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info.regulatory@saiglobal.com

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

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 Reform of over-the-counter derivatives markets

On 12 December 2014, Acting Assistant Treasurer Mathias Cormann provided an update on the Australian Government's reforms of the over-the-counter derivatives markets.

The reforms include:

- requiring central clearing of over-the-counter interest rate derivatives denominated in Australian dollars and four other global currencies;
- providing relief from the trade reporting requirements for organisations that undertake small amounts of over-the-counter derivative activity by allowing "single-sided" reporting;
- permanently exempting end users from the regulatory framework applying to over-the-counter derivatives; and

- increasing cross-border cooperation in derivatives market regulation between Australia and Singapore.

(a) Central clearing of over-the-counter interest rate derivatives

Following the consultation process earlier this year, the government will mandate central clearing of over-the-counter interest rate derivatives denominated in Australian dollars and four global currencies for the major domestic and foreign banks. This aligns Australia with global peers in progressing reforms agreed by the G20 in the aftermath of the global financial crisis. A Ministerial determination and regulations will be made available for public consultation in early 2015. Rules setting out the details of implementation will be released at the same time by the Australian Securities and Investments Commission (ASIC).

(b) "Single-sided" reporting for Phase 3B entities

Financial services organisations that engage in small amounts of over-the-counter derivative activity will benefit from "single-sided" reporting relief, provided they conclude their derivatives transactions with counterparties that are already required to report the trade.

This will apply to all Phase 3B entities as defined in the trade reporting rules. This means that the trade reporting compliance burden will mainly fall on larger financial institutions that are systemically important, while still providing regulators with information they need to effectively supervise over-the-counter derivatives markets. Regulations setting out the details of the "single-sided" reporting regime will be released for public consultation in early 2015.

(c) Permanently exempt end users from the regulatory framework

Research indicates that end users, in particular non-financial corporates, do not play a systemically significant role in over-the-counter derivatives markets in Australia. The government has therefore permanently exempted end users from the regulatory framework applying to over-the-counter derivatives. The previous relief was due to expire on 31 December 2014. This permanent exemption provides certainty for end users that they can continue to use over-the-counter derivatives to hedge their business risks without incurring unnecessary compliance costs.

(d) Information sharing agreement between Australia and Singapore

The government is also implementing an information sharing arrangement between ASIC and the Monetary Authority of Singapore for derivatives market regulation. Fostering such cooperation is a declared objective of G20 leaders and global supervisors such as the Financial Stability Board.

Further information is available on the Acting Assistant Treasurer's website.

1.2 Revisions to the international securitisation framework

On 11 December 2014, the Basel Committee on Banking Supervision issued revisions to the securitisation framework. The revisions aim to address a number of shortcomings in the Basel II securitisation framework and to strengthen the capital standards for securitisation exposures.

This framework, which will come into effect in January 2018, forms part of the committee's broader Basel III agenda to reform regulatory standards for banks in response to the global financial crisis and thus contribute to a more resilient banking sector.

The crisis highlighted several weaknesses in the Basel II securitisation framework, including mechanistic reliance on external ratings, lack of risk sensitivity, cliff effects and insufficient capital for certain exposures. The committee has revised the securitisation framework to address these issues.

The most significant revisions with respect to the Basel II securitisation framework relate to changes in (i) the hierarchy of approaches (that reduces reliance on external ratings); (ii) the risk drivers used in each approach; and (iii) the amount of regulatory capital banks must hold for exposures to securitisations.

The revised framework is available on the Basel Committee website.

1.3 Criteria for identifying "simple, transparent and comparable" securitisations: consultative document issued by the Basel Committee and IOSCO

On 11 December 2014, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) released the consultative document Criteria for identifying simple, transparent and comparable securitisations (11 December 2014).

The purpose of these criteria is to identify—and to assist the financial industry's development of—simple, transparent and comparable securitisations structures, as well as to help parties involved in a securitisation transaction evaluate the risks of a particular securitisation as part of their due diligence on securitisations.

Criteria promoting simplicity refer to the homogeneity of underlying assets with simple characteristics, and a transaction structure that is not overly complex. Criteria on transparency provide investors with sufficient information on the underlying assets, the structure of the transaction and the parties involved in the transaction, thereby promoting a more thorough understanding of the risks involved. Criteria promoting comparability assist investors in their understanding of such investments and enable more straightforward comparison between securitisation products within an asset class.

The proposed criteria have been mapped to key types of risk in the securitisation process: (i) generic criteria relating to the underlying asset pool (asset risk); (ii) transparency around the securitisation structure (structural risk); and (iii) governance of key parties to the securitisation process (fiduciary and servicer risk).

The consultation document is available on the Basel Committee website.

1.4 Cyber security for non-executive directors

On 10 December 2014, the UK Department for Business, Innovation and Skills (BIS) published guidance aimed at assisting non-executive directors discuss with other directors cyber security risks. It provides a set of questions that non-executive directors can ask of others, including those on audit and risk committees of the board.

The guidance is available on the BIS website.

1.5 Crowd-sourced equity funding discussion paper

On 8 December 2014, the Australian Treasury released Discussion Paper - Crowd-sourced Equity Funding (December 2014) for public comment. The Acting Assistant Treasurer and Small Business Minister Bruce Billson have jointly stated (8 December 2014) that the publication of the discussion paper "progresses [the government's] election commitment to improve small businesses' access to affordable finance".

Crowd-sourced equity funding (CSEF) is an emerging form of funding that allows entrepreneurs to raise funds online from a large number of small investors. Along with other innovative finance options, including peer-to-peer lending, angel investing and venture capital, CSEF has the potential to increase small businesses and start-ups' access to funds to develop and implement their ideas and products.

The discussion paper outlines three options:

- option 1: a regulatory framework based on the model recommended in the report of the Corporations and Markets Advisory Committee (CAMAC);
- option 2: a regulatory framework based on the New Zealand model; and
- option 3: the status quo.

Option 1

Option 1 involves the implementation of a CSEF regime based on CAMAC's recommendations. CAMAC recommended the development of a separate legislative framework for CSEF to make it easier for CSEF to be used in Australia.

CAMAC recommended that CSEF issuers be required to be public companies. A new category of public company—the "exempt public company"—would be created and would be relieved of some of the compliance requirements for public companies for a period of up to three to five years. Such companies would be exempt from requirements for continuous disclosure, holding an annual general meeting, executive remuneration reporting, half-yearly reporting, and appointing an independent auditor and having a financial report audited (unless certain financial thresholds are exceeded). CAMAC's recommendations focused on the Corporations Act 2001 (Cth) (the Corporations Act), and it did not propose any changes to any other legislation, including to the tax treatment of exempt public companies.

CAMAC's proposed framework for CSEF fundraising includes:

- for issuers: limitation of the regime to certain small enterprises that have not already raised funds under the existing public offer arrangements, limitation of the regime to one class of fully paid ordinary shares, reduced disclosure requirements, a cap of $2 million on the amount that can be raised through CSEF in any 12-month period (excluding funds raised under existing exemptions from the need to provide a prospectus to certain wholesale investors), restrictions on advertising of the equity offer and prohibitions on conflict of interest;
- for intermediaries: requirements for intermediaries to have an Australian Financial Services Licence (AFSL) including membership of an external dispute resolution scheme, requirements to undertake limited due diligence and provide risk warnings to investors, provisions to prevent certain conflicts of interest, prohibitions on offering investment advice and on lending to CSEF investors; and
- for investors: investment caps of $2,500 per investor per 12-month period for any particular CSEF issuer and $10,000 per investor per 12-month period in

total CSEF investment, signed risk acknowledgement statements prior to investment and cooling off and other withdrawal rights.

Option 2

Option 2 involves the implementation of the New Zealand model that came into force in April 2014. New Zealand's Financial Markets Authority issued the first financial licence to a CSEF platform in July 2014, with the first CSEF raising completed in mid-September 2014.

New Zealand's model has some broad similarities to CAMAC's proposed scheme, including:

- limitation of the regime to one class of fully paid ordinary shares;
- a cap of $2 million on the amount that can be raised through CSEF disclosure relief in any 12-month period inclusive of any fundraising via the New Zealand equivalent of the small scale personal offer exemption but excluding investments by wholesale investors;
- requirements for intermediaries to be licensed and belong to an external dispute resolution scheme, undertake limited due diligence checks and provide disclosure statements and risk warnings to investors; and
- investors must sign a risk acknowledgement statement.

Differences in the New Zealand model compared to CAMAC's recommended framework include:

- no CSEF-specific exemptions from public company compliance costs such as financial reporting and audit;
- the regime is not specifically limited to small enterprises;
- there are minimum disclosure requirements and investment caps are voluntary, with issuers and intermediaries to have in place arrangements to provide greater disclosure where there are no or high voluntary investor caps or the issuer is seeking to raise a significant amount of funds;
- there are no restrictions on intermediaries' fee structures, although fees paid by the issuer must be disclosed; and
- intermediaries are able to invest in issuers using their platform, although details of any investments must be disclosed.

Option 3

Under option 3, there would be no change to the current requirements under the Corporations Act for proprietary companies, public companies and for public fundraisings.

These include:

- the limit of 50 non-employee shareholders for proprietary companies, and prohibitions on making public offers of equity, subject to certain exemptions, including the small scale personal offer exemption;
- financial reporting and corporate governance requirements for public companies that are more onerous than those that apply to proprietary companies; and
- the requirement to provide a disclosure statement when making public offers of equity.

Intermediaries would remain subject to a number of existing requirements, including:

- the need to hold an AFSL and comply with AFSL licensing obligations if they meet the definition of carrying on a financial services business or to hold an Australian Market Licence (AML) and comply with AML licensing obligations if they fall within the definition of conducting a financial market; and
- if a managed investment scheme (MIS) structure is used to facilitate online equity offers, the intermediary would need to comply with MIS requirements, including having a responsible entity that is a public company with an AFSL, disclosure and compliance obligations.

Under this option, CSEF would not be regulated as a specific form of investment. Small businesses and start-ups seeking to raise early stage capital would need to comply with the above existing requirements.

The discussion paper is available on the Treasury website.

1.6 Financial System Inquiry Report

On 7 December 2014 the report of the Australian Financial System Inquiry (the Inquiry) was published. The Inquiry has made recommendations on five specific themes:

- Strengthen the economy by making the financial system more resilient.
- Lift the value of the superannuation system and retirement incomes.
- Drive economic growth and productivity through settings that promote innovation.
- Enhance confidence and trust by creating an environment in which financial firms treat customers fairly.
- Enhance regulator independence and accountability, and minimise the need for future regulation.

The Inquiry identified two general themes where there is significant scope to improve the functioning of the financial system:

- Funding the Australian economy
- Competition

The following is extracted from the report.

> **Funding the Australian economy**
>
> The core function of the Australian financial system is to facilitate the funding of sustainable economic growth and enhance productivity in the Australian economy. The Inquiry believes Government's role in funding markets should generally be neutral regarding the channel, direction, source and size of the flow of funds.
>
> The Inquiry identified a number of distortions that impede the efficient market allocation of financial resources, including taxation, information imbalances and unnecessary regulation. Reducing the distortionary effects of taxation should lead the system to allocate savings (including foreign savings) more efficiently and price risk more accurately. The Inquiry has referred the identified tax issues for consideration in the Tax White Paper.
>
> A number of the Inquiry's recommendations aim to assist small and medium-sized enterprises in obtaining better access to funding. To strengthen Australia's ability to continue to access funding, both domestically and from offshore sources, recommendations have been made to improve the resilience of the Australian financial system. More broadly, given that Australia's growing superannuation system will have an increasing influence on future funding flows, the Inquiry believes that the recommendations it has made to improve the efficiency of the superannuation system would also enhance financial system funding efficiency.
>
> **Competition**
>
> Competition and competitive markets are at the heart of the Inquiry's philosophy for the financial system. The Inquiry sees them as the primary means of supporting the system's efficiency. Although the Inquiry considers competition is generally adequate, the high concentration and increasing vertical integration in some parts of the Australian financial system has the potential to limit the benefits of competition in the future and should be proactively monitored over time.

The Inquiry's approach to encouraging competition is to seek to remove impediments to its development. The Inquiry has made recommendations to amend the regulatory system, including: narrowing the differences in risk weights in mortgage lending; considering a competitive mechanism to allocate members to more efficient superannuation funds; and ensuring regulators are more sensitive to the effects of their decisions on competition, international competitiveness and the free flow of capital.

In particular, the state of competition in the financial system should be reviewed every three years, including assessing changes in barriers to international competition.

Chapter 1: Resilience

Historically, Australia has maintained a strong and stable financial system supported by effective stability settings. However, the Australian financial system has characteristics that give rise to particular risks, including its high interconnectivity domestically and with the rest of the world, and its dependence on importing capital. More can be done to strengthen the resilience of Australia's financial system to avoid or limit the costs of future financial crises, which can deeply damage an economy and have lasting effects on people's lives.

As the banking sector is at the core of the Australian financial system, its safety is of paramount importance. Australia should aim to have financial institutions with the strength to not only withstand plausible shocks but to continue to provide critical economic functions, such as credit and payment services, in the face of these shocks. Adhering to international regulatory norms will help ensure Australian financial institutions and markets are not disadvantaged in raising funds in international financial markets.

The Inquiry's recommendations to improve resilience aim to:

- Strengthen policy settings that lower the probability of failure, including setting Australian bank capital ratios such that they are unquestionably strong by being in the top quartile of internationally active banks.
- Reduce the costs of failure, including by ensuring authorised deposit-taking institutions maintain sufficient loss absorbing and recapitalisation capacity to allow effective resolution with limited risk to taxpayer funds - in line with international practice.

Chapter 2: Superannuation and retirement incomes

Australia's superannuation system is large by international standards and has grown rapidly since the Wallis Inquiry, primarily as a result of Government policy settings.

An efficient superannuation system is critical to help Australia meet the economic and fiscal challenges of an ageing population. The system has considerable strengths. It plays an important role in providing long-term funding for economic activity in Australia both directly and indirectly through funding financial institutions, and it contributed to the stability of the financial system and the economy during the global financial crisis.

The superannuation system is not, however, operationally efficient due to a lack of strong price-based competition. Superannuation assets are not being efficiently converted into retirement incomes due to a lack of risk pooling and over-reliance on individual account-based pensions.

The Inquiry's recommendations to strengthen the superannuation system aim to:

- Set a clear objective for the superannuation system to provide income in retirement.
- Improve long-term net returns for members by introducing a formal competitive process to allocate new workforce entrants to high-performing superannuation funds, unless the *Stronger Super* reforms prove effective.
- Meet the needs of retirees better by requiring superannuation trustees to pre-select a comprehensive income product in retirement for members to receive their benefits, unless members choose to take their benefits in another way.

Chapter 3: Innovation

Technology-driven innovation is transforming the financial system, as evidenced by the emergence of new business models and products, and substantial investment in areas such as mobile banking, cloud computing and payment services.

Although innovation has the potential to deliver significant efficiency benefits and improve system outcomes, it also brings risks. Consumers, businesses and government can be adversely affected by new developments, which may also challenge regulatory frameworks and regulators' ability to respond.

The Inquiry believes the innovative potential of Australia's financial system and broader economy can be supported by taking action to ensure policy settings facilitate future innovation that benefits consumers, businesses and government.

The Inquiry's recommendations to facilitate innovation aim to:

- Encourage industry and government to work together to identify innovation opportunities and emerging network benefits where government may need to facilitate industry coordination and action.
- Strengthen Australia's digital identity framework through the development of a national strategy for a federated-style model of trusted digital identities.
- Remove unnecessary regulatory impediments to innovation, particularly in the payments system and in fundraising for small businesses.
- Enable the development of data-driven business models through holding a Productivity Commission Inquiry into the costs and benefits of increasing access to and improving the use of private and public sector data.

Chapter 4: Consumer outcomes

Fundamental to fair treatment is the concept that financial products and services should perform in the way that consumers expect or are led to believe.

The current framework is not sufficient to deliver fair treatment to consumers. The most significant problems relate to shortcomings in disclosure and financial advice, which means some consumers are sold financial products that are not suited to their needs and circumstances. Although the regime should not be expected to prevent all consumer losses, self-regulatory and regulatory changes are needed to strengthen financial firms' accountability.

The Inquiry's recommendations to improve consumer outcomes aim to:

- Improve the design and distribution of financial products through strengthening product issuer and distributor accountability, and through implementing a new temporary product intervention power for the Australian Securities and Investments Commission (ASIC).
- Further align the interests of firms and consumers, and improve standards of financial advice, by lifting competency and increasing transparency regarding financial advice.

- Empower consumers by encouraging industry to harness technology and develop more innovative and useful forms of disclosure.

Chapter 5: Regulatory system

Australia needs strong, independent and accountable regulators to help maintain confidence and trust in the financial system, thereby attracting investment and supporting growth. This requires proactive regulators with the right skills, culture, powers and funding.

Australia's regulatory architecture does not need major change; however, the Inquiry has made recommendations to improve the current arrangements. Government currently lacks a regular process that allows it to assess the overall performance of financial regulators. Regulators' funding arrangements and enforcement tools have some significant weaknesses, particularly in the case of ASIC. In addition, it is not clear whether adequate consideration is currently given to competition and efficiency in designing and applying regulation.

The Inquiry's recommendations to refine Australia's regulatory system and keep it fit for purpose aim to:

- Improve the accountability framework governing Australia's financial sector regulators by establishing a new Financial Regulator Assessment Board to review their performance annually.
- Ensure Australia's regulators have the funding, skills and regulatory tools to deliver their mandates effectively.
- Rebalance the regulatory focus towards competition by including an explicit requirement to consider competition in ASIC's mandate and conduct three-yearly external reviews of the state of competition.
- Improve the process for implementing new financial regulations.

The full report is available on the Financial System Inquiry website.

1.7 APRA releases final prudential standard and prudential practice guide on risk management

On 4 December 2014, the Australian Prudential Regulation Authority (APRA) released the final version of its new risk management standard and associated guidance.

The documents include the final versions of Prudential Standard CPS 220 - Risk Management (CPS 220) and Prudential Practice Guide CPG 220 - Risk Management (CPG 220) (both undated) as well as a letter to industry (4 December 2014) summarising APRA's response to submissions on the most recent consultation, which commenced on 7 October 2014. The letter sets out a small number of minor refinements that were made to the prudential practice guide as a result of the submissions received. There were no further changes to the prudential standard.

The new requirements are applicable to authorised deposit-taking institutions (ADIs), general insurers and life companies, and authorised non-operating holding companies (authorised NOHCs), and commence 1 January 2015.

The response to submissions and the final versions of CPS 220 and CPG 220 are available on the APRA website.

1.8 OECD report on bribery by companies

On 2 December 2014, the OECD published the report An analysis of the crime of bribery of foreign public officials (undated). The report shows that most international bribes are paid by large companies, usually with the knowledge of senior management.

Bribes in the analysed cases equalled 10.9% of the total transaction value on average, and 34.5% of the profits—equal to US$13.8 million per bribe. But given the complexity and concealed nature of corrupt transactions, this is without doubt the mere tip of the iceberg, says the OECD.

Bribes are generally paid to win contracts from state-owned or controlled companies in advanced economies, rather than in the developing world, and most bribe payers and takers are from wealthy countries.

The OECD Foreign Bribery Report analyses more than 400 cases worldwide involving companies or individuals from the 41 signatory countries to the OECD Anti-Bribery Convention who were involved in bribing foreign public officials. The cases took place between February 1999, when the Convention came into force, and June 2014.

Almost two-thirds of cases occurred in just four sectors: extractive (19%); construction (15%); transportation and storage (15%); and information and communication (10%). Bribes were promised, offered or given most frequently to employees of state-owned enterprises (27%), followed by customs officials (11%), health officials (7%) and defence officials (6%). Heads of state and ministers were bribed in 5% of cases but received 11% of total bribes. In most cases, bribes were paid to obtain public procurement contracts (57%), followed by clearance of customs procedures (12%). 6% of bribes were to gain preferential tax treatment.

The report also reveals that the time needed to conclude cases has increased over time, from around two years on average for cases concluded in 1999 to just over seven today. This may reflect the increasing sophistication of bribers, the complexity for law enforcement agencies to investigate cases in several countries or that companies and individuals are less willing to settle than in the past.

In 41% of cases management-level employees paid or authorised the bribe, whereas the company CEO was involved in 12% of cases. Intermediaries were involved in three out of four foreign bribery cases. These intermediaries were agents, such as local sales and marketing agents, distributors and brokers, in 41% of cases. Another 35% of intermediaries were corporate vehicles, such as subsidiary companies, companies located in offshore financial centres or tax havens, or companies established under the beneficial ownership of the public official who received the bribes.

Governments around the world should strengthen sanctions, make settlements public and reinforce protection of whistleblowers as part of greater efforts to tackle bribery and corruption, says the OECD.

The report is available on the OECD website.

1.9 Commencement of new financial markets laws in New Zealand

On 1 December 2014, the second phase of New Zealand's new capital markets and financial services law took effect. Phase two includes licensing provisions that extend to several hundred further businesses, and a major shift in the quality of investor disclosure for financial products.

The commencement of phase two of the Financial Markets Conduct Act 2013 (NZ) (the FMC Act) largely completes the regulatory overhaul that began with the Capital Market Development Taskforce's final report in 2009.

In addition to the FMC Act's focus on licensing and conduct, the overhaul also included an expanded prudential role for the Reserve Bank covering banks, insurers, and non-bank deposit-takers.

Features of phase two of the FMC Act include:

- Product disclosure statements for financial products—including debt and equity—made concise, and subject to page limits. An online register will include all the material information on offers under the FMC Act. Offers can be made under the Securities Act 1978 (NZ) during a transition period, but the Financial Markets Authority (FMA) encourages issuers to shift to the new arrangements at the earliest opportunity.
- Further professionals come under FMA licensing, including managers of registered schemes (managed investment schemes), derivatives issuers, and independent trustees of restricted schemes. Providers of discretionary investment managements services will also be licensed.

Several hundred organisations and individuals are expected to apply for licences over the next two years, bringing more than 11,000 firms, professionals, registered schemes, and funds under the FMA's mandate.

Phase one of the FMC Act commenced on 1 April 2014.

Phase one included:

- A fair dealing requirement covering all firms or professionals that are dealing in or supplying financial products or financial services.
- A more proportionate liability regime - relative to that under existing securities laws - applying to directors of firms making offers or providing financial products under the FMC Act.
- More concise and timely financial reporting. About 2,300 firms and schemes are reporting financial information under the FMC Act, and are subject to regulatory oversight by the FMA.

Other initiatives under the FMC Act this year are:

- Providers in two new categories—peer-to-peer lending and equity crowd funding—licensed by the FMA. Providers are now offering both services.
- The NZX's proposed stepping-stone market for emerging firms (NXT), registered as a market.
- Issuers using the exemptions providing streamlined processes for "same class" offers, making it easier to raise further capital.

Further information is available on the New Zealand FMA website.

1.10 Draft regulation for enhanced register of financial advisers

On 27 November 2014, the Australian Treasury published an exposure draft of a regulation aimed at enhancing information available about financial advisors.

According to the Treasury, an enhanced register of financial advisers will enable consumers to verify that their adviser is appropriately authorised to provide advice and find out more information about their adviser before receiving financial advice. The register will also give employers greater ability to assess new financial advisers and improve the Australian Securities and Investments Commission's (ASIC) ability to identify and monitor all financial advisers.

The Exposure Draft - Corporations Amendment (Register of Relevant Providers) Regulation 2014 (the Draft Regulation) is proposed to make a number of amendments to the Corporations Regulations 2001 (Cth) to:

- enable ASIC to establish and maintain a public register of financial advisers; and
- have Australian Financial Service licensees collect and provide information to ASIC concerning financial advisers that operate under their licence.

On 1 December 2014, Acting Assistant Treasurer Mathias Cormann released further information to clarify that as of March 2015, the register of financial advisers will include:

- the adviser's name, registration number, status, and experience;
- the adviser's qualifications and professional association memberships;
- the adviser's licensee, previous licensees/authorised representatives and business name;
- what product areas the adviser can provide advice on;
- any bans, disqualifications or enforceable undertakings; and
- details around ownership of the financial services licensee and disclosure of the ultimate parent company where applicable.

The Draft Regulation and an accompanying explanatory statement and consultation note are available on the Treasury website.

1.11 Parliamentary report on ASIC and the Takeovers Panel

On 26 November 2014, the Parliamentary Joint Committee on Corporations and Financial Services published its report *Statutory Oversight of the Australian Securities and Investments Commission, the Takeovers Panel and the Corporations Legislation*.

The matters dealt with in the report include:

- oversight of the Takeovers Panel
- trends in the matters dealt with by the Takeovers Panel
- proposals for reform of the Takeovers Panel
- ASIC's 2012-13 annual report
- ASIC's statement of expectations
- emerging issues
- penalties.

The report is available on the Parliamentary Joint Committee website.

1.12 IOSCO consults on cross-border regulation

On 25 November 2014, the International Organization of Securities Commissions (IOSCO) published the consultation report of the IOSCO Task Force on Cross-Border Regulation, which identifies and describes cross-border regulatory tools and challenges.

The consultation report describes three cross-border regulatory tools that have been used, or are under consideration, by IOSCO members to help address the challenges they face in protecting investors, maintaining market quality and reducing systemic risk. These tools provide the basis for developing a cross-border regulatory toolkit and common terminology describing potential options for IOSCO members to consult when considering cross-border regulations. They can be broadly classified into three main types: National Treatment, Recognition, and Passporting.

The report also includes a detailed discussion of the key challenges and experiences faced by regulators in implementing cross-border securities regulations, including how their national rules will apply to global financial markets and interact with foreign rules and international standards.

The consultation report is available on the IOSCO website.

1.13 Corporations Amendment (Mutual Recognition of Securities Offers) Regulation 2014

On 24 November 2014, the Corporations Amendment (Mutual Recognition of Securities Offers) Regulation 2014 (Cth) (which amends the Corporations Regulations 2001 (Cth)) was tabled in the Senate and the House of Representatives.

According to the explanatory memorandum, the purpose of the amending Regulation is to ensure the continued effectiveness of the *2006 Agreement Between the Government of Australia and the Government of New Zealand in relation to Mutual Recognition of Securities Offerings* (the Mutual Recognition Agreement), in light of changes to New Zealand law, and transitional provisions provided to New Zealand issuers of securities.

Specifically the amending Regulation makes a number of amendments, including to:

- amend a number of sections that relate to "recognised offers" to update references as a consequence of the replacement of the Securities Act 1978 (NZ) with the Financial Markets Conduct Act 2013 (NZ) (the New NZ Act);
- provide for elements of the New NZ Act concerning the offering and governance of financial products to come into effect on 1 December 2014, while also providing for issuers to continue to comply with the old regime in certain circumstances until 1 December 2016; and
  make other and related amendments.

Commencement details are contained in r. 2 of the Regulation. For further information please refer to the commencement information (subscribers only) on the Lawlex Legislative Alert & Premium Research service.

1.14 Senate disallows Government regulations amending the Future of Financial Advice legislation

On 19 November 2014, the Senate passed a motion disallowing the Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014 (Cth) (the Regulations), which were introduced by the government to amend the *Future of Financial Advice* reforms (FOFA). ASIC stated (19 November 2014) that it will "take a practical and measured approach to administering the law as it now stands" and "will work with Australian financial services licensees, taking a facilitative approach until 1 July 2015" following the disallowance of the Regulations. This is because "as a result of the change to the law that applies to the provision of financial advice—many Australian financial services (AFS) licensees will now need to make systems changes.

ASIC recognises this issue may arise in particular areas, including fee disclosure statements and remuneration arrangements".

Changes resulting from the disallowance include that:

- The opt-in requirement in respect of ongoing fee arrangements entered into after 1 July 2013 has been restored with the disallowance of the Regulations. Financial services providers are again required to provide a renewal notice to a client in relation to an ongoing fee arrangement under s. 962K of the Corporations Act 2001 (Cth).
- Regulation 7.7A.8 provided that fee disclosure statements need not be provided to clients in relation to an ongoing fee arrangement entered into before 1 July 2013. The disallowance of the Regulations means that these clients will now need to be provided with fee disclosure statements.

On 26 November 2014, Acting Assistant Treasurer Mathias Cormann announced that the government has agreed with the federal parliamentary opposition that a revised regulation to progress the broadly supported elements of the disallowed Regulations be re-made by the government before the end of this year.

The agreement provides that the following specific elements of the government's amendments, which were disallowed on 19 November 2014, will be able to be re-made in a new regulation:

- amendments to the grandfathering provisions that will address unintended consequences, and facilitate competition in the financial advice industry, by enabling advisers to move licensees with their clients while continuing to receive grandfathered remuneration;
- amendments to the training and education provisions that specify that benefits in relation to education and training that relate to conducting a financial services business are not conflicted remuneration;
- amendments to the stamping fee provisions that clarify its application to capital raising activities and broaden its application to include investment entities;
- amendments to the accountants' certificate renewal period to provide that the extended two year renewal period also applies in relation to FOFA; and
- amendments to the brokerage-related provisions of FOFA to extend the provisions to products traded on the ASX24.

Further information is available Parliament of Australia website.

1.15 Study of corporate governance requirements in 25 countries

On 19 November 2014, KPMG Singapore and the Association of Chartered Certified Accountants published a study analysing the corporate governance (CG) requirements in 25 countries in terms of the clarity, degree of enforceability and number and type of instruments used by the different markets. The study did not examine levels of adoption by companies of these requirements.

A wide divergence in CG requirements was observed among the 25 markets. Six of the ten highest scorers are developed markets. In terms of economic zones, the "Rest of the World" grouping comprising the UK, the United States, Australia, Hong Kong, Taiwan, the Republic of Korea, the United Arab Emirates, New Zealand, Canada and Japan were found to have, on average, better defined CG requirements. This grouping was closely followed by the BRICS—Brazil, Russia, India, China and South Africa—with ASEAN lagging behind.

The study found that the most frequently mentioned CG requirements related to OECD principles. A majority—16 out of the 25 countries studied—have adopted more than 80% of the OECD-related principles.

The study also identified an additional 32 areas of better practice requirements, including risk governance and board diversity that were not captured in the OECD Principles.

The study is available on the KPMG Singapore website.

1.16 SEC adopts rules to strengthen the technology infrastructure of securities markets

On 19 November 2014, the United States Securities and Exchange Commission (SEC) voted to adopt new rules designed to strengthen the technology infrastructure of the US securities markets. The rules—together comprising Regulation Systems Compliance and Integrity (Regulation SCI)—impose requirements on certain key market participants intended to reduce the occurrence of systems issues and improve resiliency when systems problems do occur.

Under Regulation SCI, self-regulatory organisations, certain alternative trading systems, plan processors, and certain exempt clearing agencies will be required to have comprehensive policies and procedures in place for their technological systems. The rules also provide a framework for these entities to, among other things, take appropriate corrective action when systems issues occur; provide notifications and reports to the SEC regarding systems problems and systems changes; inform members and participants about systems issues; conduct business continuity testing; and conduct annual reviews of their automated systems.

The rules are available on the SEC website.

1.17 Report on combating financial fraud

On 17 November 2014, the Center for Audit Quality published a report examining ways to combat financial fraud. The report, titled *The Fraud-Resistant Organization: Tools, Traits, and Techniques to Deter and Detect Financial Reporting Fraud*, examines best practices for fraud deterrence and detection, highlighting the critical importance of collaboration on this issue between and among the key players in the financial reporting supply chain.

The report provides information about the conditions that might make an organisation more susceptible to fraud-and how to mitigate those conditions.
The report identifies three central themes that are critical to fraud deterrence and detection-strong "tone at the top", scepticism, and robust communications-and explains how financial supply chain participants can incorporate these important traits into their efforts and their organisations.

The report is available on the Center for Audit Quality website.

1.18 IOSCO consults on post-trade transparency in the credit default swaps market

On 17 November 2014, the International Organization of Securities Commissions (IOSCO) published a consultation report titled *Post-Trade Transparency in the Credit Default Swaps Market*, which analyses the potential impact of mandatory post-trade transparency in the credit default swaps (CDS) market.

The report's analysis is based on a review of relevant works of international standard-setting bodies and academic literature and an examination of publicly available transaction-level post-trade data about CDS transactions before and after the introduction of mandatory post-trade transparency in certain CDS markets in the United States. IOSCO also conducted a survey of market participants and other market observers regarding their use of certain publicly available post-trade data and its perceived impact on the market.

IOSCO reached a preliminary conclusion that the data does not suggest that this introduction of mandatory post-trade transparency had a substantial effect on market risk exposure or market activity for those CDS products. It believes that greater post-trade transparency in the CDS market would be valuable to market participants and other market observers, and encourages each of its members to take steps to enhance post-trade transparency in the CDS market in its jurisdiction.

CDS are contracts that transfer the credit risk of a reference entity or instrument from a buyer of credit protection to a seller of credit protection. The Bank for International Settlements estimates that gross notional amounts of outstanding CDS at end-2013 were approximately US$21 trillion. IOSCO believes that improving transparency in this market will increase the efficacy of the G20 commitments to reform the OTC derivatives markets.

The consultation report is available on the IOSCO website.

1.19 Draft Corporations Amendment (Remuneration Disclosures) Regulation

On 17 November 2014, the Australian Treasury published an exposure draft of a proposed amendment to the Corporations Regulations 2001 (Cth) (the Corporations Regulations) dealing with remuneration disclosure.

The Corporations Regulations identify remuneration information relating to transactions between key management personnel, or related parties that exert control or influence, and the listed entity, required for inclusion in the Remuneration Report.

The Corporations and Related Legislation Amendment Regulation 2013 (No. 1) 2013 (Cth) amended the Corporations Regulations to include prescribed details relating to the remuneration disclosures associated with key management personnel to replace the accounting standard *AASB 124 - Related Party Disclosures*.

A number of inconsistencies have been identified since this Regulation was made that may increase the complexity of remuneration disclosures borne by business. Therefore, the proposed amendments aim to address these inconsistencies and streamline the reporting requirements.

The amendments proposed to be made to the Corporations Regulations include:

- limiting disclosure of equities that relate to the disclosing entity to reduce the unintended burden of requiring disclosure on all equity holdings;
- requiring certain remuneration disclosures to be separated into classes of equity instruments in order to increase the usefulness of the information; and

- clarifying the scope of the disclosures in relation to certain limited-recourse loans to ensure that the scope of disclosures is consistent with accounting practices.

The exposure draft and explanatory statement are available on the Treasury website.

1.20 Financial Stability Board, IOSCO and IMF reports to G20 summit on progress in financial reforms

The G20 Leaders met in Brisbane Australia on 15 and 16 November 2014. Issues dealing with financial reforms were discussed. In advance of the meeting, the Financial Stability Board (FSB), the International Organization of Securities Commissions (IOSCO), and the International Monetary Fund (IMF) published a series of documents that were presented to the G20 Leaders:

(a) FSB documents

- a letter from the FSB Chair to the G20 Leaders, reporting on progress in financial reforms and highlighting the major issues for the attention of Leaders, with an attached dashboard summarising the status of implementation by FSB member jurisdictions on priority reform areas;
- a report to the G20 on the FSB's review of the structure of its representation;
- a progress report setting out the FSB's approach to transforming shadow banking into resilient market-based financing to date, and a roadmap for further work in 2015 presented to the G20 for endorsement; and
- an overview report on progress in the implementation of the financial reforms in order to strengthen financial stability.

In his letter, the FSB chair makes four points. First, the task of agreeing measures to fix the fault lines that caused the global financial crisis is now substantially complete. Second, the endorsement by G20 Leaders of proposals to end "Too Big To Fail" in the banking sector will be a watershed. Once implemented, these agreements will play important roles in enabling globally systemic banks to be resolved without recourse to public subsidy and without disruption to the wider financial system. Third, as the FSB enters the next phase of financial reform, it will adjust focus towards addressing new and constantly evolving risks and vulnerabilities. Many of these risks arise from outside the core of the financial system. Fourth, the FSB seeks the support of G20 Leaders to promote a system based on mutual trust and co-operation to help maintain an open global financial system.

The shadow banking report summarises progress in the two-pronged strategy to address the fault lines that contributed to the global financial crisis and to build safer, more sustainable sources of financing for the real economy:

the creation of a system-wide monitoring framework to track developments in the shadow banking system with a view to identifying the build-up of systemic risks and initiating corrective actions where necessary; and
· the development of policy measures in five areas where oversight and regulation need to be strengthened to reduce excessive build-up of leverage, as well as maturity and liquidity mismatching in the system.

The following additional reports on financial reforms that were submitted to the G20 Leaders have also been published:

- An FSB consultative document on the adequacy of loss absorbing capacity of global systemically important banks in resolution;
- An FSB consultative document on the cross-border recognition of resolution action;
- An FSB report on progress in reform of resolution regimes and resolution planning for global systemically important financial institutions;
- A report by the Basel Committee on Banking Supervision on reducing variability in banks' regulatory capital ratios;
- A report by the International Association of Insurance Supervisors on the basic capital requirements for global systemically important insurers; and
- A report by the Over-The-Counter Derivatives Regulators Group on cross-border implementation issues.

(b) IOSCO reports

IOSCO has published two reports that were presented to the G20 Leaders. The reports set out the preliminary findings of reviews in the following areas:

- peer review of implementation of incentive alignment recommendations for securitisation; and
- peer review of regulation of money market funds: Report of key preliminary findings.

(c) IMF report on global prospects and policy challenges

The International Monetary Fund (IMF) published a report that was presented to G20 Leaders on *Global Prospects and Policy Challenges*.

According to the IMF, an uneven and brittle global recovery continues, despite setbacks this year. With world growth in 2014 worse than expected, global growth forecasts have been lowered to 3.3% for 2014 and to 3.8% in 2015. Supportive financial conditions, moderating fiscal consolidation, and strengthening balance sheets should sustain the recovery in the remainder of 2014 and into 2015. Overall, slow growth highlights the importance of G20 commitments to raise global growth.

Downside risks remain significant. Heightened geopolitical tensions and potential corrections in financial markets, including due to monetary policy normalisation, are the main short-term risks. Other risks are low inflation/deflation in the euro area and low potential growth.

Policy priorities are as follows:

- Advanced economies should keep accommodative monetary policies, given still large output gaps and very low inflation. Reflecting the uneven recovery, challenges are becoming increasingly different across major central banks. While monetary policy normalization will be coming to the forefront in the United States and the United Kingdom, accommodative monetary policy in the euro area and Japan should continue to fight low inflation. To prevent premature monetary tightening, macro-prudential tools to mitigate financial stability risks-for example, in the housing market-should be the first line of defence. Fiscal consolidation should continue to balance fiscal sustainability and growth within credible medium-term plans.
- In emerging economies the focus of macroeconomic policies should remain on rebuilding buffers and addressing vulnerabilities, in preparation for an environment characterised by tighter external financing conditions and higher volatility.
- A higher priority should be placed on growth enhancing structural reforms across G20 economies. Some countries with protracted current account surpluses should focus on boosting domestic demand or modifying its composition. Further labor and product market reforms are needed in much of the euro area. In a number of euro area countries severely affected by the crisis and emerging economies with protracted current account deficits, there is a need for reforms which increase competitiveness, together with wage moderation.
- Finally, in economies with clearly identified needs and economic slack, current conditions are favourable for increasing infrastructure investment. However, while this would support economic development, efficiency of the investment process is important to maximize the growth dividend.

The report is available on the IMF website.

1.21 Australian boards of directors - composition and pay

On 14 November 2014, the Australian Council of Superannuation Investors (ACSI) released its latest study of *Board Composition and Non-Executive Director Pay in Top 200 Companies: 2013*.

The following are the highlights:

(a) Gender diversity

Diversity on boards continued to steadily improve, with women accounting for nearly 20% of all ASX 100 board seats and 17.4% of all ASX 100 directors. In the ASX 101-200 the proportion of board seats held by women was lower, but also continued to improve with women holding just over 12% of all board seats in 2013 compared to 9.9% in 2012 and accounting for 11.4% of the director pool, up from 9.6% in 2012.

(b) Directors' share ownership

This study for the first time includes an analysis of directors' share ownership in each of the companies they govern. This revealed that nearly 11% of ASX 100 directors and 19% of ASX 101-200 directors (predominately non-executive directors) had no shares in the companies that they oversaw.

For the ASX 100 sample, the total personal interest of the 646 directors who filled the 771 board seats sample was approximately $22.4 billion and was dominated by 33 founding directors whose personal interests totalled $21.03 billion.

Individual share ownership across the entire S&P/ASX 200 sample ranged from $0 to $5.77 billon (Crown Resorts' James Packer) with executives and founding directors (including directors who are members of the founding family) generally having a much larger personal stake than non-executive directors who were not founders or substantial shareholders.

(c) New director appointments

The number of new appointments to ASX 100 boards fell, with 72 board seats filled by 69 directors during the sample period compared to 108 board seats in 2012. Conversely, in the ASX 101-200, the number of new appointments increased from just 50 in 2012 to 61 in 2013, filled by 59 directors. This included 52 directors in the ASX 100 (12 females) and 46 directors in the ASX 101-200 (six females) that were classified as new entrants to the director pool.

These appointments were predominately to non-executive roles, but included 14 executive appointments in the ASX 100 and 13 in the ASX 101-200 cohort. There was only one instance of a vacancy created by a CEO departing a role at an S&P/ASX 200 company to take up a role at another ASX listed company - the CEO of Wotif

Holding, an ASX 101-200 company taking up the role of CEO of Tatts Group, a ASX 100 company.

(d) Director fees

Average fees for ASX 100 non-executive directors fell slightly to $215,662 compared to $218,434 in 2012 as did non-executive chairperson fees which fell from $481,451 to $477,266. In the ASX 100 the two highest paid non-executive chairs—who each received fees of over $1 million—continued to be the chairs of Rio Tinto and BHP Billiton.

In the ASX 101-200 average fees continued to increase, rising to $138,260 for a non-executive director (2012: $134,981) and $231,952 (2012: $225,534) for a non-executive chairperson. The highest paid director in this cohort, and the entire sample, was the Sirius Resources chair whose disclosed remuneration was $2.7 million, which included an options valuation of $2.6 million.

(e) Age

For the first time in the history of the ACSI study the average age of ASX 100 directors fell in 2013, from 62.9 in 2012 to 62.1. This fall reflected declines in the average age of female and male non-executive directors although the average age for the sample remained above the 2011 average of 61 years.

The report is available on the ACSI website.

1.22 Review of the OECD Corporate Governance Principles

On 14 November 2014, the OECD announced a review of its Principles of Corporate Governance. The Principles of Corporate Governance are intended to assist governments and regulators in their efforts to evaluate and improve the legal, regulatory and institutional framework for corporate governance. They also provide guidance for stock exchanges, investors, corporations and others that have a role in the process of developing good corporate governance. The objective of the Principles is to contribute to economic efficiency, sustainable growth and financial stability. The rationale for the review is to ensure the continuing high quality, relevance and usefulness of the Principles taking into account recent developments in the corporate sector and capital markets. The Principles are one of the key standards for sound financial systems of the Financial Stability Board and the basis for the corporate governance component of the Report on the Observance of Standards and Codes of the World Bank.

The Principles cover six areas:

- ensuring the basis for an effective corporate governance framework;
- the rights and equitable treatment of shareholders and key ownership functions;
- institutional investors, stock markets and other intermediaries;
- the role of stakeholders in corporate governance;
- disclosure and transparency; and
- the responsibilities of the board.

The 2014 draft of the Principles is available on the OECD website.

1.23 M&A in Australia: 2014 study

In November 2014, the International Institute for the Study of Cross-Border Investment and M&A published a study of M&A in Australia.

The highlights are:

- the Australian public M&A market has seen a resurgence in deal activity over the 12 months to 30 June 2014;
- the resurgence has been particularly strong in large transactions;
- FY2014 also saw an increase in competitive bid scenarios;
- overall, success rates for transactions remained relatively steady at 64% in FY2014, up from 63% in FY2013;
- success rates were notably higher for transactions announced with the support of the target board, and where the bidder already had a stake in the target when they announced their bid; and
- levels of inbound cross-border public M&A activity continued to decrease with 39% of bidders in FY2014 being based offshore, down from 42% in FY2013, 46% in FY2012 and 51% in FY 2011. However, foreign bidders were particularly active at the top end of the market representing 69% of bidders for targets worth more than $1 billion.

Further details of the study are available on the International Institute website.

1.24 Latest Centre for Corporate Law and Securities Regulation research papers (Conflicted directors: What is required to avoid a breach of duty?; Defining and profiling phoenix activity; Behavioural law and economics: Regulatory reform of consumer credit and consumer financial services; Worker and shareholder protection in six countries: A longitudinal analysis)

The following are the most recent research papers authored by members of Melbourne Law School's Centre for Corporate Law and Securities Regulation.

(a) Conflicted directors: What is required to avoid a breach of duty? (by Rosemary Teele Langford and Ian Ramsay)

Directors with a conflict of interest or conflict of duties may be subject to different requirements. These include disclosure of the conflict, disclosure of further information relevant to the particular transaction and taking positive action to protect the company's interests, which may include the director preventing the transaction from proceeding. The authors analyse the relevant case law to identify the factors that lead to courts imposing these requirements. They show that the cases are best analysed as a continuum of required action, with increased action by the director being required where the company needs protection and the director is in the best position to take protective action. The authors also demonstrate that the relevant duty under which these requirements are imposed varies, with duties such as the duty to act in good faith in the interests of the company and the duty of care applying in addition to the duty to avoid conflicts.

The paper is available here.

(b) Defining and profiling phoenix activity (by Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers)

Phoenix activity occurs where the business of a failed company is transferred to a second (typically newly incorporated) company and the second company's controllers are the same as first company's controllers. Phoenix activity can be legal as well as illegal. Phoenix activity has become a significant concern for governments because of the number of individuals promoting illegal phoenix activity, the significant loss of tax revenue it causes, and the recognition of the potentially devastating impact it has on creditors and employees.

A key problem faced by regulators is the difficulty associated with identifying whether particular phoenix activity is illegal or not. This report (which forms part of a larger research project) profiles the characteristics of both legal and illegal phoenix activity to assist regulators in formulating education, detection, and enforcement strategies. The report examines the various historical attempts to define phoenix activity and then identifies the following five categories of phoenix activity and provides examples: (1) the legal phoenix or business rescue; (2) the problematic phoenix; (3) illegal type 1 phoenix: intention to avoid debts formed as company starts to fail; (4) illegal type 2 phoenix: phoenix as a business model; and (5) complex illegal phoenix activity.

The report also examines the role of professional advisors in facilitating illegal phoenix activity, the victims of illegal phoenix activity (including governments, unsecured trade creditors and employees) and two industries (the building and construction industry and the financial services industry) where illegal phoenix activity has been identified as a particular concern.

The research report is available here.

(c) Behavioural law and economics: Regulatory reform of consumer credit and consumer financial services (by Paul Ali, Ian Ramsay and Cate Read)

The authors examine the influence of behavioural research upon economic policy-making, as it relates to the regulation of consumer credit and consumer financial services. Using the examples of credit cards in the United States and Australia, and retirement savings' infrastructure in the United States, New Zealand and Australia, they investigate the impact of "nudging" upon regulation in these areas, and the degree to which such policies are capable of substantive change without the support of mandatory measures, and other forms of targeted regulation. They conclude that nudging, alone, is not sufficient to achieve effective regulatory reform, and that other policies recommended by behavioural economics, such as mandatory measures and other forms of targeted regulation, are also required to achieve durable change in consumer behaviour. In light of this conclusion, they suggest that "nudging" is best viewed as a regulatory supplement, or one of a range of regulatory tools, and that more attention should be focussed on the full range of behavioural law and economics regulatory reform recommendations, especially in the areas covered by the paper.

The paper is available here.

(d) Worker and shareholder protection in six countries: A longitudinal analysis (by Peter Gahan, Ian Ramsay and Michelle Welsh)

In this paper the authors utilise leximetric analysis, which involves the numerical coding of the strength of formal legal protections, to document changes in the level of worker protection and shareholder protection in six countries (Australia, France, Germany, India, the United Kingdom and the United States) for the period 1970–2005. Both worker and shareholder protection increased in five of the six countries and in the sixth country (Australia) shareholder protection increased and the level of worker protection in 2005 was similar to the level of protection in 1970. The results of statistical tests show that increased formal legal protection for shareholders is not obtained at the expense of formal protection for workers. Implications of this finding are explored by the authors.

The paper is available here.

1.25 2015 Corporate Law Teachers Conference

Melbourne Law School, in association with the Centre for Corporate Law and Securities Regulation, will host the Corporate Law Teachers Association's (CLTA) annual conference in Melbourne. The conference will run from Sunday 1 February 2015 to Tuesday 3 February 2015.

The theme of the 2015 conference is *Corporate law: local and global dimensions*. Over 60 papers will be presented at the conference. The keynote speaker is Professor Bob Thompson of Georgetown Law School. There are two panel sessions. The first is on empirical research in corporate law and corporate governance. The second is a panel of Federal Court and Supreme Court judges. There is also a session focussed on teaching corporate law on the afternoon of Sunday 1 February 2015.

Registrations details are available on the Centre for Corporate Law website.

2. Recent ASIC Developments

2.1 ASIC class order clarifies fee and cost disclosure requirements

On 12 December 2014, following a review of fee disclosure practices, ASIC released Class Order [CO 14/1252] clarifying key fee and cost disclosure requirements for Product Disclosure Statements (PDSs) and periodic statements for superannuation and managed investment products.

The class order, which ASIC consulted on in September 2014, addresses:

- disclosure of costs of investing in interposed vehicles
- disclosure of indirect costs
- removal of doubt that double counting of some costs for superannuation products is not required, and
- the appropriate application of the consumer advisory warning.

The class order will apply to all PDS for superannuation and managed investment products from 1 January 2016. It will also apply to periodic statements that must be given for these products by 1 January 2017 or later.

Consultation on Regulatory Guide 97

As indicated in Report 398 - Fee and cost disclosure: Superannuation and managed investment products (July 2014) (REP 398) ASIC has also commenced a review of Regulatory Guide 97 - Disclosing fees and costs in PDSs and periodic statements (November 2011) (RG 97) to reflect the effect of the Stronger Super reforms and the class order.

2.2 Findings from review of 30 June 2014 financial reports

On 12 December 2014, ASIC announced the results from its review of the 30 June 2014 financial reports of 300 listed and other public interest entities.

Following the review, ASIC has made enquiries of 55 entities on 73 matters seeking explanation of their accounting treatments. The largest number of inquiries and findings continue to relate to inadequate asset impairment and inappropriate accounting treatments. ASIC's risk-based surveillance of the financial reports of public interest entities for reporting periods ended 30 June 2010 to 31 December 2013 has led to material changes to 4% of the financial reports of public interest entities reviewed by ASIC.

Further information on ASIC's findings is available on the ASIC website.

2.3 Consultation on proposals to remake "sunsetting" class orders

On 11 December 2014, ASIC published two consultation papers proposing to remake a number of class orders that are due to expire (or "sunset") in 2015 and 2016. ASIC proposes to remake these class orders without significant changes before they sunset so that their ongoing effect will be preserved without any disruption to the entities who rely on them.

Under the Legislative Instruments Act 2003 (Cth), all class orders are repealed automatically or "sunset" after a specified period of time (mostly ten years) unless ASIC takes action to exempt or preserve them. This ensures that legislative instruments like class orders are kept up to date and only remain in force while they are fit for purpose and relevant.

(a) Class orders on secondary services and general advice

The class orders are on:

- relief relating to general advice warnings in advertisements (Class Order [CO 05/835] on general advice in advertising), due to sunset on 1 October 2015;
- relief permitting a simplified warning for oral general advice (Class Order [CO 05/1195]), due to sunset on 1 April 2016; and
- Financial Services Guide (FSG) relief for secondary services, financial services provided to a retail client via an intermediary. The relief applies to experts and persons arranging for the issue of a financial product (Class Order [CO 04/1572] - Secondary Services: Financial Services Guide relief for experts and Class Order [CO 04/1573] - Secondary Services: Financial Services Guide relief for arrangers acting under an intermediary authorisation). These class orders are due to sunset on 1 April 2016.

Consultation Paper 226 - Remaking ASIC class orders on secondary services and general advice (December 2014) (CP 226) outlines the changes ASIC is proposing to make to these class orders, including:

- updating the name, format, legislative references and definitions;
- simplifying the drafting to give greater clarity and correct minor drafting errors;
- removing obsolete paragraphs; and
- updating the class order on general advice in advertising to encompass contemporary forms of advertising.

(b) Class orders facilitating offers by foreign companies

ASIC proposes to remake class orders that facilitate Australian investors participating in scrip offers on the same basis as foreign investors where adequate safeguards are in place. The relief applies to certain rights issues, schemes of arrangement, scrip bids and small scale personal offers.

Consultation Paper 225 - Remaking ASIC class orders on offers of foreign securities (December 2014) (CP 225) outlines proposals to update these class orders with minimum amendments so that they better reflect the current law, and also make changes aimed at reducing regulatory requirements, including:

- removing requirements to lodge offer documents with ASIC for foreign rights issues;
- reducing the quotation requirement for foreign rights issues from 36 months to three months; and

- allowing offer documents to be in a foreign language (if no English version is available).

ASIC's policy on offers of foreign securities is set out in Regulatory Guide 72 - Foreign securities prospectus relief (June 2009) (RG 72). There are no changes to this policy but ASIC is seeking feedback on its proposal to update RG 72 to reflect changes to the class orders.

(c) Background to relief on class orders facilitating offers by foreign companies

The Corporations Act 2001 (Cth) (the Corporations Act) requires a prospectus or Product Disclosure Statement for an offer of securities or interests that is received in Australia (unless an exemption applies). ASIC has given conditional relief from these disclosure requirements where a foreign entity makes a relatively small number of offers in Australia.

The relief allows Australian investors to participate in offers that might not otherwise be extended to them because of the time and expense involved in complying with regulatory requirements in multiple jurisdictions. The relief is subject to conditions to ensure adequate safeguards are in place. For example, much of the relief applies where the foreign securities are quoted on an approved foreign market.

The relief applies to:

- rights issues where the foreign company is listed on an approved foreign market and the securities are in the same class as those already held by Australian investors: Class Order [CO 00/183] - Foreign rights issues;
- foreign scrip takeovers where the bid class securities are quoted on an approved foreign market: Class Order [CO 09/68] - Prospectus and PDS relief for foreign scrip takeovers;
- scrip schemes of arrangement where the scheme is regulated in Hong Kong, Malaysia, New Zealand, Singapore, South Africa or the United Kingdom: Class Order [CO 07/9] - Prospectus relief for foreign schemes of arrangement and PDS relief for Pt 5.1 schemes and foreign schemes of arrangement;
- foreign entities making 20 or fewer offers in Australia in 12 months where the entity is listed on an approved foreign market: Class Order [CO 00/214] - Foreign securities: listed foreign companies making 20 or fewer offers in Australia in 12 months; Class Order [CO 02/263] - Foreign interests in a managed investment scheme traded on an approved foreign exchange: 20 or fewer offers in Australia in 12 months;
- advertising and other notices relating to foreign securities aimed at a foreign market and only incidentally published in Australia: Class Order [CO 00/178], Class Order [CO 00/179], Class Order [CO 00/180], Class Order [CO 02/144] and Class Order [CO 02/150] on foreign securities: publishing of reports and notices.

ASIC proposes to allow only a couple of related class orders to sunset having formed the view this relief is not useful or often relied on. These class orders are Class Order [CO 00/181] - Foreign securities: publishing of notices and reports and Class Order [CO 00/185] - Foreign securities. CP 225 asks for feedback on whether these class orders should be allowed to sunset.

2.4 ASIC consultation to encourage more electronic disclosure

On 14 November 2014, ASIC published a consultation paper seeking feedback on proposals to make it easier for businesses to deliver financial services disclosures electronically while preserving choice for consumers. ASIC's proposals also encourage the use of more innovative formats for Product Disclosure Statements.

Consultation Paper 224 - Facilitating electronic financial services and disclosures (November 2014) (CP 224) is aimed at enhancing investor engagement with disclosure.

ASIC is consulting on updates to Regulatory Guide 221 - Facilitating online financial services disclosures (December 2010) (RG 221) to reflect these proposals and to remove uncertainty about the circumstances in which electronic communications can be used.

CP 224 is available on the ASIC website.

2.5 Further guidance on superannuation forecasts

On 13 November 2014, ASIC issued further guidance relating to superannuation forecasts to assist superannuation fund trustees to provide their members with retirement estimates. The changes will allow a superannuation fund to include an estimate of the age pension which might be available to the member along with the member's superannuation benefit at retirement. The changes are to ASIC's existing relief for retirement estimates. These estimates help members to engage with their superannuation.

Regulatory Guide 229 - Superannuation forecasts is available on the ASIC website.

3. Recent ASX Developments

3.1 ASX completes investment in Yieldbroker

On 28 November 2014, ASX completed its acquisition of a 49% shareholding in Yieldbroker for a total of $65 million. Yieldbroker is a leader in electronic trading in the Australian over-the-counter (OTC) debt and interest rate derivatives markets.

ASX's proposal to make the investment was announced to the market on 18 September 2014. The investment makes ASX a shareholder in Yieldbroker alongside ANZ, CBA, Citi, Deutsche Bank, JP Morgan, Macquarie, NAB, Royal Bank of Canada, Royal Bank of Scotland, Toronto Dominion, UBS and Westpac, who will remain equal shareholders. ASX's 49% stake is non-controlling and Yieldbroker remains independently managed. The investment is funded from ASX's existing cash and is expected to be broadly EPS neutral in the first full-year.

The media release is available here.

3.2 ASX Clear long-term "AA-" S&P rating outlook

In November 2014, S&P assigned an "AA-" long-term and "A1+" short-term credit rating to ASX Clear Pty Limited. The rating outlook on the long-term issuer credit rating is stable. These ratings are consistent with the ratings announced in February 2014 obtained for ASX Limited and ASX's derivatives clearing house, ASX Clear (Futures). The three ratings confirm ASX's position as one of the highest quality exchange groups in the world.

The media release explaining this rating is available on the ASX website.

3.3 ASX signs Heads of Agreement with Bank of China to expand cooperation in RMB

The Australian Securities Exchange (ASX) and Bank of China have signed a Heads of Agreement to expand their strategic cooperation to develop the Renminbi (RMB) as a currency in Australia's financial markets. This follows the appointment of the Bank of China as the official RMB clearing bank in Australia by the People's Bank of China, China's central bank.

ASX and Bank of China launched an RMB settlement service in Australia in July 2014. This service allows Australian companies to pay and receive RMB in near real-time and in the same way as they transact in Australian dollars, reducing their risk and the cost of doing international business. By signing the Heads of Agreement ASX and the Bank of China commit to explore opportunities that will expand the role of the RMB in financial markets.

The media release is available on the ASX website.

3.4 Introduction of ASX Pack and Bundle Products on 90 Day Bank Bill Futures

On 1 December 2014, ASX launched Pack and Bundle product functionality applicable to the 90 Day Bank Bill Futures (ASX 24 code: IR).

A Pack product is a futures strip that enables participants to trade four successive Bank Bill Futures contract months as a single average price without legging risk inherent with trading each Bank Bill Futures contract separately. Similarly, a Bundle will enable participants to trade all successive Bank Bill contracts in the next two or three years.

Packs and Bundles will be available on the ASX 24 trading platform, ASX Trade24, with each product allocated its own ASX 24 code with no pricing interaction with the underlying Bank Bill Futures contract. Participants will be allocated underlying IR futures contracts upon execution of a Pack or Bundle contract.

Key contract features (90 Day Bank Bill Futures - IR):

- Three Packs and two Bundles on the 90 Day Bank Bill Futures contract (IR)
- Minimum price increments of 0.005 basis points
- Pack and Bundle products are not cleared
- Underlying Bank Bill Future legs will be cleared at 0.005 basis point increments
- The last trading day will be one trading day prior to the last trading day of the expiring underlying 90 Day Bank Bill Futures spot contract.

A notice concerning these amendments is available on the ASX website.

3.5 Reports

On 3 December 2014, ASX released:

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

for November 2014.

4. Recent Takeovers Panel Developments

4.1 Yancoal Australia Limited - Declaration of unacceptable circumstances and orders

On 15 December 2014, the Takeovers Panel announced that it had made a declaration of unacceptable circumstances and final orders) in relation to an application dated 21 November 2014 by Senrigan Capital Management Ltd and Nicholas Taylor in relation to the affairs of Yancoal Australia Limited.

On 10 November 2014, Yancoal announced a *pro rata*, renounceable rights offer of 2.32112 Subordinated Capital Notes (SCNs) for every 100 Yancoal shares to raise up to approximately US$2.3 billion. Distributions on the SCNs are perpetually deferrable, non-compounding and within the control of Yancoal's board.

The issue price of the SCNs is US$100 per note. The SCNs will be initially convertible into Yancoal shares at a conversion price of US$0.10 per share. Yanzhou Coal Mining Company Limited (which holds approximately 78% of Yancoal) has committed to subscribe for its full entitlement of approximately US$1.8 billion of SCNs. Its commitment is dependent (among other things) on Yancoal committing to repay it and its subsidiaries US$1.8 billion in shareholder loans from the proceeds of the offering. If no other shareholders take up their rights, Yanzhou could acquire up to 98.8% of Yancoal by converting its SCNs into shares over time in reliance on the 3% creep exception to the takeovers prohibition.

The Panel considered that the circumstances were unacceptable. The Panel has made orders to the effect that Yanzhou can only convert any SCNs it holds to maintain (but not increase) the level of its voting power in Yancoal as at the date of the orders, unless it obtains approval from minority shareholders.

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

4.2 Celamin Holdings NL - Panel declines to make a declaration of unacceptable circumstances

On 4 December 2014, the Takeovers Panel announced that it had declined to make a declaration of unacceptable circumstances following additional disclosure by Celamin Holdings NL in response to an application dated 7 November 2014 from Psons Limited in relation to the affairs of Celamin.

On 4 November 2014, Celamin announced a 15 for 4 renounceable rights issue at an issue price of $0.01 per share to raise up to $8.8 million. Celamin also offered a shortfall facility to existing shareholders and external "sophisticated investor" applicants and its directors reserved full discretion to allocate shortfall shares.

Two of Celamin's largest shareholders and two of Celamin's directors agreed to act as sub-underwriters in an arrangement which fills their commitment in priority to other sub-underwriters. All sub-underwriters were entitled to receive one option for every two shares underwritten, or a cash equivalent if shareholders did not approve the issue of the options under ASX Listing Rule 7.1. If no other shareholders took up their entitlements, this could result in each of the two shareholder sub-underwriters increasing their shareholdings from approximately 12% to approximately 35%.

The Panel considered there was inadequate disclosure regarding:

- the way directors would exercise their discretion to allocate shortfall shares (and also had concerns about how the discretion was to be exercised);
- the fact that approval for conversion of the sub-underwriter options would be sought under item 7 of s. 611 (if required) independently of listing rule approval for the issue of the options and no cash equivalent would be payable if shareholders withheld item 7 approval; and
- the scenarios under which a shareholder would be diluted under the rights issue.

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

Celamin agreed, however, to provide further disclosure regarding the rights issue, which was released to ASX on 3 December 2014 and the Panel has therefore declined to make a declaration of unacceptable circumstances. Celamin has taken the view that the rights issue meets the requirements of item 10 of s. 611. The Panel makes no comment on this.

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

On 15 December 2014, the Panel announced that a review Panel had declined to conduct proceedings on an application dated 5 December 2014 from Psons Limited seeking a review of the initial Panel's decision. Psons submitted that there were issues that the initial Panel had not adequately considered. However, the review Panel considered that there was no reasonable prospect that it would come to a different conclusion to the initial Panel. Accordingly, the review Panel declined to conduct proceedings.

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

4.3 Wollongong Coal Limited - Panel declines to conduct proceedings

On 27 November 2014, the Takeovers Panel announced that it had declined to conduct proceedings on an application from Gujarat NRE India Pty Ltd (Controller Appointed) in relation to the affairs of Wollongong Coal Limited. The application concerned an entitlement offer by Wollongong announced on 4 November 2014.

The Panel concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances. It considered that the entitlement offer by Wollongong complied in most respects with the Panel's guidelines on minimising the control impact of a rights issue. However, the Panel noted, in particular, the discretion of the directors to allocate shortfall shares to applicants and directed Wollongong's attention to the importance of exercising that discretion in a way that facilitated an appropriate dispersion strategy. The Panel also noted (among other things) the time it took for the application to be made and the fact that shareholders are free to take up their entitlements and apply for shortfall shares. Accordingly, the Panel declined to conduct proceedings.

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

5. Recent Research Papers

5.1 Documenting the deal: How quality control and candour can improve boardroom decision-making and reduce the litigation target zone

This paper addresses what legal and financial advisors can do to conduct an M&A process in a manner that: (i) promotes making better decisions; (ii) reduces conflicts of interests and addresses those that exist more effectively; (iii) accurately records what happened so that advisors and their clients will be able to recount events in approximately the same way; and (iv) as a result, reduces the target zone for plaintiffs' lawyers.

The paper is available on the SSRN website.

5.2 Do small and large shareholders have a say on pay?

This paper investigates the voting patterns of shareholders on "Say On Pay" (SOP) for US publicly traded corporations, and the efficacy of vote outcomes on governing executive compensation. The authors find that small shareholders are more likely than large shareholders to use the non-binding SOP vote to govern their companies: small shareholders are more likely to vote for a more frequent annual SOP vote, and more likely to vote "against" SOP (i.e. to disapprove executive compensation). Further, the authors find that low support for management in the SOP vote is more likely to be followed by a decrease in excess compensation, and by a more reasonable selection of peer companies for determining compensation, when ownership is more concentrated. Hence, the non-binding SOP vote offers a convenient mechanism for small shareholders to voice their opinions, yet, larger shareholders must be present to compel the board to take action. Thus, diffuse shareholders are able to coordinate on the SOP vote to employ the threat that large shareholders represent to management.

The paper is available on the SSRN website.

5.3 Behavioural differences between founder CEOs and professional CEOs: The role of overconfidence

The authors provide evidence based on a sample of large S&P 1500 companies that founder chief executive officers (CEOs) are more overconfident than their non-founder counterparts (Professional CEOs). They approximate overconfidence via CEO tweets, CEO statements during earnings conference calls, management earnings forecasts, and CEO option-exercise behaviour. The authors find that, compared with Professional CEOs, founder CEOs use substantially more optimistic language in their tweets and in their statements during earnings conference calls. In addition, founder CEOs predict their firms' earnings to be significantly higher and are more likely to perceive their firms to be undervalued than professional CEOs, as implied by their option-exercise behaviour. Further, they find that the difference in overconfidence between founder CEOs and Professional CEOs is larger among more senior CEOs but smaller among CEOs who graduated from an elite school. Finally, the authors provide evidence that, to date, investors are unaware of the overconfidence bias among founders.

The paper is available on the SSRN website.

5.4 Director tolerance: Evidence from the appointments of outside directors who have fired CEOs

The authors study the impact of director tolerance on firm risk taking and board monitoring by examining new board appointments of outside directors who have previously fired a CEO. Firms with inadequate monitoring benefit from appointing such directors, as evidenced by improved performance and higher valuation when compared to matching firms. Further, these firms exhibit lower idiosyncratic risk, make less risky acquisitions, experience higher acquisition returns, and are more likely to withdraw bad deals and to replace poorly performing CEOs. They, however, tend to manage earnings when performance deteriorates. Taken together, director tolerance appears to influence managerial behaviour and shareholder wealth.

The paper is available on the SSRN website.

5.5 Board diversity and its effect on firm financial and non-financial performance

Legislators and regulatory bodies across the globe are mandating public disclosure of diversity or imposing quotas on board structure to enhance gender and ethnic diversity. In this research study, the authors investigate the impact of gender and board diversity on long-term firm financial performance and nonfinancial performance which is not addressed in prior studies. Using observations from 2003–2012, they find that a more gender and ethnically diverse board may enhance a firm's performance on social, environmental and governance dimensions but increasing board diversity does not necessarily result in better financial performance for the firm. Their findings are consistent with the arguments presented in the literature that boards with higher gender and ethnic diversity will be more sensitive to stakeholders other than just shareholders, hence enhancing a firm's non-financial performance. These findings suggest that improvement in non-financial performance dimensions may bring benefits to society, in general, and to the firm in the longer term.

The paper is available on the SSRN website.

5.6 Executive remuneration - A comparative overview

The authors analyse current trends in the regulation and practice of executive remuneration. No doubt, the role of regulation in this area is on the rise, particularly after the recent financial crisis, and the standards as to pay governance and structures are spreading from the financial sector to the non-financial one. As a consequence, today's remuneration practices are shaped not only by the need to reduce managerial agency costs at listed companies through appropriate incentives, but also by the hard and soft laws tackling corporate governance and remuneration structures. Moreover, regulation also responds to social issues and political pressures, reflecting concerns about either inequality in the distribution of wealth or incentives to undertake "excessive" risks in the financial sector. The authors examine, in particular, the main policy questions concerning incentive pay, including the optimal design of stock options and the importance of long term pay. Among the governance mechanisms, they consider both the role of boards and independent directors, and that of shareholders under say on pay rules, taking into account the rise of shareholder engagement in listed companies. They also analyse regulatory developments in Europe over the last decade and current post crisis proposals by the European Commission, comparing the same with developments at member state level and in the US. In particular, the authors highlight the impact of say on pay rules on shareholder activism, expanding on the role of proxy advisors and the behaviour of large institutional investors. They lastly focus on the regulation of pay structures, showing that long-term incentives are clearly favoured for both financial and non-financial companies by either regulators or institutional investors. However, financial institutions are the main target of post-crisis reforms, firstly at international level and secondly in the US and the EU, where the FSB principles have been implemented along partially diverging routes. CRD IV, in particular, has marked a new trend in the regulation of bankers' pay, by imposing a bonus cap that the authors criticise from an economic perspective and which clearly goes beyond the international principles.

The paper is available on the SSRN website.

5.7 Board interlocks and corporate governance

The authors argue that director interlocks, a phenomenon in which directors sit on more than one corporate board, ought to be an object of expanded discussion in corporate governance research and practice. Thus far, interlocks have attracted little attention from legal scholars, and when interlocks have received attention from regulators, it is usually negative. A growing body of evidence points to interlocks as having a significant role in governance propagation and evolution. Core governance practices, including ones that are closely monitored by professionals, propagate via interlocks. Interlocks are not purely channels for spreading information; they have a significant impact even in an informationally rich environment. Both bad and good governance practices propagate via interlocks, and overall board connectivity is associated with higher returns. Interlocks help explain similarities and variations in corporate governance. Drawing strong normative conclusions in light of the state of the literature would be premature. Instead, the authors summarise the literature on interlocks and governance, analyse how and why interlocks could matter for governance, and suggest that, at the very least, recognising interlocks as facilitating the diffusion of governance, and highly connected firms as potentially influential in setting governance practices, is important.

The paper is available on the SSRN website.

6. Recent Corporate Law Decisions

6.1 Successful application to strike out a defence of unclean hands

(By Cal Samson, Ashurst)

Sino Iron Pty Ltd v Palmer (No2) [2014] QSC 287, Supreme Court of Queensland, Jackson J, 26 November 2014

The full text of this judgment is available here.

(a) Summary

This decision arises from broader proceedings alleging a breach of trust by Mineralogy Pty Ltd (Mineralogy), a company controlled by Clive Palmer. The plaintiffs were successful in their application to strike out part of a defence which sought to raise the equitable defence of unclean hands.
Jackson J found that the allegations of breach of contract did not bear the necessary relationship to the equity sued for. It was accepted that some allegations of intention to apply illegitimate pressure could raise an arguable defence of unclean hands, even though the defendants were not parties to the contracts. His Honour found, however,

that these were not pleaded with sufficient particularity. The defendants were granted leave to re-plead the subject matter in an amended defence.

(b) Facts

The plaintiffs—Sino Iron Pty Ltd and Korean Steel Pty Ltd—are parties to royalty contracts and facility deeds relating to port facilities in Western Australia, with Mineralogy. An administrative fund was established by Mineralogy under the facility deeds for the payment of administration and other specific costs. Mineralogy was trustee of the administrative fund bank account. On 5 August 2013, Mineralogy made a payment of A$10 million to the second defendant, Cosmo Developments Pty Ltd (Cosmo). On 2 September 2013 Mineralogy made a payment of approximately A$2.2 million to another person. Both payments were made from the administrative fund bank account with cheques drawn by the first defendant, Mr Palmer.

In separate proceedings (see *Sino Iron Pty Ltd v Palmer* [2014] QSC 259), the plaintiffs claim that these payments were made in breach of trust and that Mr Palmer dishonestly procured, was involved in or assisted the breaches of trust. Further, they claim that Cosmo received the A$10 million payment knowing it was paid in breach of trust. These grounds are generally known as the first and second limbs of *Barnes v Addy*.

In this proceeding, the plaintiffs applied to strike out part of Mr Palmer's defence which sought to raise the equitable defence of unclean hands.

The defence relevantly alleged the following:

- the plaintiffs breached their obligations under the facility deeds and royalty contracts;
- the plaintiffs intended to deprive Mineralogy of the benefit of the facility deeds and royalty contracts, and used this to apply illegitimate pressure to Mineralogy;
- the purpose of commencing and continuing the proceedings was to apply illegitimate pressure to Mr Palmer.

The plaintiffs argued that the defendants were not parties to the facility deeds or royalty contracts, and that the alleged misconduct did not bear an immediate and necessary relationship to the relief sought.

The defendants claimed that they were not required to be parties to the agreements before the alleged misconduct could constitute unclean hands, noting that the first defendant is the controlling shareholder of Mineralogy and the second defendant is a wholly owned subsidiary of Mineralogy.

(c) Decision

Jackson J took as the starting point that the equity sued for against Mr Palmer was alleged liability as constructive trustee under the second limb of *Barnes v Addy* and the equity sued for against Cosmo was alleged liability to account as a constructive trustee under the first limb of *Barnes v Addy*.

His Honour found that the alleged breaches by the plaintiffs of the facility deeds and royalty contracts did not, by themselves, raise an arguable defence of unclean hands as they did not bear the immediate and necessary relationship to the equity sued for. Jackson J rejected the argument that a breach of contract by a plaintiff per se raises an arguable defence of unclean hands. The alleged deprivation by the plaintiffs of the benefit of the royalty contracts does not raise an arguable defence as Mineralogy has a right under common law to claim damages for breach of contract and any other accrued right to contractual royalty payments.

His Honour also found the use of the word "illegitimate" in the defence to be problematic as no facts were specifically alleged to explain how this was the case. Justice Jackson held that "it is not illegitimate for a beneficiary to make a claim for the restoration of a trust fund" established under a contract. A party continuing such a proceeding in accordance with the rules of court is not, by itself, able to constitute a defence of unclean hands.

The other allegations of illegitimate pressure were found to be more difficult. His Honour suggested that an arguable defence could be made out if the defendants could show "a deliberate course of conduct engaged in by the plaintiffs" repudiating the facility deeds and royalty contracts "both for the actual purpose of destroying Mineralogy and [Mr Palmer]". this was not, however, found to have been adequately pleaded: "the bare allegations of intention or purpose ... are not enough".

The plaintiffs' submission that the misconduct could not amount to clean hands because the defendants are not parties to the contract was rejected by Jackson J.

His Honour ordered the defendants to strike out the defence of unclean hands but granted leave to the defendants to re-plead the subject matter of that part of the defence in an amended defence.

6.2 Application of the parity principle regarding sentencing of co-offenders and failure to take into account effect on offender of hardship on family

(By Anthony Pitruzzello, Herbert Smith Freehills)

Johnson v The Queen [2014] VSCA 286, Supreme Court of Victoria, Court of Appeal, Weinberg and Santamaria JJA, 18 November 2014

The full text of this judgment is available here.

(a) Summary

The applicant was the sole director and majority shareholder in a brokerage and financial advisory firm specialising in leveraged financial derivatives. During 2007 and 2010 the firm encountered some significant financial difficulty. As a result the applicant along with the co-offender, the CEO of the firm, engaged in several acts of false accounting, submitted false documents to ASIC, stole from client accounts, and obtained financial advantage by deception to give the appearance of solvency.

At first instance the applicant was sentenced to imprisonment for 6.5 years with a non-parole period of 3.5 years. The co-offender was sentenced to imprisonment for 5 years with a non-parole period of 2.5 years. Notably the co-offender's effective sentence was significantly mitigated by his "exceptional" cooperation with authorities and his level of remorse.

The applicant sought to appeal the sentence imposed by the trial judge on two bases:

- that the trial judge failed to take into account the effect on the applicant of hardship caused to his family by his being imprisoned; and
- that the trial judge failed to give effect to the principle of parity as between his sentence and the sentence imposed on the co-offender.

The Court of Appeal rejected both grounds, noting that the argument regarding the effect on the applicant of hardship caused to his family was not put to the Court at first instance, and, secondly, that the significant contrition and cooperation demonstrated by the co-offender was reason for the difference between the sentences imposed on the applicant and the co-offender.

(b) Facts

The applicant (Mr Johnson) was the sole director of Sonray Capital Markets Pty Ltd (Sonray) which he established in April 2003. In addition, through RJ Equity Pty Ltd, a company associated with him, he was the majority shareholder in Sonray.

Sonray was a broker/adviser which offered to clients financial products, including leveraged financial derivatives known as Contracts for Difference (CFDs), through a trading platform of a Danish based global bank, Saxo Bank (Saxo).

Co-offender Scott Murray, the applicant's brother-in-law, was Sonray's chief executive officer.

In 2007 and 2008, Sonray was under heavy financial pressure due to a trading error made by Mr Murray, unauthorised trading on behalf of clients by a rogue trader and expenses of developing a new trading platform.
To give the appearance of solvency, between 6 December 2007 and 22 June 2010 the applicant and Mr Murray together committed multiple acts of theft from their clients' accounts, false accounting, financial benefit by deception and submission of false documents to ASIC.

On 22 September 2011, the applicant was charged. On 6–8 August 2012, a committal hearing was conducted. On 17 May 2013, the applicant entered pleas of guilty in relation to three charges on a 24-charge indictment in the Supreme Court. On 2 October 2013, which was the first day on which the matter was listed for trial, the applicant entered pleas of guilty in relation to the remaining charges the subject of this application.

As mentioned above, the applicant was sentenced to imprisonment for 6.5 years with a non-parole period of 3.5 years. The co-offender was sentenced to imprisonment for 5 years with a non-parole period of 2.5 years. The applicant sought to appeal the sentence imposed by the trial judge on two bases:

- that the trial judge failed to take into account the effect on the applicant of hardship caused to his family by his being imprisoned; and
- that the trial judge failed to give effect to the principle of parity as between his sentence and the sentence imposed on the co-offender.

(c) Decision

The Court of Appeal unanimously upheld the sentence imposed by the court of first instance.

(i) Proposed Ground 1 - Failure to take into account effect on offender of hardship on family

The majority applied *Romero v The Queen* (2011) 32 VR 486, noting that the Court will not lightly entertain arguments that could have been, but were not advanced on the plea.

The Court of Appeal determined that the psychological reports regarding the applicant were used in support of contentions relating to the impact of the applicant's imprisonment on his family; they were not used in support of any proposition relating to the impact on the applicant of the hardship that his imprisonment would visit upon his family.

Further, the Court rejected the contention that the psychological reports sufficiently addressed the point of effect on the applicant from hardship caused to his family and where they did, did not in any case support that contention.

(ii) Proposed Ground 2 - Failure to give effect to principle of parity

The trial judge did not fail to have regard to the lesser sentences imposed on co-offender.

In reaching this conclusion the Court noted that the differences in sentences could be explained by the conduct of the applicant and the co-offender.

The co-offender confessed his criminality, provided an extensive record of interview, waived his right to a committal proceeding, pleaded guilty and gave an undertaking to give evidence at the applicant's trial. The trial judge described his cooperation as having been "exceptional".
By contrast, the applicant was more limited in his display of remorse - his participation in the ASIC hearing was compelled pursuant to coercive powers and his apology to creditors at the mediation was cautious; it did not involve a confession that, in addition to being negligent, he had been criminally delinquent. Further, the applicant availed himself of a committal hearing to dispute the charges and did not plead guilty until October 2013.
Applying *Postiglione v The Queen* (1997) 189 CLR 295, the Court of Appeal found that the principle of parity was satisfied by having proper regard "to the different circumstances of the co-offenders in question and their different degrees of criminality". Given the difference in cooperation and remorse evidenced by the co-offender, compared with the begrudging cooperation of the applicant, the Court of Appeal was unable to discern any error in the trial judge's reasoning.

6.3 Court makes declaratory orders relating to voting rights of certain category of members

(By Emily Steiner, DLA Piper)

In the matter of New South Wales Leagues' Club Limited [2014] NSWSC 1610, Supreme Court of New South Wales, Brereton J, 14 November 2014

The full text of this judgment is available here.

(a) Summary

The NSW Rugby League Limited (the League) and fifty natural persons who are members of both the League and the NSW Leagues' Club Limited (the Club) sought declaratory relief from the Supreme Court of NSW to resolve a number of issues. Such issues included whether certain members ("B" members) alone were entitled to make a determination under the Club's Memorandum of Association and whether or not the Club should be wound up on the just and equitable ground in the Corporations Act 2001 (Cth) (the Corporations Act).

The Supreme Court of NSW ultimately made a declaration that, in accordance with the Club's Articles, "B" members alone were entitled to make a determination under the Club's memorandum. However, the court did not make a declaration that the Club should be wound up, partially on the basis that internal corporate processes had been inappropriately bypassed.

(b) Facts

For many years, the Club operated at 165-167 Phillip Street. In 1915, the NSW Rugby Football League (then an unincorporated association, which in its incorporated form is now the first plaintiff (the League)), acquired the Club's assets with the intention of establishing a club for the members of the League. The Club then amended its Articles (article 7) to provide for three classes of ordinary members: "A", "B" and "C" members.
In 2013, the Club's directors sold the Phillip Street property, the Club's major asset. As a result of the sale, the Club had net surplus assets in excess of $9 million in cash.

The plaintiffs sought declaratory relief to resolve a number of issues, including:

- Whether "B" members in general meeting alone are entitled to make a "determination" referred to in cl. 8 of the Memorandum of Association in respect of the destination of surplus assets on a winding up.
- Whether the Club should be wound up on the just and equitable ground in the Corporations Act.

(i) "B" class members

According to the Club's articles (Article 7), "B" members are those who are also members of the Committee of the NSW Rugby League Ltd and who pay a prescribed annual subscription fee. The Articles contain no definition of the "Committee of the New South Wales Rugby League Ltd".

At issue was whether, since the adoption of the current constitution of the League in April 2013, there was any body in existence that could be described as the "Committee of the New South Wales Rugby League Ltd" and therefore whether there were any "B" class members.

(ii) The Referendum

By notice to members of the Club dated 28 July 2014, the directors purported to submit to a referendum of members the question:

> That upon the winding up or dissolution of the Club any property of the Club remaining after the satisfaction of all debts and liabilities shall be given or transferred to Club Distribution Limited.

Clause 8 of the Club's Memorandum provides that if on the winding up or dissolution of the Club, after the satisfaction of all debts and liabilities, there remains any property whatsoever, such property shall be given or transferred to some other institution or institutions to be determined by the members at or before the time of the dissolution. The Memorandum is silent as to how a determination under cl. 8 is to be made. Article 7(5) provides, however, that only "B" members shall have the right to vote at any meeting, ordinary or extraordinary (except on the election of directors, for the sole purpose of which "A", "B", and "C" members are each entitled to one vote).

The court was required to consider whether the referendum was effectively carried out so as to have constituted a "determination" for the purposes of cl. 8 of the Memorandum.

(iii) Winding up

The plaintiffs sought an order that the Club be wound up on the just and equitable ground under s. 461(1)(k) of the Corporations Act.

They relied upon the accumulation of the following grounds:

- Failing to comply with the Club Constitution and applicable legislation by reason of:
    - Wrongful refusal to convene an Extraordinary General Meeting to allow "B" members to vote on proposed resolutions for winding up and transfer of surplus assets;
    - Wrongful attempt to obtain surplus assets determination, other than by resolution of the B members, through the referendum; and
    - Sale of the Phillip Street property beyond power and in breach of the Club's constitution and the Registered Clubs Act 1976 (NSW);
- Failure of the purposes of the Club, by reason of:
    - The Club no longer serving the purposes or interests of the League;
    - The Club trading at substantial losses;
    - The Club having no sensible plan for the future; and
    - The existence of a genuine dispute between the Club and the League in relation to a debenture.

(c) Decision

In relation to the qualification of "B" members, the court undertook an historical review of the evolution of the governance structures of the League to determine whether there was a body in existence that could be sufficiently recognised as the "Committee of the New South Wales Rugby League Ltd". Following this review, the court found that life members remained qualified for "B" membership of the Club. It followed that the persons who are now qualified to be "B" members are the individuals who are entitled to participate in the general meeting, comprising the members' representatives and the life members.

The court also found that the referendum was an "extra-legal irrelevancy"; its outcome was not a determination for the purposes of cl. 8. This finding followed Brereton J's comments that there is nothing in the Corporations Act, the memorandum or articles of the Club, or the common law of companies, that recognises a referendum of members as a means of corporate decision-making. As such, the court held that the determination referred to in cl. 8 of the Memorandum was one to be made by members assembled in general meeting. In accordance with Article 7, only the "B" members were entitled to vote at such a meeting on such a resolution.

Finally, the court heard a number of arguments in favour of winding up. Of these, the most compelling was that more than 75% of the "B" members, who alone were entitled to vote on a resolution that the Club be wound up (and could therefore carry a special resolution that the Club be wound up by the Court) had come before the Court as plaintiffs seeking to wind up the Club. Brereton J, however, was not convinced that the just and equitable ground was established. His Honour found that the "B" members had not been "deprived of the ordinary facilities which compliance with the Companies Acts ... would provide them with for the extrication of their rights". Nothing had precluded them, or now precludes them, from validly requisitioning a meeting to consider the proposed resolutions. The plaintiffs did not establish a sufficiently strong case for bypassing the internal corporate processes under the just and equitable ground.

The court ultimately held that the plaintiffs were entitled to declarations to the effect that:

- The persons qualified to be "B" class members of the Club are the individuals who are entitled to participate in the general meeting of the League, being the Members' Representatives and the Life Members;
- The determination referred to in cl. 8 of the Club's Memorandum of Association is one to be made by resolution of the members eligible to vote, assembled in general meeting;
- Only the B members of the Club are entitled to vote on such a resolution; and
- The referendum conducted by the Club is not a determination for the purposes of cl. 8 of the Club's Memorandum of Association.

6.4 Court upholds company officer entitlement to be indemnified for legal costs incurred in defending criminal proceedings

(By Jessica Taylor, DLA Piper)

Leckenby v Note Printing Australia Ltd [2014] VSC 538, Supreme Court of Victoria, Sifris J, 11 November 2014.

The full text of this judgment is available here.

(a) Summary

The Supreme Court of Victoria considered the terms of a deed of indemnity entered into between Note Printing Australia Limited (NPAL) and John Leckenby (who was, at the date of the deed, the chief executive officer of NPAL). The question before the court was whether Leckenby was entitled to be indemnified by NPAL for ongoing legal costs incurred in defending criminal proceedings prior to any verdict.

NPAL submitted that any right of indemnity and entitlement to payment found to exist would only arise:

- in the event that criminal proceedings had ceased (including any appeals); and
- upon a verdict of not guilty against Leckenby.

The Court found, however, that based on the construction of cll. 2.3, 2.4 and 6.2(a) of the Deed of Indemnity it was clearly the intention of the parties that NPAL provide funding prior to verdict. The Court, upon construing the explanatory memoranda of s. 212 of the Corporations Act 2001 (Cth) (the Corporations Act), found that it was clear at the time of the insertion of the provision that the legislature was concerned with ensuring an officer could, in particular circumstances, receive payments in advance of criminal proceedings being finalised. The court concluded that the s. is directed to indemnification, with the section failing to address payments made prior to verdict. Thus, his Honour found that it is simply to be assumed, based on the construction of s. 199A(3)(b) that payments made prior to verdict cannot be made even though the trigger for the prohibition (a guilty verdict) has not been made. Thus, while cl. 2.2 of the Deed used the word "indemnity" it was found to be no different to an agreement that provides for an advance which requires repayment upon a guilty verdict.

(b) Facts

The plaintiff (John Leckenby) was the CEO of the defendant (NPAL) from September 1998 to June 2004. Along with former officers of NPAL, Leckenby was charged with conspiring to bribe foreign officials to secure bank note printing contracts for the benefit of NPAL.

On 5 August 2010, NPAL and Chubb Insurance Company of Australia Limited entered into a Directors' and Officers' policy. Payments were made to Leckenby in respect of his legal costs to date pursuant to this policy. However, the limit of cover under the policy was insufficient to cover Leckenby's legal costs. Thus, Leckenby sought to be indemnified by NPAL in respect of these costs.

Leckenby claimed that the basis for indemnification arose out of a Deed of Indemnity entered into between him and NPAL on 27 July 2001. Clause 2.2 of the Deed provided that NPAL would indemnify an officer against all liabilities for legal costs and expenses an officer may incur in defending an action for liability, and expressly excluded indemnity for costs incurred in defending criminal proceedings where the officer is found guilty. Clause 6.2 of the Deed also imposed an obligation on Leckenby to "refund to NPAL all amounts incurred by NPAL under this Deed" in respect of "a Claim that the Officer is not entitled to be indemnified" for. Based on this, NPAL submitted that if Leckenby was entitled to be indemnified by NPAL for his legal costs, then this entitlement would not arise until and unless criminal proceedings (as well as appeals) have ceased and Leckenby has been granted a verdict of not guilty.

Importantly, the Deed did not expressly deal with advances of money paid by NPAL to officers in respect of legal costs incurred before determination of a verdict by a court.

(c) Decision

(i) Ground 1: Construction of ss. 199A(3)(b) and 212 of the Corporations Act

In finding that NPAL was liable to pay the legal costs incurred by Leckenby in defending criminal proceedings before the handing down of a verdict, Sifris J turned to the construction of ss. 199A and 212 of the Corporations Act which concerns the payment of legal costs to company officers.
Sifris J first looked at s. 199A(3)(b) of the Corporations Act, which provides that an officer of a company cannot be indemnified for costs incurred in defending criminal proceedings where the officer is found guilty. He noted that this section did not directly address the issue of indemnity in respect of costs prior to verdict. However the explanatory memoranda provided that there was a view of the law then that no payments could be made by a company until after a verdict of not guilty. He then turned to s. 212 of the Corporations Act, which provides that once the outcome of a proceeding is known, an officer may have to pay back any amounts advanced if the costs are for costs for which the company must not give an indemnity under s. 199A (that is, if the officer is found guilty). In relying by analogy on the decision of Jacobson, Siopsis and Foster JJ in *Rickus v Motor Trades Association Superannuation*

Fund Pty Ltd [2010] FCAFC 16, his Honour found that the prohibition in s. 199A(3)(a) does not "bite" prior to the verdict of guilty.

(ii) Ground 2: Ordinary meaning

The court found that, apart from the relevant provisions of the Corporations Act, and the other terms of the Deed of Indemnity, the ordinary meaning of the indemnity in cl. 2.2 is that the right to indemnity arises immediately. The court found that, if NPAL wished to place a limitation on the indemnity it could have done so. For example, the company could have clearly and easily drafted words to the effect that no indemnity is offered to the company officer while criminal proceedings are pending. It was clearly the intention of the parties that NPAL provide funding to Leckenby prior to verdict.

6.5 Court provides advice sought by a responsible entity regarding convening a meeting of unitholders

(By Tom Ward, Minter Ellison)

Mirvac Funds Management Ltd in its capacity as responsible entity of Mirvac Industrial Trust [2014] NSWSC 1569, Supreme Court of New South Wales, Black J, 10 November 2014

The full text of this judgment is available here.

(a) Summary

This case is an example of the Court providing advice sought by a responsible entity to the effect that it would be justified in convening a meeting of unitholders to consider, and, if thought fit, agree to proposed scheme resolutions.

(b) Facts

The responsible entity of a scheme may obtain judicial advice under s. 63 of the Trustee Act 1925 (NSW) (the Trustee Act) at the first court hearing, that it is justified in propounding resolutions to implement a scheme and in proceeding on the basis that proposed amendments to the constitution of the registered managed investment scheme to implement the scheme would be within the powers of alteration conferred by that document and s. 601GC of the Corporations Act.

Mirvac Funds Management Ltd (MFML), as responsible entity of Mirvac Industrial Trust (MIX), sought such orders of the Court under s. 63 of the Trustee Act. In particular, MFML sought the opinion, advice and direction of the Court that it would be justified in convening a meeting of MIX unitholders to consider, and, if thought fit, agree to proposed scheme resolutions, distributing an explanatory memorandum to MIX unitholders in advance of that meeting; and proceeding on the basis that proposed amendments to MIX's constitution would be within the powers of alteration conferred by that Constitution and s. 601GC of the Corporations Act.

MFML, in its capacity as responsible entity of MIX, entered into a Scheme Implementation Agreement with AustFunding Pty Ltd (AustFunding) on 19 September 2014. Under the Scheme Implementation Agreement, MFML agreed to propose a trust scheme to MIX unitholders by which AustFunding would acquire all of the units in MIX. The scheme is subject to, *inter alia*, approvals from MIX unitholders, the Court's opinion, advice and directions, and the satisfaction or waiver of conditions precedent in the Scheme Implementation Agreement.

(c) Decision

Justice Black was satisfied that judicial advice leading to a meeting of the members of the managed investment schemes should be given as sought.
Firstly, his Honour considered the importance of scheme members ability to enforce entitlements to be received under a scheme. He noted that this issue had been addressed by a Deed Poll executed on 13 October 2014 by which AustFunding covenants in favour of MIX unitholders that it will observe and perform all obligations under the Scheme Implementation Agreement and by proposed amendments to MIX's constitution via a Supplemental Deed Poll which will be executed by MFML if the scheme becomes effective.

His Honour also considered cl. 4.2(a) of the Scheme Implementation Agreement which required AustFunding to make payment of the scheme consideration in US dollars into an Australian deposit taking institution to be held on trust for MIX unitholders. Clause 4.2(b) of the Scheme Implementation Agreement then provided that the payment will be converted into Australian dollars at the prevailing exchange rate before distribution to MIX unitholders. His Honour considered that the exchange rate was fairly disclosed in the explanatory memorandum and that even though AustFunding would make payment in US dollars, the payment would be made into an Australian deposit taking institution, and that creates no more risk than what is ordinarily taken by Australian citizens dealing with Australian deposit taking institutions.

Thirdly, his Honour considered cl. 41.8 of the Supplemental Deed Poll which, if the scheme becomes effective, would insert a warranty into MIX's constitution that each MIX unitholder warrants that all of their units are fully paid and free from all mortgages, charges, lien, encumbrances, pledges security interests and other interests of any kind. His Honour noted that such a clause simply ensures that a scheme participant whose shares are subject to an encumbrance is not unfairly disadvantaged, and accordingly did not consider it to be an obstacle to the court in ordering the convening of a meeting.

Finally, his Honour considered cl. 12.2(a) of the Scheme Implementation Agreement which provides that MFML must pay a "break fee" in certain circumstances. His Honour noted that this fee is not payable if requisite approvals are not obtained from MIX unitholders at the scheme meeting, and that in any event the "break fee" is specified as 1% of the scheme consideration. Accordingly the break fee was held to be of insufficient size to provide any reason not to give the advice sought.

6.6 Voidable director transactions during relation back period

(By Loren Giles, Skanda Kumble and David Bryant, King & Wood Mallesons)

Super Art Australia Pty Ltd v Foden [2014] FCA 1168, Federal Court of Australia, Davies J, 6 November 2014

The full text of this judgment is available here.

(a) Summary

This case concerned an application made by the liquidators of Super Art Australia Pty Ltd (in liquidation) (SAA) seeking orders that certain payments made by SAA, as well as its entry into a loan agreement and mortgage debenture agreement, were voidable pursuant to s. 588FF of the Corporations Act 2001 (Cth) (the Act).

The issue was whether the relevant transactions could be classified as uncommercial transactions, insolvent transactions, unreasonable-director transactions, unfair loans or circulating security interests under the Act.

Davies J held that the loan agreement and mortgage debenture agreement constituted uncommercial transactions and unreasonable director-related transactions, and that one payment (for $215,000) constituted an unfair preference. As the defendant, Mr Foden, did not meet the requirements for the relevant defence, her Honour declared each of the Agreements and the $215,000 payment void. However an additional $200,000 payment was not voidable, and as such Mr Foden was only required to repay the sum of $215,000.

(b) Facts

Under the Act, the relation back period in relation to the winding up of SAA began on 6 November 2008 and ended on 6 May 2008. During the relation back period, SAA paid Mr Foden, a former director and accountant of SAA, $215,000 on 18 June 2008 (Payment 1) and $200,000 on 30 September 2008 (Payment 2).

Further, during the relation back period, SAA, Mr Foden and a Mr Clark executed a loan agreement by which Mr Foden and Mr Clark each agreed to lend SAA a large sum of money. SAA also executed a mortgage debenture agreement (together with the loan agreement, the Agreements) which charged all of the company's undertakings and assets in favour of Mr Foden and Mr Clark to secure repayment of the loans.

The Liquidators alleged that the Agreements and each of the payments were uncommercial transactions, insolvent transactions, and/or unreasonable director-related transactions under the Act. The liquidators further alleged that the loan agreement was an unfair loan and that the mortgage debenture agreement was a circulating security interest in property of SAA.

(c) Decision

(i) Whether the transactions were uncommercial transactions

Under s. 588FB(1) of the Act, a transaction is an "uncommercial transaction" if a reasonable person in the company's circumstances would not have entered into the transaction, having regard to any benefits or detriment to the company, the respective benefits to other parties to the transaction and any other relevant matter.

Davies J held that each of the Agreements with Mr Foden was an uncommercial transaction. Because Mr Foden did not actually advance any monies to SAA under the loan agreement, no benefit was obtained by SAA. Further, Mr Foden presumed that the Agreements were entered into to secure the payment of fees owed by SAA to Mr Foden, in respect of accounting services Mr Foden had provided SAA. If this were the case, the purpose of the charge under the mortgage debenture agreement was to convert an unsecured debt to Mr Foden into a secured debt, with no corresponding benefit to SAA. Her Honour concluded in either case that a reasonable person would not have entered into those transactions.

In relation to the payments, Davies J concluded that it could not be stated that a reasonable person in the company's circumstances would not have made Payment 1, as the payment made was in repayment of monies lent to the same amount. Further, her Honour accepted Mr Foden's assertion that Payment 2 was for the purpose of disbursement to third parties in repayment of monies that SAA owed those third parties. Because Payment 2 was less than the amount that SAA was required to repay under the relevant loan agreement (the remainder was repaid using funds provided by Mr Clark's parents) and because it was paid in reduction of the debt owed by SAA, Davies J held that this payment did not constitute an uncommercial transaction.

(ii) Whether the transactions were unreasonable director-related transactions

A transaction is an "unreasonable director-related transaction" under s. 588FDA(1) of the Act if the company makes a payment, or incurs an obligation to make a payment, to a director of the company, and a reasonable person in the company's circumstances would not have entered into the transaction.

In determining whether Mr Foden was a "director" at the relevant time, her Honour did not accept Mr Foden's argument that he ceased to be a director on 29 February 2008 (the date at which ASIC records show that Mr Foden ceased to be a director) and thereafter merely acted as the company's accountant. Her Honour held that Mr Foden continued to act as de-facto director after such date, as he continued to exercise significant control over the management of the company. It was critical in her Honour's opinion that Mr Clark was not called to give evidence, suggesting that his evidence would not have assisted Mr Foden.

Davies J held that both of the Agreements were unreasonable director-related transactions (and that each of the payments were not) for the same reasons as her Honour set out in her Honour's analysis of the "uncommercial transactions" provision.

(iii) Whether the transactions were insolvent transactions

Under s. 588FC(a)(i) of the Act, a transaction is an "insolvent transaction" if it is an "unfair preference" or an "uncommercial transaction" and the transaction is entered into when the company is "insolvent". Davies J accepted the Liquidator's assessment of SAA as being insolvent from December 2007. Because her Honour concluded that the two payments to Mr Foden were not uncommercial transactions, it was necessary to consider whether they were "unfair preferences".

Under s. 588FA, a transaction is an "unfair preference" given by the company to a creditor if the company and the creditor are parties to the transaction, and the transaction results in the creditor receiving (in respect of an unsecured debt) more than they would receive if they proved for the debt in a winding up of the company.

Davies J held that Mr Foden, as he was a creditor of the company, did not receive Payment 1 in repayment of client loans. Because no return to creditors of the company was expected, her Honour found that this payment was an unfair preference. However her Honour held that Payment 2 was not received by Mr Foden as a creditor of the company, and therefore was not an unfair preference.

(iv) Circulating security interest and unfair loan

Under s. 588FJ(2), a circulating security interest created in the property of a company being wound up in insolvency during the relation back period is void except insofar as it secures an advance paid to the company at or after that time and as consideration for the circulating security interest. Davies J stated that the mortgage debenture was a circulating security interest as it was created during the six-month relation back period and it did not secure an advance paid to the company by Mr Foden at or after that

time.
In relation to the loan agreement, her Honour concluded that no loan was in fact made to Mr Foden and as such the "unfair loan" section of the Act was not engaged.

(v) Whether Mr Foden was entitled to a defence

Section 588FG(2) protects a party to an unfair preference or an uncommercial transaction if three elements are proved. First, the person became a party to the transaction in good faith. Secondly, at the time the person become such a party, they had no reasonable grounds to suspect the company was, or would become insolvent, and a reasonable person in the circumstances would have no such grounds for so suspecting. Thirdly, the person provided valuable consideration under the transaction or changed their position in reliance on the transaction. The defence does not apply to unreasonable director-related transactions, and therefore her Honour only considered the availability of the defence for Payment 1.

Davies J accepted Mr Foden's evidence that he entered into the transaction relating to Payment 1 in good faith. In relation to the remaining elements, her Honour stated that the fact that SAA had failed to repay the loans in a timely fashion and had needed to borrow more money called for an inquiry as to its capacity to pay its debts as and when due. Further, it was significant that Mr Foden did not provide any evidence that he had no suspicion that the company was insolvent when he received Payment 2. Her Honour held that in these circumstances, a reasonable person would have reason to suspect SAA's insolvency, and therefore Mr Foden's defence failed.

6.7 Responsible entity exceeds its powers by distributing assets without appropriate power or authorisation

(By Alex Cook, Emily Rothfield and Hannah McMurtrie, King & Wood Mallesons)

Wellington Capital Limited v Australian Securities and Investments Commission [2014] HCA 43, High Court of Australia, French CJ, Crennan, Kiefel, Bell and Gageler JJ, 5 November 2014

The full text of this judgment is available here.

(a) Summary

Wellington Capital Ltd (Wellington) is the responsible entity of a managed investment scheme known as Premium Income Fund (the Scheme).

Wellington sold Scheme assets in consideration for the issue of shares in an unlisted public company known as Asset Resolution Ltd ("ARL"). Wellington subsequently distributed the Scheme's ARL shares to each of the Scheme's unit holders by way of in specie distribution. Wellington did not obtain the unit holders' consent before authorising the distribution of the ARL shares. Instead, Wellington purported to rely on certain clauses in the Scheme's constitution which conferred broad powers on Wellington to deal with Scheme assets.

The Australian Securities and Investments Commission (ASIC) commenced proceedings against Wellington, alleging that the distribution of the ARL shares contravened the Scheme's constitution and s. 601FB(1) of the Corporations Act 2001 (Cth) (the Corporations Act). The Full Federal Court of Australia and the High Court of Australia upheld the declarations sought by ASIC and confirmed that Wellington was not empowered to authorise the distribution of the ARL shares without the unit holders' consent.

Following this decision, responsible entities of managed investment schemes should ensure that the relevant scheme's constitution explicitly authorises a distribution in specie prior to making such a distribution without the consent of unit holders. Any broad powers under the scheme constitution to deal with scheme assets are likely to be read down by the court as being limited by the statutory duties and fiduciary constraints placed on responsible entities by s. 601FC of the Corporations Act.

(b) Facts

Wellington is the responsible entity of the Scheme. Perpetual Nominees Ltd (Perpetual) is the custodian of the Scheme, appointed by Wellington to hold Scheme property on its behalf. The members of the Scheme are its unit holders (the Members), each of whom has an undivided interest in the Scheme's funds and property (the Scheme Property). The Scheme is governed by a Deed Poll dated 20 November 1999 (the Scheme Constitution) the terms of which provide that the Members are the absolute and beneficial owners of the Scheme Property.

On 4 September 2012, Wellington sold Scheme assets to ARL in exchange for the issue of 830,532,768 shares in ARL to Perpetual (the ARL Shares). The assets disposed of had a publicly stated value of $90.75 million and represented roughly 41% of the Scheme Property's value. On the same day, Wellington directed Perpetual to distribute the ARL Shares to each of the Scheme's unit holders in proportion to the number of units held by each of the unit holders by way of *in specie* distribution (the Distribution). Perpetual conducted this Distribution on 5 September 2012.

In October 2012, ASIC commenced proceedings in the Federal Court of Australia challenging the validity of the Distribution. ASIC's application was dismissed at first instance by Jagot J. However, on 28 May 2013, the Full Court of the Federal Court of Australia allowed an appeal from Jagot J's decision and declared that the Distribution:

- was beyond Wellington's power under the Scheme Constitution; and
- contravened s. 601FB(1) of the Corporations Act, which required Wellington to operate the Scheme and perform its functions in accordance with the Scheme Constitution and the Corporations Act.

By grant of special leave, Wellington appealed the decision of the Full Court of the Federal Court of Australia to the High Court of Australia.

(c) Decision

(i) Did the Scheme Constitution authorise Wellington to make an *in specie* distribution to Members?

The High Court's decision turned on cl. 13 of the Scheme Constitution. Clause 13.1 of the Scheme Constitution conferred on Wellington all powers in respect of the Scheme that are legally possible for natural persons and corporations. Additionally, expanding on the broad powers conferred by cl. 13.1, cl. 13.2.5 specifically authorised Wellington to deal with Scheme Property as if it "were the absolute and beneficial owner" of that property.

Wellington submitted that, prior to the Distribution, legal title to the ARL Shares resided in it and beneficial title resided in the Members. Relying on a literal interpretation of cll. 13.1 and 13.2.5 of the Scheme Constitution, Wellington submitted that it was empowered to effect the Distribution.

French CJ, Crennan, Kiefel and Bell JJ read down cll. 13.1 and 13.2.5 to ensure consistency with the Corporations Act and the Scheme Constitution as a whole. Their Honours found that these clauses must be constrained in their application due to statutory duties and fiduciary constraints placed on responsible entities by s. 601FC of the Corporations Act. Their Honours found that cll. 13.1 and 13.2.5 did not relate to the return of Scheme Property to Members. Instead, these clauses merely equipped Wellington to deal in Scheme Property with third parties in compliance with its duties under s. 601FC and Chapter 5C of the Corporations Act.

Gageler J deemed the conferral on Wellington of the powers of an absolute and beneficial owner as a legal fiction. Gageler J agreed with the majority that the language in cll. 13.1 and 13.2.5 was appropriate to authorise extramural transactions with third parties. However, Gageler J found that the clauses could not authorise Wellington to distribute Scheme Property to Members, as such an interpretation would conflict with the Members' rights as absolute and beneficial owners.

All of the High Court Justices noted that cl. 16 of the Scheme Constitution made express provision for the return of capital to Members. However, their Honours noted that cl. 16 merely provided for payment in cash, and did not contemplate the distribution of assets in specie. As such, cl. 16 could not validate the Distribution.

Given that no provision of the Scheme Constitution empowered Wellington to effect the Distribution, Wellington was considered to have gone beyond its powers.

(ii) Did the Distribution contravene s. 601FB(1) of the Corporations Act?

Given that Wellington had exceeded its powers under the Scheme Constitution, its entry into the Distribution breached s. 601FB(1) of the Corporations Act.

(iii) What was the result?

The High Court dismissed Wellington's appeal with costs and affirmed the declarations made by the Full Federal Court of Australia.

Individual Members were left to decide whether they wished to bring proceedings against Wellington for exceeding its powers and breaching its duties.

6.8 Leave granted for OHS proceedings to be brought against company in liquidation

(By James Siemon, Minter Ellison Lawyers)

Worksafe Western Australia Commissioner v Australian Countertop Pty Ltd (in liq) [2014] WASC 413, Supreme Court of Western Australia, Master Sanderson, 5 November 2014

The full text of this judgment is available here.

(a) Summary

In this case, leave was granted for proceedings under the Occupational Safety and Health Act 1984 (WA) to be brought against a company being wound up in insolvency.

(b) Facts

Since 2007, there had been four fatalities at the premises of the defendant, Australian Countertop Pty Ltd. Recommendations had been made by Worksafe WA following investigations into the first three fatalities. The plaintiff, the Worksafe WA Commissioner, alleged that those recommendations had not been implemented, and that the defendant was in breach of the Occupational Safety and Health Act 1984 (WA) (the OSH Act).

At the time of the application, the defendant company was being wound up in insolvency. The plaintiff therefore brought an application under s. 471B of the Corporations Act 2001 (Cth) (the Corporations Act) for leave to commence proceedings against the defendant.

That section provides that:

> While 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.

Although the defendant had no assets and could not pay any penalty resulting from the proceedings, the plaintiff submitted that it was important that the defendant be prosecuted under the OSH Act and, if the OSH Act had been contravened, that a conviction was recorded.

(c) Decision

Finding that the leave of the Court was required to bring the proceedings, Master Sanderson noted that the purpose of s. 471B was "to preserve the limited assets of the company for the rateable distribution among potential claimants and to avoid a multiplicity of expensive and time consuming actions" and referred to the decision of the Supreme Court of Queensland in *Ogilvie-Grant v East* (1983) 7 ACLR 669 at 672.

Master Sanderson also noted the effect of s. 553B(1) of the Corporations Act, which states that "... penalties or fines imposed by a court in respect of an offence against a law are not admissible to proof against an insolvent company". As a result, no creditors would be disadvantaged by leave being granted.

Considering the likelihood that the defendant may have breached the OSH Act and the plaintiff's reasons for bringing the proceedings, Master Sanderson therefore granted leave for the plaintiff to proceed against the defendant.

6.9 Liquidator's power in relation to trust property

(By Angela Li, Ashurst Australia)

In the matter of Stansfield DIY Wealth Pty Ltd (in liq) [2014] NSWSC 1484, Supreme Court of New South Wales, Brereton J, 30 October 2014

The full text of this judgment is available here.

(a) Summary

Michael John Morris Smith, the first plaintiff, was the liquidator of Stansfield DIY Wealth Pty Limited (in liquidation) (the company), the second plaintiff. The only function of the company at the time of liquidation was to act as the trustee of Elliott Stansfield Super Fund (the Superannuation Fund), a regulated self-managed superannuation fund and of which the only member was Elliott Stansfield, the defendant. The liquidator applied for directions to the effect that he be permitted to sell trust assets held on trust by the company.

Brereton J refused the application and held that the liquidator lacked the power of sale under both legislation and the trust deed. However Brereton J gave advice that alternatively, for the purposes of enforcing the company's right of indemnity as a trustee, the liquidator would be justified in applying to be appointed as a receiver of the trust assets, with the powers that a liquidator has in respect of the property of a company under s. 477(2) of the Corporations Act 2001 (Cth) (the Corporations Act), for the purpose of enforcing the company's right of indemnity as trustee of the Superannuation Fund.

(b) Facts

The liquidator of the company applied for directions pursuant to s. 479(3) of the Corporations Act, s. 312 of the Superannuation Industry (Supervision) Act 1993 (Cth) (the SIS Act) and s. 63 of the Trustee Act 1925 (NSW) (the Trustee Act) for directions that he be allowed to sell or otherwise deal with the property of the Superannuation Fund, so that the creditors of the Superannuation Fund and the liquidator's remuneration and expenses incurred could be satisfied.

At the time of liquidation, the company had no assets or liabilities save in its capacity as the trustee of the Superannuation Fund. The Superannuation Fund had net assets valued at approximately $10,000.

(c) Decision

Brereton J held that neither the legislation nor the trust deed gave the liquidator power to dispose of or deal with the trust assets. In reaching the decision, his Honour considered three issues: (1) whether the liquidator's statutory power of sale under s. 477 of the Corporations Act extends to trust assets; (2) whether the company in liquidation should remain as trustee when doing so it would commit an offence against the SIS Act; and (3) whether the liquidator can alternatively rely on s. 479(3) of the Corporations Act for the directions sought. Brereton J answered negatively to these questions.

(i) Liquidator's power of sale

Brereton J considered the liquidator's power of sale in two scenarios. The first is when the company remains trustee of the Superannuation Fund despite having gone into liquidation. In the first scenario where the company continues to be a trustee, subject to superannuation law, Brereton J held that the liquidator can: (1) administer the trust assets, (2) pay trust creditors, (3) wind up the trust, and (4) recover all remuneration and expenses from the trust assets. This brings along the acquisition by the liquidator of the trustee company's rights of indemnity and exoneration. Thus leaving aside superannuation laws, here the liquidator obtains the power of sale under the trust deed without the need to resort to legislation.
The second is when the company ceases to be trustee by either becoming a disqualified person or by resigning. The situation becomes more complicated in the second scenario. When the trustee company ceases to be a trustee, the power of sale given to the trustee under the trust deed is no longer available. Although the retiring trustee continues to enjoy a right of indemnity from the trust assets, secured by an equitable charge over the trust assets, for its liabilities incurred by reason of acting as a trustee, this equitable charge does not of itself give the outgoing trustee a power of sale. Therefore recourse to legislation is needed if the liquidator is to dispose of the trust assets.

Finkelstein J in *Apostolou v VA Corporation of Australia Pty Ltd* [2010] FCA 64; (2010) 77 ACSR 84, held that s. 477 of the Corporations Act gives the liquidator such a power of sale. Finkelstein J held that this statutory power of sale was necessary for the liquidator to make good his right of indemnity which has been passed to him from the trustee company. This statutory power of sale survived the replacement of the trustee company.
Brereton J disagreed with Finkelstein J's reasoning. Brereton J considered specifically what constitutes "property of the company" and the question whether for the purposes of s. 477, "property of the company" extends to property of which the company is the legal owner but holds on trust, and in which it also has an equitable interest as chargee to secure its right of indemnity. Brereton J held that the equitable interest that the liquidator has in securing his right of indemnity is in the nature of a hypothecation and does not equate to beneficial ownership. Accordingly, "property of the company" is the charge only, rather than the underlying assets charged. Therefore the liquidator is only authorised by s. 477 to sell the company's interest as equitable chargee, not the underlying assets to which the charge attached.

Brereton J also examined Kitay, in the matter of *South West Kitchens (WA) Pty Ltd* [2014] FCA 670. In that case, McKerracher J concluded that the disqualification of the trustee from acting as such precluded the exercise of the liquidator's statutory power of sale in respect of the trust assets, in the absence of a court order. The judgments in

Kitay and a number of other authorities which were referred to in Kitay did not expressly examine the appropriateness of the power of sale under s. 477; rather, they proceeded on the assumption that the liquidator had no power to sell assets once the company ceased to be trustee.

Brereton J held that s. 477(2) does not empower a liquidator to sell the beneficial interest in property that the company holds on trust, even if the company has an equitable charge over it, because the property is not itself "property of the company".

(ii) Contravention of superannuation laws

Pursuant to s. 120(2)(e) of the SIS Act, Brereton J held that upon the commencement of winding up a trustee company becomes a disqualified person for the purposes of the SIS Act. This, however, is not to say that upon becoming a disqualified person a trustee stops being a trustee automatically. The effect of s. 120 is that the company commits an offence under s. 126K if it continues to act as trustee of the Superannuation Fund. Accordingly, if the company exercises its power to sell trust assets or to wind up the trust in such a scenario, it would more conspicuously commit an offence. Therefore the prudent course for the trustee would be to resign as trustee.

(iii) Other sections

Brereton J also noted the function of s. 479(3) of the Corporations Act. His Honour made it clear that the section merely enables the liquidator to obtain judicial advice as to the exercise of his powers, rather than obtaining powers and authorities that the liquidator does not otherwise have. Sections 310 and 312 of the SIS Act are concerned with retrospective validation of irregularities rather than authorising the liquidator to sell the trust assets. Section 63 of the Trustee Act only empowers a trustee to apply to the Court for advice, rather than authorising the Court to relieve a trustee from compliance with statutes or conferring powers on a trustee that it does not otherwise have.

(iv) Appointment as receiver

The remedy that the liquidator is left with is to seek appointment as a receiver and manager of the trust assets, for the purpose of enforcing the company trustee's right of indemnity. By so doing the liquidator could realise trust assets, apply the proceeds to discharge the liabilities of the company and recover the costs of the receivership and the general costs of liquidation due to the fact that the company's sole function was to act as trustee of the Superannuation Fund.

6.10 Examination of director's conduct in denuding company of assets available to satisfy judgment

(By Katrina Sleiman and Lara Nurick, Corrs Chambers Westgarth)

Michael Griffin and Raj Khatri as Liquidators of Norman Nominees Pty Ltd (in liquidation) and Norman Nominees Pty Ltd (in liquidation) v Hot Dev Pty Ltd [2014] QSC 255, Supreme Court of Queensland, Byrne SJA, 14 October 2014

The full text of this judgment is available here.

(a) Summary

The case concerned the duties and liabilities of a director in the management and administration of a company where, following certain transactions entered into by the director, the company was placed into liquidation. The liquidators alleged that John Geaney, as director of Norman Nominees Pty Ltd (In Liquidation) (Norman), contravened ss. 180–182 of the Corporations Act 2001 (Cth) (the Act) through actions he took to denude Norman of its assets as part of a strategy to avoid satisfying an adverse judgment in a claim commenced by Carlyle Villages Pty Ltd (Carlyle).

Byrne SJA found that Mr Geaney had contravened ss. 181 and 182 of the Act.

(b) Facts

Mr Geaney, a property developer, conducted his ventures through several companies. Norman was incorporated, with Mr Geaney as sole director and shareholder, to buy land at North Rockhampton for $2.95 million for eventual subdivision and sale as residential allotments. The purchase was completed using funds borrowed from the Bank of Queensland (BOQ).

In October 2004, Norman granted Citimark Properties Pty Ltd an option to purchase the Rockhampton land for $2.8 million, a price Mr Geaney and his financial adviser Mr Fennell subsequently felt was below its worth, which they valued at between $8 million and $12.5 million in 2006. In July 2005, this option was assigned to Carlyle.

Separately, Mr Geaney incorporated a number of companies to buy Lots 4, 5 and 11 at Park Ridge:

- Whitestar Holdings Pty Ltd (Whitestar) and John Harris Securities Pty Ltd (JHS) purchased Lots 4 and 11 as tenants-in-common in a 60:40 proportion. Norman later substituted Whitestar and completed the purchase borrowing $1.4 million from JHS; and

- Zervos Pty Ltd (Zervos) with Mr Geaney and Mr Fennell acting as directors, purchased Lot 5 with JHS providing a $940,000 loan. Repayment was guaranteed by Mr Geaney, his wife and Lake Morpeth Pty Ltd (Morpeth).

As expenses were incurred on the Rockhampton land, JHS was persuaded to lend $3.6 million to refinance and discharge the BOQ debt in exchange for a mortgage. A default in repayment, due on 30 April 2006, could result in JHS exercising its power of sale.

In July 2005, Carlyle exercised its option and lodged a caveat to protect its interests. In early August, Carlyle commenced proceedings seeking specific performance of Norman's obligation to sell the Rockhampton land for the option price of $2.8 million.

Mr Geaney and Mr Fennell sought legal advice to resist enforcement of the option and to remove the caveat. They were advised that removal would fail and that the prospects of defending Carlyle's action were low. Consequently, strategies to circumvent the caveat were considered, namely, allowing Norman to default on repayment and provoking a mortgagee's sale by JHS. This would enable Mr Fennell's company to buy the Rockhampton land at auction, leaving Carlyle with a damages claim only. The strategy also provided for Norman to shed surplus sale proceeds via the Park Ridge interests so that by the time of the hearing, Norman would not have any assets and Carlyle could not enforce any judgment. However, the legal advice had not found a lawful way to do this.

Despite this, the JHS loan was not repaid and JHS exercised its power of sale. The Rockhampton land sold for $7 million at auction to Mr Fennell's company, Quarterback Group Pty Ltd (Quarterback). Settlement was brought forward to coincide with JHS discontinuing its involvement with Mr Geaney through the sale of its Park Ridge shares in Lots 4 and 11 to Quarterback. At the same time Norman contracted to sell its interests in those lots to Zervos for $1,323,918. In keeping with the objective of avoiding sale proceeds reaching Norman, Mr Geaney authorised conveyance of title without requiring payment. A Deed of Acknowledgement was executed by JHS, Norman and Mr Geaney, which Mr Geaney testified he had not read and signed on Mr Fennell's direction.

On settlement, out of the $7 million purchase price:

- JHS retained about $4.2 million to satisfy Norman's Rockhampton loan;
- Norman's $1.6 million liability under the Park Ridge loan was discharged;
- $1.12 million was paid to JHS to discharge Zervos's liability under its loan notwithstanding that Norman was not a party to those transactions;
- JHS received approximately $200,000 for legal costs; and
  the remaining $57,273 was paid to Morpeth.

In addition, Mr Geaney and Mr Fennell agreed that Morpeth would take $520,000 from Norman's entitlements and that Zervos's debt to Norman be reduced by Norman's payment of $600,000 to the trust account of The Law Place (a firm of solicitors) in partial satisfaction of another purchase by Mr Fennell's company.

Following settlement, Norman had no cash or other assets. Mr Geaney then sold his shareholding in Norman and resigned as director.

(c) Decision

(i) Settlement and Deed

Byrne SJA found Mr Geaney's conduct concerning the settlements and accompanying Deed contravened ss. 181 and 182 of the Act. In depriving Norman of its entitlements, Mr Geaney acted in bad faith, contrary to Norman's best interests, to gain an advantage for Zervos and himself and to cause detriment to Norman. Mr Geaney was ordered to pay compensation of $1.12 million (the amount paid to JHS to discharge Zervos's liability).

(ii) Morpeth's $520,000

Notwithstanding Mr Geaney's contention that this amount represented services Norman engaged from Morpeth for the Rockhampton development, no money had ever been paid. Byrne SJA found that given Mr Geaney's intentions, it was impliedly agreed that Norman would not become liable to Morpeth until the Rockhampton project yielded profit through sale of subdivided lots. Since this contingency never occurred, Morpeth had no right to the money. Therefore, Mr Geaney acted in bad faith, advantaging Morpeth and causing detriment to Norman.

Given Morpeth's knowledge of these circumstances, it was knowingly concerned in Mr Geaney's contraventions and was therefore deemed to have contravened ss. 181 and 182. However, as the liquidators chose not to plead such a case, they could not recover compensation from Morpeth under s. 1317H of the Act.

(iii) Payment to The Law Place

There was no opposition to an order requiring Mr Geaney to compensate Norman for the $600,000 loss.

(iv) Norman's sale of its Park Ridge interests

The liquidators contended that Mr Geaney caused Norman to sell its interests at an undervalue without obtaining valuations, thereby breaching s. 180 of the Act. However, Byrne SJA found that Mr Geaney's business expertise exempted him from being required to obtain valuations in order to satisfy his duty of care.

The claim that Mr Geaney contravened ss. 180 of the Act by acting on Mr Fennell's directions without independent thought also failed because it was not established that

Mr Fennell was an incompetent financial adviser. The s. 181 and s. 182 claims were unsuccessful as it was not established that Mr Geaney realised the price was materially below market value, that Mr Geaney knew that JHS's keenness to discontinue business with him diminished its bargaining power or that the possible rezoning permit significantly increased the land value.

(vi) Relief from liability

Relief was unavailable as Byrne SJA found Mr Geaney's strategy was dishonest.

6.11 Court reaffirms settled principles of unjust contracts under the *Contracts Review Act 1980 (NSW)*

(By Clementyne Rawlyk and Simone Lim of Corrs Chambers Westgarth)

Agricultural & Rural Finance Pty Ltd v Atkinson (No 2) [2014] NSWSC 1397, Supreme Court of New South Wales, Ball J, 14 October 2014

The full text of this judgment is available here.

(a) Summary

This decision of the Supreme Court of NSW considered whether an indemnity agreement in respect of loan documents entered into for a failed managed investment scheme was unjust within the meaning of the Contracts Review Act 1980 (NSW) (the CRA). It also reaffirmed the key principles which must be established in order to successfully make an estoppel claim.

(b) Facts

The case concerned investments made in two tea-tree plantation projects aimed at securing tax benefits for investors (the Projects). The Projects were managed investment schemes and therefore subject to the prospectus provisions of Parts 7.11 and 7.12 of the then *Corporations Law*.

The Projects were established and managed by Oceania Agriculture Ltd (OAL), and funding of the Projects was structured by the following round robin arrangement:

- investors had an option to enter into a loan agreement with Agricultural and Rural Finance Pty Ltd (ARF) pursuant to which ARF would fund their initial investment in the Projects;

- ARF in turn borrowed most of the money advanced to investors from OAL; and
- OAL raised the money it advanced to ARF from prior investors.

Investors also had the option of entering into an indemnity agreement whereby OAL agreed to indemnify investors against their liability to repay their loans to ARF, subject to certain conditions (the Indemnity Agreement). A key condition for being able to rely on the indemnity was the punctual repayment of the loan amounts by investors. Under the terms of the loan agreements entered into with investors, ARF agreed that where the indemnity was enforceable, it would look solely to OAL for repayment of the loans.

The Projects failed, largely due to the collapse of the price of tea tree oil. The plaintiff, ARF, brought an action against certain investors (the defendants) directly for recovery of outstanding amounts owing in respect of their loans.

The fact that the defendants had failed to make their respective loan repayments on time was not an issue in the case. Rather, the defendants cross claimed against OAL and the plaintiff that certain aspects of the Indemnity Agreements were unjust within the meaning of the CRA. Further, one defendant argued that ARF was estopped from asserting that the indemnity was not enforceable, on the basis that ARF had earlier represented to him that a failure to repay his loan on time would not invalidate the indemnity.

(c) Issues

The defendants sought to invoke the power of the Court under the CRA to vary the terms of the Indemnity Agreements, on the basis that they were unjust in the circumstances in which they were made.

The defendants claimed that those unjust circumstances included the following:

- the Projects were part of a complex funding structure whereby OAL would assume the commercial risk for the Projects, through the indemnity;
- the prospectuses misrepresented the funds that were available to fund the Projects, such that there was not enough cash to meet the estimated Project expenditure; and
- the loss of the indemnity for late payment by the investors was grossly disproportionate to any detriment suffered by OAL, and not necessary for the protection of ARF and OAL's interests under the loan agreements.

In addition, one of the defendants (Mr Wardle) argued that ARF was estopped from asserting that his indemnity was not effective by reason of late payment. In this regard, Mr Wardle had asked ARF (via his accountant) whether it would accept late payment of his loan amounts. In response, OAL's managing director, Mr Lloyd, confirmed that this would be "OK". Mr Wardle contended that this amounted to a representation by

ARF that the indemnity would not be forfeited if the loan repayments were paid after the due date, and that he relied on this representation to his detriment.

(d) Decision

(i) Were the Indemnity Agreements unjust?

The Court held that there was nothing in the Indemnity Agreements, or the circumstances in which they were granted, that rendered them unjust. The applicable provisions of the CRA indicated that the Court was bound to consider, among other factors, whether the Indemnity Agreements imposed unreasonable conditions, or led to unjust consequences for the parties.
The Court recognised the principle established in *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 (*West v AGC (Advances) Ltd*), that the CRA is "beneficial legislation" that "should be interpreted liberally".

As such, the Court balanced the following principles when determining whether the Indemnity Agreements were unjust:

- there is a public interest in protecting vulnerable parties from dishonesty, trickery or other forms of predatory contracts; and
- there is a public interest in "keeping people to their freely entered bargains" identified in *Baltic Shipping Co v Dillon* (1991) 22 NSWLR 1.

The Court, citing McHugh JA in *West v AGC (Advances) Ltd* at 620-1, also noted that a contract may be unjust because its terms, consequences or effects are unjust (substantive injustice), or because the methods used to make it were unfair (procedural injustice).

The Court held that the requirement to repay the loan amounts punctually, coupled with the clear explanation in the Indemnity Agreements that late repayment of the borrowed funds would forfeit the indemnity, meant there was no substantive injustice. As the Court indicated, the requirement to pay on time was not difficult to comply with, and was important for the commercial success of the Projects to OAL and ARF.

Further, the Court deemed the defendants to be sophisticated investors, either through their investment experience, the fact they had received financial advice (or were themselves advisers), or a combination of the two. None of the defendants were pressured to invest in the Projects; they were in fact given adequate time to read and consider the prospectuses. The prospectuses clearly indicated that the investments were speculative, which was made known to the defendants prior to investing. In these circumstances, the Court held there was no procedural injustice.

As to the complex round robin arrangements, the Court found that the defendants had failed to establish how these made the Indemnity Agreements unjust. It held that the Projects failed due to a collapse in the tea tree oil price and not because the Projects had insufficient funds to obtain commercial success. Put simply, the Projects were run in the manner the defendants were led to expect, regardless of the Project funding arrangements.

(ii) Did an estoppel operate to prevent ARF from seeking recovery from Mr Wardle?

Ball J rejected Mr Wardle's estoppel claim for the following reasons:

- Mr Lloyd's confirmation that ARF would accept late payment of Mr Wardle's loan instalments did not amount to a representation that indemnification by OAL would continue regardless of the payment delay. Instead, Mr Lloyd's confirmation was nothing more than an indication that ARF would not seek to enforce its right to accelerate payment of the balance of the loan or impose penalty interest by reason of default;
- in any event, Mr Lloyd lacked the authority to make the requisite representation on behalf of ARF. There was no actual authority conferred on him to act on behalf of ARF beyond its banking arrangements. Nor did ARF hold Mr Lloyd out as having ostensible authority to bind the company (*Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480); and
- Mr Wardle failed to establish that he relied on Mr Lloyd's representation to his detriment. In fact the indication by Mr Lloyd that ARF would accept Mr Wardle's late payment did not alter the timing of Mr Wardle's payment, or his obligation to continue making payments.

The Court's decision reaffirms the principle that relief from unjust contracts will be based on a wide range of circumstances, in addition to the terms of the contract itself. However, it will not typically extend to situations where parties freely enter into contracts after informed consideration of their terms, regardless of whether the terms of a contract favour one party over another, or if the expected benefits of a venture fail to materialise. Lastly, it is a useful reminder of the fundamental principles which must be established in order to successfully make an estoppel claim.

6.12 Court's approval for companies being wound up to enter into a sale agreement and security agreement

(By Tara Alexander, Herbert Smith Freehills)

Woods and White as joint and several liquidators of Little Tiger Pty Ltd (in liq) as trustee of the BPH Trust v Little Tiger Pty Ltd (in liq) [2014] WASC 372, Supreme Court of Western Australia, Pritchard J, 7 October 2014

The full text of this judgment is available here.

(a) Summary

Approval was given to the Liquidators' application for orders that the companies be wound up in insolvency, that the Liquidators be appointed, for the companies to enter into the Sale Agreement and Security Agreement and for various ancillary orders.

(b) Facts

Mr Woods and Mr White (the Liquidators) are the joint and several liquidators of the defendant companies. Each of the companies is a private company which acts as the trustee of a trust. In addition, the companies are partners in two partnership arrangements (the Partnerships) comprising of the BYBA Partnership and the BP Partnership. The Partnerships together conduct the Accounting Practice.

The Liquidators sought to sell the Accounting Practice to Barringtons Accounting Pty Ltd (the Buyer) via the Sale Agreement. This was done in order to maximise the value of the assets of the business. On the facts, the Partnerships would no longer be able to trade if the Sale Agreement did not complete within days and if the Partnerships ceased to trade, the Sale Agreement would not complete. If this event was to occur, it would affect the financial position of the Partnership, the Accounting Practice and the companies as well as affecting the companies' creditors, including the employees of the Accounting Practice. There were a number of safeguards within the Sale Agreement, designed to protect the sellers, including the Security Agreement which provides security for the payment by the Buyer of the purchase price under the Sale Agreement.

(c) Decision

(i) Companies be wound up in insolvency

Satisfied that the companies were unable to pay all their debts as and when they became due and payable, Pritchard J ordered that the companies be wound up in insolvency under s. 459A of the Corporations Act 2001 (Cth) (the Act). Upon application by the Liquidators, Pritchard J dispensed with the advertising and service requirements under s. 467(3)(b) of the Act due to the likely detrimental result if the Sale Agreement did not complete within days.

(ii) Appointment of the Liquidators

Pursuant to s. 532(2)(c) of the Act, leave was granted *nunc pro tunc* to permit the Liquidators to apply for appointment as the Liquidators.

(iii) Approval of the companies' entry into the Sale Agreement and the Security Agreement (the Agreements)

Section 477(2B) of the Act prohibits a liquidator from entering into an agreement on the company's behalf if the term of the agreement may be discharged by performance, more than three months after the agreement is entered into, save with the leave of the court or of the committee of inspection or of a resolution by the creditors. The Sale Agreement contained a number of obligations which could be discharged by performance more than three months after the Sale Agreement was entered into. Pritchard J quoted Gordon J's summary of the principles applicable to the grant of approval under s. 477(2B) in *Re Newtronics Pty Ltd; Ex parte Stewart* [2007] FCA 13 at [26]:

> The Court's role is to review the liquidator's proposal, paying due regard to his or her commercial judgment and knowledge of the circumstances, satisfying itself that the agreement is a proper exercise of power—that there is no error of law or ground for suspecting bad faith or impropriety and that its terms are clear—and weighing up whether there is any good reason to intervene in terms of the expeditious and beneficial administration of the winding up.

Pritchard J was satisfied with the evidence presented in order to give approval to the Liquidators to cause the companies to enter into the Agreements.

Pritchard J reached this conclusion having regard to the following six considerations:

- The terms of the Agreements were clear;
- The Agreements represented a proper exercise of the Liquidators' power as officers of the companies following an assessment of the best terms the Liquidators were able to negotiate, the benefits to creditors, and the surrounding circumstances;
- There was nothing to suggest bad faith or impropriety on the part of the Liquidators in negotiating the Agreements with the Buyer;
- The Commonwealth Bank of Australia (which had provided bank facilities to the Accounting Practice) consented to the Agreement;
- The Sale Agreement protected the position of the employees in the Accounting Practice; and
- The lengthy period of the obligations under the Agreements were appropriate to the needs of the companies in the winding up process.

Normally the Court's approval should be gained in advance, however Pritchard J was satisfied that it was appropriate to approve the Liquidators' entry into the Sale Agreement under s. 477(2B) *nunc pro tunc*. Pritchard J also made an order pursuant to

s. 1322(4) to extend the time for the Liquidators to make an application for approval under s. 477(2B) to the date of the hearing.

(iv) Ancillary orders

The Liquidators sought directions pursuant to s. 479(3) in relation to particular issues arising under the winding up. Conditional on full and fair disclosure by the liquidator, s. 479(3) protects the liquidator from liability for any alleged breach of duty as liquidator, in respect of anything done by the liquidator in accordance with the Court's direction. Pritchard J found that notice was not required to be given to the creditors regarding the application under s. 479(3) as in this case, the creditors would not be affected by the making of the directions.

The Liquidators sought to have their remuneration be determined by the creditors. They did not seek to enforce their rights arising under the terms of their engagement by the companies when they were appointed in the voluntary liquidation of the companies. For that reason, Pritchard J found it proper to give a direction under s. 479(3) that the remuneration of the Liquidators be determined by a resolution of the creditors pursuant to s. 473(3).

Pritchard J also granted directions regarding the accounts to be maintained. The Liquidators were permitted to maintain a single bank account in relation to each of the Partnerships due to the real practical difficulties in determining title to specific property in the Partnerships' arrangements.

6.13 Administrators awarded costs on an indemnity basis following unsuccessful challenge to validity of administrator appointment

(By Luca Del Ciotto, Herbert Smith Freehills)

Sliteris v Ljubic [2014] NSWSC 1632, Supreme Court of New South Wales, Black J, 19 November 2014

The full text of this judgment is available here.

(a) Summary

Section 436A of the Corporations Act 2001 (Cth) (the Corporations Act) states that a company may, by writing, appoint an administrator of the company if the board has resolved to the effect that:

a. in the opinion of the directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time; and

b. an administrator of the company should be appointed.

Following the findings in relation to compliance with s. 436A, Black J exercised his discretion with respect to costs, applying the principles laid down in *Colgate-Palmolive Co v Cussons Pty Ltd* [1993] FCA 801 so as to enable a departure from the usual "costs follow the event rule', awarding costs on an indemnity basis to Mr Ljubic and Mr Davis (the Administrators) of IONA Developments (the Company). Black J thus dismissed the proceedings on all accounts by the plaintiff (Mr Sliteris), finding that the appointment of the Administrators was compliant with the Corporations Act and was appropriate and logical in all the circumstances.

(b) Facts

The Company undertook a development of units at Bluett Drive, Smeaton Grange (near Camden) in New South Wales. By August 2012, it appeared that the Company's liabilities would likely exceed its assets, threatening solvency.

On 27 March 2014, Mr Sliteris's (the Plaintiff's) solicitors served a creditor's statutory demand on the Company. Following receipt of the letter by Mr Nicholas Harrow, Mr Stephens and Mr Peter Harrow (who was not a director of the Company), Mr Nicholas Harrow sent notice of a proposed directors' meeting to determine the Company's future. This notice, which was unsigned, was sent to Mr Stephens by email and to Mr Sliteris by facsimile on 2 April 2014. At or before the 4 April 2014 meeting, Mr Stephens asked whether Mr Sliteris had received notice of meeting and Mr Peter Harrow informed him, accurately, that notice of the meeting had been sent by facsimile to Mr Sliteris at about the same time that notice was given to Mr Stephens by email. The meeting resulted in the appointment of voluntary administrators to the Company, with the execution of a notice of appointment.

On 5 April 2014, Mr Sliteris sought to challenge the appointment of the administrators, contending that the notice of the directors' meeting at which the administrators had been appointed was "not in accordance with [the Company's] constitution and otherwise invalid". When the company was later placed into liquidation and wound up on application by Mr Sliteris, he sought to set aside the 4 April appointment of the administrators such as to not pay their reasonable remuneration.

(c) Decision

(i) Form and period of notice of directors meeting

Black J determined that both the form and period of notice for the meeting were sufficient to comply with the Corporations Act. Specifically, two days' notice was held to be reasonable as it would often be the case that a short period of notice would be sufficient for a meeting to consider whether to appoint voluntary administrators, given the risk imposed upon directors pursuant to s. 588G—the director's duty to prevent insolvent trading—regarding a company's solvency. Similarly, the form of the notice—with a signature absent and having been transmitted via facsimile—did not make such notice ineffective, when "there is also no requirement to give notice of the business to be transacted at the meeting or of the specific form of the resolutions to be passed" (*Mitropoulos v The Greek Orthodox Church and Community of Marrickville and District Ltd* (1993) 10 ACSR 134 at 137).

(ii) Assumptions regarding appointment of administrators

Section 129(1) of the Corporations Act states that a person may assume that the company's constitution (if any), and any provisions of the Act that apply to the company as replaceable rules, have been complied with.
The assumptions available to the Administrators pursuant to s. 129(1) entitled reliance on the "indoor management rule". Moreover, nothing was determined on the facts to give the administrators reasonable grounds to suspect any deficiency in their appointment, such as to negate reliance on the assumptions.

(iii) Appointment of administrators not inappropriate

The facts did not support the view that the appointment of an administrator pursuant to Part 5.3A was inappropriate in the circumstances. The appointment of a voluntary administrator was not inconsistent with the objects of Part 5.3A of the Corporations Act. The requirements for the appointment of voluntary administrators under s. 436A were similarly satisfied, where the board had resolved that the Company was insolvent or likely to become insolvent at some future time, and it appeared to be common ground that that was the case.

(iv) Duties owed by company accountant

Black J reiterated that the relationship between an accountant and corporate client is not a traditional fiduciary relationship. While Black J acknowledged the circumstances in which a professional relationship can give rise to responsibilities in the nature of fiduciary duties, such did not arise on the facts. Mr Harrow's alleged failure to advise on the most efficacious and cheapest method—as between liquidation and voluntary administration—was not a breach of fiduciary duty, nor did it involve a fiduciary duty.

(v) Cost orders

Given the finding of compliance with s. 436A, the court directed that the Administrators be paid reasonable fees for work done and for reimbursement of expenses, with the costs of the administration to be borne by the Company in the ordinary course and that any adjustments for costs be made as between the creditors (*McIntosh v CMX Technologies Pty Ltd (admin apptd)* [2005] NSWSC 1282).

Black J also determined that the Administrators be awarded costs on an indemnity basis. Relying on *Colgate-Palmolive Co v Cussons Pty Ltd* [1993] FCA 801, Black J recognised some "special or unusual feature in the case is needed to justify the Court in departing from the ordinary practice". Black J referred to the later abandoned allegations of inadequate advice and lack of independence made by the plaintiff against the Administrators. Black J's award of costs against the plaintiff on an indemnity basis thus reflected the view that it was unreasonable for Mr Sliteris to have put the Administrators (and, indirectly, the Company and its creditors) to the expenditure of the costs they have incurred in their successful defence of the proceedings.