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26 June 2014 > Regulatory Newsfeed

SAI Global Corporate Law Bulletin No. 202>

Index info.regulatory@saiglobal.com

Bulletin No. 202

Editor: Professor Ian Ramsay, Director, Centre for Corporate Law and Securities Regulation

Published by SAI Global on behalf of Centre for Corporate Law and Securities Regulation, 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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1. Recent Corporate Law and Corporate Governance Developments

1.1 Underwriting fees: Research study

On 23 June 2014, the Australian Council of Superannuation Investors (ACSI) released a research report on underwritten rights issues conducted by ASX300 companies between 2010 and 2012 titled "Underwriting of rights issues: cost versus value".

Companies are paying more than twice as much in rights issue underwriting fees than benchmark modelling suggests that service should cost, according to the research. Results of the study suggest that, over three years, companies have in aggregate paid underwriters (typically investment banks and stockbroking groups) a premium of more than $170 million - or an average of around $2.7 million per raising - above the theoretical value of the risk assumed by those underwriters.

It also emerged that average underwriting fees are more than 60% higher than they were 20 years ago. This is despite innovations that, in particular, have dramatically reduced the time required to complete a rights issue, thereby decreasing underwriting risk.

Recommendations

According to ACSI, the research suggests that company directors, investors and rule makers can all help achieve more cost effective outcomes.

In particular:

- company directors should appropriately oversee the capital raising process. They should understand the model used by the underwriter to determine its fee, the assumptions that go into this model and whether the premium (if any) is appropriate. Directors should also be aware that previous research has suggested that past relationships with underwriters are associated with higher premiums and, so, should consider offering others the opportunity to tender for underwriting;

- investors should first understand the potential loss of value from poorly negotiated underwriting agreements. They should develop a policy on capital raisings and query the board oversight of the capital raising process, as well as underwriter selection and fee negotiation. Where relevant, they should also consider underwriting fees when deciding on proxy voting resolutions regarding capital raisings. Some may also consider opposing director elections if they believe overall board oversight of capital raisings to be poor; and
- rule makers can have a role to play in both enhancing disclosure and continuing to improve the efficiency of the rights issue process. First, the ASX Listing Rules should be modified to require disclosure of underwriting fees for share placements in the same way as currently applies to rights issues. This improved transparency will allow analysis to be applied to placements, not just rights issues. Second, ASX should continue in its efforts of shortening the rights issue timetable, since shorter timetables should mean less costly underwriting.

The research report is available on the ACSI website.

1.2 Supervisory guidelines for identifying and dealing with weak banks: Basel Committee consultative report

On 18 June 2014, the Basel Committee on Banking Supervision published for comment the consultative document, "Supervisory guidelines for identifying and dealing with weak banks".

The Committee is updating its guidelines in light of the significant developments that have transpired in global financial markets and the global regulatory landscape since the financial crisis. Once final, the guidelines will supersede the 2002 Committee guidance on the topic.

Key changes to the guidelines include:

- emphasising the need for early intervention and the use of recovery and resolution tools, and updating supervisory communication policies for distressed banks;
- providing further guidance for improving supervisory processes, such as incorporating macro prudential assessments, stress testing and business model analysis, and reinforcing the importance of sound corporate governance at banks;
- highlighting the issues of liquidity shortfalls, excessive concentrations, misaligned compensation and inadequate risk management; and

- expanding guidelines for information-sharing and cooperation among relevant authorities.

The consultative document and further information are available on the BIS website.

1.3 IOSCO securities markets risk survey

On 17 June 2014, the Research Department of the International Organization of Securities Commissions (IOSCO) published the Staff Working Paper, "A Survey of Securities Markets Risk Trends 2014: Methodology and Detailed Results", which provides a detailed analysis of responses to its annual survey on market trends and emerging risks.

The working paper offers a synthesis of expert opinions.

The main areas identified are:

- issues considered "macro-prudential" in nature are high among the concerns of respondents, especially in the areas of banking vulnerabilities and capital flows.
- more micro-prudential risks clustered around the areas of corporate governance, financial risk disclosure, shadow-banking activities and, especially, regulatory uncertainty.
- responses differ by the type of respondent: Regulators see risk emanating from illegal conduct, corporate governance, financial risk disclosure and benchmarking issues, while market participants are more concerned with risk arising from the search for yield, resolution and resolvability plans, central counterparties (CCPs) and market fragmentation.
- respondents saw very few "risks" sourced within securities markets. The role of securities markets with regard to risk was more likely to transmit and/or amplify shocks from outside than to originate risk.
- respondents thought the fallout from banking vulnerabilities and capital flow volatility could have considerable consequences for the real economy. Concerns about trends in the housing market continue to increase.
- over time some risk areas have attracted more attention while others have lost prominence. Sovereign debt and the global economic slowdown were leading concerns two years ago, but have declined significantly in importance as developed economies slowly return to economic growth. This shows how quickly the perception of risks can change.
- the impact of cross-border capital flows, financial risk disclosure and CCPs has drawn more attention between 2013 and 2014.

- however respondents have repeatedly and consistently cited three trends as major concerns in all three annual surveys: regulatory uncertainty; banking vulnerabilities; and volatile capital flows; and
- other noteworthy trends include an increase in the recognition that cybercrime or cyber-related issues could be a threat to systemic stability; financial risk disclosures and resolution and resolvability frameworks.

The working paper is available on the IOSCO website.

1.4 UK: Reform of 'pre-pack' insolvency deals

On 16 June 2014, the UK Business Minister Jenny Willott announced new recommendations aimed at ensuring that businesses and customers get a better deal from failing companies.

When companies are almost insolvent, arrangements are often made to sell the profitable parts of the business and or the company's assets before insolvency is announced to obtain the best price possible. These are known as pre-pack sales.

The proposals follow an independent review by Teresa Graham CBE, an expert in better regulation, launched in July last year. The review identified concerns that these particular types of sales were not always transparent or fair and were not delivering the best outcomes for customers and small businesses affected when companies failed.

Recommendations include:

- creating a 'pre-pack pool' where details of a proposed sale to a connected party can be shown to an independent person prior to the sale taking place. This will increase transparency and give greater confidence to creditors that the deal has undergone independent scrutiny;
- requesting connected parties to complete a 'viability review' for the new company to improve its chances of success.
- requiring valuations to be carried out by a valuer who holds professional indemnity insurance, to increase confidence that the sale is for a fair price; and
- ensuring proper marketing is undertaken in order to maximise sale proceeds.

Further information is available on the Insolvency Service website.

1.5 Lessons for policy cooperation from the global crisis: IMF research study

On 10 June 2014, the IMF published "After the Fall: Lessons for Policy Cooperation from the Global Crisis", a working paper regarding lessons learnt from the global financial crisis.

The working paper looks at the lessons from what did - and did not - occur in the area of policy cooperation since the crisis. Outcomes seem to be weaker over time in areas such as macroeconomic policies, where institutional procedures were less well defined and there were disagreements over spillovers. By contrast, cooperation seems to have been most effective where there was a consensus that such policies could avoid the risk of highly detrimental outcomes and institutional arrangements were more concrete. Principal amongst these was trade, but bank capital buffers, IMF resources, and derivatives exchanges also fall into this category.

Lessons for those interested in promoting cooperation seem to be that it may be more fruitful to:

- focus on the potential for major costs from a lack of cooperation, rather than the minor gains from fuller coordination;
- strive for more consensus estimated spillovers;
- convince policy-makers that costs of loss of cooperation are large; and focus on building better and more enduring institutional arrangements.

The paper is available on the IMF website.

1.6 UK FRC publishes guidance on strategic report

On 9 June 2014, the UK Financial Reporting Council (FRC) announced a program of work to promote clear and concise reporting from which investors can, with justifiable confidence, draw conclusions about a company's performance, position and prospects.

As a first step the FRC has published "Guidance on the Strategic Report", a new reporting requirement designed to give investors an insight into the way the business is run and its strategic direction.

The Guidance on Strategic Report is available on the FRC website.

1.7 CAMAC report: Crowd sourced equity funding

On 6 June 2014, the Corporations and Markets Advisory Committee (CAMAC) published its report on crowd sourced equity funding.

(a) General considerations

The CAMAC report sets out a detailed regulatory blueprint for the stimulation of the innovative start-up and other small-scale enterprise sector of the Australian economy through internet-based funding.

A legislative initiative to facilitate crowd sourced equity funding (CSEF) has the potential to promote productivity and economic growth in Australia, provide employment opportunities and return financial and other benefits to crowd investors. Equally, lack of a supportive local regulatory environment for CSEF may result in worthwhile Australian entrepreneurs incorporating in other countries, or moving their businesses offshore, to enable their ideas or projects to be funded by the crowd.

CAMAC's proposals are deregulatory in that they seek to overcome current legal impediments to Australian companies (issuers) raising funds through CSEF. However, in the view of CAMAC, for this form of corporate fundraising to operate in the best interests of investors as well as issuers, a regulatory structure specifically designed for CSEF needs to be developed.

(b) How the proposals would affect issuers

(i) The corporate form

The concept of CSEF is aimed principally at facilitating online fundraising by start-up and other small scale enterprises. Typically, such enterprises would in the past have been incorporated as proprietary, rather than public, companies. Nevertheless, for a start-up or other small scale enterprise to raise funds through CSEF, CAMAC considers that it should be a public company, given that it will be making an offer to the public, in the form of the online crowd, and will have those members of the public who accept the offer as its shareholders. However, to overcome the current disincentives on promoters to form a public company, a new classification of 'exempt public company' should be created. An eligible issuer could choose to be a public company or an exempt public company.

(ii) The crowd fundraising process

It is proposed that an eligible issuer may seek funds from the crowd by offering its equity through a licensed online intermediary, provided that:

- the offer does not exceed the issuer cap of $2 million in any 12 month period;

- the offer disclosure requirements are complied with;
- the controls on advertising are complied with;
- the issuer does not lend to crowd investors to acquire its shares; and
- any material adverse change concerning the issuer is notified.

(c) How the proposals would affect intermediaries

It is proposed that each equity offer to the crowd be conducted through one licensed intermediary only, operating online only. The issuer would choose the intermediary, subject to the intermediary agreeing to host the issuer on its website.

The CAMAC proposals seek to engender issuer and investor confidence in the CSEF process by requiring intermediaries to take a fully professional approach to their role, including to:

- conduct limited due diligence checks on issuers;
- provide a generic risk disclosure statement to crowd investors;
- check compliance with investor caps in some instances;
- provide communication facilities between issuers and investors; and
- disclose the fees they charge.

(d) How the proposals would affect investors

CAMAC puts forward various proposals to facilitate opportunities for internet users to take up equity, while giving them various protections, including risk warnings.

They include:

- any person of legal capacity can be a crowd investor;
- a crowd investor be limited to investing $2,500 per issuer, and $10,000 for all issuers, in any 12 month period;
- crowd investors must acknowledge the risk disclosure statement before investing;
- crowd investors have cooling-off and other withdrawal rights; and
- share resale restrictions apply only to persons associated with the issuer.

The Crowd Sourced Equity Funding Report is available on the CAMAC website.

1.8 IOSCO consultation on good practices on reducing reliance on CRAs in asset management

On 4 June 2014, the International Organization of Securities Commissions (IOSCO) published the consultation report, "Good Practices on Reducing Reliance on [Credit rating agencies (CRAs)] in Asset Management". The report is aimed at gathering the views and practices of investment managers, institutional investors and other interested parties, with a view to developing a set of good practices on reducing over reliance on external credit rating in asset management.

The role of CRAs has come under regulatory scrutiny, mainly as a result of the over-reliance of market participants, including investment managers and institutional investors, on CRA ratings in their assessments of both financial instruments and issuers in the run-up to the 2007-2008 financial crisis.

To address this concern, the Financial Stability Board (FSB) published the report, "Principles for Reducing Reliance on CRA Ratings" (the FSB 2010 Principles), in October 2010. The goal of these Principles is to end mechanistic reliance on ratings by banks, institutional investors, and other market participants. They concluded with a call for regulators and standard setters such as IOSCO to consider steps for translating the Principles into more specific policy action.

The report consults on the following list of possible good practices in asset management:

- investment managers make their own determinations as to the credit quality of a financial instrument before investing and throughout the holding period;
- external credit ratings may form one element, among others, of the internal assessment process but do not constitute the sole factor supporting the credit analysis;
- an internal assessment process that is commensurate with the type and proportion of debt instruments the investment manager may invest in, and a brief summary description which is made available to investors, as appropriate;
- an internal assessment process that is regularly updated and applied consistently;
- regulators could encourage investment managers to review their disclosures describing alternative sources of credit information in addition to external credit ratings;
- regulators could encourage investment managers - as represented collectively through trade associations and/or self-regulatory organisations - to include in their credit assessments alternative (internal) sources of credit information in addition to external credit ratings;
- where external credit ratings are used, investment managers understand the methodologies, parameters and the basis on which the opinion of a CRA was produced, and have adequate means and expertise to identify the limitations of the methodology and assumptions used to form that opinion;
- regulators could encourage investment managers to disclose the use of external credit ratings and describe in an understandable way how these complement or are used with the manager's own internal credit assessment methods;

- regulators could encourage investment managers, when assessing the credit quality of their counterparties or collateral not to rely solely on external credit ratings and to consider alternative quality parameters (eg, liquidity, maturity, etc); and
- where an investment manager (or collective investment scheme board, as appropriate) explicitly relies on external credit ratings among others to assess the credit worthiness of specific assets, a downgrade does not automatically trigger their immediate sale. Where the manager/board conducts its own credit assessment, a downgrade may trigger a review of the appropriateness of its internal assessment. In both cases, should the manager/board decide to divest, the transaction is conducted within a timeframe that is in the best interests of the investors.

The consultation report is available on the IOSCO website.

1.9 Bank for International Settlements data on activity in international banking and financial markets

On 2 June 2014, the Bank for International Settlements (BIS), in cooperation with central banks and monetary authorities worldwide, disseminated a data set on activity in international banking and financial markets.

In summary, the cross-border claims of BIS reporting banks contracted for a seventh consecutive quarter between end-September and end-December 2013. Nevertheless, the pace of decline was slower than in the preceding two quarters. Claims on banking offices as well as non-bank entities fell. Euro-denominated claims contracted substantially. By contrast, cross-border lending in US dollars and in Japanese yen expanded. Boosted by strong growth in lending to China, cross-border claims on emerging Asia continued their steady expansion.

OTC derivatives markets continued to expand in the second half of 2013. Increases in notional amounts were driven by interest rate derivatives, especially contracts with a medium- to long-term maturity. In credit default swap (CDS) markets, central clearing and netting made further inroads.

Further information is available on the BIS website.

1.10 IOSCO consultation on strategic framework for investor education/financial literacy

On 29 May 2014, the International Organization of Securities Commissions (IOSCO) published, "Strategic Framework for Investor Education and Financial Literacy", a consultation report which describes IOSCO's role in promoting investor education and financial literacy and its strategic approach to both.

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

IOSCO believes the need for investor education and financial literacy has never been greater than today. As the financial marketplace continues to evolve and innovate, investment products are becoming increasingly complex and financial services increasingly diverse. Greater understanding of key financial concepts is required on the part of retail investors to understand and evaluate the choices available to them and to avoid financial fraud. Strengthening investor education and financial literacy programs also is essential at a time when responsibility for saving and investing for retirement is shifting from the employer to the individual in many jurisdictions.

The report identifies practices currently used by members of the Committee on Retail Investors to address these and other issues, in an effort to help guide the wider IOSCO membership in developing and enhancing their own investor education and financial literacy programs.

The report includes appendices on behavioural economics and other findings related to financial decision-making and a behavioural economics literature review.

The report is available on the IOSCO website.

1.11 IOSCO 2015-2020 strategic plan

On 28 May 2014, the International Organization of Securities Commissions (IOSCO) launched the *IOSCO 2020 Questionnaire*, a survey aimed at eliciting feedback form IOSCO members and stakeholders on IOSCO's recent activities and performance, and its strategic direction. The survey forms part of the *IOSCO 2020 Review*, which aims to develop a strategic plan for the period from 2015 - 2020.

The objectives of the review are to:

- define the outcomes IOSCO wants to achieve by 2020;
- develop a strategic plan for IOSCO and the IOSCO Secretariat to achieve those outcomes;
- determine funding and resourcing needs of the IOSCO Secretariat to implement the strategic plan and annual business plans; and
- develop a financing plan to meet the funding and resourcing needs.

The survey seeks views on the following:

- IOSCO's performance against its Strategic Plan for 2010 to 2015;
- stakeholders' engagement with the IOSCO General Secretariat and other forms of contact with IOSCO; and
- key challenges for IOSCO and globally which will impact regulated markets and activities and the role of IOSCO in addressing these challenges over the next 5 years.

The survey is being conducted through an online questionnaire, which is available on the IOSCO website.

1.12 Consultation paper: Extending unfair contract term protections to small business

On 23 May 2014, the Treasury released a consultation paper regarding the extension of unfair contract term protections to small business.

The consultation paper seeks feedback on the inclusion of unfair contract terms being included in standard form contracts involving small businesses, causing detriment throughout the community. The consultation paper also discusses extending protections available to consumers in the *Australian Consumer Law* to protect small businesses.

The Treasury is undertaking the consultation process on behalf of Consumer Affairs Australia and New Zealand.

The consultation paper is available on the Treasury website.

1.13 IAASB proposed enhancements to auditing standards focused on financial statement disclosures

On 14 May 2014, the International Auditing and Assurance Standards Board (IAASB) released for public comment proposed changes to the International Standards on Auditing (ISAs) to clarify expectations of auditors when auditing financial statement disclosures.

The proposed changes include new guidance on considerations relevant to disclosures, from when the auditor plans the audit and assesses the risks of material misstatement, to when the auditor evaluates misstatements and forms an opinion on the financial statements.

The proposed changes to the ISAs are available on the International Federation of Accountants (IFAC) website.

1.14 A global view of risk committees: Research study

Deloitte has published a study which reveals the prevalence of board-level risk committees (whether standalone committees focused solely on risk, or hybrid committees such as audit/risk) based on analysis of 400 large public companies in eight countries.

The key findings are:

- board-level risk committees are well-established and widespread - present in 38% of the 400 companies analysed. About a quarter (22%) have standalone board-level risk committees, while 16% oversee risk through hybrid board-level committees;
- board-level risk committees are most prevalent in financial services industry (FSI) companies (88%), but are also present in other industries (26%), often to a significant extent, depending on the country;
- local regulations affect risk oversight structures. Australia, Brazil, Mexico, Singapore, the UK, and the US have regulations that require risk committees at the board level for FSI companies (sometimes dependent on the type and size of the company); and
- overall, 62% of all companies analysed do not have a board-level risk committee. This largely reflects the lack of regulatory requirements for board-level risk committees in non-FSI companies in most countries.

The full report is available on the Deloitte website.

2. Recent ASIC Developments

2.1 ASIC releases information sheet on super fee and cost disclosure

On 17 June 2014, ASIC released an information sheet on fee and cost disclosure requirements for superannuation trustees.

The requirements are part of the Government's Stronger Super reforms which start 1 July 2014, and must be met for both superannuation products and managed investment schemes.

Information Sheet 197: Fee and cost disclosure requirements for superannuation trustees (INFO 197) clarifies ASIC's expectations on the calculation of indirect costs and how performance and advice fees should be disclosed.

As part of the disclosure requirements, the consumer warning that states, "Your employer may be able to negotiate to pay lower administration fees' must be included in superannuation products' product disclosure statements (PDSs). Issuers of managed investment products do not need to include the statement in their PDSs.

ASIC's facilitative approach to compliance with fee and cost disclosure requirements has been extended to 1 July 2015 for superannuation funds and managed investment schemes. ASIC will take a measured approach where inadvertent breaches arise or system changes are underway, provided that industry participants are making reasonable efforts to comply.

Further, ASIC has deferred by class order [CO 14/541] the operation of s. 29QC of the Superannuation Industry (Supervision) Act 1993 (Cth) until 1 July 2015, so it can consult further with industry on the application of this section.

Section 29QC states a super trustee must use the same calculation when providing information to a person or on a website as it does when giving the same or equivalent information to the Australian Prudential Regulation Authority (APRA) under a reporting standard.

ASIC reiterates that APRA's *Reporting Standard SRS 700.0 Product Dashboard (MySuper)* continues to apply regardless of this deferral of s. 29QC. Trustees will need to refer to this reporting standard for the elements of the product dashboard. This includes the return target information in the dashboard.

Further, reporting fee and cost information will still be required under APRA's *Reporting Standard SRS 703.0 Fees Disclosed* regardless of the deferral of s. 29QC.

As an additional deregulatory measure, ASIC has also made changes to its PDS in-use notice forms to remove the questions relating to superannuation fees that were previously included.

The information sheet is available on the ASIC website.

2.2 ASIC guidance for disclosure on superannuation websites

On 16 June 2014, ASIC released guidance to help superannuation companies disclose information about superannuation funds and their trustees on their websites as part of making the industry more transparent.

The requirement is part of the Government's Stronger Super reforms which commence on 1 July 2014. From next month, super companies must also actively publish information on their websites about their executives, including remuneration, fund product disclosure statements, governing rules, actuarial reports and summaries of significant events that have occurred over the past two years.

The law also requires this information to be kept up to date at all times.

Regulatory Guide 252: Keeping superannuation websites up to date (RG 252) states that the "safe harbour" period, which provides the length of time a company has to update its website to remain compliant, is 20 business days. For information on remuneration, a website needs to be updated within four months.

The timeframes are set out in Class Order [CO 14/509].

RG 252 is available on the ASIC website.

2.3 Focuses for 30 June 2014 financial reports

On 6 June 2014, ASIC announced its areas of focus for 30 June 2014 financial reports of listed entities and other entities of public interest with a large number of stakeholders.

(a) Focus on impairment

ASIC encourages preparers and auditors of financial reports to carefully consider the need to impair goodwill and other assets. ASIC continues to find impairment calculations that use unrealistic cash flows and assumptions, including cases where entities have made unrealistic forecasts that have not been met over several reporting periods. ASIC notes that it also continues to find material mismatches between the cash flows used and the assets being tested for impairment.

(b) Focus on accounting policy choices

Preparers and auditors should also focus on the appropriateness of key accounting policy choices that can significantly affect reported results. These include revenue recognition, expensing of costs that should not be included in asset values, and the impact of new requirements for consolidations and joint arrangements.

(c) The role of directors

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

Although calculations supporting impairment or valuation of significant assets can be complex, directors should review the cash flows and assumptions used in the calculations prepared by management or experts, bearing in mind their knowledge of the business, its assets, and the future prospects of the business.

To ensure that financial reports are of high quality, and that useful and meaningful information is provided to users of financial reports, entities should:

- have a culture focused on quality financial reporting;
- have adequate governance arrangements, and processes and controls;
- ensure the financial literacy of directors is appropriate;
- apply the accounting standards;
- apply appropriate experience and expertise to financial reporting, and the underlying processes supporting the information in the financial report, including engaging external experts where appropriate; and
- consider accountability and internal incentives for company management that are focused on financial reporting quality.

Further information can be found in ASIC Information Sheet 183 Directors and financial reporting (INFO 183).

Financial reporting quality is supported by the quality of the independent audit, which is also important to confident and informed markets and investors. In this regard, directors should have regard to ASIC Information Sheet 196 Audit quality: the role of directors and audit committees (INFO 196).

(d) ASIC's surveillance

ASIC's surveillance of 30 June 2014 financial reports will particularly focus on listed entities and other entities of public interest with a large number and wide range of stakeholders considering factors like the nature and size of the business and the number of its employees.

ASIC's surveillance continues to focus on material disclosures of information useful to investors and other users of financial reports, such as key assumptions supporting accounting estimates. ASIC does not pursue immaterial disclosures that may add unnecessary clutter to financial reports.

INFO 183, INFO 196 and further information are available on the ASIC website.

2.4 ASIC proposals to facilitate foreign companies offering securities

On 28 May 2014, ASIC released a consultation paper proposing class order relief and guidance to help foreign companies offer CHESS Depositary Interests (CDIs) over their shares to investors in Australia.

CDIs are used to allow the shares of some foreign companies listed on ASX to be traded in Australia.

The proposals in Consultation Paper 220: Fundraising: Facilitating offers of CHESS Depositary Interests (CP 220) aim to provide the market with certainty about how offers of CDIs over foreign shares are regulated under the Corporations Act 2001 (Cth) (the Corporations Act) and to minimise costs for foreign companies.

The proposals include:

- confirming initial offers by foreign companies to investors should be made under a prospectus;
- clarifying in a class order that foreign companies, and not the depositary nominee that provides the CDIs, are responsible for providing disclosure to retail investors for offers of CDIs;
- modifying the Corporations Act so that the fundraising disclosure provisions operate effectively for offers of CDIs over shares in foreign companies; and

- guidance to help foreign companies comply with the fundraising disclosure requirements and to provide effective disclosure to retail investors for offers of CDIs.

The proposed class order relief, which reflects current market practice, will have the effect of easing the compliance burden for foreign companies as they will no longer need to approach ASIC for individual relief.

CP 220 is available on the ASIC website.

2.5 ASIC releases report on confidential information

On 27 May 2014, ASIC released Report 393: Handling of confidential information: Briefings and unannounced corporate transactions (REP 393). REP 393 looks at the way companies and their advisers handle confidential information.

Key points made in the report include that:

- listed entities must take responsibility for the management of their confidential information;
- poor practices can negatively affect reputation, jeopardise the success of a transaction and may lead to ASIC action; and
- future ASIC work includes a targeted review of research reports by analysts and a continued enforcement focus on insider trading and listed entities that fail to comply with continuous disclosure laws.

Key recommendations in REP 393 include:

- **Conduct at briefings**: Listed entities must remain vigilant about the handling and disclosure of confidential, market-sensitive information during analyst and investor briefings. Stakeholder engagement is a key risk area for selective disclosure of market-sensitive information.

  In particular:
  - listed entities should refrain from 'massaging' market expectations through selective briefings;
  - access to briefings by listed entities should be as broad as possible; and
  - analysts and institutional investors should not elicit confidential, market-sensitive information from listed entities, and should know what to do if given such information.
- **Information on unannounced corporate deals**: In the transactions reviewed ASIC found listed entities in the small to mid-capitalisation range relied

heavily on advisers on how to handle transaction-confidential information. Delegation of responsibility has risks. This is particularly so when the interests of a listed entity and the adviser do not align, such as in underwritten capital raisings. To prevent information leakage, listed entities should have frank discussions with underwriters about soundings required before the transaction's announcement, particularly where soundings are conducted in a live market.

REP 393 is available on the ASIC website.

2.6 ASIC reports on relief applications - October 2013 to January 2014

On 26 May 2014, ASIC released its latest report outlining decisions on relief applications covering the period 1 October 2013 to 31 January 2014.

This is a key part of ASIC's function and between 1 October 2013 and 31 January 2014, ASIC approved 565 relief applications.

Report 395: Overview of decisions on relief applications (October 2013 to January 2014) (REP 395), aims to improve the level of transparency and the quality of publicly available information about decisions ASIC makes when asked to exercise its discretionary powers to grant relief from provisions of the:

- Corporations Act 2001 (Cth) (the Corporations Act);
- National Consumer Credit Protection Act 2009 (Cth) (the National Credit Act), or
- National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009 (Cth) (the Transitional Act).

REP 395 also discusses the various relevant publications released by ASIC during the four-month period.

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

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

REP 395 is available on the ASIC website.

2.7 ASIC updates public comment guide

On 20 May 2014, ASIC updated information on the circumstances where it will make a public comment on investigations and enforcement actions.

The change to Information Sheet 152: Public comment (INFO 152) reflects the fact that ASIC obtains many enforcement outcomes that do not involve criminal, civil or administrative proceedings. These outcomes include ASIC accepting enforceable undertakings and agreements by people to change their conduct.

INFO 152 now makes it clear that ASIC will usually issue a media release or media advisory in these circumstances, as well as:

- at the time of a person's first court appearance in criminal proceedings;
- when originating documents in civil proceedings are filed and served; and
- when ASIC refers a case to the Takeovers Panel.

ASIC will also issue a release or advisory on the outcome of these actions.

INFO 152 is available on the ASIC website.

3. Recent ASX Developments

3.1 ASX and SGX cooperate to further enhance market connectivity

On 20 May 2014, ASX announced that customers in the Australian Liquidity Centre (ALC) and on ASX Net in Australia can now connect to the SGX Co-Location Data Centre in Singapore via ASX Net Global, ASX's international low latency network. The service allows ASX customers in the ALC or on ASX Net to connect to SGX brokers at the SGX Co-Location Data Centre and receive market data from SGX. Customers in SGX's Co-Location Data Centre have been able to connect to the ALC via ASX Net Global since September 2012.

The interconnection expands the range of international products and services available to customers in the ALC and on ASX Net, Australia's only dedicated financial markets network. ASX and SGX are cooperating to reduce the cost and technical barriers to accessing global capital market flows.

The media release is available on the ASX website.

3.2 Responses to ASX consultation on T+2 settlement cycle for Australia

The consultation period for submissions in response to the ASX Consultation Paper "Shortening the Settlement Cycle in Australia: Transitioning to T+2 for Cash Equities" closed on 7 April 2014. ASX received 23 written submissions. Eleven submissions were provided on a confidential basis. The consultation feedback was considered by the advisory forum (the Forum) established by ASX under its *Code of Practice for Clearing and Settlement of Cash Equities* at its 23 June 2014 meeting.

The 12 submissions provided on a non-confidential basis are available on the Public Consultations page on the ASX website.

The consultation paper is also available on the ASX website.

3.3 New ASX Listing Rules Guidance Note 19: Performance Shares

ASX has released "ASX Listing Rules Guidance Note 19: Performance Shares" (GN19) to assist listed entities in structuring the terms of performance shares to comply with the ASX Listing Rules. The Guidance note replaces the former, now withdrawn ASX Listing Rules Guidance Note 19 Non-Business Days and Non-Trading Days.

GN19 is available on the ASX website.

3.4 Reports

On 4 June 2014 ASX released:

- the ASX Group Monthly Activity Report;

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

for May 2014.

4. Recent Takeovers Panel Developments

4.1 Northern Iron Limited - Declaration of unacceptable circumstances and orders

On 20 June 2014, the Takeovers Panel made a declaration of unacceptable circumstances and final orders in relation to an application dated 23 May 2014 by Northern Iron Limited in relation to its affairs (see TP14/33).

(a) Background

Northern Iron is a company listed on ASX (ASX code: NFE). Its largest shareholder is Dalnor Assets Ltd, which holds a relevant interest of approximately 19.95%.

On 11 December 2012, Dalnor lodged a substantial holder notice which disclosed that the registered holder of the securities was SIX-SIS Ag as depository and the holder of a relevant interest of 5% was Dalnor.

On 27 March 2013, a tracing notice under s. 672A of the Corporations Act 2001 (Cth) (the Corporations Act) was issued to Dalnor. On 11 April 2013, Dalnor responded without providing the information required by s. 672B. On 28 May 2013, Ms Gabriella Bell was disclosed to Northern Iron as the sole shareholder of Dalnor.

On 13 May 2014, Dalnor lodged a notice of change of interests of substantial holder, which disclosed that the registered holder of the securities was SIX-SIS Ag as depository and the holder of a relevant interest of 18.99% was Dalnor.

On 22 May 2014, Dalnor lodged a revised notice of change of interests of substantial holder, which disclosed that the registered holder of the securities was SIX-SIS Ag and each of the following held a relevant interest of 18.99%:

- SIX-SIS Ag (as custodian and bare trustee for Dalnor);
- Dalnor;
- Ms Gabriella Bell (as sole shareholder of Dalnor, for the benefit of Fund GP - a wholly owned subsidiary of SPA Financial Services - in its capacity as general partner of SPA Fund); and

- SPA Multi-Strategy Fund II LP, SPA GP (II) Limited (Fund GP) and SPA Financial Services Ltd.

On 20 May 2014, Dalnor provided, in response to the tracing notice dated 27 March 2013, the information referred to in the 22 May 2014 substantial holding notice and advised that it was not aware of any other person who had given it instructions in respect of the shares.

The disclosure by Dalnor in its 20 May 2014 letter and 22 May 2014 revised substantial holding notice was deficient because it did not disclose all information required under the tracing and substantial holding notice provisions. For example, the revised substantial holding notice did not identify every person who has a relevant interest and did not contain details of any relevant agreement through which the parties disclosed have a relevant interest or provide a copy of relevant documents, including the SPA Fund Memorandum.

(b) Declaration

The Panel considered that Dalnor's failure to disclose information in accordance with the tracing and substantial holding notice provisions was unacceptable because:

- the acquisition of control over voting shares in Northern Iron has not taken place, and continues not to take place, in an efficient, competitive and informed market; and
- the holders of Northern Iron shares, the board of Northern Iron and the market in general has not known, and continues not to know, the identity of persons who acquired a substantial interest in Northern Iron.

(c) Orders

The Panel has made orders to the effect that:

- Dalnor lodge a new substantial holding notice; and
- Dalnor is not eligible to rely on the exception in item 9 of s. 611 of the Corporations Act until six months after the lodgement of the notice referred to above.

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

4.2 Gondwana Resources Limited - Declaration of unacceptable circumstances

On 6 June 2014, the Panel made a declaration of unacceptable circumstances and accepted undertakings in lieu of making final orders in relation to an application dated 29 April 2014 by Ochre Group Holdings Limited in relation to the affairs of Gondwana Resources Limited (see TP 14/28).

(a) Background

Ochre is a 17.64% shareholder in Gondwana. On 16 April 2014, when Ochre's holding was 8.27%, Gondwana lodged a prospectus with ASIC in relation to a 1 for 1, non-renounceable entitlement issue at 3.2c per share. The entitlement issue was to be partially underwritten (50%) by Bellatrix Pty Ltd, a company control by Mr Beckwith (Chairman of Gondwana), whose voting power could have increased to 43.75%. However the underwriting was terminated on 1 May 2014.

On or about 23 April 2014, Gondwana sent its shareholders a notice of annual general meeting and explanatory statement, which included resolutions to approve the issue of 15,000,000 shares and 15,000,000 options and the issue of some of those shares and options to Gondwana's directors. The annual general meeting was cancelled on 23 May 2014.

On or about 22 and 23 April 2014, Ochre lodged with ASX substantial holding notices, disclosing that it had increased its voting power in Gondwana from approximately 8.27% to 19.73%. Around the same time, Gondwana rejected an offer from Ochre to underwrite the remaining 50% of the entitlement issue and one of Gondwana's directors raised with his fellow directors whether Ochre would make a bid for Gondwana.

On 16 April 2014, Gondwana had written to its option holders stating in effect that they may not be able to participate in the entitlement issue in relation to any shares issued as a result of exercising their options unless their exercise form and relevant payment was received no later than 27 April 2014. Around 28 to 30 April 2014, Mr Beckwith approached 3 or 4 out of the 16 option holders to encourage them to exercise their 10c options by 30 April 2014 (the record date for the entitlement issue). On or after 30 April 2014, shares were issued to 5 option holders who had exercised their options, including Bellatrix and option holders associated with two other Gondwana directors. As a result of the option exercise, Mr Beckwith increased his voting power in Gondwana to 14.6%.

On 12 May 2014, Ochre announced that it intended to make a conditional off-market cash takeover bid for all the shares in Gondwana at 8.2c per share.

(b) Declaration

The Panel considered that, while the underwriting had been terminated, the circumstances were unacceptable because (among other things):

- all reasonable steps to minimise the potential control impact of the entitlement issue were not taken; and
- the exercise of the options by the directors of Gondwana and their associates appeared to be a response to Ochre's increased voting power and may contribute to Ochre not proceeding to acquire a substantial interest, including under its bid.

The Panel was also concerned about the standard of disclosure in the entitlement issue prospectus and the uncertainty surrounding the potential control impact of the proposed issue of shares and options to be approved at Gondwana's AGM.

(c) Undertakings

The Panel has accepted undertakings from Gondwana in lieu of making orders to the effect that Gondwana:

- increase the minimum subscription under its entitlement issue so as to allow Ochre to subscribe for its full entitlement;
- offer shareholders the opportunity to participate in any shortfall under the entitlement issue;
- must, if it proceeds with the shareholder approval of further shares and options, disclose the results of the entitlement issue at least 5 business days before the last day for lodgement of proxies; and
- make further disclosure in a replacement prospectus for the entitlement issue.

The Panel's reasons for its decision are on the Takeovers Panel website.

4.3 Bullabulling Gold Limited - Decision

On 5 June 2014, the Takeovers Panel made a decision in response to an application dated 13 May 2014 from Norton Gold Fields Limited in relation to the affairs of Bullabulling Gold Limited (see TP14/30). The Panel is of the view that unacceptable circumstances occurred in relation to Bullabulling's letter to shareholders dated 30 April 2014 and target's statement dated 14 May 2014.

On or about 30 April 2014, Bullabulling sent a letter to shareholders in response to the off-market takeover offer by Norton Gold, which contained the following statements (among others):

> ".Your Company has received strong messages of support from a number of Bullabulling Gold shareholders since the Offer was announced, and to date holders of 41.8% of Bullabulling Gold's

> shareholders have indicated that they DO NOT intend to accept the Offer."
>
> ".your Directors believe that if Norton fails to acquire 100% of Bullabulling Gold in its first attempt (i.e. under the Offer), which is a potential outcome given holders of 41.8% of Bullabulling Gold's shares have indicated that they do not intend to accept the Offer at the current price..."

These rejection statements were substantively repeated in Bullabulling's target's statement.

The Panel considered that the rejection statements, which were compiled from varied written and verbal statements received from 101 Bullabulling shareholders (including through an internet stock discussion site), gave rise to unacceptable circumstances because (among other things):

- Bullabulling did not inform all the rejecting shareholders how the statements were to be used;
- Bullabulling did not obtain consents from the rejecting shareholders in accordance with Panel policy or the Corporations Act 2001 (Cth) (the Corporations Act);
- Bullabulling shareholders were not given sufficient information about (among other things) how the rejection statements were compiled and the qualifications to which some statements were subject; and
- Bullabulling shareholders were not informed that Bullabulling considered that the rejection statements were no more than statements of the rejecting shareholders' intentions at certain points in time and were not intended to be statements of the rejecting shareholders' future actions.

The Panel was minded to make a declaration of unacceptable circumstances.

However, the Panel has accepted an undertaking from Bullabulling and declined to make a declaration of unacceptable circumstances.

The Panel considers that Bullabulling's undertaking sufficiently addresses the unacceptable circumstances and that it is not against the public interest to accept the undertaking and decline to make a declaration of unacceptable circumstances.

During the course of proceedings, Bullabulling raised the following statement (and variants of it) which appeared in Norton Gold's bidder's statement dated 17 April 2014:

"Bullabulling shareholders representing 6.6% of Bullabulling's issued shares have already confirmed they intend to accept the Offer."

On 20 May 2014, Norton Gold lodged a supplementary bidder's statement in which it disclosed (among other things) that the 6.6% comprised shares held by Gold Mountains (H.K.) International Mining Company Limited and Phoenix Gold Fund Limited, that Phoenix Gold had sold some of its shares on-market and that the level of support for the offer from these shareholders had decreased from 6.6% to 5.39% as a result. Norton Gold also disclosed that both shareholders had instructed their custodians to accept the offer in respect of their aggregate 5.39% holdings.

The Panel considered that the acceptance statements were misleading because (among other things) Norton Gold's bidder's statement or supplementary bidder's statement did not disclose that it was associated with Gold Mountains and that it already had voting power in Gold Mountains' 2.5% holding. Norton Gold also did not disclose that the shareholders had consented to the acceptance statements being made in the bidder's statement in accordance with the Corporations Act and did not disclose details of those consents including qualifications. Further, as evidenced by the sale by Phoenix Gold, it is not clear that it understood that its statement would be relied upon.

To address its concerns, the Panel accepted an undertaking by Norton Gold.

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

5. Recent Research Papers

5.1 Hedge fund activism and corporate innovation

This paper investigates the impact of hedge fund activism on corporate innovating activities. It finds that innovative firms, those in high-tech industries or with positive R&D, are as likely to be targeted by activist hedge funds as non-innovative firms. Activist hedge funds tend to target innovative firms with poor innovation efficiency. Hedge fund interventions are associated with significant improvements in innovation output in both high and low competitive industries. The improvement is more pronounced in active intervention events. Moreover, hedge fund activists deliver positive abnormal returns to shareholders of target innovative firms during the 5-year period following the intervention. Overall, the results suggest that activist hedge funds are not myopic investors and their interventions enhance innovative activities that benefit shareholders of innovative firms in the long term.

The paper is available on the SSRN website.

5.2 The changing landscape for derivatives

This paper describes the changes taking place in derivatives markets as a result of the 2007-2009 credit crisis. It discusses the developments of new platforms for trading, the use of central counterparties for clearing, the role of trade repositories, and the requirements for the posting of collateral. It explains the way in which the over-the-counter and exchange-traded derivatives markets are converging and argues that liquidity is becoming as important as capital to banks in their decision making.

The paper is available on the SSRN website.

5.3 Value-enhancing capabilities of CSR: A brief review of contemporary literature

This study reviews and synthesises contemporary business literature that focuses on the role of Corporate Social Responsibility (CSR) to enhance firm value. The main objective of this review is to proffer a precise understanding of what has already been investigated and the findings of those investigations regarding the value-enhancing capabilities of CSR. In addition, this review identifies gaps in existing literature, evaluates inconsistent findings, discusses possible data sources for empirical researchers, and provides direction for exploring other promising avenues in future studies. The thrust of the CSR literature largely acknowledges the value-enhancing capabilities of firms' social and environmental activities. However, the predominance of inconsistent theoretical grounds in major CSR-benefits-related areas suggests that there is ample room for future research to contribute to extant literature. Anecdotal evidence, the prevalence of theoretical arguments, and the availability of large cross-sectional firm-level data suggest that future research will enrich the literature by investigating the real insights behind several unanswered questions, by establishing implicit understandings regarding recognised findings, and by developing new theories in this emerging field.

The paper is available on the SSRN website.

5.4 Are entrepreneurs special? Evidence from board appointments

The authors study the appointment of entrepreneurs as outside directors to examine their effect on corporate outcomes in firms not created by them. They provide additional evidence on how the professional backgrounds of directors impact board effectiveness. Entrepreneur directors are more likely to join smaller firms and those whose founders currently serve as directors. Appointments of entrepreneur directors attract higher stock price reactions than appointments of other outside directors and firm value increases with their number. The value effect is greater when the firm is smaller or operates in more competitive industries. Entrepreneur directors are also associated with higher risk-taking, increased R&D investments, and improved revenue growth, each of which effect is associated with higher firm values.

The paper is available on the SSRN website.

5.5 Seven myths of CEO succession

Many believe that the selection of the CEO is the single most important decision that a board of directors can make. In recent years, several high profile transitions at major corporations have cast a spotlight on succession and called into question the reliability of the process that companies use to identify and develop future leaders.

The authors examine seven common myths relating to CEO succession.

These myths include the beliefs that:

1. Companies know who the next CEO will be
2. There is one best model for succession
3. The CEO should pick as successor
4. Succession is primarily a "risk management" exercise
5. Boards know how to evaluate CEO talent
6. Boards prefer internal candidates
7. Boards want a female or minority CEO.

The authors examine each of these myths and explain why they do not always hold true. They ask: Why aren't more companies prepared for a change at the top? Would directors make better hiring decisions if they had better knowledge of the senior management team? Would they be more likely to hire a CEO from within? Would they be more likely to hire a female or minority candidate? How many successions should a director participate in before he or she is considered "qualified" to lead one?

The paper is available on the SSRN website.

5.6 US class action lawsuits targeting foreign firms: The spill-over effect

The authors hypothesise that US shareholder class action lawsuits against foreign issuers not only affect the sued companies, but also carry a spill-over effect on non-sued foreign firms, due to investors updating their beliefs about non-sued firms' litigation risks. Examining 274 US shareholder lawsuits targeting foreign firms during the period 1996 to 2012 Q2, the authors find that non-sued foreign firms on average experience significantly negative price reactions during the event window surrounding a lawsuit filing. They further document two interesting patterns in the price reactions of non-sued foreign firms.

First, the negative price responses are more pronounced among peer foreign firms sharing certain common attributes with the sued company, for example, those originated from the same home country or in the same industry. Second, non-sued firms' price responses to a lawsuit tend to be less negative when the sued company has a relatively high ex-ante litigation probability. Controlling for the prior expectation of a lawsuit, a non-sued firm also tends to respond less significantly when it is already expected to be sued with a relatively high probability. Both patterns are consistent with the authors' proposed mechanism of litigation risk updating by investors. Utilising a clinical study of a series of lawsuits targeting Chinese issuers in 2010-2012Q2, the authors find a much stronger same-country spill-over effect for these lawsuits which, compared with relatively stand-alone lawsuits, presumably carry more information about litigation risks of compatriot non-sued firms, providing further support for litigation risk updating explanation for the spill over effect. Collectively, the findings imply that shareholder class action lawsuits in the US have economically significant impacts on US-listed foreign issuers, both sued and non-sued, and thus play an important role in disciplining foreign companies.

The paper is available on the SSRN website.

5.7 Financial systems, crises and regulation

This chapter of the forthcoming Oxford Handbook of Financial Regulation considers, in broad historical perspective and also with respect to the global financial crisis, why financial systems are crisis-prone and the relationship between financial crises and regulation. It begins with an overview of financial crises generally and then considers both the historical and potential future role of regulation in financial crises. It discusses various theories of the roots of financial crises (cognitive error, moral hazard, information asymmetry, agency costs, trust, and complications of measurement and specification), as well as relevant policy measures (governance reforms, bank capital requirements, capital controls, and the role of the lender of last resort).

The paper is available on the SSRN website.

5.8 Sovereign wealth funds: The good guy investment actors?

Sovereign wealth funds (SWFs) have been portrayed in some quarters as potential bad guys in global financial markets due to their supposed political as opposed to commercial intentions and influence. However, two key international developments during and since the 2008-2009 Global Financial Crisis have prompted some abatement in the hostility and mistrust displayed towards SWFs. First, SWFs provide substantial and growing sources of much-needed liquidity in global capital markets. Secondly, the Generally Agreed Principles and Practices - GAPP (The Santiago Principles) were created in 2008, which are a multilateral initiative to directly address governance issues associated with SWFs. Thus, SWFs have become a more accepted element of global financial markets and more is now known about how they operate and where their investment priorities tend to lie. However, there is still much to learn about the important roles that SWFs are likely to play in global markets, particularly how they may contribute to the public good. Accordingly, this article considers the "good guy" potential of SWFs by elucidating how SWFs may be not only a facilitative economic mechanism but also an important tool for societal benefit. In so doing, this article focuses on the role that they might play in domestic investment in order to stimulate the growth of social capital and nation building in their home country, as well as progress made by SWFs themselves in improving their standards and processes of governance.

The paper is available on the SSRN website.

6. Recent Corporate Law Decisions

6.1 Liability of credit rating agencies confirmed by Australian appeal court

(By Simon Clarke and Harry Edwards, Herbert Smith Freehills)

ABN AMRO Bank NV v Bathurst Regional Council [2014] FCAFC 65, Full Federal Court of Australia, Jacobson, Gilmour and Gordon JJ, 6 June 2014

The full text of this judgment is available online.

(a) Summary

The Full Federal Court of Australia has confirmed that, as a matter of Australian common law, a rating agency owes a duty of care to investors in a rated financial product. As such, the rating agency must exercise reasonable care and skill in the issue of the credit rating. The essential basis on which the Full Federal Court reached that conclusion was that the rating agency knew that potential investors in a structured credit product would rely on its opinion as to the creditworthiness of the notes in making their decisions to invest. The judgment was given after an appeal from a first instance finding of such a duty, in *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200. This Australian litigation is significant more broadly because it remains the only common law example of a rating agency being found liable to investors as a result of ratings which were found to have underestimated the default risk of products which performed poorly during the financial crisis. What is of particular interest is whether other common law courts would follow the reasoning of the Full Federal Court.

(b) Facts

The claims were brought by a number of local councils against each of: the councils' financial adviser, Local Government Financial Services (LGFS), ABN Amro and Standard & Poor's (S&P). ABN Amro had been responsible for creating the structured credit product which was at the centre of the dispute, two series of constant proportion debt obligations (CPDOs), while S&P's role was in issuing the CPDOs with a AAA credit rating. LGFS, whose business was in marketing products to local councils and government bodies in Australia, had in 2006 procured the creation by ABN Amro of A$40 million of Australian dollar-denominated issues of the CPDOs, which were known as the Rembrandt Notes. The councils between them purchased AUS$16m of the Rembrandt Notes, leaving LGFS holding A$24 million (and therefore LGFS was itself a claimant against ABN Amro and S&P). However, after their purchase, the Rembrandt Notes suffered a catastrophic fall in value caused by the dramatic change in credit conditions following the onset of the credit crisis. In particular, the Rembrandt Notes depended for their performance on the interaction between the mark to market value of a large number of CDS contracts underlying the notes and the premium income which the structure was generating on those contracts. The period of sustained widening in credit spreads caused losses within the structure when mark to market falls heavily exceeded the income. In simple terms, while their performance was expected to be strong if benign market conditions continued, the onset of the financial crisis caused the notes to fail.

(i) The first instance decision

In her 1,459-page judgment, Justice Jagot found in favour of the councils in their claims against LGFS, ABN Amro and S&P, and also in favour of LGFS (in respect of the retained AUS$24m worth of the Rembrandt Notes) against both ABN Amro and S&P.

The claims against ABN Amro and S&P were each put in terms of:

- an Australian-specific statutory claim for misleading or deceptive conduct; and
- (more significantly for those outside Australia) a breach of a duty of care to investors.

In issuing the AAA rating it gave to the Rembrandt Notes (and in ABN Amro's case deploying that rating in its marketing materials), S&P had assumed a duty to exercise due skill and care to ensure that such an opinion was reasonably capable of being held. Having identified a number of flaws in the rating process and the assumptions which were adopted by S&P in issuing the AAA rating, S&P (together with ABN Amro) was found to have breached this duty and to be liable to each of the investors for their losses.

(c) Decision

In the appeal court, S&P accepted that the rating itself was flawed, and focused on the finding that it owed a duty of care to investors. In doing so, and perhaps indicative of the significance of such a finding, the parties between them advanced comprehensive grounds of appeal which the Full Federal Court said put in issue "just about every finding of fact and conclusion of law made by the primary judge" and pursued "each allegation of error with undiscriminating vigour". However, the central issues which are of wider significance to the potential for claims against credit rating agencies are those which go to the heart of the duty of care which was said to exist. S&P contended that it did not owe a duty of care either to LGFS or to the local councils. In summary, it argued this on the basis of a lack of reasonable foreseeability in its conduct causing loss to those investors, and that the factors which the common law requires before it will impose a duty of care in the absence of a contract were not sufficiently present. Moreover, S&P contended that the effect of the first instance decision would be that rating agencies owed a legally enforceable duty to anyone who decided to take action based on a rating which they had issued and, effectively, to "turn predictions about the future into guarantees". As a matter of law and policy, it said, the decision should not stand.

The Full Federal Court was seemingly unimpressed by contentions that the important questions were ones of law and policy and instead concluded that S&P's liability to the investors turned simply on the application of established legal principles to the facts. Having described the applicable legal principles, which are largely similar to those which apply to the imposition of duties of care under English law, three key factors were considered in the context of whether such a duty should be imposed in these circumstances.

(i) Indeterminate liability

One of the key factors on which S&P had sought to rely was that the rating agency did not know the identity of the ultimate investors in the Rembrandt Notes or even how many investors there would be. More fundamentally, S&P argued that it publishes tens of thousands of opinions as to future likelihood of repayment by issuers and does so in a way which means that almost anyone, anywhere could access those opinions. Accordingly, if a duty of care arose as a result of its ratings, the class of potential claimants would be so vast and indeterminate that it offended one of the primary limitations which the common law was concerned to impose for establishing a duty of care.

However, the Full Federal Court found that liability in respect of the Rembrandt Notes was not indeterminate because, while it may not have known the precise identity or number of investors, S&P was aware that there was a class of members whose essential characteristic was that they were to purchase Rembrandt Notes. Moreover, on the facts, S&P knew the size of the issue and the minimum level of subscription (and could thus establish that the maximum number of investors in the issue would be 80), and that S&P's potential liability would be limited in time for as long as S&P retained its rating (or the ten year tenor of the Rembrandt Notes).

(ii) Vulnerability

S&P contended that the relationship between rating agency and investor did not require the law of tort to intervene and protect the investors. It submitted that neither LGFS nor the councils were vulnerable and each was capable of protecting itself from the harm which it had suffered. S&P said that vulnerability was a prerequisite for a duty of care to avoid economic loss and, accordingly, no such duty arose in the circumstances.

However, the Full Federal Court emphasised that vulnerability is the consequence, not an additional requirement, of reasonable reliance by an ascertainable class of potential claimants. Moreover, the court placed great weight on the finding that neither LGFS nor the councils could replicate or "second-guess" the rating which S&P had given to the Rembrandt Notes. In having to rely on S&P's rating for the purpose of assessing the credit-worthiness of the Rembrandt Notes, neither LGFS nor the councils were able to protect themselves and were therefore vulnerable in the sense required.

(iii) Absence of a contractual relationship

S&P had no contractual relationship with either LGFS or the councils, a factor which is commonly found to be a pointer against a duty of care being present. S&P argued that the absence of direct dealing between itself and the investors ought to preclude the finding that it owed them a duty of care. However, that submission was robustly rejected. In circumstances where ABN Amro had engaged S&P for the purpose of communicating the AAA rating to an ascertainable class of investors, the Full Federal Court was clear that the authorities did not preclude such a duty on the basis that there was no contractual relationship.

(d) Comment

The conclusions reached by the Full Federal Court confirm one of the most striking common law judgments in the aftermath of the financial crisis, given the role which rating agencies played in relation to so many of the financial products which fared poorly. The obvious question is whether it will stand alone or whether it will have a wider impact on claims by other investors in other products. Naturally, each case will depend on the precise factual findings and in particular the nature of the investors and products in question, as well as the documentation which was used by the parties.

However, it remains to be seen whether the Full Federal Court's reasoning would be followed by, for example, an English court. Fundamental to the liability of S&P both to LGFS and the councils is that each was treated as vulnerable to a flaw in the rating as a result of what was assumed to be reasonable reliance on the rating. A phrase which is repeated on a number of occasions in the judgment relates to the fact that the investors were not able to "second-guess" the rating or undertake their own analysis of the risk of default, without considering in terms the question of whether investors placing such sole reliance on the rating for this element of the risk in a financial product is reasonable. Putting to one side the question of whether an entity such as LGFS was in fact unable to assess for itself the default risk attaching to products such as the Rembrandt Notes, such an approach surely risks providing investors with a route to recover losses in circumstances where they have made no attempt themselves to assess default risk. It is unclear that an English court would so readily adopt that approach. As Hamblen J put it in *CRSM v Barclays* [2011] EWHC 484 (Comm): if there is one thing which a sophisticated investor should be deemed to have made up its own mind about when purchasing an investment product, it was default risk. Equally, if the investor truly did not, and could not, make its own assessment of the default risk of a particular product, it may be a better allocation of risk and reward for the investor either to engage an adviser who can (and to pay for that advice), or to instead choose to invest its funds elsewhere.

Finally, since the first instance decision, the *European Regulation on Credit Rating Agencies* (Regulation (EU) No 462/2013) (CRA 3) has introduced a statutory cause of action which provides investors (and issuers) with a claim where a rating agency has, intentionally or with gross negligence, committed a breach of the regulatory requirements contained in CRA 3. This cause of action would be available in relation to ratings issued or retained after June 2013, but is not available retrospectively. However, it is noteworthy in the context of *Bathurst* that, to avail itself of the statutory cause of action, an investor must show that it has relied reasonably on the rating in question. This provision is intended to help to pursue the policy objective of reducing what is widely regarded as an over-reliance by investors on ratings. The unfortunate consequence of a decision such as *Bathurst*, at least were it to be followed more widely, may be to encourage greater reliance on ratings by, as S&P put it in its submissions, "turn[ing] predictions about the future into guarantees".

6.2 Member of a limited liability partnership held to be a "worker" entitled to the benefits of whistle-blower protections under the Employment Rights Act 1996 (UK)

(By Louis Italiano, DLA Piper)

Clyde & Co LLP and another (Respondents) v Bates van Winkelhof [2014] UKSC 32, Supreme Court of the United Kingdom, Lord Neuberger, Lady Hale, Lord Clarke, Lord Wilson, Lord Carnwath, 21 May 2014.

The full text of this judgment is available online.

(a) Summary

This case concerned an appeal against a decision that a member of a limited liability partnership (LLP) was not a "worker" within the meaning of s. 230(3) of the *Employment Rights Act 1996* (UK) (the 1996 Act) and was therefore unable to claim the benefit of the protection afforded to whistleblowers under the 1996 Act.

In considering whether the appellant was a "worker" within the meaning of s. 230(3) of the 1996 Act, the Court examined the ordinary meanings of relevant provisions in the 1996 Act and the *Limited Liability Partnerships Act 2000* (UK) (the 2000 Act), having regard to the statutory context in which they appeared and the relationship between the two Acts.

(b) Facts

The appellant was an English qualified solicitor who was employed by Shadbolt & Co LLP (Shadbolt) to develop joint ventures with Tanzanian law firms from 2005.

In February 2010, after Clyde & Co LLP (Clyde) acquired parts of Shadbolt's business, the appellant signed a Deed of Adherence to Clyde's Limited Liability Partnership Members' Agreement (the Members' Agreement). Upon signing, the Applicant became an "Equity Member" of Clyde, a level of membership subordinate only to the level of "Senior Equity Member".

In November 2010, the appellant disclosed to Clyde's money laundering reporting officers that the managing partner of a Tanzanian firm with whom Clyde was undertaking a joint venture had admitted to paying bribes to secure work and favourable outcomes. The appellant claimed that as a result of the disclosure she was suspended, allegations of misconduct were made against her, and she was ultimately expelled from Clyde in January 2011.

In 2011 the appellant brought claims in the Employment Tribunal (the Tribunal) against Clyde and one of its Senior Equity Members under, *inter alia*, the whistleblowing provisions of the 1996 Act.

In order to claim the benefit of the whistleblowing provisions of the 1996 Act, the appellant was required to demonstrate that her relationship with Clyde rendered her a "worker" within the ambit of the definition in s. 230(3) of the 1996 Act. Section 230(3) defined two sorts of workers for the purpose of the 1996 Act: (a) those working under a contract of employment; and (b) those working under any other contract whereby they undertake to personally perform work or services for a party who is not their client or customer.

The Tribunal refused the appellant's application for relief on the basis that as a Member of Clyde she was "in business in her own right" and therefore not a "worker" under s. 230(3)(b) of the 1996 Act.

The appellant appealed to the Employment Appeal Tribunal (the Appeal Tribunal), which allowed the appeal. The Appeal Tribunal held that because the appellant was an integral part of Clyde's business, could not offer her services to others and was in a subordinate position, she was a "worker" pursuant to s. 230(3)(b) of the 1996 Act notwithstanding that she was a member of a LLP.

Clyde subsequently appealed to the Court of Appeal. The Court of Appeal allowed the appeal, finding that the appellant was not a "worker" because s. 4(4) of the 2000 Act provided that a member of a LLP could not be regarded as being "employed by" a LLP unless he or she would be regarded as being employed by the LLP if it was a partnership, and because it was established under the common law that a partner could not be an employee of his or her own partnership.

The appellant appealed to the Supreme Court, arguing that she was a "worker" within the plain wording of s. 230(3)(b) of the 1996 Act and that s. 4(4) of the 2000 Act did not modify that status. Further, the appellant argued that the legislation should be construed in a manner consistent with her right to freedom of expression pursuant to article 10 of the European Convention on Human Rights (the Convention).

(c) Decision

In concluding that the appellant was a "worker" within the meaning of s. 230(3) of the 1996 Act, Lady Hale, with whom Lord Neuberger and Lord Wilson agreed, considered the ordinary meanings of the relevant provisions in the 1996 Act and the 2000 Act, having regard to the statutory context in which they appeared and the relationship between those Acts.

Lady Hale noted that it was common ground between the parties that the appellant worked under a contract personally to perform work or services for Clyde and was therefore a "worker" within the plain meaning of s. 230(3)(b) of the 1996 Act. Her Honour therefore considered that the question to be decided by the Court was whether the term "employed by" in s. 4(4) of the 2000 Act had a meaning that included "workers" within the meaning of s. 230(3)(b) of the 1996 Act.

Lady Hale noted that there was a clear distinction in law between those employed under a contract of service and self-employed persons. Her Honour further noted that there were two classes of self-employed people at law: those who carry on a profession or business on their own account and those who provide services as part of a profession or business undertaking carried on by others. Her Honour noted that Parliament could have included the latter class of self-employed people within the meaning of s. 4(4) of the 2000 Act but it did not, as the provision was confined to persons "employed by" a LLP. Further, her Honour noted that Parliament had enacted no law to preclude a person from constituting a "worker" for a partnership of which he or she is a partner.

Her Honour noted that provisions in the 1996 Act explicitly extended the ordinary meaning of the terms "employed" and "employment" to persons who are "workers" rather than merely being confined to those who work under a contract of employment. As such an explicit extension was lacking in the 2000 Act, her Honour considered it was not possible to construe those terms by reference to such an extended definition in that Act.

Noting that the Court of Appeal gave considerable weight to whether the appellant was sufficiently "subordinate" so as to constitute a "worker", Lady Hale held that while subordination may aid in distinguishing workers from other self-employed people, it was not a freestanding and universal characteristic of workers.

Finally, Lady Hale noted that such a broader interpretation of s. 230(3)(b) to provide the appellant protection for unfair dismissal for "whistleblowing" was consistent with the appellant's right to freedom of expression under article 10 of the Convention. Her Honour noted that applying such a construction to give effect to a state's positive obligations rather than merely to prevent the state from acting incompatibly with rights under the Convention raised difficulties for the Court. However, her Honour held it was not necessary for the Court to interpret the relevant provisions having regard to the Convention, as a plain reading of the provisions supported a finding that the 1996 Act afforded the applicant such protections.

In his minority judgment, Lord Clarke noted that s. 4(4) of the 2000 Act prevented LLP members from being regarded as being employed by a LLP "for any purpose" unless they would be so regarded if the LLP was a partnership. His Honour opined that as s. 230(5) of the 1996 Act extended the definition of "employment" under the 1996 Act to "workers", the relevant question was therefore whether the appellant should be regarded "for any purpose" as employed by Clyde. His Honour therefore opined that in order for the appellant to be considered a "worker" under s. 230(3) of the 1996 Act, she would need to be regarded as "employed" by Clyde if Clyde was a partnership and she was a partner. His Honour concluded that this question was of "some complexity and difficulty" and, noting that his views were in the minority, refrained from expressing an opinion on this point.

Lord Carnwath agreed that the appeal should be allowed for the reasons given by Lady Hale. However, his Honour added that he was unpersuaded by the appellant's submissions that legislation that allowed contracts between a partner and other members of his firm to be effective in law challenged the traditional view that a partner could not be an employee of his own firm. His Honour opined that such contracts could not be equated with a contract between a partner and his or her firm, because each partner is an essential part of the firm.

6.3 Applications for no-access orders regarding a company's register of shareholders

(By Katrina Sleiman and Jonathan Schwarcz, Corrs Chambers Westgarth)

Burry & Knight Ltd v Knight [2014] EWCA Civ 604, Court of Appeal of England and Wales (Civil Division), Arden, Briggs and Christopher Clarke LJJ, 14 May 2014

The full text of this judgment is available online.

(a) Summary

The case concerned an application by two companies (the Respondents) to deny a member (the Appellant) access to their registers of shareholders (Registers) pursuant to a no-access order under s. 117(3) of the *Companies Act 2006* (UK) (the Companies Act). The application was based on the Respondents' claim that the Appellant was seeking access for an improper purpose.

This was the first time that the Court of Appeal has had to consider the new no-access provisions under the Companies Act. In the leading judgment, Arden LJ accepted the findings of the lower court that the Appellant was seeking access to the Registers for both proper and improper purposes. Consequently, the Court of Appeal upheld the lower court's decision to deny the Appellant access to the Registers but also directed the Respondents to undertake to communicate the Appellant's proper purpose to the shareholders.

Section 117(3) of the Companies Act has similarities to s. 173 of the Corporations Act 2001 (Cth) (the Corporations Act). There are, however, substantive differences between the provisions. The Companies Act does not define what will be a proper or improper purpose, whereas the Corporations Act positively prescribes what will be an improper purpose. Indeed, Arden LJ notes that because of these differences Australian decisions were not useful in aiding an understanding of s. 117(3) of the Corporations Act.

(b) Facts

The Respondents were both companies whose shares were owned by the members of two families. The Appellant held shares in both companies and had, until 2000, also been a director of both companies. In 2001, the Appellant had made several accusations of impropriety on the part of the Respondents' directors during the 1980s and 1990s. At the time of his initial complaint, the Appellant had sought to access the Respondents' Registers, but later withdrew his application.

In 2009, after a period of abeyance, the Appellant renewed his claim and in early 2012 the Appellant again requested a copy of the Registers.

As required by the Act, the Appellant gave the following purposes for his application:

- study the current shareholders of the Respondents;
- write to the Shareholders detailing his concerns about the past conduct of the directors; and
- raise his concerns about the proposed method of valuing the shares and explore the possibility of forming a shareholder group to seek independent legal and financial advice.

Upon receipt of the application, the Respondents made an application under s. 117(3) for a no-access order.

In the High Court (Chancery Division), the Registrar found that the Appellant's first two purposes were improper, while the latter was proper. Furthermore, the Registrar found that the Appellant's "real" purpose was to continue his vendetta against the Respondents' directors. Accordingly, the Registrar found that the Respondents were not obliged to supply the Appellant with copies of the Registers, provided they undertook to send a letter (with contents agreed to with the Appellant) to the shareholders regarding the proper purpose.

Subsequent to those proceedings, the Respondents sent such a letter.

(c) Decision

Arden LJ accepted the findings of the lower court in respect of the Appellant's motivations for seeking access to the Registers, in that it was largely for the purposes of continuing a vendetta against the Respondents' directors. It was also accepted that there was little evidential support for the Appellant's claims regarding the directors' alleged impropriety.

(i) Meaning of proper purpose

Arden LJ considered the meaning of "proper purpose" under the Companies Act, noting that the purpose of the provision is to prevent open access to share registers being abused, for example by those seeking the information for marketing purposes. It was further noted that Parliament appeared to have purposefully declined to define "proper purpose" thereby leaving the courts with a wide discretion as to its meaning.

Arden LJ held that the words "proper purpose" should be given their "ordinary, natural meaning". Her Honour held that a proper purpose ought generally, in the case of a member, relate to the member's interest in that capacity and/or to the exercise of shareholder rights. Furthermore, as was noted by the Registrar, the existence of improper purposes alongside a proper purpose does not "taint" the proper purpose.

Arden LJ upheld the Registrar's findings regarding the Appellant's purposes.

(ii) Multiple purposes

As the Appellant's purposes (in pursuing the application) were both improper and proper, the court was required to consider how such applications should be dealt with under the Act.

Arden LJ did not consider that the court can be satisfied that the purpose of the request is a proper one simply because it is satisfied that one of several purposes is a proper purpose (leaving aside de minimis purposes). The contrary conclusion would undermine the protection which the no-access provision was intended to give. Arden LJ indicated that the right approach is to read the words "a proper purpose" in s. 117(3) as including "proper purposes" where there is more than one of them. Thus the court would have to make a no-access provision order if any one of the purposes was improper.

The Registrar followed the decision of *Pelling v Family Need Fathers Limited* [2002] BCLC 645 (*Pelling*). In that case, the applicant also had a mixture of proper and improper purposes and the court declined access to the company's register on the undertaking that the company would communicate the applicant's concerns (for which there was a proper purpose) to the shareholders directly (the Pelling Order).

Pelling was a decision made under earlier legislation which gave the court discretion to refuse access to the share register. Now, under s. 117(3) access will take place unless the court is positively satisfied that the purpose is not a proper one. However, Arden LJ noted that a purpose may be improper not only because of the end it seeks to achieve, but also because of the way in which it seeks a proper purpose. Thus a person making the request for a proper purpose may also have an improper purpose if they want to use the opportunity to communicate matters which are not relevant to shareholders' interests. Accordingly, Arden LJ considered that the Pelling Order still works under s. 117(3) in this situation. Moreover it may well be appropriate to use it because it will enable the communication for the proper purpose to be "policed". That is what her Honour understood the Registrar meant by the good purpose not being 'tainted' by the bad, and her Honour agreed with that ruling as to the law.

Arden LJ rejected the Appellant's submission that a Pelling Order would have the effect of restricting access for proper purposes. Rather, reading proper purpose as proper purposes, Arden LJ held that the use of a Pelling Order effectively allowed for access where otherwise the court would be obliged to reject it under s. 118 of the Companies Act.

Accordingly, Arden LJ (with whom Briggs and Christopher Clarke LJJ agreed) held that the Registrar had been correct in denying the Appellant access to the Registers. Furthermore, in light of the mix of proper and improper purposes, the decision to deny access was correctly made, consequent on the undertaking by the Respondents. Arden LJ added that there was nothing to prevent, as had been done in this case, a company subject to such a direction from sending an explanatory note with the letter.

(iii) Summary decisions regarding no-access orders

The Appellant also submitted that the Registrar had erred in not allowing oral testimony. Briggs LJ said it is preferable that applications under s. 117(3) be dealt with summarily, not least because lengthy delays may disrupt an applicant's proper purpose for seeking access. Furthermore, even in cases where findings of bad faith are made, the documents may make the position clear enough to allow for summary judgment. In this instance the availability of considerable evidence regarding the Appellant's motivations and the lengthy delay in bringing his complaint meant that the Registrar had been justified in making his findings without cross examination of witnesses.

6.4 Court dismisses shareholder application to commence proceedings in company's name due to failure to satisfy all criteria under s. 237 of the Corporations Act

(By Jared Lynch, Ashurst)

Cooper v Myrtace Consulting Pty Ltd [2014] FCA 480, Federal Court of Australia, Davies J, 14 May 2014

The full text of this judgment is available online.

(a) Summary

The Federal Court has dismissed an application for leave under s. 237 of the Corporations Act 2001 (Cth) (the Corporations Act) to commence a proceeding in the name of Myrtace Consulting Pty Ltd (the Company) due to the failure to satisfy all five criteria under s. 237 of the Corporations Act.

(b) Facts

Serge Ambrose acted as sole director of the Company and he and Warwick Cooper each held one share in the Company. The Company supplied IT services to Canberra Data Centres Pty Ltd (CDC) and held a 5% shareholding interest in CDC. The relationship between Mr Ambrose and Mr Cooper broke down and the Company ceased to operate in July 2009.

In March 2012, CDC paid the Company $1.2 million to buy back its shares (the CDC Proceeds). Between April 2012 and January 2013, multiple payments totalling just over $1 million were made from the CDC Proceeds to Mr Ambrose for business expenses incurred on the Company's behalf and to pay a salary that he claimed he was entitled to under an employment contract made with the Company in June 2007.

Mr Ambrose had 11 additional shares in the Company issued to himself in June 2009 purportedly under an intellectual property licence agreement made with the Company in June 2007. The additional shares were cancelled in May 2013 but a dispute remained over whether Mr Ambrose was entitled to the amounts paid as salary and reimbursement of expenses out of the CDC Proceeds.

Mr Cooper sought leave under s. 237 of the Act to commence a proceeding in the name of the Company against Mr Ambrose. Mr Cooper alleged that Mr Ambrose, in breach of his "fiduciary powers" as sole director of the Company:

- issued himself 11 shares in the Company "so as to dilute [Mr] Cooper's interest in [the Company] and to [the] benefit of [Mr Ambrose]";
- "misappropriated or applied" $1,013,901.74 of the CDC Proceeds;
- sought to have the Company continue to trade rather than be voluntarily wound up "so as to attenuate and deny [Mr] Cooper's interests in [the Company] and to enable the CDC Proceeds to be further misappropriated or misapplied"; and

- asserted a power, as the then majority shareholder, to appoint an independent non-executive chairman to the board "to clothe" his misconduct.

Furthermore, Mr Cooper alleged that both the employment contract and the intellectual property licence agreement were invalid and in breach of Mr Ambrose's fiduciary obligations to the Company.

(c) Decision

Mr Cooper, as the applicant for leave, bore the onus of satisfying the Court on the balance of probabilities that each of the five criteria in s. 237 had been satisfied. If all five criteria had been met, the Court was bound to grant the application and, correlatively, the failure to satisfy any one of those criteria meant that the Court was bound refuse the leave. The Court did not have a residual discretion to grant leave in respect of s. 237 of the Act.

(i) Sub-section 237(2)(a) - proceedings by the Company

Based on the facts outlined above, the Court was satisfied that it was probable that the Company would not itself bring proceedings or properly take responsibility for them or for the steps in them.

(ii) Sub-section 237(2)(b) - whether the applicant is acting in good faith

The Court was satisfied that Mr Cooper was acting in good faith as a shareholder with a legitimate interest in the derivative action which, if successful, may have resulted in the recovery of property which would have increased the value of his shares.

(iii) Sub-section 237(2)(c) - whether it is in the best interests of the Company that the applicant be granted leave

The Court found that sub-section 237(2)(c) had not been met, on the basis that:

- in order to obtain relief under the pleaded action against Mr Ambrose for breach of fiduciary duties owed to the Company as sole director, the Company would have to establish that there had been a breach of fiduciary duty. The Court could not conclude that the prospects of success were so strong that the possibility of a costs order against the Company in favour of Mr Ambrose would be "remote";
- the Court was not satisfied that it was in the best interests of the Company to permit Mr Cooper to bring the proceedings on its behalf, without Mr Cooper being able to indemnify the Company and thereby bearing the risk that the proceeding may be unsuccessful; and

- the Court was not satisfied that the proposed derivative action was in the Company's best interests, which is a higher threshold than "may be", "appears to be" or is "likely to be" in the best interests of the Company.

Furthermore, the Court was not persuaded that granting leave to bring an action in the company's name under s. 237 was the only mechanism through which Mr Cooper was able to pursue a remedy against Mr Ambrose.

(iv) Sub-section 237(2)(d) - whether there is a serious question to be tried

The Court addressed the remaining criteria under s. 237 for the sake of completeness and found that there was a serious question to be tried on a number of the claims, though drafting deficiencies in the application would need to be rectified if leave were to be granted.

(v) Sub-section 237(2)(e) - notice

The Court was satisfied that Mr Cooper had provided notice to the Company.

The Court dismissed a number of other grounds submitted on behalf of Mr Cooper on the basis that the Court had no discretion to consider such matters where the Court was not otherwise satisfied that the criteria in s. 237 of the Act were met.

As Mr Cooper did not discharge the burden of satisfying all five criteria in s. 237 in relation to the proposed claims, notably the criterion in section 237(2)(c), the application was dismissed.

6.5 Court rejects Personal Property Securities Register application: Applicant's interest is a mere equitable right, not a security interest for the purposes of the Personal Property Securities Act

(By Kathryn Smith, Ashurst Australia)

Sandhurst Golf Estates Pty Ltd v Coppersmith Pty Ltd [2014] VSC 217, Supreme Court of Victoria, Robson J, 14 May 2014

The full text of this judgment is available online.

(a) Summary

In this Supreme Court of Victoria decision, the plaintiffs sought an order to restrain the defendants from entering on the Personal Property Securities Register (PPSR), any financing statement claiming an interest in the property of the plaintiffs.

The key issues considered by Robson J in this case were:

- whether the defendants had any interest in the plaintiff's personal property that would entitle them to register a financing statement on the PPSR;
- whether the Court had jurisdiction to make the orders sought; and
- whether the plaintiffs made adequate discovery.

This case provides discussion of the nature and meaning of a "security interest", and a "transaction". The plaintiff's claim was ultimately successful due to the finding that the defendant's interest was not capable of registration on the PPSR. The plaintiff's interest was not considered to be a security interest within the meaning of s. 12 of the Personal Property Securities Act 2009 (Cth) (the PPSA), it was a mere equitable right. The right also did not arise by way of a "transaction", which was held to mean a consensual transaction rather than dealings between the parties giving rise to an equitable interest.

(b) Facts

Mr Popplestone, the third defendant, was an accountant. He entered into a joint venture with a Mr Hamilton to purchase and develop a golf course at Sandhurst, and they formed a company called Novafield Pty Ltd to carry out the joint venture. Mr Popplestone had a 30% interest in Novafield.

In 2000, Mr Popplestone agreed to vary his interest in the joint venture by taking 10% of the shares in a company called Coad-87 Pty Ltd, a company that was controlled by Mr Hamilton and had an interest in the plaintiff company, Sandhurst Golf Estates Pty Ltd. Mr Popplestone understood that Coad-87 Pty Ltd was to undertake the golf course joint venture that was previously being conducted by Novafield. Mr Popplestone alleged that he did not receive the shares that had been promised to him, and has thereby lost his interest in Sandhurst Golf Estates Pty Ltd and the joint venture. In an attempt to gain access to documents disclosing an equitable right over the assets of the joint venture, Mr Popplestone sought to register financial statements claiming an interest in the property of the plaintiffs.

(c) Decision

(i) Interest in the plaintiff's personal property

Mr Popplestone's claim was held not to be registrable under the PPSA. His claim was considered to be a proprietary claim, and not a claim to a security interest. Further, it was held that any interest held by Mr Popplestone did not arise by way of a consensual transaction as required under the PPSA. The court held that a security interest must be an interest in personal property provided for by a transaction. This transaction must be a consensual transaction and does not include dealings between the parties that may give rise to an equitable interest by way of a remedy. The court also held that the rights of Mr Popplestone did not secure payment of any sum or the performance of any obligation, and thus did not fall within the meaning of ss. 150 and 12 of the PPSA.

(ii) Jurisdiction

Robson J held that the Court had jurisdiction to restrain the defendant from seeking to register a financing statement, even where the defendants conduct may otherwise be lawful. Robson J also considered s. 37(1) of the Supreme Court Act 1986 (Vic), and found that in the circumstances it was just and convenient to grant an injunction because the process of removing a financing statement is time consuming and costly and the Court should use its jurisdiction to protect the plaintiffs from this trouble and expense.

(iii) Discovery

Mr Popplestone conceded that one of the motivating factors for lodging the financing statements in respect of the plaintiff's property was to obtain access to all documents relating to his exclusion from the joint venture. Robson J held that the defendants were not obliged to discover the documents sought because they were not relevant to the issue of the claim for registration on the PPSR. At best they would only disclose an equitable right over the assets from the joint venture and such a right would not entitle the defendant to registration of the financing statements.

6.6 Deputy Commissioner of Taxation permitted to enforce tax debts and penalties against Cayman Islands company

(By Alexandra Lorenzi, Herbert Smith Freehills)

Akers as a joint foreign representative of Saad Investments Company Ltd (in Official Liquidation) v Deputy Commissioner of Taxation [2014] FCAFC 57, Full Federal Court of Australia, Allsop CJ, Robertson and Griffiths JJ, 14 May 2014

The full text of this judgment is available online.

(a) Summary

The Full Federal Court upheld the judgment of Rares J permitting the Deputy Commissioner of Taxation (DCT) to take action to recover Australian tax debts and penalties from the Australian assets of Saad Investments Company Limited (Saad Investments), a foreign company in liquidation.

(b) Facts

Saad Investments was a company registered in the Cayman Islands. It was not a registered foreign company and did not carry on business in Australia. The appellants were joint foreign representatives of Saad Investments' Cayman Islands liquidators.

Saad Investments held shares in Sunshine Gas Limited, an Australian publicly listed company. In August 2008, Saad Investments sold these shares, incurring a tax liability on the profits. In 2009, the Grand Court of the Cayman Islands made orders that Saad Investments be wound up and the Cayman Islands liquidation was recognised as a foreign main proceeding under the *Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law* (the Model Law). The purpose of the Model Law is to provide effective mechanisms for cross-border insolvencies. The Model Law is incorporated into Australian law by s. 6 of the Cross-Border Insolvency Act 2008 (Cth) (the Cross-Border Insolvency Act).

Later in 2009, the DCT sought payment of the tax debts and penalties from Saad Investments and lodged a proof of debt with the appellants. However, this proof could not be accepted under Cayman Islands law.

In 2010, Recognition Orders were made by the Federal Court recognising the proceedings of the Grand Court of the Cayman Islands as the foreign main proceeding. The Recognition Orders were made in the context of two undertakings; firstly, an undertaking by the DCT not to issue further notices seeking to recover the tax payable by Saad Investments without giving 14 days' notice and secondly, an undertaking by the appellants and Saad Investments not to send the earnings of any realisation of assets outside of Australia. In 2012, the DCT brought further proceedings in response to the appellants' intention to transfer the Australian assets of Saad Investments to the Cayman Islands. As a result, the primary judge made Modification Orders in 2013. These Modification Orders had the effect of allowing the DCT to take steps to recover tax debts and penalties from Saad Investments' assets in Australia. Saad Investments' liquidators appealed this decision.

(c) Decision

In dismissing the appeal, Allsop CJ, with whom Robertson and Griffiths JJ agreed, addressed the following five points in his judgment.

(i) Whether there was power under article 22.3 of the Model Law to make the Modification Orders

The appellant argued that the Modification Orders conflicted with the binding effect of article 20 of the Model Law and the recognition of the proceedings in the Cayman

Islands as the foreign main proceedings. Therefore, it was argued that the primary judge did not have the power under article 22.3 of the Model Law to make the Modification Orders.

Article 22.3 of the Model Law states, "[t]he court may, at the request of the foreign representative or a person affected by relief granted under article 19 or 21, or at its own motion, modify or terminate such relief."

On this point, Allsop CJ held that, "[w]hilst it can be accepted that an application of article 22.3 is not apt to amend the legal effect of recognition of the foreign main proceeding brought about by article 20, the primary judge did not purport to do so." His Honour found that the primary judge made the Modification Orders under s. 471B of the Corporations Act 2001 (Cth) (the Corporations Act) (which was made applicable to the issue in dispute under article 20.2 of the Model Law and s. 16 of the Cross-Border Insolvency Act), as well as article 22.3 of the Model Law.

(ii) The form of order 2 and its asserted lack of relationship to s. 471B

The appellants submitted that Modification Orders 2 and 4, with particular emphasis on order 2, could not have been made under s. 471B of the Corporations Act. The appellants argued this was so because these orders did not include any identification of the proceedings or the court, and the order lacked any form of particularity.

Section 471B of the Corporations Act provides:

> [w]hile a company is being wound up in insolvency or by the Court, or a provisional liquidator of a company is acting, a person cannot begin or proceed with:
>
> - (a) a proceeding in a court against the company or in relation to property of the company; or
>   (b) enforcement process in relation to such property;
>   except with the leave of the Court and in accordance with such terms (if any) as the Court imposes.

On this argument, Allsop CJ held that, while particularity and identification of a court and proceedings are ordinarily found in orders made under s. 471B of the Corporations Act, the section itself does not demand this precision of terminology and the identification of these details within an order is not a condition for the lawful exercise of the power under s. 471B. Therefore, the form of the orders did not remove them from the application of s. 471B.

(iii) The asserted destruction of the rights of the DCT and enforcement under the Taxation Administration Act 1953 (Cth)

The appellants argued that s. 468(4) of the Corporations Act ensured that the DCT could not seek to employ provisions and remedies under the Taxation Administration Act 1953 (Cth).

Section 468(4) of the Corporations Act states, "any attachment, sequestration, distress or execution put in force against the property of the company after the commencement of the winding up by the Court is void."

Section 468(4) does not normally apply to companies being wound up outside of Australia. However, Allsop CJ noted that the section would be applicable to a foreign winding up if it was made so applicable by virtue of the application of other Australian law being, in this case, article 20.2 of the Model Law. Thus, the issue was whether s. 468(4) fell under the Australian law specified by article 20.2 of the Model Law.

Article 20.2 of the Model Law states that the scope, and the modification or termination, of a stay and suspension referred to in article 20.1 are subject to Australian law relating to insolvency that applies to exceptions, limitations, modification or termination in respect of that stay or suspension. Section 16 of the Cross-Border Insolvency Act identifies the Australian law relevant to article 20.2.

Allsop CJ held that s. 468(4) of the Corporations Act does not fall under article 20.2 of the Model Law and s. 16 of the Cross-Border Insolvency Act. Therefore, it was not applicable to the foreign winding up and consequently, no applicable part of Australian statute or general law destroyed the rights of the DCT.

(iv) Whether the discretion to make the Modification Orders was rightly exercised

The appellants submitted that any exercise of discretion which had the effect of protecting the DCT would conflict with the universalism of the Cross-Border Insolvency Act and the Model Law. The Model Law reflects a universalist approach, a result of which is that there is only one recognised insolvency hearing for a company with assets situated in different jurisdictions.

In response to this argument Allsop CJ stated that, "[w]hilst the Model Law reflects universalism, there is nothing in the Model Law or the UNCITRAL Working Papers prior to its formulation, or in the [Cross-Border Insolvency Act], which would justify the stripping of rights of a local creditor by reason of recognition. The universalism that underpins the Model Law and [the Cross-Border Insolvency Act] is one for the benefit of all creditors, and the protection of local creditors is expressly recognised..." Thus, his Honour found that protection may be given to the DCT by making orders of the kind made in the Modification Orders.

Furthermore, on this point the appellants contended that the Modification Orders had the effect of ensuring the DCT was treated as a preferred creditor such that proper regard was not had to the interests of other creditors as is required by article 22.1 of the Model Law.

The Full Federal Court held that the DCT was entitled to rank equally with all other creditors in respect of the assets of Saad Investments. Allsop CJ found that, when considering all of the assets of the company, the Modification Orders were a "proper evaluative conclusion" with respect to the issue of ensuring adequate protection of local creditors and recognising the equality of all creditors of the company.

(v) Did the DCT elect to submit to the jurisdiction of the Grand Court of the Cayman Islands such that it was disentitled to the Modification Orders?

The appellants argued that by lodging a proof of debt with the appellants, the DCT submitted to the jurisdiction of the Grand Court of the Cayman Islands and thus the primary judge should have declined the application for the Modification Orders.

On this point, it was held that there is nothing to suggest that where a local creditor submits a proof of debt in a foreign main proceeding, the foreign court has exclusive jurisdiction on all matters regarding that insolvency. Furthermore, there is nothing to suggest that where a local creditor submits a proof of debt in a foreign main proceeding, that creditor cannot make an application to their local court. Allsop CJ noted that the Model Law "assumes complementary authority of the local court and the court supervising the foreign main proceeding."

Therefore, it was held that the lodgement of proof in the Cayman Islands by the DCT did not disentitle the DCT from making an application for the Modification Orders.

The appeal was dismissed with costs.

6.7 Extension of time application by liquidator relating to voidable transaction

(By Elise Caldwell, Herbert Smith Freehills)

Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher [2014] NSWCA 148, New South Wales Court of Appeal, Bathurst CJ, Beazley P, Macfarlane, Barrett and Gleeson JJA, 14 May 2014

The full text of this judgment is available online.

(a) Summary

The validity of liquidators' applications for extensions of time to make an application for a voidable transaction under s. 588FF(3) of the Corporations Act 2001 (Cth) (the Corporations Act) was upheld on the basis of statutory interpretation and policy considerations. The Court considered the decision in *BP Australia Ltd v Brown and Others* (2003) 58 NSWLR 322 and did not overturn it, meaning that liquidators can seek an extension of time in respect of any application for a transaction to be made voidable pursuant to s. 588FF(1) of the Corporations Act.

(b) Facts

Octaviar Administration Ltd (OA) was part of a group of companies whose business included the management of investment schemes and involved the ownership, operation and management of investment schemes and ownership, operation and management of various resorts, hotels, and childcare and aged care facilities.

The applicants, including Fortress Credit Corporation Australia (Fortress), were part of a group of companies whose business included investment in distressed companies. The applicants advanced $53.5 million to Young Village Estates Pty Ltd (YVE Loan) and repayment of that facility was guaranteed by a member of the Octaviar Group - Octaviar Ltd (OL).

Fortress provided a facility to a member of the Octaviar Group - Octaviar Castle Pty Ltd in the amount of $250 million. The facility was secured by a charge over the assets of OL. The facility had not been fully repaid and the applicants, OL and Octaviar Castle agreed to extend the charge in favour of the applicants to cover the obligations of OL under the guarantee of the YVE Loan, which previously had been unsecured.

The board of OL then accepted an offer by a third party to acquire 65% in a group of companies and the applicants were to be paid out of the proceeds of the sale. Payment was made of approximately $189 million.

OL was then placed into voluntary administration and the applicants were appointed receivers and managers. OA was also placed into voluntary administration and it was contended by the receivers for OL that OA held $19.7 million on a bare trust for OL subject to the charge. A transfer of $19.7 million was accordingly made to the receivers of OL.

The liquidators sought an order that the transaction was voidable pursuant to s. 588FF(1) of the Corporations Act and applied to have the period of time under which such an order can be made extended pursuant to s. 588FF(3)(b).

The order to extend the time (Shelf Order) was made. Fortress were not notified of the application but at this time the liquidators were not aware of a potential claim against Fortress.

The liquidators brought proceedings in the Supreme Court of Queensland seeking to avoid transactions which led to consequential actions against Fortress.

In June 2012 the liquidators filed an interlocutory process seeking that their Shelf Order be reheard as against the applicants. The applicants filed a further interlocutory process seeking that the Shelf Order exclude the applicants or that the Shelf Order be varied or set aside so far as it applied to the applicants.

(c) Decision

The case involved consideration of the decision of Austin J in *BP Australia Ltd v Brown* (2003) 58 NSWLR 322 that any application for an extension of time under s. 588FF(3)(b) to make an application under s. 588FF(1) is a valid application and an order made on those terms will be a valid order. The court determined that this decision was not 'plainly wrong' and that it should be followed.

It was noted that the words of s. 588FF(1) refer to a particular application rather than conferring a general power to extend the limitation period because they refer to "an application" rather than "any application". This supports a rejection of the principle in BP v Brown.

However, an application made under s. 588FF(3)(b) is a different application to one made under 588FF(1) and as such, the restrictive wording of s. 588FF(1) should not impact upon the interpretation of s. 588FF(3)(b).

Furthermore, the implicit policy underlying the legislation recognises that a liquidator may not be in a position to bring an application within the time specified in 588FF(3)(a) for good reason. This is consistent with the previous law which set a 6 year time period.

A broader construction is also consistent with the principle that provisions conferring power on the courts should be liberally construed. The appeal was therefore dismissed.

6.8 English Court of Appeal allows company to impose restrictions on shares resulting in the disenfranchisement of shareholders

(By David Bryant and Ned Sutton, King & Wood Mallesons)

JKX Oil & Gas PLC v Eclairs Group Ltd [2014] EWCA Civ 640, England and Wales Court of Appeal (Civil Division), Sir Robin Jacob, Longmire and Briggs LJJ, 13 May 2014

The full text of this judgment is available online.

(a) Summary

The Court of Appeal of England and Wales has held that provisions in the Companies Act 2006 (UK) (the Companies Act) and a company's Articles of Association allowing directors to impose restrictions on shareholders preventing them from attending and voting at meetings were validly exercised in the matter at hand and are not subject to a proper purpose test.

(b) Facts

The appellant, JKX Oil and Gas PLC (JKX), is a publically traded company listed on the London Stock Exchange. Its business is the development of oil and gas reserves and the sale of the resulting products. The two respondents, Eclairs Group Ltd (Eclairs) and Glengary Overseas Ltd (Glengary) owned, through nominees, 27.55% and 11.45% of the shares in JKX respectively.

The owners of Eclairs, a Mr Kolomoisky and a Mr Bogolyubov, had a reputation as being corporate raiders. A corporate raider was described in the judgment as "a person who acquires shares (less than a majority) and then exploits that shareholding to lever his way to managerial or actual voting control . without paying what the other shareholders would regard as a proper premium for their shares".

(i) The perceived "raid" and the directors' response

It was against this backdrop that JKX sought to raise further capital, without success. This was attributed in part to the reputation of Mr Kolomoisky and the fact he controlled sufficient shares to block a special resolution to issue further shares. This failure to raise capital was followed by the service on JKX by Eclairs of a requisition notice for an EGM to replace three incumbent directors with three directors associated with Eclairs and Glengary. In response to what was perceived by the board as the first steps in a planned raid on JKX, the company sent out two sets of notices under s. 793 of the Companies Act to Eclairs and others, seeking information about interests in JKX shares and arrangements between shareholders, including agreements to vote shares in a certain way. Importantly, the responses uniformly denied that there were any such arrangements.

Part 22 of the Companies Act contains, at ss. 793 to 802, provisions enabling a public company to obtain information about interests in its shares, from anyone whom the company knows or has reasonable cause to believe to be, or to have been within a specified period, interested in those shares. Non-compliance with a notice requiring the provision of such information is a criminal offence. Further, the company may seek court orders imposing restrictions on transfer, voting and the payment of dividends in respect of shares in which the defaulter is interested.

In addition to the statutory provisions, article 42 of JKX's Articles of Association contained provisions enabling the company by its directors to impose restrictions upon shareholders similar to those in Part 22 of the Act, without having to go to court. Furthermore Article 42 enabled the company to treat information requested as not having been provided in circumstances where its Board knows or has reasonable cause to believe that the information actually provided is false or materially incorrect.

(ii) Issue of restriction notices

It was under the provisions of article 42 of the Constitution that the directors of JKX sought to place restrictions on, and effectively disenfranchise, Eclairs and Glengary. The directors unanimously resolved to issue restriction notices on the basis that the information supplied was false or materially incorrect, by reason of the failure of all the addressees to provide particulars of the agreements or arrangements between them as to the exercise of voting rights which the directors believed then existed. The restriction notices prohibited both the voting and the transfer of Eclairs' and Glengary's shares.

(iii) Trial

At trial, Eclairs and Glengary challenged the imposition of the restrictions on the following grounds:

- that the disclosure notices by which the information was sought were invalid, because they sought information not permitted to be requested by Part 22 or Article 42;
- that the directors were not entitled to impose restrictions for non-compliance because they did not have reasonable cause to believe that the responses received were incorrect; and
- that the directors imposed the restrictions for an improper purpose, namely to secure the passage of resolutions at the AGM which they feared that Eclairs and Glengary would or might be able to impede, rather than for the purpose of enforcing the company's demand for the specified information.

At trial Mann J found that the notices were not invalidated by reason of the scope of the requests for information. It was further held that the directors had reasonable grounds to believe that the information provided in response had been false or materially incorrect. Importantly however, the judge found that the restrictions were invalid, having been imposed for an improper purpose. This improper purpose, according to the trial judge, was to improve the prospects of carrying the directors' motions at the forthcoming AGM. He found that the purpose of maximising the prospects of passing the resolutions at the AGM was a separate and dominant purpose, not linked either to the extraction of the information or to the protection of the company pending the provision of it.

On appeal JKX challenged the judge's conclusions as to proper purpose. Eclairs sought to resurrect its assertion that the company's disclosure notices were invalid and that the directors had no reasonable cause to believe that they had been inadequately answered.

(c) Decision

The Court of Appeal unanimously upheld both the validity of the disclosure notices and the trial judge's findings that the directors had reasonable cause to believe that they were false or materially incorrect.

The Court differed however as to whether the restrictions were imposed for a proper purpose. The majority on that issue (Briggs LJ dissenting) held that it was not material to the validity of the restrictions that the board's purpose in making the restriction had been to prevent the shareholder voting at the meeting, rather than, for example, to protect the interests of the company or to elicit information which was in fact truthful.

The majority found that the misuse of power doctrine has no significant place in the operation of article 42 or Part 22 of the Companies Act when applied to cases such as this. It was held that the proper purpose test was inappropriate in this case because it was Eclairs and Glengary's own choice not to answer the questions which resulted in their disenfranchisement. The majority distinguished the cases of *Howard Smith Limited v Ampol Petroleum* [1974] AC 821 and *Hogg v Cramphorn Limited* [1967] Ch 254 in which the victims subjected to the improper exercise of directors' powers had no choice. Their Honours reasoned that to limit the director's power to impose restrictions on voting, a power conferred by the constitution, would be to subvert the constitution itself.

Furthermore the majority held that if the predominant motive test, as applied by the trial judge, was applied to Part 22 of the Act or Art 42 of the constitution, the provisions would be unlikely to have any or much application. Consideration of the wording of Part 22 of the Act, on which Art 42 is based, led the majority to hold that there is no purposive restriction on the exercise of the powers under the relevant provisions. Therefore the fact that the directors' primary purpose was to maximise the chances of passing resolutions at the AGM, rather than to obtain the information requested was of no consequence to the validity of the exercise of the power. Their honours viewed the most likely circumstance in which the provisions would apply as being a scenario such as this where the directors' primary motive was to disenfranchise the shareholders. Thus the construction that the predominant motive test did not apply was necessary for the effective operation of both Part 22 of the Companies Act and article 42 of the Constitution.

(i) Minority view

Briggs J, in a detailed dissent, considered that the court should uphold the proper purpose principle in relation to the exercise of fiduciary powers by directors, especially in cases such as this where the power is capable of affecting, or interfering with, the constitutional balance between shareholders and directors, and between particular groups of shareholders. It was on this basis that Briggs J held the primary purpose, being the purpose of maximising the chances of passing resolutions at the AGM, rather than to obtain the information requested rendered the exercise of power invalid.

6.9 Waiver of legal professional privilege where privileged document insufficiently protected

(By David Bryant and James Marburg, King & Wood Mallesons)

Asahi Holdings (Australia) Pty Ltd v Pacific Equity Partners Pty Limited (No 2) [2014] FCA 481, Federal Court, Bromberg J, 13 May 2014

The full text of this judgment is available online.

(a) Summary

The case turned on the question of whether a copy of a report (the original of which was protected by "litigation privilege" - a type of legal professional privilege) provided to an insurer in the course of an insurance claim, was still subject to legal professional privilege.

The disclosure of the report to the insurer was voluntary and to a party that was a potential litigation adversary.

Few steps had been taken to control or limit the dissemination of the report. Bromberg J found that as a result legal professional privilege had been waived.

The case highlights a number of practical steps for companies to take regarding the maintenance of legal professional privilege over documents:

- marking a document "Private and Confidential" does not carry much weight regarding the dissemination of documents to third parties unless there is an agreement (preferably express) to this effect between the parties; and
- companies should be wary that third parties could in fact be potential adversaries in future litigation. Providing privileged documents to these parties should be treated and managed accordingly.

(b) Facts

Asahi and Independent Liquor NZ (Asahi) had entered into a share purchase arrangement with Flavoured Beverages Group Holdings (FBGHL). Prior to the purchase of the shares, Asahi had taken out insurance against the breach of the warranties given by FBGHL in the purchase agreement.

Following the purchase, Asahi became concerned that the respondents had engaged in misleading and deceptive conduct in relation to the sale in contravention of s. 18 of the *Australian Consumer Law* (the ACL). Asahi sent a notice of claim to their insurers under the insurance policy and filed in the Federal Court to recover damages. The claim centred on an allegedly incorrect EBITDA figure that had artificially inflated the estimated value of FBGHL prior to the purchase. The loss alleged by Asahi exceeded the cover available under the insurance policies.

In investigating the EBITDA figures Asahi's lawyers had prepared an EBITDA Adjustment Report (the EA Report). A copy of the EA Report was provided to the insurer (American Home Assurance Company), and was marked "Privileged and Confidential". It was uncontested by the parties that the original copy of the EA Report was privileged, the question was whether privilege had been lost when a copy of the EA Report was provided to the insurer.

(c) Decision

Bromberg J found that Asahi had waived its legal professional privilege over the EA Report as it had delivered a copy of the EA Report to the insurer, a third party with no commonality of interest to Asahi, with few restrictions placed on further dissemination. Bromberg J subsequently ordered Asahi to produce the EA Report to the sellers.

(i) Type of privilege

The EA Report, which did not provide the lawyer's opinion on the law, the client's prospects of success or the strategy which ought to be adopted in litigation, was held by the Court to be subject to litigation privilege. The rationale for litigation privilege is to keep hidden from an opponent material that may prejudice the privilege holder or advantage their opponent.

Privilege of this type will usually only be waived by a voluntary disclosure as opposed to an involuntary disclosure. Whilst the applicants did have a duty to disclose certain information to the insurer under the Policy, they were not compelled to disclose any documents protected by legal privilege, including the EA Report - their disclosure was voluntary.

(ii) Principles of waiver

Bromberg J found that waiver of legal privilege was guided by a number of common law principles. The key principles mentioned by his Honour are as follows. Firstly, legal professional privilege exists to protect and benefit the client, and it is the client's privilege to waive. Secondly, an inconsistency between the client's conduct and the maintenance of confidentiality will waive privilege. Thirdly, the test for determining waiver is assessed objectively based on the actions of the client, whether the client intended to waive privilege or not is irrelevant.

Subsequently, his Honour found that through their actions the applicants had caused their legal professional privilege to be waived in relation to the EA Report.

(iii) Maintaining privilege

His Honour also found that privilege may be maintained despite the disclosure of documents if the basis of the disclosure is clearly restricted to secure the confidentiality of the documents. In his Honour's view, this would most effectively be done by an express agreement that spells out on what basis the disclosure is made and the limitations of its use.

(iv) Commonality of interest

Bromberg J found that Asahi had failed to recognise that the insurer was not under any duty to maintain confidentiality or privilege in relation to the documents. The insurer was, in fact, a potential adversary from the beginning.

The Applicants had argued that they and the insurer had a common interest at the time the report was disclosed, and thus that the report was subject to common interest privilege. However, at the time that the EA Report was divulged to the insurer it was not clear that the insurer was likely to indemnify Asahi in respect of its claim under the policy. Bromberg J found that there was an absence of any significant commonality of interests between Asahi and the insurer and that there was potential for disparate and competing interests to arise between those parties by reason of the claim under the policy. Accordingly, his Honour found that Asahi had in fact voluntarily provided privileged information to a potential opponent, and that the insurer's interests were more commonly aligned with the interests of FBGHL. This was based on the fact that it was financially in the interests of both FBGHL and the insurer to establish that FBGHL did not engage in misleading and deceptive conduct, such that the insurer would not be required to pay Asahi under the policy and FBGHL would not be liable for any claim made against it by Asahi under the ACL.

(v) 'Private and Confidential' means little

The fact that the documents were marked "Private and Confidential" held little weight in the circumstances and could not be used or expected to preclude the insurer from pursuing their legitimate interests. The markings were more likely to have been objectively understood as a hangover from the prior use of the memo. No steps other than this were made to try to control the dissemination of the document further or limit its use.

6.10 Evidence of solvency not evidence that a ground of dispute is material to solvency: Interpretation of s. 459S of the Corporations Act

(By James Siemon, Minter Ellison Lawyers)

Soundwave Festival Pty Ltd v Altered State (W.A.) Pty Ltd (No 1) [2014] FCA 466, Federal Court of Australia, Wigney J, 12 May 2014

The full text of this judgment is available online.

(a) Summary

This decision concerned the Court's power to grant leave under s. 459S of the Corporations Act 2001 (Cth) (the Corporations Act) for a company to oppose an application that it be wound up in insolvency for failure to comply with a statutory demand on a ground that the company had previously relied on in applying to set aside the statutory demand, or on which it could have so relied.

(b) Facts

This decision was made in relation to an application, brought by Soundwave Festival Pty Limited (Soundwave) in the Federal Court under s. 459P of the Corporations Act, for an order that Altered State (W.A.) Pty Limited (Altered State) be wound up in insolvency under s. 459A.

Section 459A provides that:

> On an application under section 459P, the Court may order that an insolvent company be wound up in insolvency.

In turn, s. 459P (after defining who may apply for an order under s. 459A) provides that:

> (3) The Court may give leave [to bring such an application] if satisfied that there is a prima facie case that the company is insolvent, but not otherwise.
> (4) The Court may give leave subject to conditions.

> (5) Except as permitted by this section, a person cannot apply for a company to be wound up in insolvency.

That application was the subject of a later decision by Wigney J in *Soundwave Festival Pty Limited v Altered State (W.A.) Pty Limited (No 2)* [2014] FCA 562.

In bringing the application, Soundwave relied upon Altered State's failure to comply with a statutory demand for the sum of $340,690.46. That amount resulted from a share of the net profit in respect of "beverage services" provided by Altered State (a Western Australian music promotion and events company) for the 2013 Soundwave Festival in Western Australia, a music festival promoted by Soundwave.

The present decision related to whether the Court should grant leave to Altered State under s. 459S, which provides that:

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

(c) Decision

Wigney J noted that the exercise of the discretion to grant leave under s. 459S involved three considerations, set out by Austin J in *Chief Commissioner of Stamp Duties v Paliflex Pty Limited* (1999) 47 NSWLR 382; [1999] NSWSC 15. The reasons of Wigney J, and the headings which follow below, reflect those considerations.

(i) What was Altered State's basis for disputing the debt the subject of the demand?

Altered State appeared to dispute the debt on two grounds. Firstly, Altered State contended that, whatever amount was owed to Soundwave, Soundwave owed Altered State a larger sum arising under other agreements or arrangements. Secondly, Altered State suggested that a spreadsheet, which provided the basis for the debt allegedly owed by Altered State, was not a final reconciliation of the revenue and expenses that the debt arose from.

His Honour criticised the evidence provided in relation to both those contentions. However, on the basis that Soundwave had not disputed the existence of the offsetting claims referred to by Altered State and did not cross-examine Christopher Knight, Altered States manager, in relation to those claims, his Honour was prepared to accept that there was a seriously arguable case as to a genuine dispute over the debt.

(ii) Was there a satisfactory explanation for why there was no application to set aside the statutory demand? Was Altered State's conduct reasonable?

His Honour examined evidence which both supported and undermined the reasonableness of Altered State's actions but ultimately was not satisfied that the evidence of Mr Knight provided an adequate or satisfactory explanation for why no application was brought to set aside the demand.

In particular, his Honour stated that:

> If the kind of inattention, want of care, inactivity and lack of urgency displayed by Mr Knight could provide a satisfactory explanation for a failure to comply with or set aside a statutory demand, the statutory scheme in relation to statutory demands would be significantly undermined.

However, his Honour did not proceed to determine whether this finding alone was sufficient to refuse leave under s. 459S.

(iii) Was the dispute concerning the debt material to Altered State's solvency?

In relation to an application for leave under s. 459S, subsection (2) provides for a mandatory precondition that the ground (on which the company seeks to oppose the application that it be wound up in insolvency) is material to proving that the company is solvent. Wigney J noted authorities in support of two approaches: a strict approach, requiring proof that "if the disputed debt exists then the company will be insolvent, and that if the debt does not exist then the company will be solvent", and a broad approach, requiring "evidence that the company would undoubtedly be insolvent if the debt was owed, as well as evidence that it "might be" solvent if the debt is not owed."

His Honour held that Altered State failed to meet either of these tests of materiality. Noting that the issue had not been raised in argument before the Court, his Honour also declined to decide which approach was correct. However, his Honour expressed his view that it was not necessary to prove under s. 459S that "the existence or otherwise of the disputed debt is pivotal, crucial or determinative of solvency" but merely that the debt "is relevant to, or has the capacity to have some influence or effect on the conclusion as to the company's solvency." His Honour therefore suggested that the word 'material' in s. 459S was synonymous with "relevant", and noted other authorities in support of this view.

Wigney J also noted that the evidence produced must support a conclusion that the existence of the debt is material to the company's solvency. His Honour found that the evidence produced by Altered State was instead directed at proving its solvency irrespective of whether the debt claimed by Soundwave was due and payable. His Honour also held that the evidence, in any event, failed to satisfy him of Altered State's continuing solvency, even in the absence of the disputed debt.

(iv) Conclusion

On that basis, his Honour concluded that the mandatory precondition for leave in s. 459S(2) had not been satisfied by Altered State. Regardless, his Honour stated that leave would not have been granted given the unsatisfactory evidence produced in relation to the disputed debt and the financial position and solvency of Altered State and the unsatisfactory explanation as to why no application was brought to set aside the statutory demand. His Honour therefore refused the application by Altered State for leave under s. 459S.

Subsequently, in *Soundwave Festival Pty Limited v Altered State (W.A.) Pty Limited (No 2)* [2014] FCA 562, Wigney J went on to order that Altered State be wound up and an official liquidator be appointed.

6.11 Oppression claims for diversion of business

(By Adam Katz, DLA Piper)

Catalano v Managing Australia Destinations Pty Ltd [2014] FCAFC 55, Full Federal Court of Australia, Siopis, Rares and Davies JJ, 8 May 2014

The full text of this judgment is available online.

(a) Summary

Fine Food Solutionz Pty Ltd (FFS) was a frozen finger food manufacturer and seller. Its shareholders consisted of Mr Kurth and Mr Hepner (the Kurth/Hepner Camp) and Mr Nathan Catalano (whose father, Samuel, was also involved in the affairs of FFS, and together formed the Catalano Camp). Following a breakdown in relationship between the Kurth/Hepner Camp and the Catalano Camp, each made claims against the other for oppression. In addition, the Kurth/Hepner Camp claimed a breach of directors' duties and fiduciary duties by Nathan Catalano. The claims were largely on the basis of diverted business opportunities. In the first instance, the primary judge found that the Catalano Camp was responsible for oppressive conduct and made orders for damages and injunctive relief accordingly. Both parties appealed to the Full Federal Court which ultimately held that both parties had engaged in oppressive conduct and there was no basis for the primary judge's award of damages and injunctive relief against the Catalano Camp.

(b) Facts

FFS was originally owned and controlled by Hepner and Kurth, who set up the company's business. Seeking an injection of funds, FFS advertised for investors, to which Nathan Catalano responded, taking a 50% shareholding via a trust entity, Equicap. Thereafter, the two directors of FFS were Nathan Catalano and Kurth, with Kurth (through a company associated with him) holding 200 shares, Hepner holding 300 shares, and Equicap holding 500 shares. Catalano's father, Samuel Catalano, had also become involved in the affairs of FFS.

Soon after, rifts appeared between the Catalano Camp and the Kurth/Hepner Camp in respect of the direction of FFS. Ultimately, Catalano made claims of oppression, breaches of directors' duties, and misleading or deceptive conduct against the Kurth/Hepner Camp, and the Kurth/Hepner Camp made cross-claims of oppression, misleading and deceptive conduct and breaches of directors' duties, and additionally sought damages, compensation and restraints against both Nathan and Samuel Catalano.

The primary judge dismissed the claims by the Catalano Camp, but found for the Kurth/Hepner Camp on the basis that:

> (a) the Catalano Camp had wrongfully diverted business opportunities from FFS to Innova Foods Pty Ltd (Innova), a company set up by Samuel and Nathan Catalano (Innova claim); and (b) had wrongfully refused to permit FFS to contract the manufacturing of certain products to a company called Rethink Group Pty Ltd (Rethink), thereby causing loss and damage to FFS (Rethink claim).

The primary judge ordered that the Catalano Camp be restrained for one year from disparaging, competing with, and utilising any of FFS's intellectual property or confidential information, and that Nathan and Samuel Catalano be ordered to pay $130,000 in damages plus interest to the Kurth/Hepner Camp.

The Catalano Camp appealed against those orders. The Kurth/Hepner Camp cross-appealed, claiming that the restraint should have been broader and that the amount of loss and damage awarded should have been greater.

(c) Decision

The Court concluded that:

- the primary judge was correct to find that the Catalano Camp engaged in oppressive conduct by diverting business opportunities to Innova, but that the

Kurth/Hepner Camp had also engaged in oppressive conduct. In light of this, and because the business relationship had irretrievably broken down, there was a compelling case for making a winding up order under s. 233(1) of the Corporations Act 2001 (Cth) (the Corporations Act); and
- there was no foundation in law or in fact for the restraining order or for the award of damages.

(i) The Innova Claim

The primary judge found that Innova was set up by Nathan and Samuel Catalano as the vehicle to which business opportunities of FFS could be diverted. The Catalano Camp, however, claimed that the product lines were not a FFS "business opportunity", nor could FFS have profitably exploited the products manufactured and sold by Innova.

In considering whether the conduct of the Catalano Camp was oppressive, the Court considered s. 233 of the Corporations Act, which provides for remedies where "the conduct of a company's affairs" is "oppressive to ... a member or members whether in that capacity or any other capacity". The Court considered that conduct would be oppressive if it was unfair according to ordinary standards of reasonableness and fair dealing, assessed objectively. It considered that the relevant question was whether, objectively in the eyes of the commercial bystander, there had been unfairness, namely conduct that was so unfair that reasonable directors who consider the matter would not have thought the conduct or decision was fair.

In finding that the Catalano Camp had engaged in oppressive conduct, the Court held that Samuel Catalano, while not a director of FFS, was involved in the decision-making processes of the company and intruded into its day-to-day management on an ongoing basis which provided sufficient grounds for an application of oppressive conduct under s. 232 of the Act. Further, it was held that Nathan and Samuel Catalano need not have been directors of Innova in order to oppress FFS. The oppressive conduct was their involvement in setting up Innova contrary to the interests of FFS and the Kurth/Hepner Camp.

The primary judge approximated the loss from the Innova claim at $30,000, which the Kurth/Hepner Camp argued should have been $69,773.40. The Court held that the Kurth/Hepner Camp failed to prove their case for any damages in respect of the Innova claim, and hence, no damages were capable of being assessed.

The Kurth/Hepner Camp also claimed that the conduct of Nathan and Samuel Catalano in relation to Innova was in contravention of ss. 180(1), 181(1), 182(2) and 183(1) of the Corporations Act and a breach of fiduciary duties owed to FFS, which caused FFS to lose profits that it would have earned had it, instead of Innova, supplied the products to its customers. The court held that no damages should be awarded here as the Kurth/Hepner Camp failed to adduce reasonably precise evidence of loss.

(ii) The Rethink Claim

The Kurth/Hepner Camp alleged that since September 2012 Nathan and Samuel Catalano had required FFS to contract with Innova for dumpling and gyoza manufacturing and had refused to permit the company to contract with Rethink for that work. They claimed that this was oppressive, had caused loss to FFS, constituted a contravention of ss. 180(1), 181(1), 182(2) and 183(1) of the Act, and was in breach of Nathan and Samuel Catalano's fiduciary duties.

The Kurth/Hepner Camp argued that Rethink could have performed the dumpling and gyoza manufacturing at the cost of $0.15 per unit whereas then current supplier, Barramundi Gardens, was $0.22 per unit. The primary judge held that Mr Hepner had used Barramundi Gardens consistently before any involvement of Catalano with the business of FFS. Further, there was no evidentiary or factual basis to conclude that the dumpling or gyoza manufacturing could have been performed for FFS by Rethink at all, let alone at $0.15 per unit.

The primary judge approximated the loss from the Rethink claim at $100,000, which the Kurth/Hepner Camp argued should have been $296,694. Since the primary judge gave no reasons for finding that the Catalano Camp were liable for damages, the Court set aside this award.

(iii) Injunction Orders by the Primary Judge

The Court held there was no contractual foundation for restraining the Catalano Camp from competing with FFS or using any of its intellectual property or confidential information. In any event, since the orders had the effect of requiring the Catalano Camp to cease having any interest or role in FFS there was no legal, equitable or contractual basis for restraining Catalano from pursuing any business in competition to FFS. The orders made by the primary judge for the Catalano Camp to cease involvement with and transfer their interests in FFS brought any effect of oppression by them to an end. The court, therefore, discharged the injunction.

(iv) Oppression by the Kurth/Hepner Camp

The Court also held that the primary judge wrongly concluded that the Kurth/Hepner Camp had not also engaged in oppressive conduct when it used a company associated with Mr Hepner (Gourmet Dim Sim Company Pty Ltd), in which the Catalano Camp had no interest, to supply products directly to a customer of FFS. The Court held that the primary judge erred by focussing on the motives of Messrs Hepner and Kurth in assessing whether there was commercial unfairness (who claimed the purpose was not to divert business from FFS), because the test of unfairness is an objective one.

(v) Orders of the Court

The Court set aside the orders made by the primary judge for damages, share buy-back of the Catalano Camp's shares, and costs. The Court noted that both parties opposed the making of an order that FFS be wound up, but stated that unless the parties could arrive at a commercial resolution, winding up would be the appropriate order.

6.12 Liquidators' liens: Universal Distributing principle upheld by the High Court

(By Theonie Scott, Mimosa Rizzo and Adam Purton, Corrs Chambers Westgarth)

Stewart v Atco Controls Pty Ltd (in liq) [2014] HCA 15, High Court of Australia, Crennan, Kiefel, Bell, Gageler and Keane JJ, 7 May 2014

The full text of this judgment is available online.

(a) Summary

In this case, the High Court of Australia unanimously overturned a decision of the Supreme Court of Victoria Court of Appeal that found a company liquidator was not entitled to an equitable lien to secure his reasonable costs in obtaining a settlement sum.

The Court confirmed the principle set out by Dixon J in *Re Universal Distributing Co Ltd (in liquidation)* (1933) 48 CLR 171 (*Universal Distributing*) that a secured creditor should not have the benefit of a fund created by a liquidator's efforts in a winding up without the liquidator's costs and expenses of creating such a fund being first met.

The Court held that in determining whether an equitable lien arises, it is not necessary for the Court to conduct a wide ranging inquiry into actions or motives of a liquidator. Provided that he or she acts properly and in accordance with his or her duties, a liquidator will be entitled to priority for costs incurred in preserving and realising assets in the liquidation.

(b) Facts

Atco Controls Pty Limited (in liquidation) (Atco) was a lighting manufacturer. Newtronics Pty Limited (receivers and managers appointed) (in liquidation) (the Newtronics) was a subsidiary of Atco. Newtronics received financial support from Atco secured by a fixed and floating charge. As at December 2001, just before it was wound up, Newtronics owed $19 million to Atco.

In January 2002, Atco appointed receivers and managers to Newtronics after Newtronics was ordered to pay damages of $8.9 million, together with interest and costs, to Seeley International Pty Limited (Seeley, a former customer of Newtronics). The receivers sold the business of Newtronics for $13 million and in February 2002, Newtronics was placed into liquidation on Seeley's application.

The liquidator of Newtronics (the Liquidator) sought and obtained funding from Seeley, who was Newtronics' largest unsecured creditor, to pursue a claim against Atco and its receivers. Seeley also undertook to indemnify the Liquidator for his costs and expenses incurred in pursuing the claim. The Liquidator ultimately settled the claim against the receivers for $1.25 million and was unsuccessful on appeal against Atco.

The whole of the $1.25 million settlement sum that the Liquidator had received from the receivers was paid to Seeley to reimburse Seeley for the costs and expenses it had paid under the indemnity agreement. However, Atco claimed that it was entitled to receive the entire settlement sum under the terms of its security. The Liquidator did not pay the settlement sum to Atco because he asserted an equitable lien over those funds in accordance with the principle in *Universal Distributing*.

(c) Decision

The principle set out by Dixon J in *Universal Distributing* is that a secured creditor may not have the benefit of a fund created by a liquidator's efforts in the winding up without the liquidator's costs and expenses, including remuneration, of creating that fund first being met. A liquidator is entitled to an equitable lien over such a fund that takes priority to the interest of the secured creditor.

The ordinary application of the *Universal Distributing* principle is that if a secured creditor stands by and lets a liquidator realise secured assets, the secured creditor cannot then take the whole of the funds realised without first allowing the liquidator to be reimbursed for his or her remuneration and expenses incurred in realising the assets.

In the present case, Atco argued that the principle ought not apply for reasons including that:

- the court proceeding was not in Atco's interests. It did not stand to benefit from the primary proceeding and it did not willingly participate in the realisation of assets;
- in essence, the primary proceeding was designed to challenge Atco's security. Therefore, Atco argued, it was not a creditor who had (as described by Dixon J in *Universal Distributing*) "come in" and had its rights decided in the winding up; and

- the Liquidator had the benefit of an indemnity for his remuneration and expenses. As the major unsecured creditor, it was Seeley that stood to benefit from the action and it was appropriate that Seeley bear the costs of doing so.

(i) The decision of the Court of Appeal

The Supreme Court of Victoria Court of Appeal was satisfied that the above factors distinguished the present case from Universal Distributing. The fact that the expenses were properly incurred by the Liquidator was not considered sufficient for the application of the principle.

The Court of Appeal held that the relevant question was "whether Atco would be acting unconscientiously if it were to assert priority over the assets without the relevant costs, expenses and remuneration of the Liquidator having been discharged." As the proceeding commenced by the Liquidator was contrary to Atco's interests and it was Seeley that stood to benefit, the Court of Appeal held that Universal Distributing should not apply and the funds should be remitted to Atco.

(ii) The decision of the High Court

The High Court reversed the decision of the Court of Appeal and found that it was unnecessary to qualify the rule in *Universal Distributing* in the manner set out by the Court of Appeal.

The High Court reached its decision by considering the role of a liquidator, noting that:

- a liquidator is not under a duty to ensure litigation is conducted or assets are realised for the benefit of a secured creditor or any other particular creditor. A liquidator's duty is to the body of creditors as a whole and to the Court. In performing this duty, a liquidator should do what he or she can to augment the disposable assets of the company;
- in exercising his or her duties, it is appropriate for a liquidator to carefully scrutinise charges over company property and where appropriate, to challenge those securities;
- a liquidator must exercise care in determining whether to commence litigation and act with propriety in doing so. In the present case, the Liquidator had received advice from counsel and there was no suggestion that he had been reckless in bringing the actions or that the actions had no prospects of success; and
- the fact that the Liquidator had the benefit of an indemnity for his remuneration and expenses was not unusual and did not impact on the application of the rule in *Universal Distributing*. In the present case, the Court recognised that the indemnifier had a right of subrogation and the Liquidator was obliged to reimburse the indemnifier out of any recovered funds.

The High Court held that the fact that the proceeding may have been for the benefit of Seeley did not mean that it was improper for the Liquidator to have brought that proceeding. It also considered Atco had participated in the liquidation by making a claim on the fund and seeking orders against the Liquidator. Accordingly, the Court held that the Liquidator should be paid his remuneration and expenses in priority to the secured creditor and was entitled to the benefit of an equitable lien as security for those amounts.

The High Court also cautioned that courts should not proceed on general notions of justice without regard to long-standing principles of equity and endorsed Gibbs CJ statement in *Hewett v Court* (1983) 149 CLR 639 that "a principle should be applied when the circumstances of a case fall within it".

6.13 Application for an "interim" stay of a winding up dismissed due to public interest concerns

(By Annabel Humphreys, Minter Ellison)

In the matter of Wine National Pty Ltd, James Estate Wines Pty Ltd, Liquor National Pty Ltd [2014] NSWSC 507, Supreme Court of New South Wales, Black J, 1 May 2014

The full text of this judgment is available online.

(a) Summary

This case provides an example of where a court will refuse to exercise its discretion under s. 482 of the Corporations Act 2001 (Cth) (the Corporations Act) to stay the winding up of a company. In considering whether a winding up should be stayed, regard should be had to the interests of creditors, the liquidator and contributories, and the public interest. In particular, the court will consider commercial morality and favour the initial approach that insolvent companies should be wound up.

(b) Facts

James Australia Group Pty Ltd (receivers and managers appointed) (in liquidation) (JAG) borrowed $385,000 from Australia and New Zealand Banking Group Limited (ANZ) which was secured by a fixed and floating charge and a real property mortgage over a property situated at Rutherford, New South Wales (the Rutherford Property).

After making several demands for repayments of amounts due under the loan, ANZ appointed administrators (the Administrators) to several companies including JAG and

Rugama Trading Pty Ltd (receivers and managers appointed) (in liquidation) (Rugama) (collectively, the TLT Companies) pursuant to s. 436C of the Corporations Act. ANZ also appointed receivers and managers (the TLT Receivers) over substantially all of the assets of the TLT Companies.

The Administrators' report to creditors recorded that:

- David James, who previously controlled the TLT Companies, had failed to comply with their request for access to the TLT Companies' books and records;
- there were serious issues with the record-keeping practices of the TLT Companies which could give rise to a presumption of insolvency;
- the Rutherford Property was unlikely to be of sufficient value to repay ANZ in full; and
- the unsecured creditors' prospect of a return would be through the successful pursuit of voidable transactions or claims against David James, which would only be possible in a winding up.

The Administrators' recommended that the TLT Companies, including JAG, be wound up because the companies were, or were likely to become, insolvent and a liquidation would facilitate the completion of investigations commenced by the Administrators. JAG passed into voluntary liquidation.

The TLT Receivers caused Rugama, as sole shareholder of Wine Investment Services Pty Ltd (WIS), to resolve that WIS be wound up.

The applicants, Douglas Hawkins Pty Ltd, Shelteo Pty Ltd, Aramax Nominees Pty Ltd, Primax Nominees Pty Ltd and David James, sought an interim order staying the winding up of JAG and WIS pursuant to s. 482 of the Corporations Act.

(c) Decision

Black J dismissed the application and ordered the applicants pay the respondents' costs.

Black J considered that s. 482 of the Corporations Act does not authorise the Court to take an "interim" step falling short of a stay of a winding up, which is itself an order that is interim in character. His Honour proceeded on the basis that the application was for a stay of the winding up.

Black J considered that a stay of a winding up is in the nature of final relief because it does not preserve the status quo, but instead restores the powers of the directors. As such, the question of whether a winding up should be stayed is not to be determined by reference to the principles applicable to interlocutory relief, that is, whether there is a 'serious question to be tried' or the 'balance of convenience'.

A stay of a winding up will only be ordered if there is a valid reason why it is appropriate to make that order, rather than permit the winding up to take its normal course.

Black J referred to the following categories of interests a court should have regard to in considering whether to stay a court-ordered winding up as set out by Austin J in *Mercy & Sons Pty Ltd v Wanari Pty Ltd (subject to deed of company arrangement) (in liq)* [2000] NSWSC 756:

- first, the interests of the creditors, including the interests of future creditors;
- second, the interests of the liquidator, particularly with respect to costs;
- third, the interests of contributories; and
- finally, the public interest, including matters of commercial morality, and taking the initial approach that insolvent companies should be wound up.

In relation to the winding up of JAG, the applicants argued that the appointment of the Administrators served no purpose because the TLT Receivers could seek repayment of the loan from the sale of JAG's assets, namely the Rutherford Property and a sum of $650,000 recovered from a Family Court proceeding (Deposit).

Black J rejected this argument because:

- the Deposit was subject to a claim by JAG's former solicitors in the sum of $390,000 and Irene James had a claim over the balance of the Deposit;
- the receiver's costs would be paid before the debt was paid out in full;
- the amount recoverable from the sale of the Rutherford Property and when that sale would occur was unknown; and
- ANZ's ability to appoint an administrator to JAG was not conditional on any requirement of necessity.

The applicants also argued that the appointment of the TLT Receivers was analogous to a clog on the equity of redemption because it put JAG in a position where the mortgage could not be redeemed. Black J rejected this argument because JAG, by its liquidators, could redeem the mortgage if it was in funds to do so, and it was open to Irene James to put the liquidators in funds to do so.

Black J then considered the public interest in staying the winding up of JAG. Black J rejected the applicants' submission that the solvency of a company is of less relevance in an application to stay a winding up where JAG was not placed into liquidation because it was insolvent, but rather passed into voluntary liquidation. His Honour considered that notices of assessment issued to JAG in respect of payroll tax totalling $303,405 and a claim made by the Commissioner of State Revenue in the amount of $5,833,959 indicated that JAG was likely to be insolvent which tended strongly against a stay of the winding up. Black J referred to case law recognising that, in consideration of commercial morality, the Court may be steered against terminating a winding up where there is serious impropriety in the conduct of a company's affairs or significant risk to future creditors. His Honour expressed concern in relation to the matters raised in the Administrators' report to creditors in relation to the actions of David James and the record keeping of JAG.

In relation to the winding up of WIS, the applicants submitted the winding up did nothing to realise Rugama's shareholding in WIS and had the effect of jeopardising WIS's business and wine stock. Black J rejected this submission and accepted the TLT Receivers evidence that WIS was placed into liquidation for the purpose of protecting and realising the value of WIS's assets for the benefit of Rugama and ANZ, and to resolve ownership disputes in relation to the wine.

The applicants submitted that the control of WIS should be returned to David James and his brother Murray James. Black J rejected this argument because there was uncertainty about whether there was a properly appointed director of WIS who was capable of discharging the duties of a director. There was also uncertainty about who owned the wine in stock and whether WIS's records were capable of resolving that uncertainty. His Honour also considered that an independent person would be in a better position to resolve competing claims in relation to the wine in stock because members of the James family had claimed an interest in the wine. Further, in consideration of issues of commercial morality, Black J noted that there was insufficient evidence that WIS would have the financial strength and stability to continue as a going concern without any real risk that it would be returned to liquidation.

Each of the applicants also argued they were a person aggrieved by the decision of the TLT Receivers to cause Rugama to place WIS into liquidation. Black J rejected this argument and noted that the Court's power to review a discretionary decision of a receiver is generally confined to circumstances where the receiver is acting unreasonably or in bad faith, of which there was no evidence.

Black J noted that the Applicants had not addressed the position of the Liquidators other than to initially seek an order that the TLT Receivers pay the costs of the winding up of WIS. In that regard, the Liquidators' position would not be protected if the Court ordered the winding-up of JAG or WIS be stayed.

6.14 Alleged sham trusts and trustee discretion

(By Peter Motti, Minter Ellison)

In the matter of ICS Real Estate Pty Ltd (in liquidation); and In the Matter of Independent Contractor Service (Aust) Pty Ltd (in liquidation) [2014] NSWSC 479, Supreme Court of New South Wales, Brereton J, 29 April 2014

The full text of this judgment is available online.

(a) Summary

In each proceeding, the liquidator of the companies ICS Real Estate Pty Ltd (in liquidation) (ICSRE) and Independent Contractor Services (Aust) Pty Ltd (in liquidation) (ICS) applied for directions, pursuant to s. 511 of the Corporations Act 2001 (Cth) (the Corporations Act), that the liquidator would be justified in treating certain moneys standing to the credit of those companies as assets of those companies, and thus to be distributed in accordance with s. 556 of the Corporations Act, or whether the moneys were held by the companies as trustees of two trusts - respectively the ICS Real Estate Trust (the ICSRE Trust) and the Independent Contractor Services Trust (the ICS Trust). The Court held in both proceedings that the liquidator would not be justified in treating the amounts standing to the credit of the companies as being beneficially owned by each of the companies and that the liquidator would not be justified in treating the claiming contractors and agents' representatives in respect of whom invoices have been rendered by the companies as unsecured creditors.

(b) Facts

ICSRE and ICS were respectively parties to trust deeds, both dated 16 November 2006, constituting the ICSRE Trust and the ICS Trust. Each trust was, according to the terms of the trust deed that constituted it, a discretionary trust, the objects of which were described as "general beneficiaries" or "beneficiaries", including a "primary beneficiary". On 8 November 2012, a meeting of creditors resolved, separately, that both ICSRE and ICS be wound up.

The two trust deeds were in identical terms. In each case, the trust fund comprised a settled sum and "all moneys investments and property paid transferred to or accepted by the trustee as additions to the trust fund". The trustee held the income and the capital of the trust on trust for the beneficiaries and could, in its absolute discretion pay, apply, allocate or set aside all or part of the income or capital of the trust fund for any of the general beneficiaries. As the trustees were corporations which went into liquidation, each trustee was disqualified from holding office and the companies were no longer trustees (except as bare trustees pending replacement).

Both companies carried on business under similar models, whereby they supplied persons whom they had retained to entities to deliver services on behalf of those agencies or consultancies. The clients of ICSRE were the operators of real estate agencies. Through a series of agreements, ICSRE agreed to engage "agents' representatives", to deliver real estate consultancy, sales and marketing services on behalf of the client agency to its clients. ICSRE was liable for all remuneration to be paid to the agents' representatives, and for workers compensation insurance. The client agency agreed to pay ICSRE a fee, and ICSRE agreed to submit invoices to the client agency. The clients of ICS were consultancies that provided consultants (mainly in information technology and engineering) to companies such as banks that required the services of external contractors. Such client consultancies entered into an agreement with ICS, under the terms of which ICS provided a consultant to deliver services on behalf of the consultancy to the end user. The consultant remitted timesheets to ICS, from which ICS raised invoices to the client consultancy.

A person who wished to be placed as an "agent's representative" (representative) by ICSRE applied to become a general beneficiary of the ICSRE Trust by completing an application form and acknowledging he or she was not an employee, and had no right or entitlement to any income or capital of the trust. The applicant also supplied bank instructions as to how any distributions were to be split between the primary and secondary beneficiary. Representatives agreed to pay ICSRE a fee. A person who wished to be placed as a consultant (contractor) by ICS applied to become a beneficiary of the ICS Trust in substantially the same manner, making similar acknowledgements. Contractors agreed to pay ICS a fee.

(c) Decision

(i) The questions

The liquidator sought directions as to two related matters:

- that he would be justified in treating the amounts standing to the credit of ICS and ICSRE in their bank accounts as beneficially owned by each, and any amounts collected by the liquidator since his appointment in respect of invoices rendered by ICS or ICSRE as beneficially owned by each; and
- that he would be justified in treating the claiming contractors and agents' representatives in respect of whom invoices have been rendered by ICS or ICSRE, as unsecured creditors.

The trust deed bound the trustee to hold the moneys received on trust, in accordance with the terms of the deed. However, the liquidator submitted that the directions sought should be given on the basis that the purported discretionary trusts were shams, and that the true underlying relationship between the companies and the representatives or contractors involved no trust but was contractual only.

(ii) Were the trusts shams?

His Honour observed that the doctrine of "sham" has at its core the concept of a dichotomy between the true transaction and/or relationship between the parties, and the manner in which it is overtly represented and, in determining whether a document or a transaction is a sham, the Court must identify and give effect to the parties' subjective intentions as regards their dealings or relationships, as opposed to the disguise or facade that has been adopted. His Honour emphasised that a "finding that a document or arrangement is a sham is a serious matter, and requires a finding of an intention to deceive", noting that there is a presumption against such a finding, and the Court "should adopt a cautious approach when dealing with such an allegation".

His Honour accepted that, as a matter of fact, income received by the trustee was invariably distributed promptly to or as directed by the beneficiary whose work had generated that income, and apparently without the trustee turning its mind and giving real and genuine consideration to the exercise of its discretion in the case of each individual payment and that the representatives and contractors believed with a high degree of certainty that they would be paid by ICS or ICSRE. However, his Honour held that it did not follow that the true arrangement was that there was no discretion to be exercised by the trustee and that it was at least equally consistent with the trustee having a standing policy that receipts would be distributed to the beneficiary who generated them, without excluding the possibility that it might exercise its discretion otherwise.

His Honour took the view that if the trusts were shams it would involve a conclusion that the trustee was bound, by the true arrangement between the parties, to distribute income generated by a beneficiary to that beneficiary and that the beneficiary could enforce that obligation if the trustee were to fail to do so.

His Honour observed that the trust deeds and other documents contained written terms directly inconsistent with the existence of any such right, noting that:

> by their application forms, each representative and contractor acknowledged that they had no right or entitlement to any income or capital of the trust except for income or capital that the trustee in its discretion determines to distribute to them ... and that the trustee could in its absolute discretion decide not to make any trust distributions to them in any year.

His Honour stated that even if the true arrangement was that there was no discretion to be exercised and that the trustee was bound to distribute income generated by a beneficiary to that beneficiary, that would not mean that there was no trust and that the relationship was purely contractual, but rather that it would mean only that the trust was not one under which the trustee had a discretion as to distribution of the income, but one under which the trustee was bound to distribute the income to or as directed by the beneficiary who generated it.

Even if the real intention were that, it would not establish that the parties intended that the relevant moneys, despite the terms of the trust deeds, not be held on trust at all.

(iii) Conclusion and orders

His Honour considered that the evidence did not make out the allegation that the trust arrangement was a sham: neither to the narrower extent that there was no discretion to be exercised; nor to the broader extent that there was no trust at all, but a merely contractual relationship. Consequently, his Honour concluded that the trusts were not shams and that they were discretionary trusts and that the funds in question were held on trust absolutely for the individual representatives or contractors whose efforts generated them.

In respect of each of the proceedings, the Court ordered, *inter alia*, that:

- the liquidator would not be justified in treating the amounts standing to the credit of the companies as being beneficially owned by each of the companies; and
- the liquidator would not be justified in treating the claiming contractors and agents' representatives in respect of whom invoices have been rendered by the companies as unsecured creditors in the liquidation of the companies.