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Bulletin No. 211

Legislation Hotline

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 Report on the relationship between the audit committee, the external auditor and the internal auditor

On 10 March 2015, the Center for Audit Quality in the United States published the report Intersecting Roles: Fostering Effective Working Relationships Among External Audit, Internal Audit, and the Audit Committee (March 2015). The report focuses on the relationship between the audit committee, the external auditor and the internal auditor and provides examples of communication and cooperation from various companies, with the goal of building a clearer understanding of what external auditors require to be able to use the work of internal audit, and when it is not appropriate to use that work.

The report documents practitioners' best practices and strategies for coping with challenges in three areas:

- creating a more productive and efficient external audit process;
- audit committees fostering better communication between internal and external auditors to build more effective working relationships; and
- introducing enterprise risk management to an organisation.

1.2 Germany passes law requiring 30% of the board seats of its largest companies to be held by women

The New York Times (NYT) reports (6 March 2015) that Germany has become the latest and most significant country so far to commit to improving the representation of women on corporate boards, passing a law that requires some of Europe's biggest companies to give 30% of supervisory seats to women beginning next year.

According to NYT, Norway was the first in Europe to legislate boardroom quotas, joined by Spain, France and Iceland, which all set their minimums at 40%. Italy has a quota of one-third, Belgium of 30% and the Netherlands a 30% nonbinding target.

The NYT article concludes by stating:

> A study last year from economists in the United States and Norway found that the

legislative mandates in some European nations led to more women on corporate boards. But they did not do much to usher more women into executive ranks, decrease the gender pay gap or increase family-friendly policies. These are goals that many advocates consider a truer guide as to whether women are advancing.

1.3 Proposed assessment methodologies for identifying non-bank non-insurer global systemically important financial institutions

On 4 March 2015, the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO) published for second public consultation Consultative Document (2nd) - Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (4 March 2015). The proposed methodologies for identifying non-bank non-insurer global systemically important financial institutions (NBNI G-SIFIs) complement the methodologies for identifying G-SIFIs that currently cover banks and insurers, and take into account responses (25 April 2014) received on the first consultative document (8 January 2014).

The proposed methodologies aim to identify NBNI financial entities whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity at the global level or NBNI G-SIFIs in short. These methodologies comprise a high-level framework and an operational framework for identifying G-SIFIs that would apply across NBNI financial entities, as well as detailed NBNI sector-specific methodologies. Detailed sector-specific methodologies include: (a) near-final methodologies for finance companies and market intermediaries; and (b) a revised proposal on sector-specific methodologies for asset management entities. The latter comprises a revised methodology for investment funds (including hedge funds) and a new proposed methodology for asset managers.

1.4 International audit regulators express concern over continued significant deficiencies in audits of public companies

On 3 March 2015, the International Forum of Independent Audit Regulators (IFIAR) reported concern about the recurrence of high levels of deficiencies in key areas of public company audits around the world. According to IFIAR, this demonstrates the need for audit firms to pursue initiatives to improve audit quality and the consistency of audit execution.

IFIAR's Report on 2014 Survey of Inspection Findings (3 March 2015) finds the highest number of audit inspection deficiencies in the areas of fair value measurement, internal control, and revenue—topics among the core building blocks of audited financial statements.

The rate of deficiencies in these audited areas, measured as the percentage of all inspected audits for these areas, also is high:

- Internal control testing, 24%;
- Fair value measurement, 20%; and
- Revenue recognition, 14%.

For audits of systemically important financial institutions, or SIFIs, including global banks and insurers, the survey found the highest number of deficiencies related to auditing of allowance for loan losses and loan impairments, internal control testing, and auditing the valuation of investments and securities.

IFIAR's report summarises key inspection results from audits of public companies, including systemically important financial institutions, submitted by 29 IFIAR members from around the world.

These results came from inspection reports issued during the members' most recent annual reporting periods that ended by July 2014. Findings of the report include that:

- the areas with most deficiencies in inspected audits of listed public interest entities, or public companies, relate to auditing fair value measurements; internal control testing; and revenue recognition;
- the areas with most deficiencies in audits of systemically important financial institutions, including global systemically important banks and insurers, relate to auditing of allowance for loan losses and loan impairments; internal control testing; and auditing of the valuation of investments and securities; and
- audit firms' own quality control systems had the highest number of inspection findings in the areas of engagement performance; independence and ethics requirements; and human resources.

The 29 IFIAR member countries reporting 2014 inspection findings inspected 948 public company audits and found deficiencies in 47% of those audits. Seventeen IFIAR member countries reported 2014 inspection findings on audits of systemically important financial institutions. Those members inspected 148 financial institution audits, of which 41% had deficiencies.

Further information is available on the Financial Reporting Council website.

1.5 Abolition of right of 100 shareholders to call a meeting

On 2 March 2015, the Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014 (Cth) was passed by the Australian Senate and the Bill is now awaiting Assent.

The changes proposed by the Bill include:

- the removal of the requirement for directors of a listed company to hold a general meeting on the request of 100 members. Members with 5% of voting shares remain able to call such a meeting while 100 members retain the right to put a resolution on the agenda of a general meeting;
- the reduction in the executive remuneration reporting requirements. Unlisted disclosing entities that are companies will not need to meet the requirement to prepare a remuneration report. Listed disclosing entities that are companies will report on the number of lapsed options of key management personnel, and the year in which those options were granted, rather than their value and the percentage of the individual's remuneration that consists of options;
- the removal of the requirement for certain small companies limited by guarantee to appoint or retain an auditor where they are not required to undertake an audit;
- giving the Remuneration Tribunal the authority to set the remuneration of the Chair and members of the Financial Reporting Council, the Australian Accounting Standards Board and the Auditing and Assurance Standards Board;
- giving Takeovers Panel members the powers to perform Panel functions while overseas; and
- clarifying the circumstances in which directors can determine that a financial year will be shorter than 12 months.

Earlier, on 11 February 2015, the Senate Economics Legislation Committee published its report (February 2015) on the Bill. Most of the report is devoted to the proposed elimination of the right of 100 shareholders to call an extraordinary general meeting of a listed company. The majority of the committee (with one member dissenting) recommended that the Bill be passed and it is stated in the report that "the committee considers that the amendments made by the present bill will improve [the Corporations Act 2001 (Cth)] and [the Australian Securities and Investments Commission Act 2001 (Cth)], by removing unnecessary regulation, clarifying existing regulatory obligations, and enhancing the efficient operation of certain government bodies".

Further information is available on the Parliament of Australia website.

1.6 Asia Region Funds Passport Rules released for public consultation

On 27 February 2015, the Australian Government released for consultation the internationally negotiated rules for the Asia Region Funds Passport (the Passport).

With $2.4 trillion in funds under management, Australia's funds management industry is well established. Only around 4% of those funds, however, are managed on behalf of foreign residents. The Passport will create a regional market for managed investment funds by facilitating cross-border issuing. According to the Government, this will provide Australian fund managers with an important opportunity to increase their presence in Asia and develop further business.

The Passport will also create a standardised set of rules that will apply across Passport participants while providing Australian investors with a greater choice of investment products.

The release of the rules for public consultation follows the signing of a statement of intent on the Passport by finance ministers from Australia, Korea, New Zealand and Singapore at the APEC Finance Ministers' Meeting in Bali in September 2013. Consultation will now take place jointly with government agencies from Korea, New Zealand, Singapore, Thailand, and the Philippines.

The consultation paper is available on the Asia Region Funds Passport website.

1.7 Survey of US directors points to importance of shareholder engagement, board diversity and oversight of cybersecurity

On 27 February 2015, NYSE Governance Services released its annually published *What directors think* survey. The survey of nearly 500 US directors highlights that daily risk oversight continues to be one of the central challenges facing boards, as well as an increased focus on shareholder engagement and board composition.

Communicating with shareholders occupies more of the board's time today, spurred by increased disclosure, majority voting in director elections, and say on pay, among other reasons. Nearly 90% of directors surveyed rated their board's understanding of its investor base as excellent or good, but respondents indicated the need for coaching, as well as the desire to bring on directors who have experience with shareholder activism. Almost two-thirds of the respondents noted that their board has clear protocols designed to outline how to engage with investors, but most respondents indicated that they have not been trained in this area.

Respondents recognised that shareholders desire more transparency into board composition and to keep pace with the changing corporate landscape, and boards acknowledged the need to have directors with varying skill sets. Respondents ranked industry expertise as the most important attribute of a potential director followed by financial expertise, IT/cyber experience, gender diversity, and CEO experience. Other attributes rising on the list compared to previous surveys include legal/regulatory experience and racial diversity. Risk oversight has historically been noted as a challenge facing the boardroom and this year's survey found that 55% of directors do not believe a public company board can ever fully anticipate the different aspects of risk in the current corporate environment, particularly emerging risks like cybersecurity and social media. Among the findings, the majority (80%) of boards noted that cyber risks were on the agenda in the past year. And social media risk continues to be a lower priority, with only 35% of respondents confirming that their board had discussed social media risk as an agenda item in the past year.

The survey results are available on the NYSE Governance Services website.

1.8 Disclosure standards for central counterparties

On 26 February 2015, the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) published Public quantitative disclosure standards for central counterparties (February 2015) (the Disclosure Standards).

To help ensure that the risks of using central counterparties (CCPs) are properly understood, CCPs need to make relevant information publicly available, as stated in the CPSS-IOSCO Principles for financial market infrastructures (April 2012). The CPSS and IOSCO published a Disclosure framework (December 2012) (the Framework) to improve the overall transparency of financial market infrastructures. The Framework primarily covers qualitative data that need relatively infrequent updating (for example, when there is a change to a CCP's risk management framework). To complement the Framework, the Disclosure Standards set out the quantitative data that a CCP should disclose more frequently.

Taken together with the Disclosure framework, the proposed disclosures in this document are intended to help stakeholders, including authorities, participants (direct, indirect and prospective) and the public, to:

- compare CCP risk controls, including financial resources to withstand potential losses;
- have a clear and accurate understanding of the risks associated with a CCP;
- understand and assess a CCP's systemic importance and its impact on systemic risk; and
- understand and assess the risks of participating in a CCP (directly, and to the extent relevant, indirectly).

1.9 Shareholder litigation and M&A deals in the United States

On 25 February 2015, Cornerstone Research published Shareholder Litigation Involving Acquisitions of Public Companies (undated), a report showing that the percentage of 2014 lawsuits filed by shareholders in M&A deals in the United States remained consistent with the previous four years, while other key indicators suggest a slowdown. The report reveals that investors contested 93% of M&A transactions in 2014. Despite this typically high percentage, shareholders brought a smaller number of competing lawsuits per deal and in fewer jurisdictions, challenged fewer deals valued below US$1 billion, and took slightly longer to file lawsuits.

In a significant shift from recent years, 60% of contested M&A deals had lawsuits filed against them in only one jurisdiction. Just 4% of these deals were challenged in more than two courts, the lowest number since 2007.

Key trends

- plaintiff attorneys filed more than 600 lawsuits challenging M&A deals announced in 2014 that were valued over US$100 million;
- the percentage of deals challenged in litigation remained high at 96% for deals valued

over $1 billion, but declined for deals valued under $1 billion, from 94% in 2013 to 89% in 2014;

- the average number of lawsuits per deal declined from 5.2 in 2013 to 4.5 in 2014, the lowest annual rate since 2009;
- the number of deals with more than 10 filings decreased, from 14 in 2013 to nine in 2014;
- the percentage of lawsuits resolved before M&A deals closed in 2014 slid to the lowest level since 2008. In 2014, only 59% of litigation was resolved before the deals were concluded, compared with 74% in 2013;
- only one M&A case in the data went to trial in 2014, resulting in a US$76 million damages award;
- lawsuits challenging M&A deals were filed more slowly in 2014. The first lawsuit was filed an average of 14 days after the deal announcement, compared with 11 days in both 2012 and 2013; and
- similar to prior years, almost 80% of settlements reached in 2014 provided only additional disclosures. Just six settlements involved payments to shareholders.

1.10 IOSCO reviews implementation of financial benchmark principles

On 25 February 2015, the International Organization of Securities Commissions (IOSCO) published Review of the Implementation of IOSCO's Principles for Financial Benchmarks (February 2015).

The report sets out the findings of IOSCO's review of the implementation of its *Principles for Financial Benchmarks* (the Principles) by a sample of administrators of financial benchmarks across a range of geographical areas and asset classes.

The review indicated that there has been a significant market reaction to the publication of the Principles, with widespread efforts being made to implement the Principles by the majority of the administrators surveyed. The responses received from administrators also show that the benchmarks industry is in a state of change, as seen from the reported levels of administrators continuing to work towards compliance with the Principles as well as examples of benchmarks being transitioned to new methodologies and administrators. The report notes that further steps may need to be taken by IOSCO in the future; however it is too early to determine what those steps should be.

The Principles were published in July 2013 with the aim of creating an overarching framework of principles for benchmarks used in financial markets, covering governance and accountability, as well as the quality and transparency of benchmark design and methodologies.

Further information is available on the IOSCO website.

1.11 IOSCO report on prudential standards in the securities sector

On 24 February 2015, the International Organization of Securities Commissions (IOSCO) published Final Report - A Comparison and Analysis of Prudential Standards in the Securities Sector (February 2015), which makes a high level comparative analysis of the key prudential/capital frameworks for securities firms.

The report seeks to highlight similarities, differences and gaps among the different frameworks. IOSCO's objective is to update its 1989 report *Capital Adequacy Standards for Securities Firms* (the Capital Standards Report), based on the issues identified in this report.

The report's comparative analysis focuses on the Net Capital rule (NCR) approach, in particular the US approaches, and the Capital Requirements Directive (CRD), which is founded on the Basel Committee approach. While focusing on those two main prudential frameworks, the report also recognises relevant national variations.

Many of the key themes identified in the report are already reflected in the existing IOSCO capital adequacy standards report, such as the need for risk-based capital requirements and for minimum capital requirements that reflect the type of business being conducted by securities firms.

The report highlights prudential regulatory and supervisory areas that might be considered in an update of the 1989 Capital Standards Report, particularly:

- to identify opportunities for regulatory capital arbitrage that might (or actually have) materialised from differences in prudential regulations across jurisdictions; and
- to account for the increasing use of internal models and the commensurate increase in infrastructure, systems and controls that are necessary to help ensure that firms are not undercapitalized compared to the risks posed by their positions and activities.

Further information is available on the IOSCO website.

1.12 United Nations guidance for businesses on human rights reporting

On 24 February 2015, the United Nations (UN) issued a Reporting Framework (undated) for its UN Guiding Principles on Business and Human Rights (2011) (the Guiding Principles), which contains guidance designed to assist companies to report on human rights issues in line with the Guiding Principles.

The reporting framework comprises 31 questions which address the reporting principles. The implementation guidance to the reporting framework addresses each question of the reporting framework and states its objective, and provides supporting guidance, relevant information, citations from the Guiding Principles and cross-reference points to eight other reporting initiatives.

1.13 Report of US President's Council of Economic Advisors on the costs of conflicted financial advice

On 23 February 2015, the US President's Council of Economic Advisors published the report The effects of conflicted investment advice on retirement savings (February 2015). The report shows how misaligned incentives cause advisers to move clients to higher-cost financial products with higher fees.

The research findings include that:

- conflicted advice leads to lower investment returns for working and middle class families. Working and middle class families receiving conflicted advice earn returns roughly one percentage point lower each year (for example, conflicted advice reduces what would be a 6% return to a 5% return);
- an estimated US$1.7 trillion of Individual Retirement Account (IRA) assets are invested in products that generally provide payments that generate conflicts of interest. Thus, the aggregate annual cost of conflicted advice is about US$17 billion each year;
- a typical worker who receives conflicted advice when rolling over a 401(k) balance to an IRA at age 45 will lose an estimated 17% from their account by age 65. In other words, if

a worker has US$100,000 in retirement savings at age 45, without conflicted advice it would grow to an estimated US$216,000 by age 65 (adjusted for inflation), but if they received conflicted advice it would only grow to US$179,000—a loss of US$37,000 or about 17%; and

- a retiree who receives conflicted advice on how to invest their IRA at retirement will lose an estimated 12% of the value of their savings if drawn down over 30 years compared to a retiree who receives unconflicted advice.

In response to the report, on 23 February 2015 US President Barack Obama announced that the US Department of Labor will propose a new rule that will require retirement advisers to put their client's best interest first, by expanding the types of retirement investment advice subject to the *Employee Retirement Income Security Act*—i.e. when giving advice relating to retirement accounts. Such a duty is already imposed on investment advisers who register with the US Securities and Exchange Commission. The change would put brokers—who sell stocks, bonds, annuities and other investments—under the stricter requirements for registered financial advisers when they provide advice relating to retirement accounts.

1.14 UK Prudential Regulation Authority issues consultation paper on how it will hold senior managers and certain non-executive directors accountable for failure to meet its requirements

On 23 February 2015, the UK Prudential Regulation Authority (PRA) issued a consultation paper (February 2015) setting out how it proposes to hold senior managers in banks, building societies and designated investment firms to account if they do not take reasonable steps to prevent or stop breaches of regulatory requirements in their areas of responsibility.

The Financial Services (Banking Reform) Act 2013 c. 33 (UK) (the Banking Reform Act) introduced new powers which allow the PRA and Financial Conduct Authority (FCA) to impose regulatory sanctions on individual senior managers when a bank breaches a regulatory requirement if the senior manager responsible for the area where the breach occurred cannot demonstrate that they took reasonable steps to avoid or stop it.

The PRA has now published proposed guidance for banks clarifying how it will exercise this new power; including examples of the kind of actions which may constitute reasonable preventive steps and how firms and individuals may evidence them.

The Banking Reform Act also creates a separate offence which could result in individual senior managers being held criminally liable for reckless decisions leading to the failure of a bank. This new criminal offence will, however, be subject to the usual standard of proof in criminal cases (beyond reasonable doubt).

In November, the PRA indicated that it would issue a further consultation confirming how the PRA will apply the new Senior Managers' Regime and Senior Insurance Managers' Regime to NEDs in banks and insurers respectively.

The PRA also proposes that it will apply the Senior Managers' Regime and Senior Insurance Managers' Regime to the following non-executive directors in banks and insurance companies:

- Chairperson;
- Senior Independent Director;
- Chair of the Risk Committee;
- Chair of the Audit Committee; and
- Chair of the Remuneration Committee.

The PRA's Senior Managers' Regime and Senior Insurance Managers' Regime will therefore focus on those NEDs with specific responsibilities for areas or committees directly relevant to a firm's safety and soundness. In addition to any collective responsibility they may have as members of the board, non-executives in scope of the Senior Managers' Regime and Senior Insurance Managers' Regime will be held individually accountable for their areas of responsibility. The PRA is also proposing to require firms to ensure that all board members are held to high standards of conduct.

Further information is available on the Bank of England website.

1.15 Resolution regime for financial market infrastructures

On 20 February 2015, the Australian Treasury published a consultation paper on a resolution regime for financial market infrastructure. Financial market infrastructures (FMIs) include critical elements of the financial system such as central counterparties and trade repositories, and to some extent also major exchange markets. FMIs have been growing in importance under recent global reforms, in particular those requiring central clearing of over-the-counter (OTC) derivatives. There is accordingly increased awareness that a failing FMI could pose a risk to the stability of the financial system and that a resolution framework is required to guard against that risk. International bodies such as the Financial Stability Board (FSB) have noted this emerging risk and have developed standards setting out the powers regulators should have to resolve a failing FMI.

Initial high-level consultation on a proposed framework was conducted in 2012 in the consultation paper Strengthening APRA's crisis management powers (September 2012). Further work was halted under the moratorium imposed by the federal government in 2013 pending the completion of the Financial System Inquiry (FSI). The FSI final report was released in December 2014. Recommendation 5 *inter alia* supports completion of the policy development and consultation process with respect to an FMI resolution framework.

The consultation paper accordingly sets out a proposal for an FMI resolution framework and requests submissions on key issues and questions arising in this context. It discusses a number of key matters relating to the proposed framework, including:

- institutional scope of the framework, i.e. which types of entities should be subject to the resolution regime;
- resolution authorities, i.e. which regulators should act as resolution authorities for particular types of FMIs, as well as the objectives that should guide their work and the powers that they should be given;
- matters relating to the funding of resolution actions; and
- enhancements to the directions powers of regulators and resolution authorities, primarily for the purpose of supporting the successful implementation of recovery and resolution actions.

These proposals are consistent with the standards promulgated by the FSB.

The consultation paper is available on the Treasury website.

1.16 European Commission consults on a single market for capital, prospectuses and securitisation

On 18 February 2015, the European Commission launched three consultations dealing with a European single market for capital, prospectuses and securitisation.

(a) Single market for capital

The Capital Markets Union aims to break down the barriers that are blocking cross-border investments in the EU and preventing businesses from getting access to finance.

The key objectives of the consultation are:

- improve access to finance for all businesses and infrastructure projects across Europe;
- help small and medium-sized enterprised (SMEs) raise finance as easily as large companies;
- create a single market for capital by removing barriers to cross-border investments; and
- diversify the funding of the economy and reduce the cost of raising capital.

The consultation paper identifies the following key principles which should underpin a Capital Markets Union (CMU):

- it should maximise the benefits of capital markets for the economy, growth and jobs;
- it should create a single market for capital for all 28 Member States by removing barriers to cross-border investment within the EU and fostering stronger connections with global capital markets;
- it should be built on firm foundations of financial stability, with a single rulebook for financial services which is effectively and consistently enforced;
- it should ensure an effective level of investor protection; and
- it should help to attract investment from all over the world and increase EU competitiveness.

The consultation paper also seeks views on how to overcome other obstacles to the efficient functioning of markets in the medium- to long-term, including how to reduce the costs of setting up and marketing investment funds across the EU; how to further develop venture capital and private equity; whether targeted measures in the areas of company, insolvency and securities laws as well as taxation could materially contribute to the CMU; and the treatment of covered bonds, with a specific consultation in 2015 on a possible EU framework.

(b) Prospectus directive review

The Commission has launched its consultation on the Prospectus Directive with a view to making it easier for companies (including SMEs) to raise capital throughout the EU while ensuring effective investor protection. The consultation will, among other things, consider ways to simplify the information included in prospectuses, examine when a prospectus is necessary and when it is not and how to streamline the approval process.

(c) Securitisation review

Securitisation is the process where a financial instrument is created by pooling assets: more investors are then able to purchase shares of those assets, thereby increasing liquidity and freeing up capital for economic growth. An EU-wide initiative on "high-quality" securitisation is aimed at ensuring high standards of process, legal certainty and comparability across securitisation instruments through a higher degree of standardisation of products. This would notably increase the transparency, consistency and availability of key information for investors, including in the area of SME loans, and promote increased liquidity. This should facilitate issuance of securitised products, and allow institutional investors to perform due diligence on products that match their asset diversification, return and duration needs.
Available on the European Commission website are consultation papers (all dated 18 February 2015) on the following:

- Capital Markets Union;
- prospectus directive (further information); and
- securitisation (further information).

1.17 Crowdfunding developments - Singapore proposals for securities-based crowdfunding

Countries are continuing to develop regimes for crowdfunding. On 16 February 2015, the Monetary Authority of Singapore (MAS) published a consultation paper setting out proposals to facilitate access by corporates to alternative sources of funding through securities-based crowdfunding (SCF).

Under the proposals, the, MAS would facilitate SCF offers to accredited investors (AIs) and institutional investors through the following initiatives:

- MAS proposes to ease the current financial requirements for intermediaries that deal in securities, so long as they do not handle or hold customer monies, assets or positions and do not act as principal in transactions with customers. The minimum base capital requirement for such intermediaries would be lowered to S$50,000, and they would not need to lodge a security deposit of S$100,000 with MAS. The current base capital requirement is S$250,000 or S$500,000 if such intermediaries deal with AIs or retail investors respectively. This would allow potential SCF platform operators with lower financial resources to apply for a licence to offer SCF investments.
- MAS has clarified that the advertising restriction for restricted offers made to AIs (that are exempted from the prospectus requirement) does not prohibit SCF platform operators from advertising their platforms, so long as reference is not made to any specific SCF offer listed on their platforms. This clarification would provide certainty to potential SCF platform operators on the manner in which they could publicise their business.

The consultation paper is available on the MAS website.

1.18 Current IOSCO projects

On 13 February 2015, the Board of the International Organization of Securities Commissions (IOSCO) announced that its current work includes:

- research with the Financial Stability Board on Non-Bank Non-Insurance SIFIs including the timing of implementation of margin requirements for non-cleared OTC derivatives;
- research on central counterparties (CCPs), asset management and conduct risk;
- the development of new mandates on secondary bond market liquidity and order routing incentives;
- identification of current risks in capital markets including a proposal to identify the risks and vulnerabilities in market based financing and a proposal to develop tools for identifying data gaps and eliminating barriers to data gathering; and
- research on cyber resilience, investor protection, credible deterrence, IOSCO's Enhanced Multilateral Memorandum of Understanding on cooperation and the exchange of information and cross border regulation.

Further information is available on the IOSCO website.

1.19 European financial benchmarks reforms

On 13 February 2015, the Council of the European Union announced that it has responded to the recent scandals over the manipulation of the LIBOR and EURIBOR financial benchmarks by progressing the approval process for new rules to enhance the robustness and reliability of benchmarks, which are used in financial instruments (e.g. bonds, shares, futures or swaps) and financial contracts (e.g. mortgages or consumer contracts) in the EU.

The European Commission adopted a proposal for a Regulation on benchmarks on 18 September 2013 with the aim of improving the functioning and governance of benchmarks produced and used in the EU and ensuring they were not subject to manipulation. The Council announced that it has agreed on a negotiating mandate towards agreement with the European Parliament on that proposal. Once the European Parliament has agreed a position, EU co-legislators will negotiate in order to find a final agreement on the text.

When adopted, the new rules will contribute to the accuracy and integrity of benchmarks used in financial instruments and financial contracts by:

- ensuring that contributors to benchmarks are subject to prior authorisation and on-going supervision depending on the type of benchmark (e.g. commodity or interest-rate benchmarks);
- improving their governance (e.g. management of conflicts of interest) and requiring greater transparency of how a benchmark is produced; and
- ensuring the appropriate supervision of very important, so-called critical benchmarks, such as Euribor/Libor, the failure of which might create risks for many market participants and even for the functioning and integrity of markets of financial stability.

The commission expects a final agreement by the middle of 2015.

Further information is available on the European Union website.

1.20 Key considerations for board and audit committee members

In January 2015, PwC's Centre for Corporate Governance published its Key considerations for board and audit committee members 2014-15 (undated). The report focuses on topics that directors may want to consider in the coming year as part of their evolving oversight roles.

These topics include:

- shareholder activism;
- emerging technologies (big Data, mobile computing, the cloud, and social media);
- risk oversight;
- cybersecurity;
- crisis management;
- financial reporting and revenue recognition; and
- noteworthy investor perspectives.

Further information is available on the PwC website.

2. Recent ASIC Developments

2.1 Report on no-claims discount schemes for motor vehicle insurance policies

On 26 February 2015, ASIC released a report on the operation of no-claims discount (NCD) schemes for motor vehicle insurance policies: Report 424 - Review of no-claims discount schemes (February 2015). The report found that these schemes do not operate in the way consumers might reasonably expect.

NCD schemes which are described by insurers as "no-claims bonus", "no-claims discount" or "ratings" schemes, typically offer discounts to consumers who do not make claims. The schemes are a prominent feature of many comprehensive motor vehicle insurance policies, and are generally presented by insurers as a means of rewarding careful driving. Some schemes also allow consumers to keep the highest no claim discount percentage even when at-fault claims are made.

ASIC found that NCD schemes create an impression that claims history has been separated from other factors that determine the price of an insurance policy. ASIC found that this is not the case in practice, and consumers may not understand the full impact a claim may have on their premium. For example:

- making a not-at-fault claim can have an effect on the underlying premium even where there is no effect on the NCD rating; and
- making an at-fault claim can have an effect on the underlying premium in addition to the NCD rating.

Key findings from the report include:

- Purchased ratings protection can be a poor value proposition: Purchased "ratings protection" is a feature offered by most brands that allows a consumer to pay an amount of money to retain their NCD rating, even when making a claim that would otherwise affect their rating. ASIC found that in some instances the cost of purchasing ratings protection is higher than the benefit obtained by maintaining the NCD rating.
- Disclosure can be improved: ASIC found that while the disclosure of key elements of an NCD scheme varied considerably between brands, there was room for improvement across the board so that consumers can make fully informed decisions about purchasing or renewing a particular insurance policy or about making a claim.
- NCD schemes involve inconsistent messaging: ASIC found that insurers generally position their NCD schemes as a reward for careful driving. However, ASIC found that for most brands the majority of consumers (between 90% and 99%) are on the highest NCD rating. The concept of rewarding careful drivers is further challenged by brands that offer ratings protection, which can reward drivers who claim and result in partial subsidisation of these consumers by other consumers who do not make claims.
- Some consumers may be unable to realise full discounts: ASIC found that the majority of insurers apply minimum premiums, which have the potential to undermine and limit the full NCD entitlement. It found that the existence and application of minimum premiums is generally poorly disclosed.

Further information is available on the ASIC website.

2.2 Second report on corporate finance regulation

On 24 February 2015, ASIC published Report 423 - ASIC regulation of corporate finance: July to December 2014 (February 2015) (REP 423), the second report in its series on the regulation of corporate finance issues in Australia.

REP 423, which covers the period July to December 2014, provides companies and their advisers with insights into ASIC's regulatory approach in the corporate finance sector and aims to assist them with their associated legal and compliance obligations.

REP 423 provides statistical data, highlights key focus areas, and includes relevant guidance about ASIC's regulation of:

- fundraising transactions;
- mergers and acquisitions;

- corporate governance issues;
- financial reporting; and
- share buy-backs.

REP 423 details the approach ASIC takes in these areas, including the types of issues that have caused ASIC to intervene, and ASIC's approach to novel issues seen in transactions during the period.

Further information is available on the ASIC website.

2.3 Consultation on collective action by investors

On 17 February 2015, ASIC announced that it is reviewing its regulatory guidance for investors who want to take collective action to improve the corporate governance of listed entities. Consultation Paper 228 - Collective action by investors: Update to RG 128 (February 2015) (CP 228) proposes draft updates (February 2015) to *Regulatory Guide 128 - Collective action by institutional shareholders* (RG 128).

Collective action by investors can give rise to compliance issues under the takeover and substantial holding provisions of the law. These provisions are concerned with the aggregated voting power of groups of investors who are either related to or associated with some aspect of the entity's affairs. For instance, an agreement to vote together on a matter could result in an investor contravening the 20% takeover threshold.

CP 228 includes:

- updated guidance on how the takeovers and substantial holding notice provisions apply to collective action by investors, including illustrative examples of conduct which is unlikely or likely to trigger these provisions
- an outline of ASIC's proposal to approach enforcement in relation to these provisions by focusing on conduct that is control seeking rather than simply promoting good corporate governance; and
- an overview of other legal and regulatory issues that can arise in relation to investor engagement.

ASIC also proposes to discontinue the existing class order relief available to facilitate agreements between institutional investors about voting as it does not reflect the way in which institutional investors tend to engage with entities and has not been used for many years.

Further information is available on the ASIC website.

3. Recent ASX Developments

3.1 Consultation paper on reducing red tape

The Australian Securities Exchange (ASX) has released the consultation paper Reducing Red Tape: Results of Consultation Process and Invitation to Comment on Additional Rule and Procedure Changes - Guidance Note 1 *Admission as a Participant*, New Participant Application Form (16 February 2015). The paper summarises and responds to submissions from the "Reducing Red Tape" consultation package that ASX released on 31 October 2014.

Subject to further feedback, ASX will seek regulatory approval for Rule and Procedure amendments regarding the red tape consultation package. The consultation paper also attaches ASX's proposed Guidance Note 9 on "Offshoring and Outsourcing".

ASX is inviting comments from participants, their advisers and their stakeholders regarding:

- Rule and Procedure amendments identified in the consultation paper;
- drafts of a new Guidance Note 1 on "Admission as a Participant"; and
- a draft new participant admission application form for ASX and ASX 24 markets and the ASX Clear, ASX Clear (Futures) and ASX Settlement facilities.

Further information is available on the ASX website.

3.2 Consultation paper on continuous disclosure

On 6 March 2015, ASX released a consultation paper seeking comments from listed entities and other stakeholders on proposed changes to *ASX Listing Rules Guidance Note 8 - Continuous Disclosure: Listing Rules 3.1 - 3.1B*.

The changes expand the guidance given in relation to analyst and investor briefings, analyst forecasts, consensus estimates and earnings surprises.

The consultation paper is available on the ASX website.

3.3 Reports

On 4 March 2015 ASX released:

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

for February 2015.

4. Recent Research Papers

4.1 How are distressed firms sold? Evidence from termination fees

The authors provide evidence that large termination fees mitigate contracting problems in acquisitions of distressed firms. Targets negotiate larger termination fees when suffering from financial constraints and low investment. Premiums are lower in bids with large fees, but switching regressions suggest that targets would receive even lower premiums with smaller fees. Target managers in large fee deals do not receive superior severance or employment packages from bidders, and such deals are more likely to attract competing bids, suggesting they do not "lock-in" friendly bidders. Instead, large fees appear to facilitate acquisitions of constrained targets by ensuring bidders recover their bidding costs.

The paper is available on the SSRN website.

4.2 Information networks: Evidence from illegal insider trading tips

This paper exploits a novel hand-collected dataset to provide a comprehensive analysis of the social relationships that underlie illegal insider trading networks. The author finds that inside information flows through strong social ties based on family, friends, geographic proximity, and ancestry. On average, inside tips originate from corporate executives and reach buy-side investors after three links in the network. Inside traders earn prodigious returns of 35% over 21 days, with traders farther from the original source earning lower returns, but higher dollar gains. More broadly, this paper provides some of the only evidence on information networks that employs direct observations of person-to-person communication.

The paper is available on the SSRN website.

4.3 Rules versus principles based financial regulation

The authors study the relative strengths and weaknesses of principles based and rules based systems of regulation. In the principles based systems there is clarity about the regulatory objectives but the process of reverse-engineering these objectives into meaningful compliance at the firm level is ambiguous, whereas in the rules based systems there is clarity about the compliance process but the process of forward-engineering this into regulatory objectives is also ambiguous. The ambiguity leads to social costs, the level of which is influenced by regulatory competition. Regulatory competition leads to a race to the bottom effect which is more harmful under the principles based systems. Regulators applying principles based systems make dramatic changes in the way they regulate faced with regulatory competition, whereas regulators applying rules based systems make less dramatic changes, making principles based regulation less robust than rules based regulation. Firms prefer a rules based system where the cost of ambiguity is borne by society rather than the firms, however, when faced with regulatory competition they are better off in principles based systems if the direct costs to firms is sufficiently small.

The paper is available on the SSRN website.

4.4 Delaware and the transformation of corporate governance

The corporate governance arrangements of publicly traded companies have been transformed over the past four decades. Various observers have suggested that Delaware, where more than half of US public companies are incorporated, has done much to influence corporate governance changes. This article considers the nature and extent of Delaware's contribution to the development of corporate governance, indicating in so doing that this contribution was substantial but not decisive. Delaware had only a marginal impact on changes affecting key corporate governance topics such as executive pay and shareholder activism. On the other hand, with boards a series of well-known Delaware court decisions in the mid-1980s fortified the status of independent directors and provided incentives for boards to be attentive. Also, Delaware court rulings helped to bring to an end the hectic takeover activity of the 1980s, which in turn likely prompted a shift in emphasis away from the market for corporate control in favour of "internal" corporate governance mechanisms.

The paper is available on the SSRN website.

4.5 Myopic investor myth debunked: The long-term efficacy of shareholder advocacy in the boardroom

Over the past two decades, hedge fund activism has emerged as a new form of corporate governance mechanism that brings about operational, financial and governance reforms to a corporation. Many prominent business executives and legal scholars are convinced that the entire American economy will suffer unless hedge fund activism with its perceived short-termism agenda is significantly restricted. Shareholder activists and their proponents claim hedge funds function as a disciplinary mechanism to monitor management and are instrumental in mitigating the agency conflict between managers and shareholders. The authors find statistically meaningful empirical evidence to reject the anecdotal conventional wisdom that hedge fund activism is detrimental to the long term interests of companies and their long term shareholders. Moreover, their findings suggest that hedge funds generate substantial long term value for target firms and its long term shareholders when they function as a shareholder advocate to monitor management through active board engagement.

The paper is available on the SSRN website.

4.6 Foundations of responsible leadership: Asian versus western executive responsibility orientations toward key stakeholders

Exploring the construct of social-responsibility orientation across three Asian and two Western societies (Germany, Hong Kong, Japan, South Korea, and the United States), the authors show evidence that top-level executives in these societies hold fundamentally different beliefs about their responsibilities toward different stakeholders, with concomitant implications for their understanding and enactment of responsible leadership. The authors further find that these variations are more closely aligned with institutional factors than with cultural variables, suggesting a need to clarify the connection between culture and institutions on the one hand and culture and social-responsibility orientations on the other.

The paper is available on the SSRN website.

5. Recent Corporate Law Decisions

5.1 Federal Court of Australia finds that loan statement not capable of conversion to bill of exchange

(By Emily Steiner, DLA Piper)

Wilmink v Westpac Banking Corporation [2015] FCAFC 17, Federal Court of Australia, Full Court, Foster, Yates and Gleeson JJ, 23 February 2015

The full text of this judgment is available here.

(a) Summary

The Full Court of the Federal Court of Australia heard an appeal from two decisions of a single judge of the Federal Court. The claim was based upon an alleged default by the bank under a purported bill of exchange. In order to determine the claim, the Court was required to consider whether or not a particular loan statement was in fact capable of conversion into a bill of exchange.

The Court held that the loan statement did not satisfy the requirement in s. 25 of the Bills of Exchange Act 1909 (Cth) (the Bills of Exchange Act) of a "simple signature on a blank stamped paper", and as such, it was not a document capable of being converted into a bill of exchange.

(b) Facts

Mr Waden, as trustee of the Waden Family Investment Trust, entered into a loan agreement with the bank through RAMS Financial Group Pty Ltd (RAMS), acting as loan originator. The loan was secured by a mortgage over real property and by a guarantee given by Mr Waden in favour of the bank. RAMS is a wholly owned subsidiary of the bank.

The bank (by its solicitors) issued default notices dated 23 April 2012 to Mr Waden both in his personal capacity and in his capacity as trustee of the Waden Family Investment Trust. It subsequently commenced proceedings in the District Court of Queensland seeking judgment for $313,563.55 being the amount of the loan plus interest, and possession of the security property.

RAMS sent Mr Waden a loan statement for the period 1 March–31 May 2012 (the Loan Statement). Mr Waden claimed that on 21 May 2013, he paid to Westpac the sum of $325,000 by Registered Post which was the amount claimed in the statement of claim plus incidentals. He claimed that he had paid the sum of $325,000 by way of a bill of exchange.

The document comprised four pages, including the Loan Statement on which there were several handwritten annotations and stamps, together with other pages created by Mr Waden or on his behalf. The document contained a section titled "Default and Liability Clause". The latter section is claimed to impose an obligation on the bank to pay $1.3 million to Mr Waden in certain circumstances.

On 2 December 2013, the rights created in Mr Waden by the Default and Liability Clause, if any, were allegedly assigned to Mr Wilmink as trustee of the Bangarra Trust. On 13 December 2013, a judge of the District Court ordered that the bank have summary judgment on its money claim and its claim for possession of the security property. Wilmink then asserted an entitlement to damages against the bank in the sum of $1.3 million. The underlying proposition was that, by RAMS's act in issuing a loan statement, Mr Waden was enabled to impose upon the bank (through the creation of the purported bill of exchange) a liability for damages of $1.3 million.

The appellants contended that the primary judge erred in finding that "a Loan Statement was incapable of conversion to a bill of exchange as referred to in section 25" of the Bills of Exchange Act.

The appellants also complained that the primary judge denied them procedural fairness by hearing the proceeding on the papers.

(c) Decision

(i) Was the Loan Statement capable of conversion to a bill of exchange?

The primary judge concluded that the purported bill of exchange was not a bill within the meaning of the Bills of Exchange Act and that the various provisions of that Act relied upon by the appellants (Mr Wilmink and Mr Paalvast) to support their claim had no relevant operation. This finding was not challenged on appeal.

The primary judge also found that the Loan Statement was not capable of conversion into a bill of exchange because, as is required by s. 25:

- it was not a "simple signature on a blank stamped paper"; and
- it was not "stamped with an impress duty stamp" apart from an Australian five-cent stamp which either Mr Waden or the appellants appeared to have affixed themselves.

On appeal, Foster, Yates and Gleeson JJ found that the words "simple signature" refer to a mark which indicates that the document bearing the mark may be converted into a bill. In this case, there was nothing to indicate that the logo on the Loan Statement was intended to have that function. Their Honours concluded that the mere reproduction of the logo on the Loan Statement, without more, does not perform that function, and there was no other evidence suggesting that it was intended to perform that function. It followed from this finding that the primary judge was correct in concluding that the Loan Statement did not satisfy the requirement in s. 25 of a "simple signature on a blank stamped paper". As such, the Loan Statement was not a document capable of being converted into a bill of exchange.

(ii) Procedural fairness

Foster, Yates and Gleeson JJ did not consider that the primary judge had denied the appellants procedural fairness. Their Honours held that the primary judge's reasons revealed that she was satisfied that determination of the matter would not be significantly aided by an oral hearing because the requirements of s. 20A(2)(c) of the Federal Court of Australia Act 1976 (Cth) were satisfied.

That is, her Honour was satisfied that determination of the matter would not be significantly aided by an oral hearing because:

- there was no real issue of fact relevant to determination of the matter; and
- the legal arguments in relation to the matter can be dealt with adequately by written submissions.

This was not a case where it was necessary to assess credibility or differing versions of events. The questions concerned the proper construction of the Bills of Exchange Act. It was open to the primary judge to determine that no oral hearing was required.

5.2 Settlement arrangement with third party not an uncommercial transaction

(By Antony Freeman and Will Heath, King & Wood Mallesons)

640 Elizabeth Street Pty Ltd (in liq) v Maxcon Pty Ltd [2015] VSC 22, Supreme Court of Victoria, Sifris J, 20 February 2015

The full text of this judgment is available here.

(a) Summary

A developer failed to set aside and pay a builder certain amounts in breach of a building contract. The developer, developer's agent and builder entered into a settlement arrangement under which the builder was provided with security over the property of the developer's agent in exchange for the builder's forbearance of legal action. The developer's agent fell into administration and was wound up. Its liquidators commenced proceedings against the builder claiming the settlement arrangement was an uncommercial transaction under s. 588FB of the Corporations Act 2001 (Cth) (the Act). Sifris J upheld the trial judge's decision that the arrangement was not an uncommercial transaction.

(b) Facts

640 Elizabeth Street Pty Ltd (640) and Jabbour 640 Pty Ltd entered into a joint venture deed (JVD) for the development of 640 Elizabeth Street, Melbourne (the Property). Elan Apartments Pty Ltd (Elan) was the special purpose vehicle (SPV) for the project. Under the JVD, 640 was appointed to act as agent of Elan, with responsibility for the primary conduct and management of the development. Elan entered into a building contract with Maxcon Pty Ltd (Maxcon) for the construction of apartments on the Property. Under the building contract, certain amounts were to be set aside by Elan and paid to Maxcon on completion of the development.

The Property development completed, but Maxcon was not paid the relevant amounts by Elan. Maxcon discovered that the amounts required to be set aside and paid by Elan under the building contract had been misappropriated to pay off a separate debt. Maxcon requested security over Elan's debt.

In consideration of Maxcon's forbearance to sue in respect of the unpaid mounts, Elan and 640 executed a Deed of Acknowledgement (DA) which created a charge in favour of Maxcon over 640's land. To secure the charge, 640 also agreed to provide a mortgage in registrable form. Maxcon lodged a caveat on title to various apartments, claiming an interest as chargee, but did not register the mortgage.

Subsequently, 640 fell into administration and was wound up. Maxcon's caveat was later removed and the last unit in the development sold. The net proceeds of the sale were paid into a trust account and were the subject of this dispute.

At first instance, the liquidators claimed the DA and mortgage together constituted an uncommercial transaction pursuant to s. 588FB of the Act and thus both the DA and mortgage should be set aside. Section 588FB(1) provides:

> A transaction of a company is an uncommercial transaction of the company if, and only if, it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction, having regard to:
>
> a. the benefits (if any) to the company of entering into the transaction; and
> b. the detriment to the company of entering into the transaction; and
> c. the respective benefits to other parties to the transaction of entering into it; and
> d. any other relevant matter.

The liquidators argued that, by entering into the DA and executing the mortgage, 640 had suffered detriment and encumbered its Property without any corresponding benefit. The building contract was between Elan and Maxcon and 640 was not a party to it. The liquidators further argued Maxcon derived the benefit of acquiring security over the Property to secure payment of Elan's debt and suffered no detriment. According to the liquidators, it therefore followed that the interests of 640's unsecured creditors were unfairly burdened by the DA and mortgage.

At trial, Efthim AsJ dismissed the liquidators' claim that there was an uncommercial transaction. His Honour held that:

- the DA, the mortgage and Maxcon's forbearance to sue all constituted one transaction (Transaction), which was the sort of transaction that reasonable business people would enter into when faced with similar circumstances to preserve an ongoing business relationship;
- if the Transaction not been entered into, Elan would have incurred considerable legal fees in defending the subsequent litigation. The forbearance and avoidance of those legal costs, which would have been paid out of the joint venture account increased the net profit to 640 and was therefore a benefit to 640; and
- Elan would most likely have applied the proceeds of sale of the apartments in payment to Maxcon and there was thus no detriment to 640 of any real substance.

The liquidators appealed the decision of Efthim AsJ.

(c) Decision

On appeal, Sifris J affirmed the decision of Efthim AsJ and dismissed the liquidators' claim that the Transaction was an uncommercial transaction pursuant to s. 588FB of the Act.

His Honour held that:

- 640 self-evidently received a benefit from entering into the Transaction because it avoided exposure to a direct or derivative claim by Maxcon. In the particular circumstances and taking into account the agency relationship between 640 and Elan, 640 was undoubtedly exposed to a direct claim by Maxcon. This was despite the absence of a direct contractual relationship between Maxcon and 640.
- The Transaction was not detrimental to 640. The consequences of the Transaction and the position had the Transaction not been entered into would, given the provisions of the JVD, have had substantially the same effect on 640. In particular, under the JVD, Maxcon had priority over unsecured creditors to the proceeds of sale of the apartments. The proceeds were to be held by 640 (as agent for Elan) until Maxcon's debt had been

paid. Therefore, 640 was no worse off in agreeing to the Transaction.

- The benefit to Maxcon as a result of the Transaction was not disproportionate and was explicable by ordinary commercial practice. Sifris J approved Efthim AsJ's reasoning that providing a mortgage in circumstances of an egregious breach of the building contract by Elan was the very kind of thing that reasonable business people would do in this situation. Sifris J added that "an otherwise commercial and entirely appropriate transaction of a company does not simply become uncommercial because creditors are not treated equally particularly in circumstances where, from the company's point of view, the transaction is reasonable and otherwise desirable and the indebtedness to creditors remains the same".

5.3 Application to set aside a deed of company arrangement dismissed

(By Kristina Popova, Ashurst)

Traivelog Pty Ltd v Electrometals Technologies Limited (Subject to Deed of Company Arrangement) [2015] QSC 27, Supreme Court of Queensland, Philip McMurdo J, 18 February 2015

The full text of this judgment is available here.

(a) Summary

The Supreme Court of Queensland has held that there were no grounds to set aside a Deed of Company Arrangement (DOCA) under s. 447A and s. 445D(1) of the Corporations Act 2001 (Cth) (the Act).

The application to set aside the DOCA was made by two participating creditors who claimed the DOCA should be set aside on the grounds that it was oppressive or unfairly prejudicial to creditors and that information provided to creditors in deciding to vote in favour of the DOCA was false and misleading.

(b) Facts

Electrometals Technologies Limited (subject to a Deed of Company Arrangement) (the Company) carried on a business of providing engineering design and manufacturing services for metal recovery in the mining industry.

In 2012, the Company was engaged to supply services to an Iranian company located in Tehran. The contract became the Company's largest source of income and was potentially very profitable. By late 2013, however, there were delays in the payment of the Company's invoices.

In February 2014, the Company was experiencing liquidity problems and was placed under administration. At the date of appointment of the administrators, approximately $1.1 million was owed to the Company by the Iranian company. This constituted nearly all of the debts owing to the Company (the Iranian Debt). Accordingly, the prospects of payments to creditors were dependent on the receipt of payment of the Iranian Debt.

The administrators reported to the second meeting of creditors that the Iranian Debt remained "outstanding and may be uncollectable". This was based on the fact that the Company had been pursuing part of the payment since November 2012. The administrators also noted that the directors believed that the debt was "uncollectable".

Pursuant to a resolution of creditors, the Company executed a DOCA. The effect of the DOCA, once it was performed, would be that participating creditors would be paid part of their debts from a Deed Fund established by a majority shareholder of the Company. The Company was to then continue trading with the debts owing to non-participating creditors being unaffected. It was expected that unsecured participating creditors would receive six cents in the dollar.

Subsequent to execution of the DOCA, the Iranian Debt was paid in full.

As a result, the applicants, two creditors of the Company, sought orders to the effect that:

- the resolution of creditors be set aside;
- the DOCA be set aside *ab initio*;
- the Company be wound up; and
- the liquidator be directed to seek the recovery of the funds which the Company received on payment of the Iranian Debt for the benefit of the Company and all of its creditors.

The orders to set aside and terminate the DOCA were sought by reference to ss. 447A and 445D of the Act.

Section 447A of the Act provides the court with a discretion to make an order that it thinks appropriate about how Part 5.3A is to operate in relation to a particular company.

Section 445D(1) of the Act provides the Court with a discretion to terminate a DOCA in certain circumstances. This includes where the Court is satisfied that:

- information about the company's business, property, affairs or financial circumstances was given to the administrator of the company or to the creditors which:
  - was false or misleading; and
  - could reasonably be expected to have been material to creditors of the company in deciding whether to vote in favour of the resolution that the company execute the deed (see s. 445D(1)(a)); or
- such information was contained in a report or statement accompanying the notice of meeting of creditors at which the resolution was passed (see s. 445D(1)(b)); or
- the deed or a provision of it is, an act or omission done or made under the deed was, or an act or omission proposed to be so done or made would be oppressive or unfairly prejudicial to, or unfairly discriminatory against, one or more such creditors, or contrary to the interests of the creditors of the company as a whole (see s. 44D(1)(f)).

(c) Decision

The Court held that there were no grounds to set aside the DOCA under the Act.

McMurdo J was not satisfied that the participating creditors were provided with information that was false or misleading. His Honour considered that the directors statement that the debt might be "uncollectable" was not without any reasonable factual foundation. His Honour had regard to the fact that much of the Iranian Debt had been outstanding for more than six months, was entirely unsecured and was in a foreign jurisdiction in which an Australian judgment could not be enforced. Accordingly, there was no ground established under s. 445D(1)(a) and (b).

Further, his Honour considered that no ground was established under s. 445D(1)(f) as the DOCA was more beneficial to all creditors at that time than a liquidation. Under the DOCA, participating creditors were assured of a dividend and non-participating creditors had the chance of being paid some or all of their debts. Even though the non-participating creditors received more than the participating creditors (due to the way the events occurred), his Honour was not persuaded that the DOCA was unfairly prejudicial to or unfairly discriminatory against the participating creditors.

5.4 Delay is a valid basis of a court's discretion to refuse to grant relief in oppression proceedings and admitting an entire membership of another entity for the purpose of effecting a merger is an improper purpose of the power to admit new members

(By Calvin Shaw, Herbert Smith Freehills)

Falkingham v Peninsula Kingswood Country Golf Club Ltd [2015] VSCA 16, Supreme Court of Victoria, Court of Appeal, Warren CJ, Whelan and Beach JJA, 13 February 2015

The full text of this judgment is available here.

(a) Summary

The Court in this case considered the availability of traditionally an equitable defences of laches, acquiescence and delay as a valid basis for exercising discretion to refuse to grant relief in oppression proceedings. The Court also considered whether there was an improper purpose where the directors of a golf club purported to effect a merger of two golf clubs by admitting *en masse* an entire membership of another golf club to it under the power to admit new members and other powers of the constitution.

(b) Facts

In general, golf clubs in Victoria are experiencing financial difficulties. On 17 September 2013, the members of the Kingswood Golf Club (a company limited by guarantee) passed an ordinary resolution directing its board of directors to give effect to a merger of their club with the Peninsula Country Golf Club (an incorporated association). It was contemplated that the merger would occur in steps. First, by the admission of approximately a thousand members of the Peninsula Club to the Kingswood Club. Second, by the conversion of the Peninsula Club from an incorporated association to a company limited by guarantee with the sole member to be the Kingswood Club. Last, by the sale of the golf course owned by the Kingswood Club which has significant value as a potential residential development. The end result, it was envisaged, would be that the merged clubs are financially secure and the members of the merged club play exclusively at the Peninsula Club's golf courses. The steps were conceived in this way to avoid stamp duty associated with asset transfers.

Sometime after the ordinary resolution was passed, the Kingswood board admitted approximately a thousand members of the Peninsula Club to the Kingswood Club.

On 20 August 2014, a member of the Kingswood Club, the appellant Mr Falkingham, started proceedings seeking relief under ss. 232 and 233 of the Corporations Act 2001 (Cth). Among other things, Mr Falkingham contended that the ordinary resolution and the subsequent admission of the Peninsula members were invalid.

Section 232 provides that the Court may make an order under s. 233 if the conduct of a company's affairs, an act or omission by a company or a members' resolution of a company is contrary to the interests of the members as a whole or oppressive to a member. Section 233 provides that the Court can make any order that it considers appropriate.

The trial judge found that the Kingswood board had exercised its power to admit new members for a purpose other than that for which that power had been conferred. The trial judge also found that the board's conduct in doing so had been oppressive. The trial judge refused, however, to grant relief on the grounds of laches, acquiescence and delay, largely because of Mr Falkingham's delay in bringing proceedings against the Kingswood Club.

Mr Falkingham appealed the trial judge's decision. His key contention was that the trial judge had made an error in refusing to grant relief based upon laches, acquiescence and delay. The respondent, Kingswood Club, subsequently filed a notice of contention submitting that the trial judge had been wrong to find that the Kingswood board had acted for an improper purpose.

(c) Decision

(i) Laches, acquiescence and delay

The appellant submitted that laches as an equitable defence is not available in answer to a legal claim, relying on *Orr v Ford* (1989) 167 CLR 316. The respondent in return submitted that courts had historically considered delay as a ground for refusing to grant relief in oppression proceedings. The respondent relied on *Re Jermyn Street* [1970] 1 WLR 1194. In this case, Pennycuick J concluded that the analysis of delay is the same whether relief is sought under statutory oppression provisions or by way of an action to set aside a share issue. The Court agreed with the respondent and said that an attempt to analyse distinctions between the equitable doctrine of laches and the relevance of delay in the exercise of statutory discretion is largely academic.

As the appeal is therefore an appeal against an exercise of discretion, the Court said that the appellant had to establish that the trial judge acted upon a wrong principle, took into account some extraneous matter or mistook the facts. The appellant then identified a few instances where that might have occurred, which the court disagreed with, largely on the facts.

One of those instances is worth a brief mention here. The appellant said the trial judge wrongly took into account the position of the majority of pre-merger members of the Kingswood Club who had voted in favour of the merger. This is because, it was contended, oppression proceedings were designed to protect minorities and it could not be a proper exercise of discretion to form a conclusion based upon the views or interests of the majority. The Court disagreed with this argument. The Court said the judge was entitled to take into account the expressed views of the majority of the members of the Kingswood Club who favoured the merger because those members were not wrongdoers.

The Court ultimately decided that the appellant failed to establish any relevant error in relation to the exercise of the trial judge's discretion not to grant relief by reason of delay.

(ii) Improper purpose

It was not strictly necessary for the Court to decide the respondent's cross contention point that there had been no improper purpose. This is because the Court's decision that delay is a valid basis of a court's discretion to refuse to grant relief had decided the whole appeal. The Court nevertheless went on to decide whether the Kingswood board had acted for an improper purpose when it admitted a thousand members to the Kingswood Club.

After considering various provisions of Kingswood Club's constitution, the Court found that there were no provisions that conferred upon the directors the powers they had purported to exercise. The Court, by looking at the substantial purpose for which the directors purported to exercise their power to admit a thousand members to the Kingswood Club, chose to characterise the power as a power to effect a merger. The constitution did not confer upon directors that power. Those provisions submitted by the respondent as conferring upon the directors the power to do what they did (powers relating to management of the Kingwood Club's affairs and powers relating to admission of members) were held to not extend to the power to admit members *en masse*.

5.5 The extensive powers of s. 447A(1) of the Corporations Act: Curing non-compliance with s. 201A(2)

(By David Suttner, Clayton Utz)

James as administrator of ZYL Ltd [2015] WASC 57, Supreme Court of Western Australia, Master Sanderson, 13 February 2015

The full text of this judgment is available here.

(a) Summary

ZYL Ltd (ZYL) resolved, under s. 436A of the Corporations Act 2001 (Cth) (the Act), to appoint the plaintiff as its administrator. The resolution was in accordance with ZYL's constitution. It was, however, in contravention of s. 201A(2) of the Act, which requires a public company to have a minimum of 3 directors, at least 2 of whom ordinarily reside in Australia.

The Court determined that, although the actions of the directors constituted non-compliance with s. 201A(2) of the Act, it did not derogate from the validity of the resolution (in terms of the company's constitution). Therefore, the Court could exercise the power provided to it by s. 447A(1) of the Act, and render the plaintiff's appointment as administrator valid from the date of appointment.

(b) Facts

On 8 January 2015, the plaintiff was appointed as the administrator of ZYL by resolution of the company pursuant to s. 436A(1) of the Act.

Section 436A(1) of the Act provides:

> 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.

At the time of the resolution ZYL had only 2 directors. ZYL is a public company listed on the Australian Securities Exchange. The resolution was in accordance with ZYL's constitution, and in particular with:

- cl.15.3, which said, "No business shall be transacted at any meeting of Directors unless a quorum is present, comprising 2 Directors present in person, or by instantaneous communication device, notwithstanding that less than 2 Directors may be permitted to vote on any particular resolution or resolutions at that meeting for any reason whatsoever ..."; and
- cl. 15.8, which said, "In the event of vacancy or vacancies in the office of a Director, the remaining Directors may act but, if the number of remaining Directors is not sufficient to constitute a quorum at a meeting of Directors, they may act only for the purposes of appointing a Director or Directors, or in order to convene a general meeting of the Company".

The resolution was, however, passed at a time when ZYL was in contravention of s. 201A(2) of the Act, which provides:

> A public company must have at least 3 directors (not counting alternate directors). At least 2 directors must ordinarily reside in Australia.

As a result, the plaintiff sought an order under s. 447A(1) of the Act that, notwithstanding any noncompliance with s. 201A(2) of the Act, Part 5.3A of the Act would operate to the effect that the plaintiff was validly appointed as administrator of ZYL from the date of original appointment.

(c) Decision

Section 201A(2) of the Act imposes an obligation on a company to have the requisite number of directors. Failure to do so is an offence under ss. 1311(1)(b) and 1312 of the Act.

Administrators have a positive nonfiduciary duty to satisfy themselves immediately that they have been properly appointed (*Correa v Whittingham* [2013] NSWCA 263 [132], [144], [154]) and they should seek to confirm the validity of their appointment if, immediately after the appointment, the resolution or instrument of appointment does not appear to be valid or if, during the administration, they are put on inquiry about the validity of their appointment (*Wilson v Manna Hill Mining Co Pty Ltd* [2004] FCA 1663; (2004) 51 ACSR 404).

Section 447A(1) (General power to make orders) provides that:

> The Court may make such order as it thinks appropriate about how [Part 5.3A] is to operate in relation to a particular company.

Courts have interpreted s. 447A(1) as a provision conferring upon them an extremely wide jurisdiction to make any order considered appropriate for the operation of the regime (*Deputy Commissioner of Taxation v Portinex Pty Ltd (Subject to deed of company arrangement)* [2000] NSWC 99 [30]). The Court pointed out several examples of s. 447A(1) being used to sanction the appointment of an administrator, despite the appointment being contrary to s. 201(A)(1) of the Act.

The following three principles were distilled from the case law:

- Where doubt arises in relation to the validity of an appointment (including by reason of the potential for any breach of s. 201A of the Act) it is reasonable for an administrator to seek to dispel that doubt by seeking an appropriate curative order from the court pursuant to s. 447A(1) of the Act.
- the administrator's costs in connection with any such application will be costs in the administration of the relevant company.
- A court will not make a validation order if the irregularity has caused or may cause any injustice that cannot be remedied by any order of the court (*McIntosh v CMX Technologies Pty Ltd (Administrators Appointed)* [2005] NSWSC 1282; (2005) 56 ACSR 283).

The Court considered the facts and determined that the directors acted in accordance with ZYL's constitution. Therefore, ZYL's noncompliance with s. 201A(2) did not derogate from the validity of the resolution. Furthermore:

the directors appeared to have been acting bona fide when appointing the administrator. They believed it was in the best interests of ZYL and, relying on clause 15.8 of ZYL's constitution, they believed they had the power to do so; and
no one was prejudiced by the decision.

In turn, the Court determined that:

- there had been a breach of s. 201A(2);
- without making a final determination, it was arguable that the resolution passed by the remaining directors was invalid; and
- the Court has the power, pursuant to s. 447A and Part 5.3A of the Act, to cure a defect in the plaintiff's appointment.

Therefore, the court made an order that, notwithstanding any non-compliance with s. 201A(2) of the Act:

- the plaintiff's appointment was valid from 8 January 2015; and
- the plaintiff's costs and expenses of the application be paid out of ZYL's assets.

5.6 Joinder of insurer successful on basis of liquidators' interest under s. 562 of the Corporations Act

(By James Siemon, Minter Ellison)

Akron Roads Pty Ltd (in liq) v Crewe Sharp Pty Ltd [2015] VSC 34, Supreme Court of Victoria, Judd J, 13 February 2015

The full text of this judgment is available here.

(a) Summary

This decision related to an application for the joinder of an insurer who had denied liability where that denial was not disputed by the insured. The Court ordered the joinder on the basis that it was just and convenient and that the interest of the liquidators in the indemnification of the insolvent insured, under s. 562 of the Corporations Act 2001 (Cth) (the Corporations Act), meant that there was a justiciable dispute.

(b) Facts

The interlocutory application which was the subject of this decision related to a proceeding brought by the liquidators of Akron Roads Pty Ltd (Akron Roads) against the former directors of Akron Roads, including Trevor Crewe. That proceeding claimed compensation for loss resulting from insolvent trading by Akron Roads and alleged that the directors had contravened their duty to prevent insolvent trading under s. 588G of the Corporations Act. The liquidators also claimed that Crewe Sharp Pty Ltd (Crewe Sharp), of which Trevor Crewe was a director, was a shadow director of Akron Roads (within the extended definition of director in s. 9 of the Corporations Act) and had also contravened s. 588G.

Following public examinations by them, the liquidators became aware that Crewe Sharp and Trevor Crewe were insured under professional indemnity policies of insurance that had been issued by CGU Insurance Limited (CGU). Those policies indemnified both insured for civil liability to third parties incurred in the conduct of particular, defined professional services.

The liquidators of Akron Roads brought an interlocutory application for leave in relation to two matters. Firstly, they sought leave to proceed against Crewe Sharp in liquidation pursuant to s. 500(2) of the Corporations Act. That application was unopposed and leave was granted by Judd J on the condition that no order or judgment against Crewe Sharp be enforced without having first obtained the leave of the Court. Secondly, the liquidators also sought leave to join CGU as a defendant to the main proceeding, pursuant to rl. 9.06(b) of the Supreme Court (General Civil Procedure) Rules 2005 (Vic) (the Civil Procedure Rules), and to file and serve an amended statement of claim on CGU.

(c) Decision

Rule 9.06 of the Civil Procedure Rules addresses the addition, removal or substitution of a party and provides that:

> At any stage of a proceeding the Court may order that— ...
>
> b. any of the following persons be added as a party, namely—
>
> i. a person who ought to have been joined as a party or whose presence before the Court is necessary to ensure that all questions in the proceeding are effectually and completely determined and adjudicated upon; or
>
> ii. a person between whom and any party to the proceeding there may exist a question arising out of, or relating to, or connected with, any claim in the proceeding which it is just and convenient to determine as between that person and that party as well as between the parties to the proceeding; ...

Section 562(1) of the Corporations Act provides that:

> Where a company is, under a contract of insurance ... insured against liability to third parties, then, if such a liability is incurred by the company ... and an amount in respect of that liability has been or is received by the company or the liquidator from the insurer, the amount must ... be paid by the liquidator to the third party in respect of whom the liability was incurred ... in priority to all payments in respect of the debts mentioned in section 556.

Section 117 of the Bankruptcy Act 1966 (Cth) also has a similar effect.

The plaintiffs contended that this gave the liquidators of Akron Roads a sufficient interest in the determination of CGU's liability to the insured to warrant the joinder of CGU as a party, even though neither insured was an applicant for joinder or intended to actively pursue a determination of the question of CGU's liability. The plaintiffs noted the decision of Vickery J in *Anjin No 13 Pty Ltd v Allianz Australia Insurance Ltd* [2009] VSC 371; (2009) 26 VR 148, where his Honour stated his view that s. 562, "although it does not confer a cause of action on Anjin as against the insurer, does give Anjin a very real interest in having the indemnity obligations of Allianz to the architect companies determined" and therefore gave rise to a *bona fide* legal controversy.

CGU opposed the application for joinder on a number of grounds:

- because no claim was made by an insured against CGU, the proposed declaratory relief in respect of CGU's liability would not be granted, as there was no justiciable controversy;
- the right of a liquidator under s. 562 of the Corporations Act did not confer a right of action against an insurer and the liquidator's interest in any proceeds of insurance was hypothetical and contingent;
- Trevor Crewe's bankruptcy was also hypothetical and contingent;
- the relevant authorities were in conflict on the question of the Court's jurisdiction to grant declaratory relief;
- the Court had no jurisdiction under s. 36 of the Supreme Court Act 1986 (Vic) to grant the declaratory relief sought or should decline to do so; and
- in any event, the terms of the policy excluded liability to each insured.

In support of their contentions, CGU referred to a number of decisions which they alleged indicated that there was no justiciable controversy (involving CGU) for determination by the Court in the absence of a direct or special interest (*Truth About Motorways Pty Limited v Macquarie Infrastructure Investment Management Limited* [2000] HCA 11; 200 CLR 591) or because the parties to the contract had not themselves raised any issue or dispute (*CE Heath Casualty & General Insurance Limited v Pyramid Building Society (in liq)* [1997] 2 VR 256). They also identified a real risk that joinder might create cost and inconvenience due to the need for both the insurer and the insured to maintain separate legal representation and might deny the insurer any right under the policy to take over and defend a claim against the insured, and contended that this should inform the Court's discretion under rule 9.06.

In response to CGU's contention that the only justiciable controversy under a private contract was between the parties to the contract, Judd J adopted the summary of principles outlined by Lindsay J in *The Owners Strata Plan 62658 v Mestrez Pty Ltd* [2012] NSWSC 1259 at [54]. Those principles suggested that, in cases such as the one before Judd J, a true legal controversy existed and the exercise of the Court's discretion was warranted by "the interests of justice, and the convenient administration of justice".

In respect of CGU's allegations of a conflict of authority, Judd J noted that this could be analysed at trial and, if necessary, resolved on appeal but was ultimately not persuaded that there was a clear conflict of authorities. In any event, his Honour found this insufficient reason for the refusal of the application for joinder where the exercise of the Court's discretion was otherwise justified. In relation to CGU's arguments that the exclusion clause applied to prevent liability under the policy, Judd J found that the plaintiff's proposed case was not hopeless, bound to fail, fanciful or without any prospect of success.

Judd J noted that CGU accepted it would be not be open to it and Trevor Crewe to relitigate the question of liability under different proceedings, and noted that the liquidators of Crewe Sharp might also be unable to relitigate the same question. As it was unlikely that the joinder would be prejudicial to the efficient and cost-effective management of the trial or would disproportionately extend the proceeding, his Honour held that the plaintiffs' claim that CGU was bound to indemnify the insured "arises out of, or relates to, or is connected with their claim against the insured as defendants" and that there was "a justiciable dispute consequent upon CGU's denial of liability" by reasons of s. 562 of the Corporations Act and the duty of the liquidators to creditors of Akron Roads. His Honour therefore found that it was just and convenient that the disputes between the plaintiffs and insured and the plaintiffs and CGU be resolved at the same time in the same proceeding.

Judd J therefore ordered that CGU be joined as the fifth defendant pursuant to rl. 9.06(b) of the Civil Procedure Rules and that the plaintiffs have leave to file and serve an amended statement of claim.

5.7 Recovery of a guaranteed debt from a co-surety

(By Wen-Ts'ai Lim, Chris Masters and Eli Ball, Ashurst)

Lavin v Toppi [2015] HCA 4, High Court of Australia, French CJ, Kiefel, Bell, Gageler and Keane JJ, 11 February 2015

The full text of this judgment is available here.

(a) Summary

The High Court of Australia has unanimously held that a surety who pays more than its share of a guaranteed debt to a creditor can recover contribution from a co-surety despite that co-surety having the benefit of a covenant not to sue from that creditor.

(b) Facts

Lavin and Toppi were each one of multiple appellants and respondents respectively who had jointly and severally guaranteed a bank loan to a company. The bank commenced enforcement proceedings against the guarantors when the company went into receivership. Lavin cross-claimed against the bank and subsequently executed a deed of settlement with it (note that Toppi was not a party to these arrangements). Under the settlement, Lavin agreed to pay part of the guaranteed debt and to release the bank from all claims, while the bank entered into a covenant not to sue Lavin under the guarantee.

Later, Toppi discharged the guarantee by paying the (larger) outstanding balance of the debt, and then claimed contribution from Lavin for half the difference of the sum each had paid. Lavin resisted that claim on the basis that the parties were not under "coordinate liabilities" by reason of the bank's covenant not to sue Lavin.

The primary judge and NSW Court of Appeal rejected this argument, and Lavin appealed to the High Court.

(i) Lavin's arguments

The rationale of the doctrine of contribution is that people under "coordinate liabilities" with respect to a loss should share that burden *pro rata*: *Albion Insurance Co Ltd v Government Insurance Office (NSW)* (1969) 121 CLR 342 at 349-50 per Kitto J. Contribution thus prevents the unjust enrichment of one person at another's expense: *Burke v LFOT Pty Ltd* (2002) 209 CLR 282 at [38] per McHugh J.

Lavin argued that as Toppi's liability was enforceable by the bank, while Lavin's liability was not enforceable by the bank, their respective liabilities were different and therefore there was no coordinate liability. Lavin also submitted that the Court of Appeal erred in finding that the discharge of the guarantee (by Toppi) benefited her, as this implies that the bank's covenant not to sue her was of no "practical benefit".

(c) Decision

Lavin's appeal was dismissed by the High Court. Lavin's liability had not been extinguished by the bank's covenant and therefore the parties continued to have coordinate liabilities to the bank. Toppi's entitlement to contribution was further supported by equitable principles.

(i) Effect of the covenant not to sue

The Court explained that the utility of a covenant not to sue lies in the fact that it does not release liability, and therefore avoids the problem of the release of one co-surety operating as a release of all co-sureties. The idea that a covenant not to sue nevertheless altered the existence of coordinate liabilities for contribution purposes was rejected as unsupported by authority.

The bank's covenant not to sue Lavin had not extinguished Lavin's liability; indeed, the covenant was premised on that liability continuing to exist. Furthermore, Lavin's liability could still be indirectly enforced by the bank, such as by relying on rights of recoupment under any further securities that might exist between the bank and Lavin.

Lavin's argument that the discharge of the guarantee had not practically benefitted her was further rejected on the basis that it treated a benefit requirement as somehow distinct from the need for coordinate liabilities. That too was unsupported by authority and was incorrect in principle having regard to the rationale of contribution in the first place. Toppi's discharge of the guarantee had benefited Lavin because it meant that Lavin had ultimately paid less than her share of the debt.

(ii) Equity and timing of contribution

Toppi's entitlement to contribution was further supported by equitable principles.

There was also a more fundamental basis for Toppi's success. In the Court's view, the "irresistible strength" of Toppi's case was clear in equity: if Lavin's argument was correct then it would mean that the bank could select who bore the common burden of the guarantee. That was contrary to the maxim "equity is equality" and could not be accepted.

The Court also explained that a claim for equitable contribution usually arises before the co-surety makes payment to the creditor. For instance, the Court can make a declaration that a co-surety is entitled to equitable contribution provided that payment is imminent and the co-surety is ready, willing and able to pay. In Lavin v Toppi the bank's call on the guarantees gave rise to an entitlement in equity to contribution. Toppi would therefore have been entitled to a declaration of her right to contribution from that time (even though the right to contribution itself may have been conditional upon her meeting her obligations under the guarantee). Nothing could be done by Lavin or the bank thereafter to defeat this entitlement to contribution; not even the entry into the covenant not to sue.

(iii) Implications

There are two important implications from this case.

First, it confirms that a covenant not to sue does not extinguish an underlying liability but simply enjoins the obligee from suing to enforce its rights. That may be significant if the scope of other rights or liabilities depend upon the continuing existence of the liability the subject of the covenant not to sue.

Secondly, and more significantly, the High Court has, by emphasising the equitable principles underpinning the doctrine, clarified that the entitlement of a co-obligor to equitable contribution is not to be defeated by any discriminatory steps taken by the obligee.

5.8 Proceedings, plurality and practicality: Federal Court reaffirms requirements for transferring proceedings to a different court pursuant to s. 1337H of the Corporations Act

(By Clementyne Rawlyk and Jessica Salafia, Corrs Chambers Westgarth)

Yara Pilbara Fertilisers Pty Ltd v Oswal (No 8) [2015] FCA 49, Federal Court of Australia, McKerracher J, 6 February 2015

The full text of this judgment is available here.

(a) Summary

In this case the Federal Court of Australia upheld an application to transfer a proceeding from the Western Australian branch of the Federal Court of Australia to the Supreme Court of Victoria pursuant to s. 1337H of the Corporations Act 2001 (Cth) (the Act). The decision highlights the pragmatic approach that Courts take in determining whether, having regard to the interests of justice, it is more appropriate for a proceeding to be transferred to another court.

(b) Facts

(i) Victorian Supreme Court proceedings

Mr and Mrs Oswal were shareholders in Yara Pilbara Holdings Pty Ltd (YPH). In December 2009 and February 2010, the Oswals executed share mortgages and other guarantee documents in favour of Australian and New Zealand Banking Corporation Ltd (ANZ) in respect of, among other things, their shares in YPH.

The Oswals defaulted under the share mortgages and the guarantees, and in December 2010 ANZ appointed receivers in relation to the mortgaged YPH shares. The receivers subsequently sold the Oswals' shares in YPH.

Mr and Mrs Oswal each commenced separate proceedings in the Supreme Court of Victoria against numerous parties, including ANZ and the receivers, challenging:

- the validity and enforceability of the share mortgages and other documents; and
- the procedure by which, and the terms upon which, their shares in YPH were sold.

In April 2014, the Oswals joined several new parties to the Victorian Supreme Court proceedings, including Yara Pilbara Fertilisers Pty Ltd (YPF). These proceedings have been set down for trial in August 2015.

(ii) Federal Court proceeding

YPF commenced separate proceedings in the Western Australian branch of the Federal Court of Australia. YPH claimed, among other things, relief against Mr Oswal for alleged breaches of his director's duties while he was a director of YPH, and against Mrs Oswal for her involvement in those alleged breaches and her receipt of the benefits of those alleged breaches.

The Federal Court proceeding gave rise to pleadings which repeated the matters arising in the Victorian proceedings. This in effect meant that the issues before the Federal Court substantially overlapped with the two proceedings in the Supreme Court of Victoria. Accordingly, YPF sought an interlocutory order pursuant to s. 1337H of the Act to transfer the Federal Court proceeding to the Supreme Court of Victoria, so that it could be heard currently with the two Victorian proceedings already on foot.

Section 1337H of the Act permits the transfer of a proceeding brought under the Act from the Federal Court or a state or territory Supreme Court to another court if, having regard to the interests of justice, it is more appropriate for the relevant proceeding to be heard by the other court. Section 1337L of the Act provides that when determining a proceeding transfer application, the transferor court should have regard to:

- the principal place of business of any body corporate concerned in the proceeding;
- the place or places where the events that are the subject of the proceeding took place; and
- whether the other court has jurisdiction to hear the proceeding.

While all of the parties agreed that the three proceedings should be managed, tried and determined together, the Oswals opposed the application on the basis that they considered the Western Australian branch of the Federal Court to be the most appropriate venue for this purpose rather than the Supreme Court of Victoria. They argued (among other things) that:

- the events the subject of the three proceedings occurred almost entirely in Western Australia;
- most of the parties to the proceedings are based in, or carry on business in, Western Australia; and
- most of the witnesses who are likely to be called to give evidence in the proceedings are based in Western Australia.

Mr Oswal also contended that he would be unfairly prejudiced if the trial were to proceed in Melbourne as his solicitors are based in Perth and have no interstate offices. He argued that he would incur significant expenses relocating his entire legal team to Melbourne (or alternatively would lose the benefit of his existing legal team's knowledge if he was required to engage new solicitors based in Melbourne). By way of contrast, all other parties had engaged national firms to act for them.

(c) Decision

Justice McKerracher upheld the application and ordered that the Federal Court proceeding being transferred to the Supreme Court of Victoria. In reaching this decision, his Honour noted that there is a reasonably wide discretion involved in considering an application under s. 1337H of the Act and that it is necessary to conduct a balancing exercise between relevant factors to determine whether or not it is in the interests of justice to transfer a proceeding.

In this case, the following factors were considered relevant by the Court:

- there was sufficient substantial overlap between the issues in each of the Federal Court proceeding and the Victorian Supreme Court proceedings to justify them being run concurrently;
- the primary parties to the Federal Court proceeding were parties to the Supreme Court proceedings, but the reverse was not so;
- for the purposes of s. 1337L of the Act, the Supreme Court of Victoria had jurisdiction to hear the proceeding; and
- the location of the principal places of business of the parties (although the Court noted that this was a relatively neutral factor in this case).

His Honour also took into account the fact that the Supreme Court of Victoria had already scheduled a trial date for August 2015 and that the matter would be unlikely to commence by this time if it were to remain in the Federal Court of Australia. Any such delay, the Court noted, could prejudice those parties seeking to rely on oral evidence, particularly as the reliability of a witnesses' memory recedes over time.

Justice McKerracher placed little weight on the location of potential witnesses on the basis that it was simply not possible at the present stage of the proceedings to assess with certainty the ultimate number and identity of all witnesses who will be called. In any event, his Honour noted that any witness who is unable to be physically present in Melbourne to give evidence in the proceedings could be accommodated with video facilities which are readily available and universally used in trials conducted across Australia.

Similarly, his Honour held that the location and convenience of the parties' legal teams is not a primary factor to be taken into account, stating that it is "an everyday event for senior counsel and others involved in very substantial litigation to appear in courts around the country".

The Court's decision makes clear that, when considering whether to transfer a proceeding from one court to another, practicality is paramount. Citing Gleeson CJ, McHugh and Heydon JJ in *BHP Billiton Limited v Schultz* (2004) 221 CLR 400, his Honour stated that it is a "nuts and bolts" management decision as to which court, in the pursuit of the interests of justice, is the more appropriate to hear and determine the substantive dispute.

Interestingly, his Honour also noted that a transfer of proceedings from one court to another is not necessarily irreversible. In particular, if circumstances were to change such that it became more appropriate for the Federal Court to deal with the issues in dispute between the parties, his Honour could see no reason why the proceeding could not be transferred from the Supreme Court back to the Federal Court.

5.9 Are orders restraining the contractual rights of third parties "necessary" to give effect to a reconstruction scheme of arrangement?

(By Katrina Sleiman, Corrs Chambers Westgarth)

Fiducian Portfolio Services Limited v Fiducian Investment Management Services Limited (No 2) [2015] FCA 95, Federal Court of Australia, Yates J, 5 February 2015

The full text of this judgment is available here.

(a) Summary

The case concerned a scheme of arrangement for the reconstruction of the Fiducian Group of companies under Chapter 5 of the Corporations Act 2001 (Cth) (the Act). At the approval hearing, in addition to seeking orders for the approval of the scheme and the transfer of certain property and liabilities under ss. 411(4)(b) and 413(1)(a) of the Act, respectively, the plaintiff also sought an order under s. 413(1)(g) restraining the exercise of certain contractual rights of third parties which could be triggered by the restructure.

The Court made the approval and transfer orders. The Court refused, however, to make the restraint order on the basis that the plaintiff had not provided sufficient evidence to support the making of the order, and in this case, the Court should not interfere in a blanket fashion with the contractual rights which contracting parties have bargained for.

(b) Facts

The plaintiff proposed a restructure of the Fiducian Group, of which it is the holding company. Under the restructure, the Fiducian Group's superannuation trustee services will be retained by the plaintiff (as a wholly-owned subsidiary of a new company (NewCo)) and the plaintiff's other businesses will be transferred to other companies in the Fiducian Group.

Pursuant to the restructure, the plaintiff and NewCo will enter into and complete a share sale agreement in respect of the plaintiff's shares in certain Group companies to be transferred to NewCo. The plaintiff, NewCo, and other Group companies will also enter into a deed of cross-guarantee in favour of each creditor of any member of the Fiducian Group that is a "Group Entity" as defined in the deed, and the executed deed, together with the required certificate, will be lodged with the Australian Securities and Investments Commission (ASIC).

The plaintiff sought an order under s. 411(4)(b) of the Act that the Court approve the scheme of arrangement for the restructure. To give effect to the restructure, the plaintiff also sought orders under s. 413(1) providing for the transfer of certain of its property and liabilities to Group companies and the restraint of third party contractual rights which could be triggered by the restructure.

(c) Decision

After considering the evidence, Yates J was satisfied that the scheme should be approved under s. 411(4)(b) of the Act. His Honour then considered the orders sought under s. 413(1) of the Act, which relevantly provides:

> Where an application is made to the Court under this Part for the approval of a compromise or arrangement and it is shown to the Court that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of a Part 5.1 body or Part 5.1 bodies ... the Court may, either by the order approving the compromise or arrangement or by a later order, provide for all or any of the following matters:
>
> a. the transfer to the transferee company of the whole or a part of the undertaking and of the property or liabilities of the transferor body; ... and
>
> g. such incidental, consequential and supplemental matters as are necessary to ensure that the reconstruction or amalgamation is fully and effectively carried out.

His Honour observed that the word "reconstruction", as used in contexts such as s. 413(1), does not have a definite legal meaning. There is nothing in s. 413(1) which limits a reconstruction to one in which the whole undertaking or all the property of one company is transferred to another. Nor is there any reason in principle why a reconstruction cannot be one under which several parts of the undertaking or property of the transferor body can be transferred. And if that is so, the transfer of separate parts must comprehend several transfers to separate transferees. As Buckley J observed, however, in *In re South African Supply and Cold Storage Co* [1904] 2 Ch 268 (at 286), the transfers cannot simply be transfers to outsiders. His Honour considered that the conception on which s. 413(1) proceeds is that, under a reconstruction scheme, substantially the same business will be carried on by substantially the same persons.

His Honour was satisfied that, in principle, orders of the kind proposed—which involve the transfer of several parts of the undertaking or property of the transferor (plaintiff) to separate transferees (Group companies), where the transferor body and transferees are members of the one group—can be made under s. 413(1).

The plaintiff raised the possibility that, here, the scheme and the related transfers of property and liabilities "may trigger change of control, certain event of default or similar provisions" in contracts with companies in the Fiducian Group, enabling other contracting parties to exercise a right to terminate or vary those contracts.

Accordingly, the plaintiff sought an order to the effect that no party to a contract to be transferred to the transferee companies, or to another contract to which the plaintiff or a related body corporate is named as a party, shall be entitled to terminate the contract or vary its rights or obligations (or the rights or obligations of the plaintiff, the transferee companies or another related body corporate of the plaintiff) merely as a result or consequence of the implementation of, or the taking of any act or deed in connection with, the scheme or the transfers contemplated by the s. 413(1) orders, or by the scheme.

In seeking this restraint, the plaintiff stressed the breadth of s. 413(1)(g). The plaintiff submitted that the order sought, which deprives third parties of contractual rights, is not beyond the scope of s. 413(1)(g), but is rather a necessary incident of the Court's power to ensure the achievement of the purposes of s. 413, which include that reconstructions are facilitated and effectively carried out.

His Honour was not persuaded that, in the circumstances of the present case, the order sought is one that falls within the power conferred by s. 413(1)(g). While the provision is broad, what is "necessary" must be determined by its stated object, namely, to ensure that the scheme for reconstruction or amalgamation is fully and effectively carried out. Thus, the word "necessary" takes its colour from the stated object. His Honour did not think it assists to substitute "necessary" with a proxy expression, such as "more than desirable but less than vital" (*Re Norwich Union Linked Life Assurance Ltd* [2004] EWHC 2802 (Ch) at [8]); nor did his Honour think that "necessary" requires further explication. It is, after all, an ordinary English word. It is also the word chosen by Parliament to state its will.

His Honour found at least two difficulties confronting the plaintiff. First, by relying on what are truly no more than abstract or theoretical possibilities, the plaintiff did not establish that the order sought is "necessary" to fully and effectively carry out the scheme. Secondly, assuming that a particular contractual provision will be triggered in one of the ways postulated, the plaintiff merely seeks to avoid a contractual outcome that has already been agreed upon.

His Honour considered that, in truth, the order merely seeks to provide for the consequences of the reconstruction, not its effectuation. His Honour did not accept that, without the order, the purpose of the restructure will be frustrated. Further, his Honour questioned why the Court should interfere in a blanket fashion with the contractual rights which contracting parties have bargained for and obtained to cover the very circumstances in question. The plaintiff may be right to say that the implementation of the restructure will not result in economic loss or disadvantage for those parties. But if that is so, and a contractual provision is still triggered, it simply means that the contracting party must have had its own special reasons (which are not known to the Court) for making its contract on that basis.

His Honour held that, assuming power, it would not be an appropriate exercise of the Court's discretion to grant the order under s. 413(1)(g).

5.10 Court grants former director and current shareholder leave to bring a derivative action against current directors for breach of director's duties

(By James Corrigan, Herbert Smith Freehills)

In the matter of Imperium Projects Pty Limited [2015] NSWSC 16, Supreme Court of New South Wales, Black J, 3 February 2015

The full text of this judgment is available here.

(a) Summary

Michael Hourican, a former director and current shareholder of Imperium Projects Pty Limited (Imperium), was granted leave to bring a derivative action on behalf of the company against Messrs Mahaffy and Lord, current directors and shareholders of Imperium, in respect of conduct amounting to alleged breaches of ss. 181 and 182 of the Corporations Act 2001 (Cth) (the Act).

Black J found that the incurrence of personal building and other expenses by Mr Mahaffy, along with the entry by both Mr Mahaffy and Mr Lord into unsecured loans with the company, were sufficient bases upon which to conclude that there is a serious question to be tried and that it is in the best interests of the company that leave be granted in respect of those actions. Mr Hourican's willingness to indemnify the company against cost risks associated with the derivative action was a strong factor in Black J's decision.

Leave was refused in respect of certain other conduct, including building work for directors of an Imperium client, alleged indecorous treatment of company accounts and the payment of certain personal expenses to Mr Lord.

Mr Hourican will also be seeking further relief in the form of a claim in oppression, an order under s. 233 of the Act that his shares in the Company be purchased or alternatively the appointment of a receiver, or an order under ss. 461(1)(e) and 461(1)(k) of the Act that the company be wound up on the just and equitable ground.

(b) Facts

(i) Overview

Mr Hourican sought an order under s. 237 of the Act for leave to bring derivative proceedings under s. 236 of the Act on behalf of Imperium, with the intent of obtaining:

- declarations under s. 1317E of the Act that Messrs Mahaffy and Lord contravened their duties as directors under ss. 181 and 182 of the Act, namely the duties to act in good faith and for a proper purpose, and the duty not to make improper use of position;
- a compensation order under s. 1317H of the Act for the above contraventions; and
- an order for an account of profits.

(i) Conduct allegedly amounting to a breach of director's duties

Mr Hourican alleged that Messrs Mahaffy and Lord engaged in the following conduct that amounted to a breach of their duties as directors of Imperium:

- effecting inappropriate/unauthorised payments of directors' remuneration to themselves;
- undertaking building work on their personal properties and incurring payments relating to other personal affairs at the company's expense;
  entering into unsecured personal loan agreements with Imperium;
- undertaking work for the directors of a client of Imperium at the expense of Imperium; and
- concealing impropriety through dishonest accounting practices.

(c) Decision

Black J granted Mr Hourican leave to bring a derivative action on behalf of Imperium in respect of some, but not all, of the alleged conduct described above.

The declarations sought under s. 1317E were held to only be available where ASIC is the plaintiff, however the compensation orders sought under s. 1317H were said to be of potential application.

(i) Criteria for leave to bring a derivative action

The court must grant leave to bring a derivative action under s. 237(2) of the Act if:

- the company itself will not bring proceedings;
- the plaintiff is acting in good faith;
- the plaintiff has provided at least 14 days' notice to the company of its intention to apply for leave;
- it is in the best interests of the company that the plaintiff be granted leave; and
- there is a serious question to be tried.

(ii) Whether the company itself will not bring proceedings

Given Messrs Mahaffy and Lord are the sole current shareholders of Imperium, it was not contentious that the company itself is unlikely to bring proceedings.

(iii) Whether the plaintiff is acting in good faith

Black J found that Mr Hourican subjectively believed that a good cause of action exists with a reasonable prospect of success, supporting the conclusion that he is acting in good faith.

(iv) Whether the plaintiff has provided at least 14 days' notice to the company of its intention to apply for leave

The requirement of provision of 14 days' notice to the company was found to have been satisfied.

(v) Whether it is in the best interests of the Company that Mr Hourican be granted leave and whether there is a serious question to be tried

Black J answered the final two questions together, finding that only some of the alleged conduct formed a basis for a derivative action in respect of possible contraventions of ss. 181 and 182 of the Act.

Leave was granted for the following conduct:

- the building expenses and cash payments made to Mr Mahaffy, given the company will not have access to those funds for several years; and
- the entry into loan agreements between Messrs Mahaffy and Lord, given the exposure of the company to credit risk and the inappropriate use of company resources.

The fact that Mr Hourican was willing to indemnify the company against the cost risks of bringing a derivative action contributed strongly towards the conclusion that it is in the company's best interests to grant leave.

Leave was refused in respect of the following conduct:

- the payment of remuneration to the directors (held not to be irregular);
- the payment of personal expenses to Mr Lord, given the disproportionality between the costs of recovery and the amounts involved;
- the building works for directors of a client of Imperium due to likely evidentiary issues; and
- the alleged deceptive treatment of accounts due to evidentiary issues and the disproportionality between the costs of recovery and the amounts involved.

5.11 Guarantee does not cover a new credit arrangement without consent

(By Tal Shmerling and Will Heath, King & Wood Mallesons)

Australia and New Zealand Banking Group Ltd v Manasseh [2015] WASC 34, Supreme Court of Western Australia, McKechnie J, 3 February 2015

The full text of this judgment is available here.

(a) Summary

McKechnie J held that a guarantee executed by the defendant, Dr Manasseh, with respect to a 2006 credit agreement (the 2006 Agreement) between ANZ Banking Group (ANZ) and Vivaldi Investments Pty Ltd (Vivaldi), did not extend to a later credit arrangement entered into between ANZ and Vivaldi in November 2009 (the 2009 Arrangement).

His Honour concluded that, in substance, the 2009 Arrangement constituted a new credit agreement that replaced the 2006 Agreement, rather than being a variation of the 2006 Agreement. Therefore, Dr Manasseh could only be liable under the guarantee for the 2009 Arrangement if she consented to it or entered into a new guarantee. Since she did neither, McKechnie J dismissed ANZ's claims and found that the terms of the original guarantee did not extend to the 2009 Arrangement.

(b) Facts

In October 2006, Dr Manasseh's husband borrowed money under the 2006 Agreement from ANZ on behalf of Vivaldi to finance a property development. A few days later, Dr Manasseh executed a guarantee with respect to the 2006 Agreement, secured by a mortgage over the family home (registered in her name).

In late 2007, ANZ offered additional facilities to Vivaldi and variations to the 2006 Agreement. The offer was accepted by Vivaldi and Dr Manasseh consented to an extension of her guarantee.

Subsequently, ANZ and Vivaldi entered into the 2009 Arrangement which provided for, among other things, new credit arrangements including a facility limit in excess of the 2006 Agreement. The 2009 Arrangement provided that a "guarantor acknowledgment" should be signed by Dr Manasseh. Upon receiving a copy of the 2009 Arrangement documents, Dr Manasseh refused to sign the guarantor acknowledgment. Despite this, ANZ provided the loan to Vivaldi without having obtained Dr Manasseh's guarantor acknowledgment on the basis that such acknowledgment was unnecessary.

ANZ sued on the 2009 Arrangement. The key issue in contention in this proceeding was whether the guarantee given by Dr Manasseh extended to the 2009 Arrangement between ANZ and Vivaldi.

Dr Manasseh contended:

- the guarantee given by her ended on 28 February 2008, which was the termination date of an extension to the guarantee to which she had agreed;
- the guarantee stated that the guarantors "may agree to vary or extend the guarantee", but a change or replacement to the guarantee was not contemplated; and
- the guarantee contained a provision that specifically stated that, as guarantor, Dr Manasseh would not be bound "by a change to the credit contract, or by a new credit contract, that increases your liabilities under the guarantee unless you have agreed in writing". Since, according to Dr Manasseh, the 2009 Arrangement was an entirely new credit contract (and not a variation to the original 2006 Agreement), it required her consent in order for the guarantee to cover it.

ANZ argued that:

- Dr Manasseh's guarantee extended to the 2009 Arrangement irrespective of whether or not she consented to it, since the guarantee executed in 2006 stated that "any securities given or to be given, secure all present and future obligations of the Borrower to ANZ with respect to the facilities as noted in the Letter of Offer"; and
- the 2009 Arrangement was simply a variation to the original credit contract and therefore didn't require Dr Manasseh's consent.

The key question was therefore whether the 2009 Arrangement should be characterised as a new contract or a variation of the 2006 Agreement. ANZ conceded that if the court characterised the 2009 Arrangement as a new contract, that it would have required Dr Manasseh's consent.

(c) Decision

McKechnie J rejected ANZ's contention that the 2009 Arrangement was simply a variation of the 2006 Agreement. McKechnie J reasoned that the 2009 Arrangement was a new contract because it:

- was supported by valid consideration, in the form of a fee of $30,000 debited from Vivaldi's account;
- was expressed to have the effect of "wholly replacing" the conditions that existed under the 2006 Agreement. An arrangement that wholly replaces the conditions of a previous

agreement must be regarded as an entirely new contract, rather than a variation;

- involved an increase to the facility limit that was greater than the amount in the 2006 Agreement;
- extended the date of termination to 2010, which was two-and-a-half years later than the date set out in the original 2006 Agreement; and
- materially changed the interest provisions to be met by Vivaldi.

On this basis, his Honour held that ANZ was obliged to obtain the consent of Dr Manasseh in relation to the 2009 Arrangement in order for the guarantee to extend to it.

In obiter, McKechnie J considered an alternative argument of Dr Manasseh that ANZ had engaged in misleading or deceptive conduct by representing to her that any security provided by her would be limited in time to expire on 28 February 2008.

His Honour rejected the alternative argument because:

- there was nothing unusual or surprising about the inclusion of a termination date for the facility;
- ANZ made no representation that obligations under the guarantee would expire on termination of the facility; and
- although Dr Manasseh appears to have misunderstood her obligations under the guarantee, the terms of the guarantee were clear and expressly set out and she had the opportunity and did, in fact, seek legal advice as to the guarantee.

5.12 Statutory demands set aside in the context of winding up a company

(By Suzanne Marlow, Minter Ellison)

Greenhills Securities Pty Ltd v Loire Consultants Pty Ltd [2015] NSWSC 13, Supreme Court of New South Wales, Ball J, 3 February 2015

The full text of this judgment is available here.

(a) Summary

This case assesses the merits of various arguments for the setting aside of statutory demands served on the plaintiff company Greenhills Securities Pty Ltd (Greenhills) pursuant to ss. 459G, 459H and 459J of the Corporations Act 2001 (Cth) (the Act). All three of the defendants' statutory demands were set aside and costs were awarded to the plaintiff.

(b) Facts

David Dixon (the second defendant) became a client of Michael Unicomb, a tax accountant and a director of Greenhills, in 2008. With Mr Unicomb's assistance, Mr Dixon established Lovedale Road Unit Trust (LRUT) and acquired the first defendant, Loire Consultants Pty Ltd (Loire) to act as trustee of the unit trust. Loire, as trustee of the LRUT, acquired an investment property at Lovedale Road, Allandale in September 2009. According to Mr Unicomb's evidence, the trust did not open its own bank account, so during the relevant period Loire and the beneficiaries of LRUT used an account operated by Greenhills to receive and disburse trust monies.

The defendants claimed that the following advances were made to Greenhills at the request of Mr Unicomb and each repayable on demand:

- $207,594.27 on or about 5 March 2014, claimed by Loire;
- $141,535.00 on or about 7 December 2010, claimed by Mr Dixon; and
- $120,000.00 on or about 3 December 2010, which the defendants argued was paid to

Greenhills by mistake and which was claimed by Mr Dixon.

The first statutory demand for $207,594.27 was made in respect of the same debt as the second demand, and the defendants conceded that it should be set aside. The second demand was made by Loire for $207,594.27 in connection with the first advance. The third demand was made by Mr Dixon for $261,535.00 in relation to the second and third advances combined.

Several facts were disputed in relation to identification of the size and nature of the debts and to whom the debts were owed. It was unclear whether debts were incurred by Loire or Mr Dixon, which party was acting as trustee of LRUT at the relevant times, and in which capacity Mr Dixon, who was also a director of Loire, was acting at the relevant times.

Greenhills sought to have the second and third demands set aside on the basis that there was a genuine dispute concerning the existence of the debts pursuant to s. 459H of the Act. The plaintiffs filed four affidavits to this effect. The first affidavit was filed within 21 days of the service of the relevant statutory demands, the second affidavit was filed within 21 days to the extent it related to the third statutory demand, but not the second statutory demand. The third and fourth affidavits were not filed within 21 days of either demand. The plaintiffs claimed that the first and (to an extent) the second affidavits validly instituted the application, and that the further affidavits simply supplemented the relevant factual grounds.

The defendants claimed that Greenhills' application to set aside the statutory demands was defective because of (i) the combination of applications relating to separate demands into one proceeding and (ii) formal defects with the application meaning it did not comply with s. 459G of the Act.

(c) Decision

Section 459G of the Act sets out the requirements in relation to an application to the Court to set aside a statutory demand. An application must be made within 21 days of service of the demand by filing a supporting affidavit with the Court and serving copies of the application and the supporting affidavit on the person who served the demand on the company.

Section 459H of the Act further provides a method for determining the substantiated amount (if any) of a statutory demand where the Court is satisfied either "that there is a genuine dispute between the company and the respondent about the existence or amount of a debt to which the demand relates" or "that the company has an offsetting claim" or both.

(i) Joinder of applications

Ball J considered various authorities on the question of whether, where statutory demands are issued by separate creditors in respect of separate debts, it is necessary for the plaintiff to file separate originating processes in respect of setting aside each demand. A number of cases including *Help Desk Institute Pty Ltd v Adams* [1998] NSWSC 586 support the view that separate applications are necessary by implication under s. 459G. Ball J preferred the approach taken by *Barrett J in Remo Constructions Pty Ltd v Dualcorp Pty Ltd* [2008] NSWSC 1172 that s. 459G did not specifically require separate applications to be made for each statutory demand and that the Court's rules of procedure should apply. Applying the principles of joinder then under rl. 6.19 of the Uniform Civil Procedure Rules 2005 (NSW), Ball J accepted that the applications for setting aside the statutory demands may be joined as they give rise to a common issue of fact, namely when Mr Dixon became a trustee of LRUT and whether his actions were done as trustee of LRUT.

(ii) Defects in service and the originating process

Service was held to be effective and timely, despite being achieved indirectly by a mutual acquaintance delivering the originating process to Mr Dixon for Mr Unicomb. Ball J considered that the originating process clearly named Mr Dixon as the second defendant and clearly sought an order that the statutory demand served by him on Greenhills be set aside. Parts of the originating process omitted various details about Mr Dixon and the intention to serve a copy on him. No substantial injustice was claimed by the defendants to have resulted from these omissions and as such Ball J held that the defects fell within the scope of s. 467A of the Act (Effect of defect or irregularity on application under Part 5.4 or 5.4A) and did not provide grounds for dismissal of the application.

(iii) Existence of a genuine dispute with respect to the second statutory demand

Greenhills claimed that there was a genuine dispute in relation to the second demand on two grounds: firstly, concerning to whom the debt was owed and, secondly, whether the amount was disbursed in accordance with directions given by Mr Dixon either as a director of Loire or in his capacity as trustee of LRUT. Ball J concluded on the evidence there remained real uncertainty as to whether Loire or Mr Dixon was the trustee of LRUT. His Honour held that the question of whether the rights in respect of the sum of $207,594.27 belong to Loire or Mr Dixon meant that Greenhills could not pay one or the other without exposing itself to the risk of having to later pay the other party the same amount. The second statutory demand was therefore set aside on the basis of the existence of a genuine dispute pursuant to s. 459H(1) of the Act.

(iv) Setting aside the third statutory demand on other grounds

Mr Dixon conceded in the course of the hearing that $120,000.00 of the sum demanded in the third demand was never paid to Greenhills and that he was therefore not entitled to claim that portion of the third demand. Section 459J(1) of the Act provides that a Court may set aside the demand if it is satisfied that "because of a defect in the demand, substantial injustice will be caused unless the demand is set aside; or ... there is some other reason why the demand should be set aside".

Three questions therefore arose in relation to the third demand:

- whether there was a genuine dispute in relation to the remaining $141,535.00 of the third demand, pursuant to s. 459H(1) of the Act;
- whether Greenhills had an offsetting claim under s. 459H; and
- if Greenhills did not have an offsetting claim, whether the Court should vary the third demand so that it becomes a demand for $141,535.00.

Ball J decided the matter on the basis that the demand was defective in a way that causes substantial injustice due to the real uncertainty of whether $141,535.00 was in fact advanced by Mr Dixon or Loire and due to inconsistencies in the demand on that point. Ball J noted that the evidence was poorly expressed and confused from both sides, meaning that the matters in dispute were not readily amenable to resolution by way of statutory demand. While not the basis of the decision, his Honour also found there to be a genuine dispute about the existence of the debt. As the parties' evidence was so confused, his Honour was not prepared to vary the demand. The demand therefore stood for a greater sum than was accepted as owing, and was also set aside for that reason.

The Court ordered that all three statutory demands be set aside and that the defendants pay the plaintiff's costs of the proceedings.

5.13 Approval granted for settlement of litigation surrounding an unregistered managed investment scheme but refusal to grant non-publication order

(By Alex Moores, DLA Piper)

Australian Securities and Investments Commission v Piggott Wood & Baker (a firm) [2015] FCA 18, Federal Court of Australia, Kerr J, 29 January 2015

The full text of this judgment is available here.

(a) Summary

The Federal Court of Australia (the Court) accepted the application of the liquidator, Mr Barry Hamilton, to enter into a settlement deed for the litigation surrounding the wind up of an unregistered managed investment scheme. The litigation was the result of a law firm in Tasmania, the mortgage scheme associated with the firm, and the firm's insurers all going into liquidation. Mr Hamilton was appointed a liquidator by virtue of s. 601EE(1) of the Corporations Act 2001 (Cth) (the Corporations Act) by an inferior court in 2001. The parties reached a settlement in September 2014 and Mr Hamilton applied to the Court to have the settlement deed accepted. It was ultimately accepted by establishing Mr Hamilton had the power to lodge such an application due to the terms of his original appointment, his wide authority to act as liquidator, and his evidence of having sought independent legal and commercial advice.

The Court held, however, that the application for a non-publication order relating to the liquidator's materials could not be granted as the publication of those documents would not prejudice the administration of justice and it was in the public interest for the Court to be transparent, particularly when dealing with the legal profession.

(b) Facts

(i) Background

Piggott Wood & Baker (PWB) was a firm of solicitors in Tasmania that were operating a mortgage scheme (the Scheme) in conjunction with its practice. In 1998/1999, PWB notified its insurers that there were potential claims in relation to the Scheme and in 2002 the Law Society of Tasmania obtained orders under s. 111 of the Legal Profession Act 1993 (Tas) that PWB was in default. Between this time and 2013, the sums of $195,601.74, $6,173,312.31 and $1,036,529.27 were paid by way of drawdowns from the Solicitor's Trust to investors in the Scheme equivalent to a return of principal. Only two investors remained unpaid a total of $11,400.00.

It became apparent following these payments that the Solicitor's Trust, which had been assigned the rights and interests of investors, would be unable to recover the required amount from the individuals who were or had been partners of PWB. This was primarily due to the insolvency of these individuals following the collapse.

The action commenced in the Tasmanian Supreme Court because the applicant liquidator, Mr Hamilton, sought to recover the principal paid from the Solicitor's Trust, the outstanding principal owed to investors, and the interest. As the interest was essentially the main amount in contention, the case depended on whether PWB's insurers were deemed liable for that payment. To further complicate the chance of recovery, in 2001, FAI General Insurance—which acted as a substantial insurer of PWB for the years in question—itself went into liquidation. Scheme Administrators were appointed for all HIH group companies including FAI.

(ii) Settlement

When the matter came before the Supreme Court of Tasmania in early 2014 as an application for acceptance of a settlement deed, as opposed to resolving the matter through trial proceedings, there were seven parties; Mr Hamilton as liquidator, the trustee for the bankrupt former partners, the Solicitor's Trust, FAI General Insurance, all other insurers, the FAI Scheme Administrators, and the Commonwealth Government. The latter was involved due to administration of the HIH support scheme. The parties entered mediation and, by September 2014, had reached agreement. This settlement deed was presented to the Federal Court for approval.

It was argued by counsel for Mr Hamilton that the Court had power to grant such approval under the following provisions of the Corporations Act:

- the power to give directions under s. 479(3);
- the power to approve long-term agreements under s. 477(2B); and
- the power to approve a compromise of a debt to the company over $20,000 under s. 477(2A).

Subsequent written submissions also highlighted s. 601EE(2) which gives the Court power to make any order it considers appropriate for the winding up of an unregistered managed investment scheme, and with reference to the powers bestowed on the liquidator as per the terms of his original appointment.

(iii) Notice and confidentiality

Mr Hamilton submitted that his affidavit and annexures not be published without leave of the Court. The power of the Court to grant this order is sourced from the Federal Court of Australia Act 1976 (Cth) under s. 37AF. Section 37AG(1)(a) provides guidance on the grounds for a successful application being that "the [non-publication] order is necessary to prevent prejudice to the proper administration of justice". Mr Hamilton also did not provide notice to the investors and the estates of deceased investors about the proceedings to apply for acceptance of the settlement deed.

(c) Decision

(i) Approval sought by liquidator for the settlement of litigation

The Court rejected the application that s. 477(2A) or s. 477(2B) applied as it was not satisfied the settlement was a debt to a company. However, it accepted the subsequent written application that s. 601EE(2) was sufficient to approve the liquidator entering into the settlement notwithstanding certain caveats.

The Court justified its decision by referring to jurisprudence on previous applications by liquidators outlining its process as:

- the Court does not simply "rubber stamp" liquidator applications;
- the Court will not approve an application with unclear terms;
- the Court should grant or deny the application, not provide an alternative;
- the Court should defer to the commercial expertise of the liquidator (provided the law has been complied with and there is no bad faith); and
- the Court will, therefore, generally grant approval to a liquidator's application.

The Court determined this process applied to both s. 477 and to s. 601EE(2), and also that the process could be applied despite the recovery amount under the settlement deed being lower than what was originally estimated to be the legal entitlement. Mr Hamilton provided justification for his acceptance of this recovery amount in his deposition, and satisfied the Court that he had received appropriate independent and commercially sound advice that the settlement deed amount was acceptable. The Court concluded that Mr Hamilton was entitled as liquidator to make an application for acceptance of the settlement deed.

(ii) Granting of non-publication orders in relation to liquidator's materials

The Court did not object to the lack of notice to investors as to the proceedings for acceptance of the settlement deed and the non-publication order. It held that had there been only a few investors he may have been required to notify them but in the circumstances, with over 300 individual investors or estates, it was not required as there was not any realistic prospect of their being able to meaningly contribute to the proceedings.

The Court did not, however, grant the application for a non-publication order on the grounds that disclosure of the decisions and material of the liquidator would not prejudice the administration of justice. The concerns raised by liquidators in cases where there is a successful granting of an application relate to the liquidator's position in future proceedings being weakened by revealing material from previous proceedings. The Court held this was not a relevant concern in this case as, by Mr Hamilton's own admission in his deposition, he had already exhausted almost all avenues of recovery against other parties such as borrowers, mortgagors and guarantors. It followed that no further litigation was foreseeable other than some identified matters which would not be prejudiced by the release of the information.

By way of compromise, however, the Court made an order under s. 37AF to withhold the publication of the decision for 14 days following the judgment. This would allow Mr Hamilton the opportunity to pursue any specific confidentially matters of which he was advised. The Court also cited policy considerations in the granting of non-publication orders. According to the Court, PWB was a significant legal institution in Tasmania and the default and subsequent proceedings attracted a great deal of public attention. In such situations, the administration of justice is in fact better served by transparency and full disclosure, rather than secrecy, and there is a risk that non-publication could be interpreted as the legal profession protecting its own. For these reasons, only the temporary withholding of the reasons for decision was allowed by the Court.

5.14 Directions granted to trustee to commence proceedings against former trustee for alleged breaches of trust

(By Fiona Schmedje, Clayton Utz)

KordaMentha Pty Ltd & Calibre Capital Ltd v LM Investment Management Ltd (in liq); Park & Muller v KordaMentha Pty Ltd & Calibre Capital Ltd [2015] QSC 4, Supreme Court of Queensland, Martin J, 23 January 2014

The full text of this judgment is available here.

(a) Summary

KordaMentha Pty Ltd and Calibre Capital Ltd (together, KordaMentha), as trustee of a unit trust called the LM Managed Performance Fund (MPF), applied for a direction under s. 96 of the Trusts Act 1973 (Qld) (the Trusts Act) with respect to the commencement of legal proceedings. The proposed proceedings concerned alleged breaches of trust by the former trustee of the MPF, LM Investment Management Limited (in liquidation) (LMIM).

After considering the merits of the proposed proceedings, including the estimated costs and recoveries in the event KordaMentha was successful, the Court granted the direction sought.

The Court did not consider, however, that this was an appropriate case in which to make an order that KordaMentha's future costs of the proceedings be paid from the trust estate, on an indemnity basis, to the extent that those costs were not met by LMIM.

(b) Facts

On 12 July 2013, KordaMentha replaced LMIM as trustee of the MPF pursuant to an order of the Queensland Supreme Court. LMIM was also the responsible entity for a registered scheme called the LM Australian Income Fund (AIF). Trust Company (PTAL) Limited (PTAL) was the legal owner of the relevant assets of the MPF and AIF under a custody agreement between PTAL and LMIM.

The business of LMIM as trustee for the MPF, and LMIM as responsible entity of the AIF, was the purchase and development of investment properties, by entering into property investment and loan transactions using funds obtained from members.

As part of one such transaction, LMIM as trustee for the MPF had loaned a sum of money to Peregian Beach Pty Ltd (Peregian), secured by a first mortgage (the MPF Loan). When the outstanding balance of the MPF Loan was approximately $3.2 million, LMIM as responsible entity of the AIF loaned $1.7 million to Peregian (the AIF Loan). KordaMentha claimed that the terms of this loan were such that the MPF Loan was entirely subordinated to the AIF Loan.

When Peregian defaulted, LMIM exercised rights it had under various securities. However, there was a significant shortfall in the amount recovered. In September 2013, KordaMentha recovered $429,135.04 in respect of the MPF Loan. On the other hand, PTAL as custodian for LMIM received $1,925,729.92 in respect of the AIF Loan.

KordaMentha claimed that LMIM had breached its duty to act honestly and in good faith for the benefit of the members of the MPF and had also placed itself in a position of conflict of interest and duties.

The principal relief proposed to be claimed by KordaMentha was an order that PTAL, alternatively LMIM, pay the proceeds of $1,925,719.92 plus interest to the plaintiffs.

(c) Decision

(i) Statement of facts or affidavit evidence?

Section 96(1) requires that an application for directions be made upon a written statement of facts. KordaMentha's application was supported by affidavit evidence, a draft statement of claim and written submissions.

Martin J stated that s. 96 explicitly provides that the application is to be made upon a written statement of facts, so that it is unnecessary for affidavits to be produced. Martin J also held that it is not a function of the court, under s. 96, to decide disputed questions of fact. However, Martin J was prepared to proceed on the basis that the written statement of facts was contained within the outline of submissions and draft statement of claim, on the basis that to require KordaMentha to produce a statement would delay the matter and increase costs.

(ii) Merits of the proposed proceedings

Section 96(1) of the Trusts Act provides that any trustee may apply, upon a written statement of facts, for directions concerning any property subject to a trust, or respecting the management or administration of that property, or respecting the exercise of any power or discretion vested in the trustee.

Martin J held, adopting the principles set out in *Macedonian Orthodox Community Church St Petka Inc v Petar* (2008) 237 CLR 66, that the sole purpose of the court in giving advice under s. 96, as to whether the trustee should prosecute or defend proceedings, is to determine what should be done in the best interests of the trust estate. This includes whether it is proper for the trustee to incur the cost and expense of prosecuting or defending litigation.

In relation to costs, KordaMentha submitted that its estimated future costs of prosecuting the action against LMIM were approximately $480,000 and, if it were successful, it would be the recipient of an order in its favour of approximately $1.9 million. KordaMentha also submitted that the current cash holdings of the MPF were approximately $4.6 million, prior to future realisations and other recovery actions, meaning there were sufficient funds available to prosecute the claim against LMIM and meet any adverse costs orders. By contrast, LMIM argued that costs would be substantially more and, if KordaMentha were successful, the amount that might be recovered would be approximately $500,000.

With respect to the merits of the application, Martin J stated that the court's function did not extend to investigating the evidence, making findings or determining whether an applicant would be successful. Rather, it is for the court to determine whether or not the proceedings should be taken in the best interests of the trust estate.

LMIM argued that it had not breached its duties as trustee and that the true benefit obtained by AIF from having the first mortgage was not the amount of money it lent to Peregian but the interest it received. KordaMentha argued that LMIM would not have been able to recover the whole amount had it not acted in breach of its duties to MPF and that LMIM had obtained the benefit of being placed in a position where it was able to recover the whole amount of the AIF Loan.

Martin J noted the complexity of the matter and concluded that it could not be said that the claim by KordaMentha was without foundation. Accordingly, Martin J granted the direction sought.

(iii) Leave to proceed against company in liquidation

As LMIM was in liquidation, KordaMentha required the leave of the court, under s. 471B of the Corporations Act 2001 (Cth), to proceed against LMIM. Martin J granted leave to proceed against LMIM, as the nature of KordaMentha's claim is outside the scope of the proof of debt system (*Ong v Lottwo Pty Ltd (in liquidation)* (2013) 304 ALR 651).

(iv) Court's discretion as to future costs of proceedings

After granting the direction sought, Martin J went on to consider whether KordaMentha's future costs of prosecuting the proceedings should be borne from the trust estate on an indemnity basis, to the extent they were not paid by LMIM. KordaMentha relied upon the fact that similar orders had been made by the trial judge in Macedonian Orthodox Community Church, applying *In re Dallaway, decd* [1982] 1 WLR 756 (*In re Dallaway*).

Martin J noted that, although such a "pre-emptive" order may be made, it was not appropriate to do so in this case. This was because KordaMentha had the right, under rl. 700(2) of the Uniform Civil Procedure Rules 1999 (Qld), to have its costs of the proceedings that are not paid by someone else paid from the trust fund.

Further, in *In re Dallaway*, the court had made the order on the basis that, although there was a similar provision to rl. 700(2), if the trustee's defence was unsuccessful, there would be no estate from which it could be paid its costs. By contrast, there was no suggestion that KordaMentha would not be able to have recourse to the trust fund for its costs.

6. Contributions

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

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