any minority shareholder interest might be oppressed or any other interest affected, and that the company had promptly sought to remedy the irregularities once they had been identified.

Her Honour then turned to the ancillary orders sought by the Company, which her Honour thought were appropriate to make on the evidence before the Court.

Finally, her Honour addressed the company's submissions that no costs order should be made. Her Honour took the view that where the court is satisfied that there has been no failure of the persons concerned or the company to act honestly, under s. 1322(6)(a)(ii) of the Corporations Act, it is only in the most unusual circumstances that an order for costs is made against the officers of the company. Her Honour thus made no order as to costs.

In light of the above, Hill J was satisfied that the company was entitled to the relief sought, and granted that relief.

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