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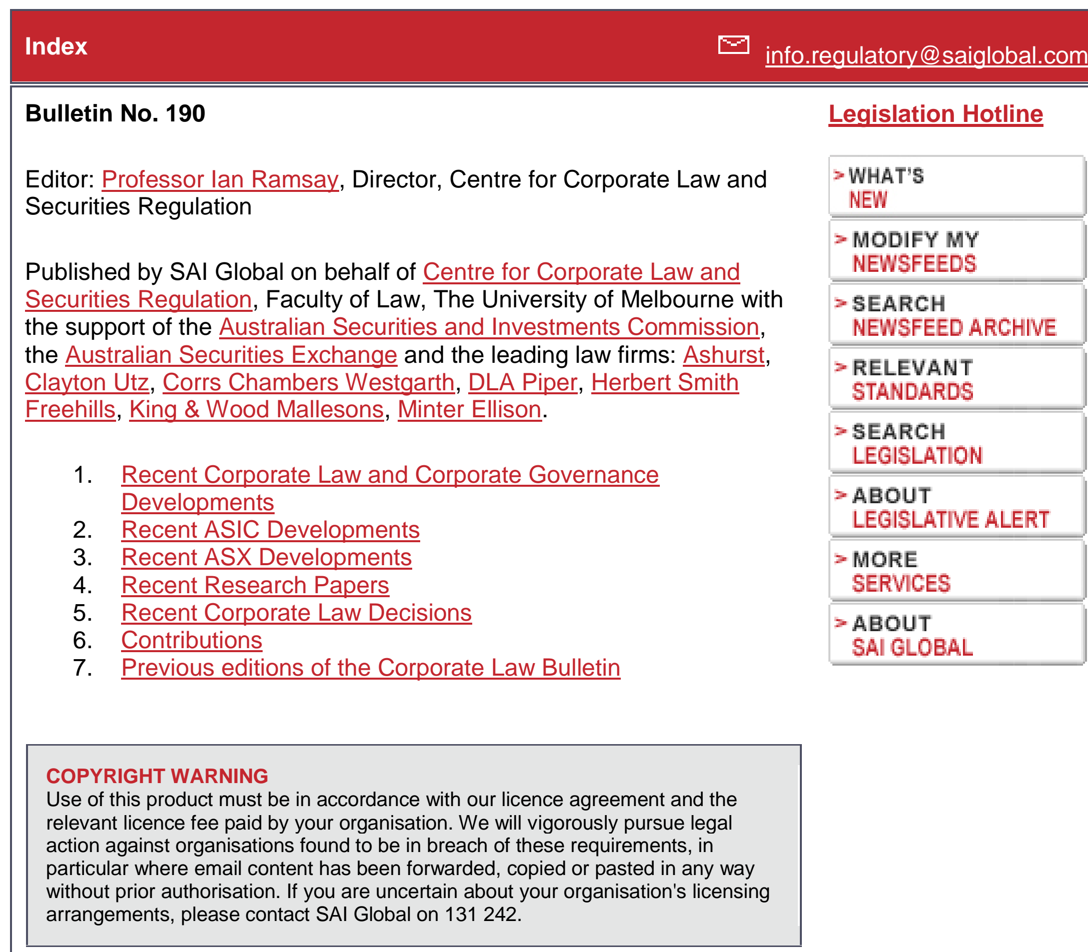

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Bulletin No. 190

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1. Recent Corporate Law and Corporate Governance Developments

1.1 Stricter rules for credit rating agencies in the European Union

On 20 June 2013, stricter rules for credit rating agencies (CRAs) came into force in EU member states. Contained in a regulatory package that was passed on 21 May 2013, the new rules aim to make credit rating agencies more responsible for their actions and also aim to reduce over-reliance on credit rating agencies, while simultaneously improving the quality of the rating process.

The primary changes brought about by the new rules include:

- reduced overreliance on credit ratings by requiring financial institutions to strengthen their own credit risk assessment and not to rely solely and mechanistically on external credit ratings;
- making credit rating agencies more accountable for their actions by ensuring that a rating agency can be held liable when it infringes intentionally or with gross negligence the CRA Regulation, thereby causing damage to an investor or an issuer;
- reduced conflicts of interests due to the issuer pays remuneration model through the introduction of mandatory rotation of rating agencies for certain complex structured financial instruments; and
- publication of ratings on a European Rating Platform, which will be available from June 2015, to improve the comparability and visibility of ratings of financial instruments rated by rating agencies registered and authorised in the EU.

A press release and the full text of the regulatory package are available from the European Commission website.

1.2 UK Banking Commission publishes report on changing banking for good

On 19 June 2013, the UK Banking Commission published its report, "Changing Banking for Good".

Established in July 2012, the UK Banking Commission was charged with conducting an inquiry into professional standards and culture in the UK banking sector and to make recommendations for legislative and other action. Through its inquiry the Commission found that due to misalignment of incentives in banking, lapses in standards were commonplace throughout the sector.

In order to rectify these issues the report makes the following key recommendations:

- the establishment of a new Senior Persons Regime, replacing the Approved Persons Regime, to ensure that the most important responsibilities within banks are assigned to specific, senior individuals so they can be held fully accountable for their decisions and the standards of their banks in these areas;

- a new licensing regime underpinned by Banking Standards Rules to ensure those who can do serious harm are subject to the full range of enforcement powers;
- a new criminal offence for Senior Persons of reckless misconduct in the management of a bank, carrying a custodial sentence;
- a new remuneration code better to align risks taken and rewards received in remuneration, with much more remuneration to be deferred and for much longer; and
- a new power for the regulator to cancel all outstanding deferred remuneration, along with unvested pension rights and loss of office or change of control payments, for senior bank employees in the event of their banks needing taxpayer support, creating a major new incentive on bankers to avoid such risks.

The full text of the report is available from the UK Parliament website.

1.3 G8 principles on transparency of company ownership and control

On 18 June 2013, the G8 published a set of agreed principles on preventing the misuse of companies and legal arrangements for the furtherance of illicit conduct.

Recognising the different constitutional circumstances of each of the G8 countries, the members agreed to publish national action plans based on the agreed principles in order to counter money laundering and tax evasion.

In summary, the agreed principles are as follows:

1. companies should know who owns and controls them and their beneficial ownership and basic information should be adequate, accurate, and current;
2. beneficial ownership information on companies should be accessible onshore to law enforcement, tax administrations and other relevant authorities including, as appropriate, financial intelligence units;
3. trustees of express trusts should know the beneficial ownership of the trust, including information on beneficiaries and settlors;
4. authorities should understand the risks to which their anti-money laundering and countering the financing of terrorism regime is exposed and implement effective and proportionate measures to target those risks;
5. the misuse of financial instruments and of certain shareholding structures which may obstruct transparency, such as bearer shares and nominee shareholders and directors, should be prevented;
6. financial institutions and designated non financial businesses and professions, including trust and company service providers, should be subject to effective anti-money laundering and counter terrorist financing obligations to identify and verify the beneficial ownership of their customers;
7. effective, proportionate and dissuasive sanctions should be available for companies, financial institutions and other regulated businesses that do not comply with their respective obligations, including those regarding customer due diligence; and
8. national authorities should cooperate effectively domestically and across borders to combat the abuse of companies and legal arrangements for illicit activity.

The full text of the agreed principles is available from the G8 website.

1.4 Improved governance of NFPs

On 18 June 2013 the Australian Institute of Company Directors (AICD) published "Good Governance Principles and Guidance for Not-For-Profit Organisations".

The Principles and Guidance set out a number of fundamental principles and guidance that are intended to provide a framework for not-for-profit organisations in adopting good governance practices.

Recognising the diversity of the NFP sector, the Principles and Guidance are not an attempt to formulate rules on what might constitute good governance practice for NFP organisations, or prescribe related behaviours and specific actions. Rather, the Principles and Guidance are designed to assist directors and boards in their conversation on good governance and how they can implement practical approaches in improving governance within their organisation.

The ten principles under which further commentary is provided cover:

- roles and responsibilities;
- board composition;
- purpose and strategy;
- risk - recognition and management;
- organisational performance;
- board effectiveness;
- integrity and accountability;
- organisation building;
- culture and ethics; and
- engagement.

The press release and full text of the Principles and Guidance are available from the AICD website.

1.5 OECD consultation on best practice for improving regulatory enforcement and inspections

On 14 June 2013, the Organisation for Economic Co-operation and Development (OECD) published a consultation on best practice principles for improving regulatory enforcement and inspections.

The goal of this consultation document is to present a basis for discussion on key issues as well as some key principles on which effective and efficient regulatory enforcement and inspections should be based in pursuit of the best compliance outcomes and highest regulatory quality. The principles will have informal guidance status and will not be binding on OECD countries. They will complement the 2012 Recommendation of the Council on Regulatory Policy and Governance.

The draft principles are available on the OECD website.

1.6 Monetary Authority of Singapore proposes regulatory framework for financial benchmarks

On 14 June 2013, the Monetary Authority of Singapore (MAS) announced a proposed regulatory framework for financial benchmarks. The new framework is intended to enhance the integrity of the processes for setting financial benchmarks.

The proposed new regulatory framework will have two pillars. First, MAS will introduce specific criminal and civil sanctions under the *Securities and Futures Act* (the SFA) for manipulation of any financial benchmark. Second, MAS intends to subject the setting of key financial benchmarks to regulatory oversight. MAS will have the powers under the SFA to designate key benchmarks based on considerations such as the systemic importance of a benchmark and an assessment of its susceptibility to manipulation.

The administrator and submitters of key benchmarks will be required to be licensed by MAS, and will be subject to regulatory requirements.

A press release and the full text of the proposed framework are available from the MAS website.

1.7 ESMA publishes guidelines on remuneration policies and practices

On 11 June 2013, the European Securities and Markets Authority (ESMA) published its "Guidelines on Remuneration Policies and Practices (MiFID)".

The purpose of the Guidelines is to ensure that remuneration policies are aligned with effective conflicts of interest management duties and conduct of business risk management obligations, as set out in the Markets in Financial Instruments Directive (MiFID).

Firms to which MiFID applies must ensure that they have appropriate remuneration policies and practices in place in accordance with the Guidelines.

The Guidelines are available from the ESMA website.

1.8 ESMA publishes report on prospectus directive liability regimes in the EU

On 10 June 2013, the European Securities and Markets Authority (ESMA) published a report on the "Comparison of Liability Regimes in Member States in Relation to the Prospectus Directive".

The report provides a comparison of liability regimes covering the European Economic Area (EEA), comprising the 27 EU Member States along with Iceland and Norway, and is aimed at providing clarity for market participants about the different regimes in place.

The press release and report are available on the ESMA website.

1.9 ECB consults on draft regulation on oversight requirements for systemically important payment systems

On 7 June 2013, the European Central Bank (ECB) published for public consultation a draft of its regulation on oversight requirements for systemically important payment systems.

The draft regulation aims to implement in the euro area the "Principles for financial market infrastructures", introduced in April 2012 by the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements and the Technical Committee of the International Organization of Securities Commissions (IOSCO). It will replace the "Core principles for systemically important payment systems", developed by the CPSS, which the Eurosystem adopted in 2001 and has since been implementing.

The draft regulation, which implements the CPSS-IOSCO principles in a legally binding way, covers both large-value and retail payment systems of systemic importance, whether operated by Eurosystem national central banks or private entities. It defines the criteria for qualifying a payment system as systemically important.

A press release and the draft regulations are available from the ECB website.

1.10 European Commission consults on harmonisation of national laws regulating single member limited liability companies

On 6 June 2013, the European Commission commenced a consultation process on the harmonisation of national laws regulating single member limited liability companies.

The purpose of the consultation is to gather more in-depth information on whether the harmonisation of national laws with regard to single-member limited liability companies would provide companies, and in particular small and medium enterprises, with more simple and harmonised rules across the EU which could reduce the administrative burden and costs they are currently facing.

Further details of the consultation are available on the European Commission website.

1.11 APRA releases final reporting requirements for superannuation

On 6 June 2013, the Australian Prudential Regulation Authority (APRA) released a letter to industry and final versions of 32 reporting standards, reporting forms and instructions for APRA-regulated superannuation funds.

These reporting requirements implement the transparency and accountability recommendations from the Commonwealth Government's *Stronger Super* reforms and the superannuation reporting proposals on which APRA had previously consulted in 2009.

The requirements in 22 of the final reporting standards will take effect from 1 July 2013, with the remaining ten taking effect from 1 July 2014. The first publication using the new data will be published in late 2013.

The letter outlining the final reporting requirements for superannuation and the 32 reporting standards, reporting forms and instructions is available on the APRA website.

1.12 EBA-ESMA publish principles for benchmark setting processes in the European Union

On 6 June 2013, the European Banking Authority and European Securities and Marketing Authority published their joint final report "Principles for Benchmark Setting Processes in the EU".

The Principles have been developed to address the problems in the area of benchmarks in the period until a potential formal regulatory and supervisory framework for benchmarks has been devised for the EU.

The full text of the Principles is available from the ESMA website.

1.13 FCA bans promotion of unregulated collective investment schemes to most retail investors

On 5 June 2013, the UK Financial Conduct Authority (FCA) published rules to ban the promotion of

unregulated collective investment schemes and certain close substitutes to most retail investors in the UK

The rules have been introduced to address the serious problems identified in the distribution of high-risk, complex investments to ordinary retail investors. The rules recognise that while sophisticated or high net worth retail clients may be better able to protect their own interests, many ordinary retail investors are exposed to significant risk of detriment from non-mainstream investment funds.

The rules come into force on 1 January 2014 and are published in the FCA's policy statement. Firms will have until this time to implement changes to comply with the new rules.

The Policy Statement containing the new rules is available from the FCA website.

1.14 Draft regulation to facilitate the operation of Australia's derivatives trade reporting regime

On 5 June 2013, the Australian Treasury released draft regulations and explanatory material to modify Australia's derivatives trade reporting regime.

In May 2013 the Deputy Prime Minister and Treasurer made a Determination to allow reporting obligations to be imposed across all five derivatives asset classes: commodity derivatives that are not electricity derivatives; credit derivatives; equity derivatives; foreign exchange derivatives; and interest rate derivatives.

The trade reporting obligations will apply following the entry into force of the Australian Securities and Investments Commission (ASIC) rules for trade repositories and trade reporting. ASIC consulted on rules for trade repositories and trade reporting in March and April 2013, and expects to make these rules in July.

These draft regulations include restrictions on ASIC's rule making power in relation to end users and operational measures to ensure the trade reporting regime has appropriate regulations governing the enforcement of trade reporting rules and regulations for confidential information. Subject to stakeholder feedback, the Government will aim to finalise these regulations shortly after the close of consultation.

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

1.15 SEC proposes money market fund reforms

On 5 June 2013, the US Securities and Exchange Commission (SEC) voted unanimously to propose rules that would reform the way that money market funds operate in order to make them less susceptible to runs that could harm investors.

The SEC's proposal includes two principal alternative reforms that could be adopted alone or in combination. One alternative would require a floating net asset value (NAV) for prime institutional money market funds. The other alternative would allow the use of liquidity fees and redemption gates in times of stress. The proposal also includes additional diversification and disclosure measures that would apply under either alternative.

The SEC's proposed reforms are designed to:

- mitigate money market funds' susceptibility to heavy redemptions during times of stress;
- improve money market funds' ability to manage and mitigate potential contagion from high levels of redemptions;

- preserve as much as possible the benefits of money market funds for investors and the short-term financing markets; and
- increase the transparency of risk in money market funds.

A fact sheet outlining the proposed reforms is available from the SEC website.

1.16 FRC publishes revised auditing standard "The independent auditor's report on financial statements"

On 4 June 2013, the UK Financial Reporting Council (FRC) published a revised edition of "International Standard on Auditing (UK and Ireland) 700: The independent auditor's report on financial statements".

The revisions apply to the audits of companies subject to the UK Corporate Governance Code and require greater disclosure in respect of the risks of material misstatement, the application of materiality and the scope of the audit.

The revised standards are available from the FRC website.

1.17 Securities Investment Fund Law comes into force in China

On 1 June 2013, the new *Securities Investment Fund Law* (the New Fund Law), that was released by the Standing Committee of the National People's Congress on 28 December 2012, came into force in China.

The New Fund Law will for the first time regulate certain private funds in addition to mutual funds in China, although private equity and venture capital funds will remain beyond the scope of the New Fund Law.

Under the New Fund Law, private funds are defined as being funds which are offered to 200 or fewer qualified investors and which trade in publicly offered shares, bonds and fund units and other securities and derivatives approved by the China Securities Regulatory Commission. The New Fund Law relaxes registration and filing requirement for such funds and brings the requirements into line with those applicable to mutual funds registered in China.

An English translation of the New Fund Law is available from the China Securities Regulatory Commission website.

1.18 CAMAC releases report on administration of charitable trusts

On 30 May 2013, the Australian Corporations and Markets Advisory Committee (CAMAC) released its report "Administration of Charitable Trusts". This report deals with administrative arrangements for charitable trusts managed by licensed trustee companies (LTCs).

Completed in accordance with terms of reference set by the Parliamentary Secretary to the Treasurer, CAMAC's starting point was to determine the reason why donors might set up charitable trusts. CAMAC determined that the primary intent of each donor is to achieve the philanthropic or benevolent purposes or objectives for which the donor established and funded the charitable trust, within the time frame of the trust, and in an effective and efficient manner. Consequently it was determined that this primary intent should be the policy cornerstone which underpins the regulation

of charitable trusts generally.

For the purpose of ensuring that the legislative regime for administering charitable trusts promotes the primary intent of the donor, CAMAC proposes a two-stage reform process.

Stage 1 would essentially comprise of three measures:

- the conducting of Stewardship audits of a cross-section of charitable trusts administered by LTCs, to address the present deficit of relevant and indisputable information on the state of administration of charitable trusts;
- the introduction of a "fair and reasonable" requirement for all fees and costs charged against a charitable trust; and
- changes to the judicial dispute resolution procedures to enhance access to the court and to broaden its remedial powers, including in regard to whether fees and costs charged against a charitable trust are excessive or whether an LTC should be replaced as the trustee of a charitable trust.

Stage 2 would build on the information gathered from the Stewardship audits and any preliminary indications from the enhanced judicial dispute resolution procedure. It would focus on what, if any, additional changes to the regulation of administrative arrangements for charitable trusts are required to promote the primary intent of the donor.

The Report is available from the CAMAC website.

1.19 Transparency requirements for issuers of securities in the European Union

On 29 May 2013, the Permanent Representative Committee, on behalf of the European Council, announced a compromise reached with the European Parliament on updated transparency requirements for issuers of securities on regulated markets.

The new directive sets out to make obligations applicable to listed small and medium-sized issuers more proportionate, whilst guaranteeing the same level of investor protection, and to facilitate cross-border access to information.

The agreed improvements are specifically aimed at:

- simplifying certain obligations so as to make regulated markets more attractive for raising capital for small and medium-sized issuers;
- improving legal clarity and effectiveness, notably with respect to the disclosure of corporate ownership; and
- providing for sanctions that are sufficiently dissuasive in the event of transparency requirements being breached.

The press release outlining the agreement is available here.

1.20 SEC charges NASDAQ for failures during Facebook IPO

On 29 May 2013, the US Securities and Exchange Commission (SEC) charged NASDAQ with securities laws violations resulting from its poor systems and decision-making during the initial public offering (IPO) and secondary market trading of Facebook shares. NASDAQ has agreed to settle the SEC's charges by paying a $10 million penalty, which is the largest ever against an exchange.

Under US securities law, exchanges have an obligation to ensure that their systems, processes, and contingency planning are robust and adequate to manage an IPO without disruption to the market. According to the SEC's order instituting settled administrative proceedings, despite widespread anticipation that the Facebook IPO would be among the largest in history with huge numbers of investors participating, a design limitation in NASDAQ's system to match IPO buy and sell orders caused disruptions to the Facebook IPO. NASDAQ then made a series of ill-fated decisions that led to the rules violations.

A press release as well as the text of the SEC order are available from the SEC website.

1.21 High Pay Centre reports on remuneration developments in the UK and internationally

On 28 May 2013, the UK High Pay Centre published a report titled "Leading or lagging? Where does the UK stand in the international debate on top pay?"

The High Pay Centre is an independent non-party think tank established to monitor pay at the top of the income distribution and set out a road map towards better business and economic success. The Report provides an overview of executive pay throughout the European Union, with a particular focus on France and Germany, as well as the United States and Japan.

The Report notes that whilst the UK initially led the way when the "say on pay" advisory vote was first introduced over ten years ago, other countries have now gone further in introducing mechanisms to deal with the problems associated with levels of executive pay.

The Report is available from the High Pay Centre website.

1.22 APRA releases quarterly superannuation statistics for March 2013

On 23 May 2013, the Australian Prudential Regulation Authority (APRA) released its March 2013 Quarterly Superannuation Performance publication.

The Report highlights that over the 12 months to 31 March 2013, total estimated superannuation assets, which include the assets of self-managed superannuation funds and the balance of life office statutory funds, rose by $187.8 billion (13.5%) to $1.58 trillion. This included an increase of $68.4 billion (4.5%) in total assets over the March 2013 quarter.

Over this quarter, the total estimated assets of industry funds increased by 5.7% ($16.7 billion) to $311.4 billion, corporate funds by 4.3% ($2.5 billion) to $60.3 billion, public sector funds by 4.3% ($10.3 billion) to $247.2 billion and retail funds by 4.2% ($16.9 billion) to $415.0 billion.

The report is available from the APRA website.

1.23 Corporate governance - guide on responsible investment

On 21 May 2013, the UK National Association of Pension Funds (NAPF) released its Responsible Investment Guide 2013 (the Guide).

Last published in 2009 the Guide updates the NAPF's Responsible Investment Guidance. The Guide aims to summarise the case for why pension fund investors should be seeking to incorporate extra-financial risks - including governance and material environmental and social risks, within their investment decisions in an effort to protect against value destruction, to potentially enhance risk

adjusted returns and ultimately support better member outcomes.

It also sets out strategies for how pension funds can, in keeping with their fiduciary duty, move the market towards one where responsible investment is considered the norm.

The Guide seeks to differentiate responsible investing from socially responsible investing and argues that the objective of responsible investment is decreasing investor risk and improving risk-adjusted returns. Compiling evidence for the financial case of responsible investing the Guide highlights the congruence between responsible investing and the fiduciary duties owed by pension funds to their members.

The Guide is available from the NAPF website.

1.24 OECD consultation on G20 principles of financial consumer protection

On 20 May 2013, the Organisation for Economic Co-operation and Development (OECD) published a consultation on a draft report on effective approaches to support the implementation of the G20 high-level principles of financial consumer protection that are being formulated by the the G20/OECD Task Force on Financial Consumer Protection.

The draft report follows three priority principles:

- disclosure and transparency;
- responsible business conduct of financial services providers and their authorised agents; and
- complaints handling and redress.

Further details about the Report are available from the OECD website.

1.25 European Commission consultation on EU banking structure

On 16 May 2013, The European Commission published a consultation paper on reforming the structure of the EU banking sector. The consultation focuses on the structural separation recommendation of the Liikanen High-Level Expert Group. It is stated in the consultation paper that in the run-up to and during the on-going crisis, some large and complex EU banking groups have faced problems of balance sheet expansion, high leverage, lack of market discipline, lack of bank resolvability, excessive risk-taking, trading and market-based activity, implicit bail-out expectations, competition distortions, and conflicts of interest.

According to the consultation paper, structural reforms of the banks that are too-big-to-fail would directly address intra-group complexity, intra-group subsidies, and excessive risk-taking incentives. Structural reforms may increase the credibility and effectiveness of the recovery and resolution process for large and complex banking groups, thereby lowering the ultimate taxpayer costs. Structural reforms also aim at a broader set of objectives, such as aligning the private incentives of banks with socially useful activities.

The consultation document is available from the European Commission website.

1.26 Corporations and Financial Sector Legislation Amendment Bill Inquiry - report published

On 15 May 2013, the Parliamentary Joint Committee on Corporations and Financial Services published its report relating to its inquiry into the Corporations and Financial Sector Legislation Amendment Bill 2013 (Cth).

The Bill amends the following legislation to introduce a range of miscellaneous measures relating to the regulation of financial markets and products:

- Corporations Act 2001 (Cth);
- Payment Systems and Netting Act 1998 (Cth);
- Mutual Assistance in Business Regulation Act (Cth);
- Australian Securities and Investments Commission Act 2001 (Cth);
- Reserve Bank Act 1959 (Cth);
- Clean Energy Regulator Act 2011 (Cth); and
  Carbon Credits (Carbon Farming Initiative) Act 2011 (Cth).

The key measures in the Bill are intended to:

- assist central counterparties (CCPs) in managing defaults of clearing participants;
- improve the allocation of resources by the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia (RBA) in assessing the compliance of Australian market licence and clearing and settlement facility licence holders with their legal obligations;
- allow certain Australian regulators including the RBA to exchange protected information with other entities in Australia and overseas in the execution of their duties subject to appropriate safeguards; and
- allow ASIC to gather and share protected information with regulatory entities overseas for supervision and enforcement purposes and require ASIC to report on the use of those powers.

The report recommends that the Bill be passed, subject to a report by ASIC and the Treasury in relation to the operation of Australia's over-the-counter (OTC) derivative regulatory framework, to ensure that appropriate protections are in place before the Bill comes into operation.

Specifically, the Committee recommends that the report by ASIC and the Treasury include reference to:

- progress in implementing the framework established by the Corporations Legislation Amendment (Derivative Transactions) Act 2012 (Cth);
- Australia's progress in implementing OTC derivatives market reforms compared to international efforts; and
- advice on any further reforms required to implement Australia's G20 commitments in relation to OTC derivatives.

Further information about the inquiry by the Joint Committee and the Report are available from the Parliament of Australia website.

1.27 Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill Inquiry - report published

On 15 May 2013, the Parliamentary Joint Committee on Corporations and Financial Services published its report relating to its inquiry into the Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013 (Cth). The Bill proposes legislative amendments to the Corporations Act 2001 (Cth) which include:

- streamlining the disclosure regime for simple corporate bonds;

- changing directors' civil liability provisions in respect to simple corporate 8onds issued to retail investors;
- clarifying the application of directors' defences in respect to misleading and deceptive statements and omissions in disclosure documents relating to simple corporate bonds issued to retail investors; and
- restricting the use of the terms "financial planner" and "financial adviser".

The report recommends a number of actions to be taken to coincide with the passing of the Bill, including that:

- Treasury amend the explanatory memorandum to more accurately reflect that the clarification of "reasonable steps" applies across the entire Corporations Act to all offers of securities;
- ASIC consult with key stakeholders in the financial advice sector to implement a grace period to ensure that in the short-term, passive breaches of the new provisions will not be prosecuted; and
- ASIC clearly sets out on its MoneySmart website the changes that the Bill makes to inform consumers about what they can expect when they receive a service from a financial planner or a financial adviser.

Further information about the inquiry by the Joint Committee and the Report are available from the Parliament of Australia website.

2. Recent ASIC Developments

2.1 ASIC and the Australian Charities and Not-for-profits Commission sign an MoU

On 18 June 2013, ASIC and the Australian Charities and Not-for-profits Commission (ACNC), the national charity regulator, formally agreed to collaborate and assist each other to achieve their objectives and to deliver streamlined regulation for registered charities that are also registered with ASIC as companies.

The MoU is a principles-based document that will underpin the future relationship between ASIC and the ACNC. It allows for information sharing, staff secondments, mutual training arrangements, joint taskforces and service agreements.

It does not affect the legal position on what information may or may not be disclosed to the other agency. Both agencies remain subject to existing secrecy and confidentiality provisions in the law.

The press release and MoU are available from the ASIC website.

2.2 Refinement of dark liquidity, high-frequency trading rules

On 18 June 2013, ASIC refined its proposed rules on dark liquidity and high-frequency trading. Following extensive consultation with industry and a recent drop in the number of small and fleeting orders ASIC has confirmed that dark liquidity and high-frequency trading are now an integral part of the Australian financial market landscape and a number of proposed changes to regulations have been modified.

ASIC will now not proceed with:

- small order resting time for high frequency trading, although the need for regulation in this area will continue to be monitored;
- implementation of a proposal to remove "materiality" with respect to manipulative trading and to instead rely on the impact of any order;

- minimum size thresholds and tick size reform, at this stage. Although it will monitor will monitor the impact of the new meaningful price improvement rule introduced on 26 May 2013 that has already seen a decline in dark liquidity;
- requiring client orders to receive time priority over principal orders and instead amend the existing rule on fairness and priority in dealing so it applies to crossing systems; and
- enhanced record keeping rules.

ASIC will proceed with:

- crossing system transparency and disclosure rules. However, it will allow disclosure of fees and order types to clients only and not require publication of aggregation statistics;
- crossing system fair treatment rules, but without a fee constraint on client opt-out;
- rules requiring that all crossing systems comply with core existing requirements for automated order processing, and proceed with requiring notification to ASIC and impacted clients of system outages;
- rules to protect client information (with carve outs for client consent) and to prevent intentional interposing between client orders;
- T+3 course of sale reporting.

The changes to the proposed rules are available from the ASIC website.

2.3 Update and consolidation of electronic prospectus guidance

On 17 June 2013, ASIC released a consultation paper proposing updates to current guidance to help facilitate email and internet distribution of offers of securities. A draft regulatory guide has also been proposed.

Consultation Paper 211 "Facilitating electronic offers of securities", is an Update to Regulatory Guide 107 on "Electronic Prospectuses". It proposes updates to the Regulatory Guide and aims to ensure that ASIC's guidance reflects current market practices and technological advancements.

The proposed updated guidance includes:

- an explanation of ASIC's view on the way the internet and other means of electronic distribution can be used in making offers of securities;
- good practice guidance to assist persons distributing offers of securities via electronic means; and
- continuation of relief for the use of personalised or AFS licensees created application forms.

A key part of the update is clarifying to what extent electronic distribution of prospectuses is permitted under the law.

The Consultation Paper is available from the ASIC website.

2.4 Refinement of rules on access to EDR schemes for small business borrowers

On 13 June 2013, ASIC released a report and updated regulatory guidance refining the rules for access to external dispute resolution (EDR) schemes for small business borrowers. The report follows a detailed review of the existing EDR access arrangements in situations where the lender has already commenced legal proceedings.

The report outlines that:

- small business borrowers will continue to be able to take disputes with their lender to the lender's EDR scheme;
- even where the lender has already commenced court proceedings against them, if the credit contract is $2 million or less, the small business borrower will continue to be able to take the matter to the EDR scheme; and
- where the loan exceeds $2 million and the lender has already commenced proceedings in a court, the small business borrower will not have access to EDR. This restriction commences from 1 January 2014.

At the same time updates to Regulatory Guide 165 "Licensing: internal and external dispute resolution", have also been made in order to:

- remove outdated transitional references for consumer credit and traditional trustee company services; and
- update timeframes for handling complaints at internal dispute resolution to reflect legislative changes made to the hardship regime.

The report and updated Regulatory Guide are available from the ASIC website.

2.5 Consultation on demutualisation approval procedure rules

On 11 June 2013, ASIC released a consultation paper seeking feedback on its approach to considering requests from credit unions to switch off demutualisation approval procedure rules. Demutualisation approval procedure rules are contained in some credit unions' constitutions and apply when the credit union is seeking member approval of certain types of transactions that will affect the mutuality of the credit union.

Consultation Paper 210 "Demutualisation approval procedure rules: Minimum member participation requirement", seeks feedback on whether ASIC should change its current approach to requests by credit unions to cease the effect of the minimum member participation requirement in the demutualisation approval procedure rules. At issue is whether the current requirement for 25% of all members of a credit union to vote in a preliminary postal ballot on specified proposals is set at an appropriate level and whether the required percentage should be altered or removed.

The Consultation Paper is available from the ASIC website.

2.6 Release of updated guidance on constitutions of registered managed investment schemes

On 5 June 2013, ASIC released revised regulatory guidance to assist operators of registered managed investment schemes and their advisers understand ASIC's views on the content requirements of constitutions for schemes. The revised guidance is contained in an updated version of Regulatory Guide 134 "Managed investments: Constitutions".

Under the revised guidance ASIC sets out its policy in relation to and the action it may take in assessing constitutional provisions relating to ss. 601GA and 601GB of the Corporations Act 2001 (Cth), including to:

- the consideration to acquire an interest in the scheme;
- the powers and rights of the responsible entity;
- complaints handling for retail clients and wholesale clients;

- withdrawal rights of members of the scheme;
- winding up the scheme; and
- the legal enforceability of the constitution.

The updated Regulatory Guide is available from the ASIC website.

2.7 Release of updated guidance for auditors reporting of contraventions

On 31 May 2013, ASIC released an update to Regulatory Guide 34 "Auditors' obligation: Reporting to ASIC".

Under the update guidance will continue to be provided on the legislative obligations of auditors of companies and registered schemes to report suspected contraventions of the Corporations Act 2001 to ASIC, and similar obligations under other legislation.

The update also provides new examples of circumstances that may and may not require reporting to ASIC, and introduces guidance for auditors of credit licensee trust accounts.

The updated Regulatory Guide is available from the ASIC website.

2.8 Consultation on approach to auditor resignation, removal and replacement

On 30 May 2013, ASIC released Consultation Paper 209 "Resignation, removal and replacement of auditors", which announces a review into the approach taken to the resignation, removal and replacement of auditors.

ASIC's existing regulatory guides Regulatory Guide 26 "Resignation of auditors" and Regulatory Guide 136 "Managed investments: Discretionary powers and closely related schemes", provide guidance on ASIC's approach to consenting to the resignation of public company auditors, and to the resignation and removal of scheme auditors.

The Consultation Paper seeks views on matters contained in the existing Regulatory Guides, such as whether ASIC should continue to:

- normally consent to the resignation of a public company auditor at the next annual general meeting;
- normally consent to the resignation or removal of scheme auditors within one month after lodgement of the annual audit report; and
- continue to give consent only if the entity has obtained a possible replacement auditor.

The Consultation Paper is available on the ASIC website.

2.9 Release of updated guidance to assist credit industry

On 29 May 2013, ASIC released an update to Regulatory Guide 203 "Do I need an Australian credit licence?" The update is intended to help individuals and entities in the credit industry decide whether they engage in credit activities and whether they need an Australian credit licence.

The Regulatory Guide has been updated to:

- reflect the current form of the National Consumer Credit Protection Act 2009 (Cth) (the National Credit Act) and National Consumer Credit Protection Regulations 2010 No. 44 (Cth), and remove information that is no longer relevant since the end of the transitional registration regime;
- provide additional guidance about, and examples to illustrate, the different types of credit activities, and
- provide additional information about licence exemptions, including examples to illustrate the scope of some of the exemptions that are more commonly relied on.

Under the update ASIC has also made structural changes to the Regulatory Guide to clarify the three main issues individuals and entities should consider when deciding whether they need an Australian credit licence.

These are:

- whether the provision of credit or consumer lease is regulated under the *National Credit Code*. If it is not, the licensing requirements in the National Credit Act will not apply;
- if it is regulated under the *National Credit Code*, whether individuals or entities engage in one or more of the specified types of activities in relation to that provision of credit or consumer lease; and
- if individuals or entities do engage in credit activities, whether one or more of the licence exemptions apply.

The updated regulatory guide is available from the ASIC website.

2.10 Further improvements to hedge fund disclosure to be considered

On 23 May 2013, ASIC announced that it will consider submissions from industry to refine the definition of "hedge fund" due to concerns the current definition affects a number of funds that do not exhibit the same risks to investors as "true" hedge funds.

In June 2012 ASIC released Class Order 12/749 "Relief from the Shorter PDS regime", which provided a temporary exclusion for hedge funds from the shorter product disclosure statement (PDS) regime. Under the class order, if an issuer had issued a shorter PDS for a hedge fund on or before 22 June 2012, it could continue to use the shorter PDS.

Under the order, a hedge fund is defined as a registered managed investment scheme that is promoted as being a hedge fund, or exhibits two or more characteristics of a hedge fund, which include:

- complexity of investment strategy or structure;
- use of debt;
- use of derivatives (subject to limited carve-outs);
- use of short selling; or
- rights to charge a performance fee.

The Class Order and further information is available from the ASIC website.

2.11 Release of ASX assessment report

On 23 May 2013, ASIC released its annual assessment report of the ASX Group (ASX) licensees.

The assessment covers the period 1 November 2011 to 30 June 2012 and focuses on how ASX dealt with a number of specific issues, including:

- the sufficiency of ASX's technological resources, in particular following the outage to its market announcements platform on 9 October 2012;
- its approach to dealing with long-term suspended entities; and
- its processes for reviewing prospectuses.

The report sets out a number of areas the ASX has agreed to address, working closely with ASIC. While important, these issues did not cause ASIC to qualify the conclusion that ASX adequately met its obligations for the assessment period.

The report is available from the ASIC website.

2.12 Report on relief decisions: October 2012 to January 2013

On 23 May 2013, ASIC released its latest report outlining decisions on relief applications covering the period 1 October 2012 to 31 January 2013. In assessing relief applications ASIC uses its discretion to vary or set aside certain requirements of the law where there is a net regulatory benefit or where ASIC can facilitate business without harming other stakeholders.

This Report aims to improve the level of transparency and the quality of publicly available information about decisions ASIC makes when asked to exercise its discretionary powers to grant relief from provisions of the Corporations Act 2001 (Cth), the National Consumer Credit Protection Act 2009 (Cth) or the National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009 (Cth).

The Report summarises examples of situations where ASIC has exercised, or refused to exercise, its exemption and modification powers. The Report also contains the first instance where ASIC exercised its powers under the ePayments Code and highlights instances where ASIC has considered adopting a no-action position regarding specified non-compliance with statutory provisions.

The Report is available from the ASIC website.

2.13 Release of consolidated guidance on takeovers

On 21 June 2013, ASIC released four new regulatory guides updating and consolidating its policies on takeovers. The new regulatory guides cover takeover bids, substantial holdings, compulsory acquisition and buy-outs, and also address some discrete issues ASIC has identified in its administration of the law.

The guides consolidate the bulk of ASIC's policies that cover Chapters 6-6C of the Corporations Act 2001 and include:

- Regulatory Guide 5 "Relevant Interests and substantial holding notices";
- Regulatory Guide 6 "Takeovers: Exceptions to the general prohibition";
- Regulatory Guide 9 "Takeovers bids"; and
- Regulatory Guide 10 "Compulsory acquisition and buyouts".

The release of the Regulatory Guides is accompanied by 11 new class orders referred to in the

Guides, as well as associated forms.

The Regulatory Guides and new class orders are available from the ASIC website.

2.14 Consultation on reforms for charitable investment fundraising

On 20 May 2013, ASIC released Consultation Paper 207, proposing reforms for charities that raise investment funds. The proposals do not affect fundraising by charities in the form of donations. The proposals are aimed at promoting confident and informed investors in charitable investment products.

The consultation paper proposes to either:

- remove existing exemptions available to charities that raise investment funds under Regulatory Guide 87; or
- retain existing exemptions on the basis that they are only available to organisations that satisfy both existing and new conditions to the exemptions.

Examples of new conditions that ASIC is proposing include that charities must hold 75% of their assets in assets that directly relate to their charitable purpose; and where the fund is offered to retail clients:

- have an Australian financial services licence, and
- meet minimum capital and liquidity requirements.

The consultation paper is available on the ASIC website.

3. Recent ASX Developments

3.1 Cash Market Margining (ASX Clear and ASX Settlement Operating Rules amendments)

On 7 June 2013, the ASX Clear Operating Rules and the ASX Settlement Operating Rules were amended to facilitate the introduction of Cash Market Margining.

In the aftermath of the global financial crisis, there has been an increased focus on the importance of systemic risk management. Regulatory and user expectations of Central Counterparty (CCP) capabilities have increased in response, particularly in relation to the strengthening of CCP risk controls.

The Reserve Bank of Australia highlighted the significance of this issue in the March 2009 "Review of Participation Requirements in Central Counterparties", published jointly with ASIC, and recommended that ASX Clear "review, particularly in the light of experience from the global financial crisis, whether there is a longer term case for considering other risk controls".

In contrast to the majority of CCPs worldwide, prior to 7 June 2013 ASX Clear did not require routine collateralisation (such as margin) on cash market exposures during the T+3 settlement cycle, or contribution to a mutualised paid-in Default Fund from its Clearing Participants. Either approach ensures that there exists a "defaulter pays" element in the resources available to meet any losses arising from a Clearing Participant default in the cash market. Importantly, routine margining provides additional protection to the pooled financial resources available to the CCP and therefore promotes systemic risk reduction in Australia's financial markets.

In response to the review, ASX introduced routine daily margining of the cash market on 7 June 2013. The margining approach is mainly based on a Historic Value at Risk simulation of potential losses to ASX Clear in the event that the CCP has to close out a defaulting Clearing Participant's

unsettled novated transactions in normal market conditions. ASX believes that margining of cash market transactions will enhance the risk management controls of ASX Clear and further reduce systemic risk in an increasingly complex Australian cash market environment.

The Reserve Bank of Australia's revised Financial Stability Standards, to be implemented in 2013, will require ASX Clear to routinely margin cash market transactions on or before 1 July 2013.

For more information see the Cash Market Margining page on ASX.com.au.

3.2 Reports

On 5 June 2013, ASX released:

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

for May 2013.

These reports are available on ASXGroup.com.au.

3.3 ASX participants support implementation of OTC clearing solution for Australian market

On 3 June 2013, ASX announced that it had received approval from the required majority of its 14 futures clearing participants for the rule amendments to implement a new OTC Derivatives Clearing Service for the Australian market. ASX will now proceed to seek formal regulatory clearance for the service.

The ASX OTC Derivatives Clearing Service will allow for the central clearing of standardised Australian dollar denominated interest rate swaps. The notional value of transactions in this market was almost A$18 trillion last financial year.

ASX has been working with seven local and international banks on the development of the OTC Derivatives Clearing Service. These banks constituted the initial foundation customers that supported ASX in the design of the service.

The media release is available on ASXGroup.com.au.

3.4 2012 Australian share ownership study

On 21 May 2013, ASX released the "Australian Share Ownership Study". The Study shows that 6.7 million people or 38% of the adult Australian population invested in the Australian share market, either directly (via shares or other listed investments) or indirectly (via unlisted managed funds), in 2012.

This is a decline from 43% total share ownership when the Study was last conducted in 2010. Total share ownership peaked in 2004 prior to the global financial crisis when 55% of adult Australians owned shares either directly or indirectly. Direct share ownership also declined from 39% to 34%

over this period.

The media release and the study are available on ASXGroup.com.au.

3.5 Submission to Treasury consultation paper: ASIC Market Supervision Cost Recovery Arrangements July 2013-June 2015

On 15 May 2013, ASX made a submission responding to the Treasury consultation paper "ASIC Market Supervision Cost Recovery Arrangements July 2013-2015". ASX supports the proposed refinements to the cost-recovery methodology but seeks an amendment to the Cost Recovery Impact Statement to clarify a section on the impact of market competition.

The ASX submission is available on ASXGroup.com.au.

3.6 Submission to ASIC CP 202: Dark Liquidity and High Frequency Trading: Proposals

On 10 May 2013, ASX made a submission to the ASIC consultation paper "CP202: Dark Liquidity and High-Frequency Trading: Proposals". ASX supports the introduction of a minimum order threshold for trades executed without pre-trade transparency and increased obligations on broker crossing networks to enhance transparency and market confidence in these venues. ASX does not support the proposals to reduce tick-sizes for some securities or to impose a minimum resting time for "small and fleeting" orders.

The ASX submission is available on ASXGroup.com.au.

4. Recent Research Papers

4.1 Is director industry experience a corporate governance mechanism?

This article investigates the valuation effect of director industry experience and the potential channels through which industry experience affects firm value in industrial S&P 1500 firms over the period from 2000 to 2010. They find that firms with more experienced directors on the board are valued at a premium compared to their inexperienced peers. When they control for a large set of additional corporate governance variables, director industry experience turns out to be one of the most valuable governance mechanisms. The authors also identify several channels through which directors with industry experience make firms more valuable. Firms with more experienced boards hold more cash, invest more in research and development, have a lower cash flow investment sensitivity with respect to capital expenditures and acquisition spending, are less likely to manage earnings, and provide better incentivised compensation packages to CEOs. In summary, the results suggest that director industry experience is a valuable corporate governance mechanism which improves both board oversight and strategic advice to top management.

The paper is available on the SSRN website.

4.2 The derivative action in Asia: A complex reality

This article uses the derivative action in Asia as a lens for re-evaluating the foundational theories of

Asian and comparative corporate law. It begins by demonstrating that the cultural theory of "Asian non-litigiousness" provides scant explanatory or predictive value for either the evolution or function of the derivative action in Asia's leading economies. Without the black box of Asian culture to erroneously explain away potential differences between "Asian" and "Western" derivative actions, the reality of the derivative action in Asia's leading economies becomes markedly more important. It allows evidence from the derivative action in Asia to be used as a valuable litmus test for three of comparative corporate law's most important theories which all claim universal applicability (the three "grand universal theories").

The paper is available on the SSRN website.

4.3 Mapping directors' duties: Strategies and trends in the EU

This paper analyses the rules on directors' duties in all EU Member States, identifies regulatory philosophies and trends, highlights differences, and discusses enforcement strategies, particularly as regards minority shareholder suits.

The paper is available on the SSRN website.

4.4 Board structure and the performance of Australian listed investment companies

This study examines the relationship between board structure and performance of Australian listed investment companies (LICs). With lower fees and simplified taxation over other managed funds, LICs provide a useful investment vehicle. LICs differ from other companies as their customers and investors are the same and fund management functions are often outsourced. LIC boards, in turn, are tasked with monitoring duties and determining service fees for fund managers. Agency problems are likely as fund managers' desire larger fees (and fund size) whereas LIC shareholders seek higher return. Whilst the nature of agency issues therefore differs from ordinary companies, the prior Australian LIC literature is limited. The authors document a significant relationship between director tenure and LIC performance. Specifically, they find director tenure to be negatively associated with LIC performance. Board busyness and independence increases LIC expense ratios whilst board size is negatively associated with market to book value.

The paper is available on the SSRN website.

4.5 The present and future of corporate governance: Re-examining the role of the board of directors and investor relations in listed companies

In this paper, the authors first shed light on the factors that underlie the differences between the "shareholder wealth maximization" and the "long-term commitment" models of corporate governance. By introducing a third type of governance model, they show that a three-dimensional approach provides a better understanding of the dynamics of corporate governance practices. The examination of the three-dimensional model's focus on growth and value creation provides a powerful catalyst for companies implementing a well-functioning governance structure. Their analysis is supported by case studies of, for instance, Facebook and LinkedIn that illustrate how shareholder value and long-term commitment are very much affected by a firm's growth and innovation prospects.

The second part of the paper provides important insights into practices and strategies that could promote growth and value-creation in listed companies. The authors show that it is a daunting task

to define best practices. However, they use two hand-collected data sets that consist of:

1. seventy venture capital backed companies that were involved in IPOs on US stock markets between 2011 and the first half of 2012; and
2. the top-forty of the world's largest companies in the Financial Times Global 500 2012 List to show how board dynamics can give companies a clear competitive advantage.

To gauge the importance of an innovative investor relations' strategy as an important condition for firm performance, they examine the impact of establishing frequent and timely interactions with investors.

The paper is available on the SSRN website.

5. Recent Corporate Law Decisions

5.1 Assets in single shareholder companies remain beneficially owned by the company, not the controlling shareholder

(By Rebecca Koh and Marissa Bendyk, King & Wood Mallesons)

Group Seven Limited v Allied Investment Corporation Limited, Marek Rejniak, Paul Sultana, Larn Limited, Luis Nobre [2013] EWHC 1509 (Ch), England and Wales High Court (Chancery Division), Hildyard J, 6 June 2013

The full text of this judgment is available at:

http://www.bailii.org/ew/cases/EWHC/Ch/2013/1509.html

(a) Summary

This case considered whether a debt owed by a third party to a company should be treated as an asset of that company's sole shareholder and director. The claimants argued that by settling the debt at a significant discount, the defendant in this case had disposed of his own asset, in breach of a freezing order made by the Court in related proceedings. Justice Hildyard upheld the principle that a company maintains a separate legal personality and held that the debt was not an asset of the defendant as a matter of corporate law or for the purposes of the freezing order.

(b) Facts

In related proceedings, the claimant, Group Seven Ltd, (Group Seven) commenced proceedings (the main proceedings) to seek a declaration that a €100 million loan agreement made between it and Allied Investment Corporation Ltd (the First Defendant) was null and void and/or rescinded on the ground that it was procured by fraud. In the main proceedings, Group Seven sought damages or equitable compensation against Mr Paul Sultana and others for their alleged fraud and fraudulent misrepresentations in selling or hawking to Group Seven an investment opportunity which ultimately proved illusory. In the main proceedings, Group Seven obtained a freezing order restraining Mr Sultana from disposing of certain assets in relation to the related proceedings (the Freezing Order).

In the present proceedings, Group Seven applied to commit Mr Sultana for contempt of court for his alleged breach of the Freezing Order. Mr Sultana was the only director and sole shareholder of his company, Wealthstorm Ltd (Wealthstorm). Group Seven argued that Mr Sultana breached the Freezing Order by settling a US$500,000 debt owed to Wealthstorm (the Debt) for US$200,000. Group Seven argued that this conduct amounted to the disposal (or procuring the disposal) of what was contended to be one of Mr Sultana's most valuable assets.

The Freezing Order provided, at Clause 8, that Mr Sultana was prohibited from "in any way disposing of, dealing with or diminishing the value of any of [his] assets whether they are in or outside England and Wales" up to the value of €12 million. Clause 9 of the Freezing Order defined assets for the purposes of the Freezing Order to include any asset which Mr Sultana had "the power, directly or indirectly, to dispose of or deal with as if it were his own". This clause also provided that Mr Sultana was to be regarded as having such power even if a third party "holds or

controls the asset in accordance with his direct or indirect instructions". Notably, Mr Sultana, in his sworn affidavit evidence, referred to the Debt as being one of his assets.

The three key substantive issues for his Honour to determine in deciding whether to allow Group Seven's application to proceed were:

i. whether the Debt was an asset of Mr Sultana as a matter of law;
ii. in any event, whether on its true construction, clause 9 of the Freezing Order applied to the Debt or required it to be treated as an asset of Mr Sultana for its purposes; and
iii. irrespective of whether the Debt falls within the scope of the Freezing Order, whether it should be treated as an asset of Mr Sultana because he regarded it as such in his affidavit evidence.

(c) Decision

Justice Hildyard held that Group Seven's application to hold Mr Sultana in contempt of court for allegedly breaching the Freezing Order failed for the following reasons:

(i) Whether the Debt was an asset of Mr Sultana as a matter of corporate law

His Honour re-iterated the principle in *Salomon v Salomon & Co* [1897] AC 22 that a company limited by shares is a separate (albeit artificially created) legal person and therefore beneficially owns all its assets unless otherwise expressly declared. This principle holds true even in cases where the company is wholly owned and controlled by one person. His Honour also added that, in such cases, the company is also not, by virtue of sole ownership and control, the agent of its owner and controller.

In the present case, it was clear that Wealthstorm, not Mr Sultana, owned all its assets (including the Debt) beneficially. His Honour found that Mr Sultana did not, by virtue of his ownership and control of Wealthstorm, have any beneficial interest in any of its assets, and nor was Wealthstorm his agent.

His Honour noted that, in certain rare cases and in order to prevent abuse, English Courts have been persuaded to pierce or lift the veil of incorporation and look to the person behind the artificial legal person of the company. However, his Honour emphasised that the exceptional circumstances where the courts are persuaded to lift the "corporate veil', do not constitute a negation of the principle that a company is a separate legal entity. His Honour went on to state that even if a court is persuaded to treat the assets of a company as answerable for some default or breach of its owner(s), those assets still remain in the separate beneficial ownership of the company itself. Accordingly, as a matter of corporate law, the assets of Wealthstorm (including the Debt) were not the assets of Mr Sultana.

(ii) Whether the Debt was an asset of Mr Sultana for the purposes of the Freezing Order because of the words extending the meaning and effect of "assets" in clause 9 of the Freezing Order

His Honour also considered whether, despite Mr Sultana having no beneficial interest in the assets of Wealthstorm and although Wealthstorm was not Mr Sultana's agent, Mr Sultana had, by virtue of his sole ownership and control "the power directly or indirectly, to dispose of or deal with [the Debt] as if it were his own". Group Seven contended that Mr Sultana's legal powers and control over the Debt were such that it was obvious that Wealthstorm held its assets in accordance with Mr Sultana's direct or indirect instructions.

His Honour rejected this contention on the basis that it ignores the "fundamental principle" that the company itself is the only entity with the power to deal with its assets. Those in control of the company's affairs (even where the company is controlled by a single individual) act merely as the company's agents. This agency extends to powers to deal with the company's assets, but those powers are still exclusively the company's own. Accordingly, even in the case of a single shareholder company, a power to deal with the company's assets, irrespective of its scope, is a power to act on the company's behalf in respect of the assets and liabilities of the company.

In the present case, in settling the Debt, Mr Sultana was not instructing Wealthstorm either directly or indirectly - he was not telling a third party what to do. His Honour found that, in dealing with the Debt, Mr Sultana was acting in right and on behalf of Wealthstorm - he was the means by which the company, as an artificial creation, acted.

(iii) Whether the Debt was an asset of Mr Sultana for the purposes of the Freezing Order because it was so regarded by the parties

Group Seven also claimed that, even if the Debt was not otherwise within the scope of clauses 8 and 9 of the Freezing Order, it should be treated as an asset of Mr Sultana because he listed it in his affidavit evidence and regarded it as such. His Honour also rejected this argument on the following bases.

First, the Freezing Order, being an order of the Court, is not a contract. Accordingly, the principles of contractual construction cannot be applied without modification. In particular, the Court would likely be more reluctant to give to words a special meaning which may have been intended by the parties but which would not be their usual meaning.

Secondly, in a similar vein, words used in an order of the Court must be given a uniform meaning which is able to be ascertained by all parties affected by the order without reference to evidence that is only available to the original parties.

Finally, settled principles of corporate law preclude the treatment of a sole shareholder's shareholding in a company and the company's assets as one and the same with the consequence that a right to enforce against shares is different from a right to enforce against the company itself.

5.2 In specie distribution by a responsible entity - Declaration of contravention made

(By Sophie McNaught and Rhys Ryan, King & Wood Mallesons)

Australian Securities and Investments Commission v Wellington Capital Limited [2013] FCAFC 52, Federal Court of Australia, Full Court, Jacobson, Gordon and Robertson JJ, 28 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCAFC/2013/52.html

(a) Summary

This case considered the power of a responsible entity of a managed investment scheme to make an in specie distribution of scheme property to the scheme's members. The Full Court of the Federal Court considered whether the distribution was permitted according to:

- clause 13.1 of the scheme's constitution which provides that the responsible entity shall have all powers that are "legally possible" for an actual person or corporation to have; or
- clause 13.2.5 which confers power on the responsible entity to dispose of or deal with scheme property as if it were the absolute and beneficial owner; or
- s. 124 of the Corporations Act 2001 (Cth) (the Corporations Act) which confers power on a company to distribute property to members.

The trial judge found that, as a matter of construction, clauses 13.1 and 13.2.5 conferred on the responsible entity the necessary power to make the in specie distribution. On appeal, the Full Court rejected the trial judge's findings and construed the constitution from a trust law perspective and in light of the statutory context surrounding managed investment schemes. The Full Court found that the responsible entity contravened the Corporations Act and that its actions were taken without power under the constitution. A declaration was made accordingly.

(b) Facts

Wellington Capital Ltd (Wellington) is the responsible entity of a managed investment scheme known as the Premium Income Fund (the Fund), the units in which are listed on the National Stock Exchange. The Fund's principal activity is the investment of unit holders' funds in mortgages, equities, debt instruments and cash.

In September 2012, Wellington sold assets comprising approximately 41% of the assets of the Fund to an unlisted public company called Asset Resolution Ltd (ARL). The consideration for the sale was all of the issued share capital of ARL, which was transferred to the Fund. The shares were then distributed to unit holders of the Fund in proportion to their unit holdings as a distribution in specie.

ASIC commenced proceedings on the grounds that the constitution of the Fund did not give Wellington power to transfer assets of the Fund, which comprised scheme property, to unit holders.

At first instance, the trial judge found that Wellington did have power to effect a distribution in specie under two provisions in the constitution, being clauses 13.1 and 13.2.5, set out in full below.

Natural Person
13.1 The Responsible Entity shall have all the powers in respect of the Scheme that is legally possible for a natural person or corporation to have and as though it were the absolute owner of the Scheme Property and acting in its personal capacity.

Additional Powers
13.2 In the administration of the provisions of this Constitution, and the Corporations Act, in relation to the Scheme and the Scheme Property, the Responsible Entity shall have the following powers. These powers shall be in addition to the powers, authorities and discretions vested in it by any other provision of this Constitution or by the Corporations Act and which shall not limit or be limited by, or be construed so as to limit or be limited by the powers, authorities and discretions otherwise by this Constitution or by the Corporations Act vested in the Responsible Entity, that is to say:

... 13.2.5 ... acquire, dispose of, exchange, mortgage, sub-mortgage, lease, sub-lease, let, grant, release or vary any right or easement or otherwise deal with Scheme Property as if the Responsible Entity were the absolute and beneficial owner ...

The primary judge found that clause 13.1 treated Wellington as a notional corporation and as an absolute owner in its personal capacity and therefore, under s. 124(1)(d) of the Corporations Act, it was entitled to "distribute any of the company's property among the members in kind or otherwise".

(c) Decision

(i) Clause 13.1 of the constitution does not confer power on Wellington to effect a distribution in specie

The Full Court of the Federal Court considered clause 13.1 in the statutory context of Chapter 5C of the Corporations Act, which deals with managed investment schemes. The Court considered the history of Chapter 5C, which was introduced to replace the prescribed interest regime - a dual party structure involving a manager and a trustee. The new regime implemented the recommendation of the Australian Law Reform Commission report that every scheme should be operated by a single entity in which the functions of a trustee and manager were united.

The critical provision of Chapter 5C that the Court considered was s. 601FC(2), which provides in unequivocal terms that a responsible entity holds scheme property on trust for scheme members.

Accordingly, the Full Court held that clause 13.1 of the constitution must be construed according to trust law. It is a fundamental principle of trust law that a trustee must adhere to the terms of the trust. Absent the consent of all beneficiaries, it is not open to a trustee simply to transfer the trust property to the beneficiaries. Here, clause 13.1 is not concerned with the power of the responsible entity in relation to unit holders; it merely enabled Wellington to deal with scheme property as though it were the absolute owner. To permit the responsible entity to deal with the scheme property as an absolute owner in its dealings with the unit holders would be contrary to the relationship of trustee and beneficiary, which exists between them.

The Full Court also held that Wellington did not attain the power contained in s. 124(1)(d) of the Corporations Act. That section empowers a company to "distribute any of the company's property among the members in kind or otherwise". The definition of "member" in the Corporations Act distinguishes between membership of a company and membership of a managed investment scheme. Section 124(1)(d) refers to the member of a company and therefore does not confer power on a notional corporation to distribute property to members of the scheme.

The Full Court decided that it was not necessary to consider whether it was "legally possible" for

Wellington to make the distribution given that clause 13.1 of the constitution did not authorise or empower Wellington to make the distribution.

(ii) Clause 13.2.5 of the constitution does not confer power on Wellington to effect a distribution in specie

Like clause 13.1, the Full Court held that clause 13.2.5 must be construed in its statutory context and in light of the unequivocal way in which the legislature has approached the concept of a managed investment scheme (i.e. a structure in which a responsible entity manages property in its capacity as trustee for members).

Clause 13.2.5 is merely an expression of the responsible entity's power to engage in a wide range of dealings with commercial parties in respect of scheme property. The clause cannot confer power on a responsible entity, such as Wellington, to distribute in specie any part of the scheme property to unit holders. An in specie distribution involves special and unique features which are not captured by the use of the words "dispose of" or "grant" (or even the phrase "or otherwise deal with") in clause 13.2.5.

(iii) Contravention of the Corporations Act

The Full Court declared that the distribution of shares in ARL to the unit holders of the Fund was contrary to the terms of the constitution and was done without power. The Court also declared that, in making an in specie distribution, Wellington did not operate the Fund and perform the functions conferred on it by the Fund's constitution, and thereby contravened s. 601FB(1) of the Corporations Act.

5.3 Acquisition scheme of arrangement - not fair but reasonable?

(By Flora Ho, Clayton Utz)

PR Finance Group Limited, in the matter of PR Finance Group Limited [2013] FCA 504, Federal Court of Australia, Farrell J, 27 May 2013

The full text of this judgment is available at:

http://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/single/2013/2013fca0504

(a) Summary

This decision sets out the reasons for the Federal Court of Australia (the Court) making orders, pursuant to s. 411(1) of the Corporations Act 2001 (Cth) (the Act), that the Plaintiff company:

- convene a meeting of its members for the purposes of considering a proposed scheme of arrangement between the Plaintiff and its members (the Scheme); and
- distribute a scheme booklet (the Scheme Booklet), as approved by the Court, to its members.

Of interest are the Court's comments regarding the independent expert's conclusion that the Scheme was "not fair but reasonable" and the relevant policies articulated in ASIC's Regulatory Guide 111.

(b) Facts

PR Finance Group Ltd (PRF) was an unlisted public company, which operated a business of providing consumer finance. As at 10 May 2013, it had 118 members and one class of shares. During the global financial crisis, PRF was required by both its primary lender, the Commonwealth Bank of Australia (CBA), and its junior lender, Keybridge Capital Ltd (Keybridge), a listed financial services company, to reduce its debts under the respective facility agreements. In February 2013, following a series of failed attempts by PRF to raise additional funding, PRF became in breach of

both the CBA facility and the Keybridge facility and Keybridge indicated that it would not extend the termination date of its facility past 7 April 2013.

Against this background, Keybridge approached PRF with a proposal to acquire 100% of the shares in PRF via a scheme of arrangement. Under the Scheme, the consideration payable by Keybridge to PRF shareholders for the transfer of PRF shares comprised both cash and scrip (Scheme Consideration). On 30 March 2013, PRF and Keybridge entered into a scheme implementation agreement, and soon after, Keybridge announced the proposed Scheme to the ASX, disclosing that the Keybridge facility would be extended if the Scheme were approved.

Pursuant to s. 411(1) of the Act, PRF applied to the Court for orders convening a meeting of its members to consider, and if thought fit, to agree to the Scheme.

(c) Decision

Having regard to the matters set out below, Farrell J considered that the formal requirements under s. 411 of the Act were satisfied and the Scheme was neither mala fide nor proposed for an improper purpose. Accordingly, the Court ordered the convening of the meeting of PRF's members and approved the Scheme Booklet for distribution.

(i) Common form of acquisition schemes

The Scheme was described as a common form of "arrangement" proposed under s. 411 of the Act, pursuant to which shareholders of a company transfer shares to a buyer of the company in exchange for cash and/or scrip consideration.

Section 411 of the Act allows companies to implement corporate reorganisations that are not specifically provided for by statute or are beyond the power of members in a general meeting. It has the benefit of allowing companies to bind all its members to the same arrangement, notwithstanding the dissent of a minority of members.

The section prescribes a "three-stage process" comprising:

1. an application to the Court under sub-section (1) for leave to convene a meeting of members (the subject of this decision);
2. the holding of a meeting during which members would vote on the Scheme; and
3. if the requisite majority votes in favour of the Scheme, a second application to the Court for its approval of the Scheme.

(ii) Tests applicable to applications under s. 411(1)

Various tests applicable to the Court's determination of a s. 411(1) application were articulated in this decision. In particular, the consideration of the Scheme Booklet was said to be central to the task of the Court.

The Court would need to be satisfied that:

- "the proposed Scheme was of such a nature and cast in such terms that, if it receives the statutory majority at the meeting of members, the Court would be able to approve the Scheme on an unopposed application at the second court hearing";
- a sensible business person might consider the proposed arrangement as beneficial; and
- members had been given sufficient information, including information required under s. 411(3) of the Act, to make a decision whether to vote for or against the proposed Scheme.

(iii) Disclosure to members

Regarding the sufficiency of disclosure to members, the Court observed that the Scheme Booklet disclosed, amongst other things, the risks associated with the implementation of the Scheme, the reasons why members might vote for or against the Scheme and the full details of the conditions to which the Scheme was subject.

More specifically, the Scheme Booklet disclosed:

- the interests of the directors of PRF (including their shareholdings in, and contractual entitlements against, the company) and the effect of the Scheme on those interests;
- the directors' recommendation that members vote in favour of the Scheme;
- the report by an independent expert, BDO Corporate Finance Ltd (BDO), and its conclusion that the proposed Scheme was "not fair but reasonable" and, in the absence of any other information or superior proposal, that it was in the best interests of PRF shareholders;
- the uncertainties associated with the Scheme and whether it would ultimately proceed; and
- the deal protection measures contained in the scheme implementation agreement, which restricted PRF from dealing with third parties, except in limited circumstances. Having regard to the evidence, the Court was satisfied that those lock-up devices were not unduly anti-competitive nor were they coercive of PRF shareholders in expressing their attitude towards the proposed Scheme.

(iv) Independent expert report

The independent expert's conclusion that the proposed Scheme was "not fair but reasonable" was drawn on the following bases:

- s. 640 of the Act requires independent experts, when analysing a change of control transaction, to express an opinion on whether the transaction is "fair and reasonable";
- according to ASIC's "long accepted" policy, as set out in its Regulatory Guide 111, the term "fair and reasonable" in s. 640 is not to be regarded as a compound phrase. Instead, there are two distinct criteria: whether it is "fair" and whether it is "reasonable";
- also in accordance with ASIC's Regulatory Guide 111, when determining whether the PRF Scheme was "fair", the value of PRF shares was to be assessed without taking into account PRF's distressed circumstances. Accordingly, the value of each PRF share was assessed by BDO at between $0.0248 and $0.0919, which was greater than the assessed value of the Scheme Consideration. BDO therefore concluded that the Scheme was not "fair";
- however, having regard to other relevant considerations such as the financial distress experienced by PRF, the possibility of Keybridge's appointment of a receiver to PRF and the likelihood that, in the event of a receivership, PRF shareholders will realise a value for their investment that is significantly less than the Scheme Consideration, BDO formed the opinion that the Scheme was "reasonable" even though it was not "fair".

Whilst finding that BDO's opinion was well-founded, the Court commented that, in circumstances such as the present case where PRF would have become technically insolvent but for the proposal of the Scheme, the methodology prescribed by ASIC, including the need to value the company's shares without having regard to its distressed state, had the effect of obscuring the common sense finding to which the expert ultimately came. Moreover, compliance with the Regulatory Guide was said to have led to over complexity in the expression of BDO's opinion and the length of its report, thereby undermining its clarity and utility to PRF shareholders.

(v) Other considerations

Other considerations that were taken into account by the Court in this decision included:

- the appropriate Scheme classes;
- the performance risks associated with the relevant parties' obligations under the Scheme and the scheme implementation agreement; and
- other formal and procedural matters, such as whether PRF was a "Part 5.1" body and whether ASIC had reasonable opportunity to consider the Scheme Booklet and to make submissions to the Court so as to satisfy the requirement under s. 411(2) of the Act.

5.4 Leave not required to proceed against registered foreign company in liquidation

(By Natasha Blake, Clayton Utz)

In the matter of ACN 092 138 442 Pty Limited (in liquidation) [2013] NSWSC 639, New South Wales Supreme Court, Black J, 23 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/639.html

(a) Summary

This decision of the New South Wales Supreme Court deals with issues of service in the context of proceedings against a registered foreign company in liquidation, and whether leave is required to continue proceedings against such a company.

The Court held that:

- the Interlocutory Process had been validly served upon the foreign company, having been sent to the registered office of both the company and its liquidator; and
- leave was not required to proceed against a registered foreign company in liquidation.

(b) Facts

The Plaintiffs, as Liquidators of ACN 092 138 442 Pty Limited (in liquidation), sought an order for leave under s. 500(2) of the Corporations Act 2001 (Cth) (the Act) to proceed with a claim against the First Defendant, Bristrol Custodians Ltd (Bristrol), a company incorporated in New Zealand which was being wound up in that jurisdiction.

Section 500(2) of the Act prohibits, without leave of the Court, proceeding with an action against a company after a resolution for voluntary winding up has been passed.

Bristrol did not appear at the hearing of the application, which was opposed by the Third Defendant on the grounds of:

- deficiencies in service of the application on Bristrol; and
- the Court lacking jurisdiction to grant the orders sought.

The Plaintiffs had sought to serve the application by:

- sending the Interlocutory Process to solicitors who had been identified as a contact point for creditors in the first report of Bristrol's liquidator. The solicitors did not accept service;
- sending a copy of the Interlocutory Process to the liquidator by email, and copies of the supporting affidavit to the liquidator and their solicitors by email;
- sending a copy of the Interlocutory Process and supporting affidavit to the liquidator by registered post to their address in New South Wales, which was also recorded as Bristrol's registered office; and
- engaging a process server who left the documents at the front door of the liquidator's premises after having not been able to obtain access.

Although Bristrol had been registered as a foreign company, the Third Defendant had lodged a notice with ASIC that Bristrol had ceased to carry on business. The Third Defendant submitted that Bristrol's non-appearance at the hearing raised a question as to the adequacy of service.

On the question of leave sought under s. 500(2), the Third Defendant submitted that the Court did not have jurisdiction to grant the order, but accepted that the consequence would be that leave was not required. s. 500(2) was submitted to be inapplicable for the reason that Bristrol was not a company within the meaning of s. 9 of the Act, which defines the term as "a company registered under this Act".

(c) Decision

(i) Bristrol had been validly served with the application

The Court held that Bristrol had been validly served in accordance with s. 601CX of the Act, which provides, inter alia, that a document may be served by leaving it at, or posting it to, the registered office of a registered body, or by sending it to the last lodged address of its appointed liquidator.

Service of the documents to the registered office of Bristrol, at the address last notified to ASIC, was held to have been effective for the purposes of the Act, particularly in circumstances where the liquidator had been placed on notice of the application through emails to him and his solicitors.

The Court specifically rejected submissions that the fact of Bristrol's non-appearance raised any question regarding service.

(ii) Leave not required to proceed against a registered foreign company in liquidation

The Court held that leave under s. 500(2) of the Act was not required for the Plaintiffs to continue proceedings against Bristrol.

The definition of "a company registered under this Act" was held to refer to the act of registering a company under s. 118 of the Act, bringing the company into existence as a body corporate under s. 119.

Citing the decision of *Feng v GMS Fulfilment Services Ltd* [2004] NSWSC 527, the Court distinguished registration of a "foreign company" under Part 5B.2 Division 2 of the Act from registration of a "company" under s. 118. Registration of a foreign company under Part 5B.2 Division 2 is directed to an entity that already exists under the law of another place. By contrast, registration of a company under s. 118 causes a "juristic" person to come into being under s. 119 of the Act.

Accordingly, the Court held that s. 500 of the Act was inapplicable and leave was not required to continue proceedings against the foreign company. The Court noted that the position of the proceedings may need to be reconsidered should Bristrol be deregistered in New Zealand, but did not express a final view on this issue.

5.5 Applications for adjournment of winding up applications: the exercise of statutory discretion by the court and creditors right to vote on a deed of company arrangement

(By David Miller, DLA Piper Australia)

Allied Express Transport Pty Limited v Exalt Group Pty Ltd (Administrator Appointed), in the matter of Exalt Group Pty Ltd (Administrator Appointed) [2013] FCA 455, Federal Court of Australia, Jacobson J, 16 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/455.html

Allied Express Transport Pty Limited v Exalt Group Pty Ltd (Administrator Appointed), in the matter of Exalt Group Pty Ltd (Administrator Appointed) (No 2) [2013] FCA 477, Federal Court of Australia, Jacobson J, 23 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/477.html

(a) Summary

These two judgments arose from the same winding up application. The Plaintiffs sought an order for the winding up of the Defendant. The Defendant conceded it had no grounds to object to the order but sought an order adjourning the winding application until after a second meeting of creditors could hear a proposal for a deed of company arrangement. In the first judgment, the Court exercised its discretion to grant the adjournment until after the meeting which was to be held the

day of the court hearing.

The Defendant then sought a further adjournment after the meeting was held. The business of the meeting was a vote on a proposed deed of company arrangement and the vote was in favour of adopting terms of the deed. However, there were a number of issues in dispute, principally the weight that the Court should give each class of voter. In the second judgment, the Court decided not to exercise its discretion to grant an adjournment and ordered the company be wound up.

(b) Facts

Allied Group (the Plaintiffs) sought an order for winding up of Exalt Group (the Defendant). The Defendant conceded it was insolvent and that unless the winding up application was adjourned, it had no ground of opposition to the winding up order. The Defendant sought an adjournment of the winding up application under the general power to grant adjournment (s. 467(1) of the Corporations Act 2001 (Cth) (the Corporations Act)) or, alternatively, under the specific power (s. 440A(2) of the Corporations Act). The adjournment was sought so that creditors could consider a proposed deed of company arrangement (DOCA), with the meeting of creditors to be held on the day of the court hearing.

The defendant carried on the business of warehousing, freight, distribution and logistics. Its principal asset was its customer base and certain software that enabled it to service that customer base. Importantly, the defendant had no trucks or other vehicles to transport customers' goods to them, and was reliant entirely on providers of transport to carry out that service. Two major service providers were Australia Post and TNT, but they were substantial creditors and were not prepared to deal with the Defendant.

The DOCA was based upon the continued operation of the Defendant's business by another company called Logistics Partners Pty Ltd (Logistics). Logistics was a shelf company which was only acquired by its owners in March 2013. Significantly, its day-to-day operations were to be run its general manager who was a director of the Defendant. The directors of Logistics were to be the general manager's wife and a UK resident who was unlikely to have any real day-to-day involvement in the conduct of Logistics' business. Accordingly, the business of Logistics was to be conducted in essence by the parties who conducted the failed business of the Defendant, and the business of Logistics was to be conducted from the premises currently occupied by the Defendant.

(c) Decision - first judgment

While noting the general power in s. 467(1), the Court appears to have based its decision on the specific power in s. 440A(2). Under the specific power in s. 440A(2) the Court may adjourn the winding up application if the company is under administration and the Court is satisfied that it is in the interests of the company's creditors for the company to continue under administration rather than be wound up.

The s. 440A(2) principles are well settled and usefully summarised in *Weriton Finance Pty Ltd v PNR Pty Ltd* [2012] NSWSC 1402 at [16]. The Court must be satisfied that there is a sufficient possibility, as distinct from a mere optimistic speculation, that creditors' interests will be accommodated to a greater degree in an administration than in a winding up. The applicant bears the onus of demonstrating that there is some persuasive evidence from which it can be inferred that there are assets which, if realised under administration rather under liquidation, would produce a larger dividend or an accelerated dividend for the creditors. The exercise involved requires a comparison between the likely return which will be produced under administration and under liquidation.

The court accepted the Defendant's application for adjournment so as to allow the creditors to consider the DOCA at the meeting of creditors. The court noted four areas of concern and stated that it expected these to be brought to the attention of the meeting. The four areas of concern were as follows:

i. the administrator of the Defendant did not make any attempt to follow up on four expressions of interest that were received by him for the purchase of the business of the Defendant. Therefore the administrator did not know whether any of those persons or companies would be prepared to purchase the business on terms more favourable than those put forward by Logistics in the DOCA;
ii. the Court had real concerns as to whether there was a sufficient possibility as distinct from a mere optimistic speculation that the creditors' interests would be accommodated sufficiently by an administration. Calculations by the administrator that the Defendant

would be better off with Logistics and the DOCA than it would be with the offers/expressions of interest must have taken into account the uncertainties that surround any future operations of the business of Logistics. Those uncertainties informed the position which would arise if Logistics were unable to meet the contributions under the DOCA;

iii. it was impossible to determine on the evidence whether subcontractors who supply transport services to the company would continue to supply those services to Logistics. Those services were at the heart of the ability of the Defendant or Logistics to continue to conduct its business. The ownership and control of Logistics suggested that there might well be reluctance on the part of substantial transport companies to deal with Logistics, which would be run by the same party who conducted the failed business of the Defendant.;

iv. the benefits to creditors which were projected by the administrator were not particularly substantial. In *Rildean Pty Ltd; ex parte TJF Scaffolding Maintenance and Hire Pty Ltd* [2002] NSWSC 631 at [6], it was held that "the whole purpose of administration is to see whether companies can continue to live under some form or another, rather than die under liquidation, and that due opportunity must be given for any reasonable possibility to be explored". The Court there added a cautionary note as to the use of administration as a last ditch effort to stave off proper winding up proceedings.

(d) Decision - second judgment

As noted above, the Defendant, having obtained an order from the Court adjourning the winding up of the company until a second meeting of creditors could be held, sought a further adjournment after the meeting was held. The principle business of the meeting was a vote on the DOCA and the vote was in favour of adopting terms of the deed. However, there were a number of issues in dispute, principally the weight that the Court should give each class of voter. The Court decided not to exercise its discretion to grant a further adjournment of the winding up application and ordered the company be wound up.

At the meeting the DOCA was put to a vote. The vote took place by a poll. The results of the poll were that 43 creditors in number with a value of $680,551.98 voted in favour of the resolution, while 15 creditors in number with a value of $633,363.58 voted against it. However, the level of weight that the Court should accord each class of voter was in issue. The Plaintiffs argued that less weight should be given to certain classes.

(i) The votes

The Plaintiff argued that notwithstanding the apparent majority in number and value, the votes of three classes of creditors should be disregarded or given less weight. The first class was the votes of employees. The impact of their votes was reflected most notably in the number of creditors in favour of the DOCA. The Plaintiff further argued that the employees voted in favour of the scheme in order to secure their employment with the DOCA entity, Logistics, and that their votes should therefore be given less weight in considering what is in the interests of the Defendant's creditors. The second class of creditors consisted of the votes of related parties. If the votes of those parties were excluded, the value of the creditors voting in favour of the DOCA would have been $494,276.98. The value voting against remained the same as above, namely, slightly in excess of $633,000. Thus if the related parties' votes were disregarded, a majority in value would have voted against the DOCA. The third class was Logistics which claimed to be a creditor by way of subrogation. If its votes were disregarded, the value of the votes in favour of the DOCA would be reduced.

(ii) Whether the votes of employees should be disregarded

The Court held that while it was true the employees were not commercial creditors who had supplied goods to the Defendant, it was also true that they had an interest which was different from commercial creditors, namely their interest in remaining in employment. Therefore, the Court gave some weight to their votes.

(iii) Whether the votes of related parties should be disregarded

The Defendant argued that in any company, creditors are not a homogeneous group but rather a body of persons with a range of views and considerations, whereas the Corporations Act looks only at what constitutes an overall majority. The Court noted that it ordinarily acts on the view that the creditors are better judges of what is in the interests than the Court. But that maxim assumes that the creditors have considered the matter in the light of all the commercial considerations that are to

be weighed in the balance. Here, the Defendant submitted that the related parties must be presumed to be interested in recovering their debts but conceded that they may also have been influenced by personal considerations. Having regard to the minimal return to creditors that was anticipated under the DOCA, the Court held that the votes of the related parties must have been largely influenced by considerations other than commercial ones and therefore disregarded their votes. This had the effect of altering the percentages to approximately 44% in value in favour of the DOCA and 56% against.

(iv) Whether to disregard the votes of Logistics

Three issues arose here. The first was whether Logistics was properly admitted to vote as a creditor whose claim was subrogated. The second was whether Logistics paid out the debts due for the purpose of improperly influencing the vote at the meeting. The third issue was whether, even if the Court determined both of the other issues favourably to the Defendant, the Court should have regard to the votes of Logistics in considering whether it was in the interests of creditors to continue the administration.

Regarding the first issue, Logistics was not a surety for the debts. However, the Defendant referred the Court to a decision of Young J in *Re Trivan Pty Ltd* (unreported, Sup Ct, NSW, Young J, 30 August 1996) in support of the proposition that Logistics was entitled to be subrogated to the debts. In that case, Young J said that the equitable doctrine of subrogation was not restricted to closed categories. His Honour referred to an American text which stated that a right of subrogation will arise, inter alia, where the party making the payment "has some interest to protect". His Honour said that this statement was intended to distinguish between cases where a person has a valid commercial reason for acting in a way that discharges the debt of another and the situation where the person making the payment is a volunteer. His Honour recognised that the exact line may be difficult to draw. The Court found that whatever the correctness of these principles, the commercial reasons why Logistics paid the debts were inextricably bound up with its desire to keep the Defendant on foot and in particular to enable it to propound the DOCA. Regarding the second issue the Court found no evidence of underhanded bargaining on the part of Logistics to buy up the debts. On the third issue the Court found that even if Logistics was properly admitted to vote, and even if it did not act improperly, it could not be considered to be a disinterested creditor whose views should be taken into account. Therefore the Court reduced the value of votes in favour of the DOCA with the effective result that more than 60% in value of creditors voted against the DOCA.

(v) Whether it is in the interests of the Defendant's creditors for the company to continue in administration

The question here was that posed by s. 440A(2). The Court balanced the value that could be realised on winding up against the speculative value in the DOCA, finding that other than the employees, the return which was anticipated was extraordinarily low and that even on an optimistic view, it was a highly conditional outcome and was not payable until the expiry of the DOCA. The Court added that it was not a rubber stamp to make an order which in effect approves an uncommercial DOCA and that it is proper and appropriate that an insolvent company be wound up unless, in the circumstances, a commercial DOCA which provides real benefits to creditors is proposed.

The Court refused to adjourn the winding up application and ordered the Defendant to be wound up.

5.6 Former employee escapes liability for misuse of confidential information

(By James Claridge, Herbert Smith Freehills)

Vestergaard Frandsen A/S (now called mvf3 Apps) v Bestnet Europe Limited [2013] UKSC 31, Supreme Court of the United Kingdom, Lord Neuberger (President), Lord Clarke, Lord Sumption, Lord Reed and Lord Carnwath, 22 May 2013

The full text of this judgment is available at:

http://www.bailii.org/uk/cases/UKSC/2013/31.html

(a) Summary

This case considers the liability of a former employee for breach of confidence pursuant to a "common design" in circumstances where:

- she did not have access to the relevant confidential information during her employment; and
- she was not aware of the misuse of the confidential information until some time after the commencement of legal proceedings.

The Supreme Court of the United Kingdom emphasised the importance of the former employee's "conscience" and held that she was not liable to the applicant for breach of confidence.

(b) Facts

A group of three companies (together referred to as "Vestergaard") successfully developed new techniques for the manufacture and sale of long lasting insecticidal nets (LLINs). The information relating to the development of the new techniques was commercially sensitive and was stored by Vestergaard in a so-called "Fence database".

Vestergaard employed Ms Sig from 2000 to 2004, initially as a sales and marketing assistant and later as a regional sales manager. In 2004, Ms Sig and Vestergaard's head of production, Mr Larsen, resigned from Vestergaard. They incorporated a new Danish company in order to sell and manufacture LLINs in competition with Vestergaard. Mr Larsen and Ms Sig sought the services of Dr Skovmand, a consultant biologist who was instrumental in the development of the new LLIN techniques for Vestergaard. Dr Skovmand developed a LLIN (referred to as "Netprotect") for the new Danish company using confidential information derived from Vestergaard's Fence database.

On learning of the development of Netprotect, Vestergaard issued proceedings in Denmark to restrain the further testing and marketing of the product. In order to avoid the consequences of the Danish litigation, the Danish entity ceased to trade and a new company was formed in England.

In 2007, Vestergaard commenced proceedings seeking damages and other relief against Dr Skovmand, Mr Larsen, Ms Sig and the corporate entities involved in the development and marketing of Netprotect. At first instance, Arnold J held that each of the defendants were liable to Vestergaard for the misuse of its confidential information. The Court of Appeal upheld all aspects of Arnold J's judgment except the finding of liability in relation to Ms Sig. Ms Sig's liability was the subject of a further appeal to the Supreme Court of the United Kingdom.

(c) Decision

Lord Neuberger (President), with whom Lord Clarke, Lord Sumption, Lord Reed and Lord Carnwath agreed, held that Ms Sig was not liable to Vestergaard for the misuse of confidential information.

The submission primarily advanced by Vestergaard before the Supreme Court was that Ms Sig should be held liable as a party to a "common design" involving the misuse of trade secrets. Vestergaard's alternative argument based on the alleged breach of an express or implied term in Ms Sig's employment contract was held by Lord Neuberger to be "not seriously arguable".

Lord Neuberger cited the judgment of Megarry J in *Coco v A N Clark (Engineers) Ltd* [1969] RPC 41 with approval and emphasised the importance of "conscience" to an action for breach of confidence. Lord Neuberger's findings with respect to Ms Sig's liability relied on key facts established at trial relating to her knowledge of and participation in the development of the LLINs.

His Lordship held at [34]:

in order for a defendant to be party to a common design, she must share with the other party, or parties, to the design ... each of the features of the design which make it wrongful ... In this case, Ms Sig neither had the trade secrets nor knew that they were being misused, and therefore she did not share one of the features of the design which rendered it wrongful, namely the necessary state of knowledge or state of mind.

Vestergaard sought to rely on *Lancashire Fires Ltd v S A Lyons & Co Ltd* [1996] FSR 629

(Lancashire Fires) in support of the proposition that Ms Sig might be liable despite not having had access to the Fence database during the course of her employment with Vestergaard. In that case an injunction was granted against a former employee who had become aware of the misuse of her former employer's trade secrets. Lord Neuberger held that Lancashire Fires was clearly distinguishable from the present case because in these circumstances, unlike in Lancashire Fires, damages were sought in respect of a time when Ms Sig was "honestly unaware of the fact that there had been any misuse of their trade secrets".

Lord Neuberger concluded by noting that cases involving the alleged misuse of confidential information by a former employee require the following policy considerations to be balanced:

- the importance of incentivising research and development by protecting trade secrets; and
- the public benefit in not unreasonably inhibiting competition in the market place.

His Lordship concluded that it would be inconsistent with the maintenance of the required balance to hold Ms Sig liable to Vestergaard on the facts of this case.

5.7 The balancing test required when considering an extension of the convening period for a second meeting of creditors

(By Katrina Sleiman, Corrs Chambers Westgarth)

In the matter of Harrisons Pharmacy Pty Limited (Administrators Appointed) (Receivers and Managers Appointed) [2013] FCA 458, Federal Court of Australia, Farrell J, 21 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/458.html

(a) Summary

This case involved an application by administrators pursuant to s. 439A(6) of the Corporations Act 2001 (Cth) (the Act) for a six month extension of the convening period for the second meetings of creditors of a number of companies. Her Honour applied the balancing test referred to in the authorities, which requires the Court to balance the expectation of speedy administration against risk of prejudice. Her Honour considered that the present circumstances, in particular, the ability to sell the businesses operated by the companies in administration as a going concern, justified the making of an order extending the convening period.

(b) Facts

On 25 March 2013, the Commonwealth Bank of Australia trading as Bankwest (Bankwest) appointed Robert Moodie (Mr Moodie) and Geoffrey Reidy (the Administrators) as joint and several administrators of Harrisons Pharmacy Pty Ltd and eight other companies (the Companies).

On 25 March 2013 and 29 March 2013, Bankwest appointed David Lombe and Jason Tracey (Mr Tracey) as receivers and managers of each of the Companies and another company, Harrisons Orion Pty Ltd (Receivers).

The Administrators sought a six month extension of the convening period within which meetings of creditors of the Companies must be convened and held. Mr Moodie deposed that the Receivers hoped for an extension of six months "to arrange for the sale of the respective businesses and assets of the Harrison Group as going concerns".

The following factors were relied on in support of the application:

- Mr Moodie deposed that the Administrators were presently unable to finalise their report to creditors required under s. 439A(4) of the Act or to provide meaningful recommendations about the future of each of the Companies because of the factors listed below;

- the Receivers had control of substantially all of the assets of the Companies and access by the Administrators to books and records was restricted. The Administrators also did not have control over the timeframes in which assets were to be sold;
- the complexity around the relationship between the Companies, the creditor situation and the difficulty in accessing books and records of the Companies. Mr Tracey deposed that the Companies, Harrison Orion Pty Ltd and a number of directors/shareholders of the Companies, together operate 20 businesses (Businesses);
- the sale of some or all of the Businesses as a going concern was more likely to maximise the returns available to all classes of creditors than an immediate liquidation of the Companies;
- employee claims were likely to be minimised if the Companies were sold as a going concern rather than wound up;
- the sale of the Businesses as a going concern would likely yield a better result for trade creditors;
- the continuation of the administration for a further period was unlikely to cause the Companies to incur additional costs which would not be incurred if the Companies were placed in liquidation. Accordingly, it was unlikely that the continuation of the administration would adversely affect any amount which unsecured creditors might receive by way of a distribution in a liquidation;
- the Receivers had received 136 final non-binding offers from 60 sets of interested parties, with no party in the final round seeking to buy all of the Businesses. The Receivers' sale process was also taking longer than anticipated;
- the Administrators could not accurately assess the assets and liabilities of the individual Companies because they did not have access to the books and records of the Companies, the books and records were not well maintained and the software used was incompatible with the Administrators' system;
- the Administrators had not received a final valuation of the assets of the Companies from the Receivers. The sale of some or all of the Businesses, and the prices they achieve, impact on the recommendations which might be made in the Administrators' report pursuant to s. 439A(4);
- the Administrators had been unable to assist in the formulation of a deed of company arrangement because of delays in financial analysis due to the complexity of the financial systems and records, securing the books and records, and liaising with lessors. The Receivers also controlled the sale process; and
- at the first meeting of creditors, the Administrators told the creditors of the possibility of an application to the Court for an extension of the convening period for two to three months. The Administrators also took steps to initially notify all known lessors and each of the top ten creditors by value of each of the Companies, and later, all known creditors and employees, of the application. No objection was raised. The Australian Securities and Investments Commission was also given notice and did not intend to oppose the application.

(c) Decision

In exercising the jurisdiction to make orders extending the convening period under ss. 439A(6) and 477A of the Act, the Court must have regard to the objects of Part 5.3A of the Act which seeks to maximise the chance of the company, or as much as possible of its business, continuing in existence; or if that is not possible, to achieve a better return for the company's creditors and members than would result from an immediate winding up of the company.

Justice Farrell observed that when considering applications of this nature, the Court is required to strike an appropriate balance between the expectation that administration will be a relatively speedy and summary matter and the requirement that undue speed should not be allowed to prejudice sensible and constructive actions directed towards maximising the return for creditors and any return for shareholders.

Her Honour considered that each of the factors identified by the Administrators above, in support of the application, militated in favour of the Court exercising its discretion to grant an extension of the convening period. Her Honour also found that the opinion of the Administrators, supported by the Receivers, that it was in the best interests of the creditors that the Businesses be sold as a going concern appeared to be well founded and reasonable.

Although no evidence was provided as to the likely value of the Businesses and there was some lack of clarity of the total liabilities, her Honour considered compelling the evidence of Mr Tracy who

testified that if the Companies were wound-up, even the secured creditor would not be fully satisfied for the amount of its draft proof of debt, having regard to the fact that the Businesses comprised substantially goodwill and the leases. Further, Mr Tracy's evidence of the substantial number of non-binding offers which had already been obtained for the Businesses suggested that there was a reasonable prospect that the Businesses could be sold within a reasonable time frame after which the Administrators would be in a position to complete the task required of them by s. 439(4) of the Act.

Her Honour noted that an extension of six months was a long time and found it relevant to consider the appropriateness of the length of the extension sought, having regard to the availability of further extensions under s. 477A of the Act and to ensure that the Court would be in a position to monitor the manner in which the administration and any associated receivership was being conducted.

Relevant considerations were found to include:

- that the extension should be for no longer than is required for a diligent exercise of the powers of the administrators and where relevant, the receivers and managers;
- that it is undesirable for claims which are subject to a moratorium to be extant any longer than necessary;
- that where the primary asset of the business is goodwill, an overly protracted administration is unsettling to staff who may leave for more certain employment, diminishing the value of the business of the company in administration;
- that unnecessary delay in prosecuting an administration exposes the assets of the company to market risk;
- that the longer the administration and the receivership, the greater potential there is for the interests of the secured creditor and the unsecured creditors to diverge, to the detriment of the unsecured creditors; and
- it was the intention of the legislature that administrations be conducted expeditiously.

Her Honour was however satisfied that it was appropriate, having regard to the objects of Part 5.3A of the Act, for the convening period to be extended for six months.

5.8 Another blow to unwilling examinees: ASIC's obligations when authorising "eligible applicants" of examinations clarified and confirmed

(By Adrian Chai and Paul Walker, Ashurst Australia)

Saraceni v ASIC [2013] FCAFC 42, Federal Court of Australia, Full Court, North, Jacobson and Gilmour JJ, 16 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCAFC/2013/42.html

(a) Summary

The Full Court of the Federal Court of Australia unanimously dismissed an appeal from the decision of Barker J in *Saraceni v ASIC* [2012] FCA 688. Barker J had summarily dismissed a challenge by Mr Saraceni to a decision by the Australian Securities and Investments Commission (ASIC) to authorise the receivers and managers of a number of companies to obtain orders for his compulsory examination under s. 596A of the Corporations Act 2001 (Cth) (the Act).

Mr Saraceni argued that ASIC was obliged to afford him procedural fairness by consulting with him prior to making its decision and ASIC had failed to do so. He also argued that he should have been allowed to seek discovery of documents to show what ASIC had actually taken into account in arriving at its decision.

The Full Court found that ASIC is never obliged to afford procedural fairness to a person who might

later be examined by a Court, when considering such applications for authorisation.

(b) Facts

The Bank of Western Australia Ltd (Bankwest) held various securities over assets of three companies, of which Mr Luke Saraceni was a director. The companies were Newport Securities Pty Ltd, Mayport Nominees Pty Ltd and Seaport Pty Ltd.

In early 2011, Bankwest appointed Ferrier Hodgson as receivers and managers of certain assets of each of the companies. In addition, Bankwest entered into possession of certain real property owned by Newport as mortgagee, and appointed Ferrier Hodgson as its agents.
Subsequent to their appointment, Ferrier Hodgson applied to ASIC for authorisation to seek the issue of examination summonses against Mr Saraceni. ASIC granted that authorisation, and Ferrier Hodgson obtained orders from the Supreme Court of Western Australia for the issue of examination summonses to Mr Saraceni under s. 596A of the Act. In addition to mounting a constitutional challenge to the Supreme Court's ability to order and conduct his examination (see *Saraceni v Jones* [2012] WASCA 59), Mr Saraceni separately applied to the Federal Court for judicial review to set aside ASIC's authorisation decision. The receivers and managers were also joined to the proceeding.

The receivers and managers, supported by ASIC, applied to dismiss the proceedings summarily. Barker J granted summary judgment and dismissed the proceeding. Mr Saraceni appealed that decision to the Full Court of the Federal Court.

(c) Decision

(i) The arguments on appeal

Mr Saraceni contended that Barker J was wrong to dismiss the proceeding summarily. He relied upon two primary arguments:

- first, Mr Saraceni argued that an obligation to afford procedural fairness to a person will arise if a decision of a government body, like ASIC, prejudices that person's rights or interests. Mr Saraceni was one of only two directors of the companies in receivership, and so if ASIC granted authorisation to a person to conduct examinations in connection with those companies, it was practically inevitable that the court would order Mr Saraceni's examination under s. 596A of the Act. Mr Saraceni said that this meant the decision of ASIC to authorise the receivers and managers to apply for the orders prejudiced Mr Saraceni by making it likely he would be compulsorily examined, and so he contended that ASIC should have consulted him before making that decision. Further, he argued that the obligation of procedural fairness depends on all the circumstances and so the case should not have been dismissed before discovery and evidence-gathering was completed; and
- second, Mr Saraceni argued that ASIC, in making its decision, had failed to take into account relevant considerations related to the status of the receivers and managers. While there was no evidence of anything to impugn the decision made by ASIC, Mr Saraceni argued that he should have been allowed to seek discovery orders against ASIC to see what information it relied on in coming to its decision. He stated that his claim should not have been summarily dismissed before then.

(ii) The decision of the Full Federal Court

The Full Federal Court confirmed that Justice Barker was correct to dismiss the proceeding summarily.

The Court found that, when considering an authorisation application, ASIC is not required to consult a person who might later be examined in a compulsory examination under Part 5.9 of the Act. It made no difference how likely it was, in a practical sense, that Mr Saraceni would be examined.

Some of the key reasons were:

- the authorisation was only the first stage of a two stage process, potentially culminating in the issue of a summons by a court for compulsory examination. That court summons, if issued, would then start an investigative process designed to gather information about the

affairs of the company in question. That was similar to powers of examination and inquiry held by public bodies like the Commissioner of Taxation. A purely investigative process like this, as a general rule, is less likely to be attended by an obligation to accord procedural fairness to affected persons.;

- importantly, ASIC's decision was even further removed from the beginning of an investigative process. A person authorised by ASIC might decide not to apply for the issue of a summons at all. Or, that person might decide to apply for summonses against only a few potential examinees;
- it also does not necessarily follow that a person who may be examined will be prejudiced in any relevant sense; and
- if a potential examinee had an entitlement to be heard by ASIC, that would impede the sensible administration of the Act. ASIC would be required to identify, in every case, those directors or other persons who would be the subject of examination and give notice to them of the application for authorisation. That would be impractical and provide two opportunities, at least, for them to challenge ASIC's decision - both the first stage authorisation decision and in the course of resisting the second stage examination in a Court.

The Court then said that Mr Saraceni's remaining contentions amounted to nothing more than an assertion that irrelevant considerations may have been taken into account by ASIC, coupled with a claim to make good those assertions by seeking to obtain information on discovery. The Court would not order discovery to assist Mr Saraceni to establish a speculative case for which he had no evidence in the first place.

(iii) Significance

The Full Federal Court's decision in *Saraceni v ASIC* confirms the difficulties potential examinees face in seeking to challenge ASIC's decision to authorise a person to apply for and conduct an examination under Part 5.9 of the Act.

The Full Court has also gone a step further than Barker J on the issue of procedural fairness. The Full Court has unequivocally stated that ASIC will never be required to consult with potential examinees prior to making such a decision. Unless the High Court determines otherwise, this removes any doubt that different facts or circumstances might require ASIC to consult potential examinees in a different case. This clear statement of the law should go even further towards eliminating, or at least significantly deterring, future judicial review challenges by unwilling examinees.

The Full Court has also emphasised the limited role that compulsory discovery orders can play in these kinds of cases. Potential examinees are unlikely to have access to any specific information about what ASIC took into account in granting an authorisation for their public examination. ASIC is also not required to give any reasons for its decision. If the examinee wants to mount a challenge, the Court will not permit him or her to run a hypothetical case and try and obtain evidence for it through discovery. In light of this, the circumstances in which an examinee might be able to mount a successful challenge would seem to be very rare.

5.9 Clarifying the distinction between an undisclosed and unnamed principal

(By Rebecca Ebzery, Minter Ellison)

In the matter of Neely v Southern Cross Feeds Pty Ltd (No 2) [2013] VSC 238, Supreme Court of Victoria, Hargrave J, 14 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/vic/VSC/2013/238.html

(a) Summary

This case was an appeal against a dismissal of an appeal from the Magistrates Court regarding whether or not an error of law was made concerning the existence of an agency relationship between Neely (Appellant) and his companies, Turquoisecroft Nominees Pty Ltd (Turquoisecroft) and Weight Lifter Pty Ltd (Weight Lifter), and whether either was a party to an agreement with Southern Cross Feeds Pty Ltd (Respondent).

(b) Facts

In 2002, a contract for the supply of animal feed was negotiated by the Respondent and the Appellant, who represented that he was entering into the agreement on behalf of his company Weight Lifter. The Respondent was unaware that Weight Lifter was unincorporated at the time. The Appellant was trustee of Turquoisecroft, however no mention was made of its existence to the respondent.

When Weight Lifter was eventually incorporated in 2006, no mention was made to the respondent, nor was its ABN provided to them. All of the invoices sent on behalf of the respondent for payment were addressed to "Weight Lifter", however no efforts were made by them to verify the existence of the company.

An ABN was later supplied by the Appellant, and although it was the ABN of Turquoisecroft it was included on invoices from that time despite not having been a party to the initial agreement. When several invoices went unpaid, the Respondent commenced proceedings against Turquoisecroft for a debt of $47,000, and the Respondent only pursued the Appellant personally when the judgment debt could not be met.

The Respondent sought to amend the proceedings, maintaining that the Appellant was personally liable as he named Weight Lifter as his company in the negotiations with the Respondent. As Weight Lifter was not incorporated at the time, and Turquoisecroft had not been named as a party to the agreement, the Respondent put forward that this meant the Appellant was their customer personally.

There was some contention as to whether a distinction should be made between whether the principal, if there was one, should be treated as undisclosed, or as unnamed. At first instance, the Magistrate found in favour of the Respondent, basing his decision on the fact that there was no agency relationship that could be found on the facts. Given that there was no company known as "Weight Lifter" at the beginning of the agreement, the Appellant could not have been acting for them as agent.

The Appellant appealed the decision to the Supreme Court, where Landsdown AJ found that the wording of the notice by the Appellant did not identify a question of law from which an appeal could be brought. The current decision was an appeal to set aside the dismissal on the basis that the finding that there was no principal, in both cases, was incorrect.

(c) Decision

Hargrave J disagreed with the decision at first instance. Hargrave J determined that the question of law formulated for the appeal by the Appellant was sufficient to support an appeal, and to decide otherwise was based on semantics only. Hargrave J further stated that it was not merely arguable but that the Appellant should succeed.

Hargrave J found that, by naming Weight Lifter in the negotiations, the Appellant in essence referred to the wrong company. Because Turquoisecroft was in existence at the time the agreement was formed, and because the Appellant clearly intended that a company associated with him was going to be a part of the agreement, then there was an agency relationship. The natural inference was that the Appellant did not intend to undertake personal liability for any breach of the agreement.

Hargrave J also noted that the Respondent had made no efforts to ascertain the worth of the company they were supplying, did not ask the Appellant to guarantee the debts of the company, and other than addressing the invoices to "Weight Lifter", made no efforts to uncover the precise name of the company they contracted with.

It was found that the circumstances of the case were such that the erroneous naming of the company in the initial stages of the agreement should be treated as the equivalent of the principal, Turquoisecroft, being unnamed. After subsequently receiving its identity with the ABN, the Respondent accepted Turquoisecroft as the principal under the agreement. This was cemented by the fact that the Respondent originally commenced proceedings against Turquoisecroft for the debt

owed under the agreement.

The circumstances in this case supported the conclusion that there was a principal when the trading relationship commenced, and consequently demonstrated the parties' intention that the Appellant should not be personally liable. The appeal against the dismissal of the Appellant's original appeal was allowed.

5.10 Application to set aside a statutory demand pursuant to section 459H(1) of the Corporations Act

(By Lily Zhang, Ashurst Australia)

Master Painters Australia Limited v Master Painters, Decorators and Signwriters Association of Western Australia [2013] FCA 507, Federal Court of Australia, Logan J, 10 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/507.html

(a) Summary

Logan J ordered that the statutory demand served by the Master Painters, Decorators and Signwriters Association of Western Australia (the WA Association) on Master Painters Australia Ltd (the MPA) pursuant to s. 459E of the Corporations Act 2001 (Cth) (the Corporations Act) be set aside on the basis that there is a genuine dispute about the existence of a debt and an offsetting claim.

Logan J also commented on the fact that as an unincorporated association, the WA Association was not a "person" for the purposes of s. 459E of the Corporations Act and therefore could not serve a statutory demand. However, Logan J did not reach a concluding view on this issue.

(b) Facts

The WA Association served on the plaintiff, the MPA, a statutory demand under s. 459E of the Corporations Act for the sum of $16,666.68. The MPA then served an application to set aside the statutory demand, giving evidence that the WA Association had overcharged it $12,500 for secretariat services provided by the WA Association. Further, the MPA put forward that the WA Association owed the MPA $19,996.52, being $49,163.19 the WA Association received and retained on behalf of the MPA less $29,166.67 for the secretariat services provided by the WA Association.

(c) Decision

The question before the Court related to whether or not there was a basis upon which the statutory demand should be set aside. As set out in s. 459H(1) of the Corporations Act, a statutory demand may be set aside if the Court is satisfied of either or both of the following:

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;
that the company has an offsetting claim.

Logan J stated that the task for the court was to identify the genuine level of a claim (not the likely result of it) and to identify the genuine level of an offsetting claim (not the likely result of it).

Further, Logan J queried whether or not the WA Association, an unincorporated association, could serve a statutory demand under s. 459E of the Corporations Act.

(i) The WA Association's ability to serve a statutory demand

The WA Association has an Australian Business Number, but is an unincorporated association.

Logan J queried whether the WA Association was able to serve a statutory demand under s. 459E of the Corporations Act.

Logan J considered whether the WA Association should be regarded as a person for the purposes of s. 459E of the Corporations Act. A "person" for the purposes of s. 459E of the Corporations Act is not defined in the Corporations Act. In the absence of statutory indication to the contrary, a "person" is defined in s. 2C of the Acts Interpretation Act 1901 (Cth) as including "a body politic or corporate as well as an individual".

The WA Association is neither a body politic, company or an individual. Therefore, Logan J doubted that the WA Association falls within the definition of a "person" under s. 459E of the Corporations Act. However, in light of the fact that there was clearly a genuine dispute and an offsetting claim, Logan J did not reach a conclusion on this matter.

(ii) Genuine dispute

The WA Association put forward the argument that given the controversy relating to the period during which the WA Association provided secretariat services and the grounds upon which the MPA sought to set aside the statutory demand emerged late, there was no genuine dispute. Despite matters emerging late, Logan J found that there was a genuine dispute.

(iii) Offsetting claim

Logan J held that given the circumstances and the purported amounts owing by the WA Association to the MPA, there was an offsetting claim. Logan J stressed that in being satisfied that there was an offsetting claim, he was not indicating the strength of the offsetting claim or the probability of the MPA succeeding in making such a claim.

(iv) Court order

Logan J ordered that the statutory demand be set aside.

5.11 Fishing for genuine disputes: Drawing the line between spurious and genuine claims under section 459H of the Corporations Act

(By Josh Spry, Herbert Smith Freehills)

Troutfarms Australia Pty Ltd v Perpetual Nominees Ltd [2013] VSC 228
Supreme Court of Victoria, Associate Justice Gardiner, 7 May 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/vic/VSC/2013/228.html

(a) Summary

Perpetual Nominees Ltd (Perpetual) served a statutory demand on Troutfarms Australia Pty Ltd (Troutfarms) for amounts due under various loan and guarantee documents. The Supreme Court of Victoria was required to consider whether Troutfarms had established a "genuine dispute" within the meaning of s. 459H(1) of the Corporations Act 2001 (Cth) (the Act) and therefore whether all or all or part of the amounts demanded by Perpetual should be set aside.

This case demonstrates the task that the Court undertakes when determining whether or not a dispute is in fact genuine. The function of the Court is not to embark upon an extended inquiry to finally resolve or determine the merits of the alleged dispute. This does not mean that the Court must uncritically accept every statement in an affidavit as giving rise to a genuine dispute however. Such a reading would require the Court to set aside statutory demands in almost all cases, a result which plainly cannot have been intended when the demand regime was introduced.

This case upholds the view that to have a statutory demand set aside under s. 459H of the Act, the

respondent's dispute must be real and bona fide, and the grounds for alleging its existence must not be spurious, equivocal or inherently improbable.

(b) Facts

Perpetual was the custodian of a mortgage pool fund, which provided several loan facilities to Troutfarms.

Under these facilities, Troutfarms was:

- joint and several debtor of a loan between Troutfarms, Racso Pty Ltd (a related body corporate of Troutfarms) and Perpetual (Racso loan); and
- joint and several guarantor for a loan agreement between Zido Pty Ltd and Perpetual (Zido loan).

In addition to the guarantee from Troutfarms, the Zido and Racso loans were secured by a mortgage from Zido, a mortgage from Racso and two mortgages from Troutfarms.

In early 2011 Troutfarms was advised that Perpetual was winding up the mortgage pool and that the Zido and Racso loans (which were due to mature on 11 August 2011) would not be rolled over. Although Troutfarms managed to refinance its mortgages with NAB, the Racso and Zido mortgages were not refinanced and the loans were not paid out as required. Following the liquidation and receivership of Racso and Zido respectively, Perpetual served a statutory demand on Troutfarms claiming $3.5 million for amounts remaining due under the Racso loan and $2.5 million for amounts remaining due by Troutfarms as guarantor of the Zido loan.

Troutfarms applied to have the statutory demand set aside under ss. 459G and 459H of the Act on the basis that:

- there was a genuine dispute as to whether Troutfarms had been fully released and discharged from its obligations under the Racso and Zido loans; and
- in the alternative, there was a genuine dispute as to whether Troutfarms was entitled to be exonerated in equity from liability relating to the Zido loan.

Section 459H of the Act provides that, where the Court is satisfied that there is a genuine dispute about the existence or amount of a debt to which a statutory demand relates, the Court must vary the demand so that it relates only to undisputed amounts.

(c) Decision

Gardiner AJ began by noting that Troutfarms was not required to advance a fully evidenced claim to establish that a genuine dispute existed. Rather, all that was required by Troutfarms was something more than a mere assertion, such that the dispute could be said to be "bona fide, [to] truly exist in fact" and to establish that the grounds for alleging its existence were "real and not spurious, hypothetical, illusory or misconceived".

(i) Genuine dispute as to whether Perpetual had agreed to release Troutfarms?

Troutfarms alleged that, as part of the refinancing of the Troutfarms mortgages, Perpetual had orally agreed to discharge and release Troutfarms from all of its obligations under the Racso loan and as guarantor of the Zido loan.

Troutfarms submitted that this oral release came about through representations from:

- a Troutfarms representative, that Troutfarms would only raise finance from NAB and pay it to Perpetual in return for a total release of all liability; and
- an unidentified Perpetual representative to Troutfarms's financial advisor, that the refinancing would fully release Troutfarms from all further liability.

Perpetual denied that it made either of these representations.

On the basis of the evidence before him, Gardiner AJ considered it "inherently improbable" that an

agreement to fully release Troutfarms was ever struck in the manner suggested by Troutfarms, and therefore Troutfarms had not established a genuine dispute on this ground.

In coming to this conclusion Gardiner AJ considered it particularly relevant that:

- Troutfarms's affidavit evidence regarding the alleged release was vague and imprecise;
- Troutfarms could not identify any contemporaneous documents to support its case;
- the detailed contemporaneous documents from Perpetual made no reference to any release of the guarantee or the balance of the Racso loan; and
- Troutfarms's financial advisor did not confirm the representation in writing (as would have been expected of a professional advisor engaged in a significant transaction involving the release of millions of dollars).

(ii) Genuine dispute as to whether there was consideration for the oral release?

Assuming his determination above was incorrect, Gardiner AJ considered whether Troutfarms had provided any fresh consideration for the oral release, as on its face the agreement appeared to offend the rule in *Pinnel's Case* [1602] 5 Co. Rep. 117a. The rule in Pinnel's Case states that, while it is possible for a debt to be discharged in full through the introduction of a new element (for example payment by chattel instead of debt or part payment on an earlier date), it cannot be assumed to be fully discharged simply through the payment of a smaller sum on the same day that the full debt was due in any event.

Troutfarms submitted that it had provided fresh consideration for the release by providing a new benefit to Perpetual. This new benefit was said to be the payment of $1.6 million from a secure source (NAB) within 18 days, instead of leaving Perpetual to enforce its rights as mortgagee, engage real estate agents and solicitors, find buyers and deal with related enforcements costs and inconvenience (which could ultimately have resulted in less than $1.6 million being received).

Gardiner AJ considered that it was arguable, even if only faintly, that these elements were advantageous to Perpetual and so could give rise to a genuine dispute as to whether fresh consideration had been provided and an enforceable agreement had been reached.

(iii) Genuine dispute as to whether Troutfarms was exonerated from guarantee?

If the Court was not satisfied that Troutfarms was fully released from the loan and guarantee, Troutfarms claimed that it was entitled to be exonerated in equity from all further liability under the Zido guarantee.

The doctrine of exoneration is a relatively obscure equitable remedy, which holds that a loan, which is solely for one party's benefit, should firstly be paid out of that party's assets, and that any call on a guarantee should only be made for any shortfall suffered by the creditor.

Troutfarms acknowledged that it was not able to be exonerated from its liability under the Racso loan (where it was a primary debtor), as exoneration is only available where the guarantor receives no direct benefit from the transaction.

In respect of the Zido guarantee, Troutfarms submitted that Perpetual was required to have recourse to Zido's mortgage before calling on Troutfarms's guarantee. Although little information was available regarding the value of the Zido property, Gardiner AJ was satisfied that the exoneration argument was available and gave rise to a genuine dispute as to the part of the statutory demand that related to the Zido loan. His Honour therefore varied the statutory demand to remove the amount claimed against Troutfarms in respect of the Zido loan.

5.12 Is the distribution of dividends out of the profits of a company on a stand alone or consolidated basis?

(By Charmaine Panickar, Minter Ellison)

Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd [No 2] [2013] NSWSC 488, Supreme of New South Wales, Hammerschlag J, 3 May 2013.

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/488.html

(a) Summary

This case demonstrates how a commercial expectation between parties may not translate into a binding contractual obligation, even if that expectation has been met by one of the parties for years. However, there may be other remedies open to the aggrieved party, such as a claim of oppression or unfair prejudice under s. 232 of the Corporations Act 2001 (Cth) (the Corporations Act).

(b) Facts

The first defendant, Wambo Coal Pty Ltd (Wambo), extracts coal from a mine at Wollemi, in the Hunter Valley region of New South Wales. The plaintiff, Sumiseki Materials Co Ltd (Sumiseki) owned and operated the mine from 1992 to 2001, owning all shares on issue in Wambo.

The mine was making losses and Sumiseki sold its shares in Wambo to Hunter Coal Pty Ltd (Hunter), the corporate vehicle used by a management buy-out group to effect the purchase. As a result of the transaction, Hunter came to hold all the ordinary shares in Wambo, while Sumiseki became the holder of B Class shares in Wambo, which entitled Sumiseki to receive a dividend equal to the "Profit Interest", but held no voting rights.

After a number of changes in shareholdings, Hunter (and by extension, Wambo) came to be 100% owned by the second defendant, Peabody Australia Mining Ltd (PAML), and Hunter was subsequently deregistered.

Article 2.1B of the Wambo constitution (the Constitution) defined "Profit Interest" as "an amount equal to the profit of the Company [Wambo] available for dividend purposes for the relevant period". In an earlier judgment, Hammerschlag J held that on its proper construction, Article 2.1B entitled Sumiseki as the B Class shareholder to receive dividends equivalent to 25% of the profit of Wambo disclosed in its accounts.

The key issue that remained to be determined was whether the "profit of the Company available for dividend purposes" under the Constitution should be the consolidated profit of Wambo and its controlled entities, or the profit of Wambo on a stand alone basis. Sumiseki took issue when Wambo began asserting that Sumiseki's dividend entitlements were to be calculated on Wambo's stand alone profit, when up to 2009, Sumiseki's entitlements had been calculated on consolidated profit. Sumiseki sought an order from the Court that its construction of the Constitution be upheld or alternatively, that the Constitution be rectified to give effect to its construction.

(c) Decision

Hammerschlag J dismissed Sumiseki's claim on two bases.

First, his Honour rejected Sumiseki's construction of the words "the profit of the Company available for dividend purposes" in Article 2.1B as meaning the consolidated profit of Wambo and any controlled entities because:

- it was contrary to the clear and ordinary meaning of the words used in the Constitution - the words "the Company" and "the profits of the Company" left no room for attributing a meaning to them other than Wambo itself and the profit of Wambo itself; and
- it was contrary to the well-established company law principle that dividends can only be paid out of the separate profits of the company paying them. Consolidated profits of a holding company and its subsidiaries as disclosed by group accounts cannot be the source of dividends paid by the holding company.

His Honour noted that the fact that the accounting standards required Wambo to produce consolidated accounts did not assist Sumiseki. The standards did not have the consequence of relieving Wambo from its obligation to produce stand alone accounts or enabling dividends to be paid on the basis of consolidated accounts.

Second, although his Honour accepted that there was a commercial understanding and expectation between the parties that the B Class dividend would reflect the profits of entities comprising Wambo and its controlled entities on a consolidated basis, and that in fact, this expectation had been met from 2005 to 2009, this did not necessarily translate into a common intention that there be a binding contractual obligation on Wambo to pay dividends calculated on a consolidated basis. His Honour therefore refused Sumiseki's contention that the Constitution should be rectified to give effect to this understanding.

Sumiseki had also brought a claim based on oppression under s. 232 of the Corporations Act, but Hammerschlag J dismissed this claim as it was limited to a refusal by Wambo to pay dividends at all, rather than a failure to pay dividends on a consolidated, as opposed to a stand alone, basis.

However, Hammerschlag J acknowledged that Sumiseki had been disappointed by Wambo reneging on the parties' understanding of how dividend entitlements would be calculated, particularly in light of Wambo's past practice. Sumiseki could potentially rely on s. 232 of the Corporations Act for relief by claiming that the affairs of Wambo are being conducted in a manner oppressive to, unfairly prejudicial to, or unfairly discriminatory against Sumiseki, if the calculation of dividends was contrary to the party's expectation and past practice, and absent any bona fide commercial justification for such conduct.

5.13 Interlocutory relief granted to a minority shareholder and director to restrain meeting from voting to remove director

(By Lucy Witheriff, Minter Ellison)

In the matter of Eden Resort Hotel Pty Limited [2013] NSWSC 493, Supreme Court of New South Wales, Black J, 24 April 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/493.html

(a) Summary

This case considers whether the applicants, who were the minority shareholders in a company, could stop the respondents, who were the majority shareholders, from moving a resolution for the removal of the applicant as a director.

The interlocutory relief was ultimately granted.

(b) Facts

On 17 April 2013 the applicants, Mr Ruiz de Roxas and HDR Hospitality Consulting International Pty Ltd (HDR), sought an interlocutory injunction restraining the respondents, Mr Yong, Joytown Pty Ltd (Joytown) and Resort Planners Pty Ltd (RP), from moving a resolution, or voting on it, at a meeting of the Eden Resort Hotel Pty Ltd (Company) proposed in a notice of meeting dated 2 April 2013.

Mr Ruiz de Roxas is the sole director and shareholder of HDR and is also a director of the Company. Mr Yong is the second director of the Company. RP is an entity owned by Mr Yong's wife. Joytown is associated with Mr Yong.

HDR and Joytown both hold 42 shares in the Company and RP holds 16 shares. Mr and Ms Young therefore hold a majority interest in the Company.

The Company purchased and was involved in planning the development of a resort in Eden, New South Wales. In February 2012, Mr Ruiz de Roxas identified concerns as to the process by which an entity named Ausbao Pty Ltd (Ausbao) became a shareholder of the Company in March 2001. Ausbao transferred its shares to RP in November 2004. It was at this stage that Mr and Ms Yong became majority shareholders in the Company.

On 6 March 2013, Mr Ruiz de Roxas and HDR sought orders by Originating Process under the general law and under ss. 247A and 290 of the Corporations Act 2001 (Cth) (the Corporations Act) for access to the Company's books and financial records. Section 247A states that on application by a member of a company the Court may make an order either authorising the applicant to inspect books of the company or authorising another person to inspect the books of the company on the applicant's behalf. Section 290 states that a director of a company has a right of access to the financial records at all reasonable times. On application by a director, the Court may authorise a person to inspect the financial records on the director's behalf.

On 2 April 2013, Joytown requisitioned a meeting of the Company under s. 249F of the Corporations Act to be held on 26 April 2013 to consider a resolution for Mr Ruiz de Roxas' removal as a director of the Company. Section 249F states that members with at least 5% of the votes that may be cast at a general meeting of the company may call, and arrange to hold, a general meeting. Due to the fact that Mr and Ms Yong hold a majority interest, the resolution would pass unless its passage were restrained by the court.

On 10 April 2013, Mr Ruiz de Roxas' solicitors wrote to Mr Yong requesting that he withdraw the notice of meeting on behalf of Joytown or he would seek relief from the Court. Mr Yong responded on 17 April 2013 stating that he was overseas and would be returning after the date of the proposed meeting.

On 17 April 2013 Mr Ruiz de Roxas and HDR sought leave to file an Amended Originating Process, which would also seek orders against Joytown and RP including orders restraining them from moving a resolution seeking to remove Mr Ruiz de Roxas as a director and order that Mr Yong, or Joytown and RP, purchase HDR's shares in the Company for a price to be determined by the Court.

Mr Ruiz de Roxas claimed, in his affidavit dated 17 April 2013, to have had an expectation that he would take part in the Company's management, which was evidenced through his involvement in aspects of the work done by the Company as well as his substantial financial contributions to the Company.

By letter dated 21 April 2013, Mr Yong disagreed with the factual matters and stated that Mr Ruiz de Roxas was "rushing off to court" when Mr Yong was overseas. However, if Mr Ruiz de Roxas was to seek the court's intervention he would have no choice but to do so while Mr Yong was away.

(c) Decision

Black J had regard to *Remrose Pty Ltd v Allsilver Holdings Pty Ltd* [2005] WASC 251; (2005) ALR 588, where an interlocutory injunction was granted to restrain the removal of a director of a company in very similar circumstances to the present case.

In determining whether an interlocutory injunction should be granted, Black J applied the principles set out by the High Court of Australia in *Australian Broadcasting Corporation v O'Neill* [2006] HCA 46; (2006) 227 CLR 57 at [65].

In order to obtain interlocutory relief in this case, the applicant needed to demonstrate the following:

- that there was a prima facie case or serious question to be tried as to the alleged breaches of the oppression provisions of the Corporations Act;
- that damages would not be an adequate remedy; and
- that the balance of convenience favoured the grant of an injunction on an interlocutory basis.

Black J stated that Mr Ruiz de Roxas had sufficiently established a serious question to be tried from the fact that he had been a director of the Company since its beginning and he had made a significant investment in the company with the expectation that he would be involved in its management. This expectation would be frustrated if he was to be removed as a director. Secondly, Black J concluded that damages were not likely to be an adequate remedy given the conflicting

views of Mr Ruiz de Roxas and Mr Yong as well as the fact that Mr Yong would then be the only director of the Company. Finally, the balance of convenience strongly favoured the grant of the interlocutory relief. All elements were therefore satisfied. Interlocutory relief was granted.

5.14 Directors' misappropriation of another's interests found to be a breach of directors' duties

(By Simon G Frauenfelder and Clementyne Rawlyk, Corrs Chambers Westgarth)

Re Manormay Investments Pty Ltd [2013] VSC 260, Supreme Court of Victoria, Robson J, 19 April 2013

The full text of the judgment is available at:

http://www.austlii.edu.au/au/cases/vic/VSC/2013/260.html

(a) Summary

In this case Robson J held that the two directors of Manormay Pty Ltd (Manormay) had breached their fiduciary duties by granting charges over Manormay's key assets, being shares in a group of companies operating aged care facilities, for the specific purpose of depriving Mr Snowden, a key investor, of his 51% interest in the aged care facilities and to give them complete control and ownership of the business. The benefit of those charges was ultimately assigned to a company which was controlled by those two directors.

On application by Mr Snowden, Robson J ordered that all of the charges granted over Manormay's assets be set aside and removed from the Personal Properties Securities Register (PPSR).

(b) Facts

This case concerned the ownership and control of five aged care facilities throughout metropolitan Melbourne and regional Victoria.

In summary, each of the five aged care facilities was owned and operated by four companies in the Manormay group (Facility Companies). The Facility Companies held the benefit of the five facilities on trust for four separate unit trusts (Facility Trusts).

Manormay owned all of the shares in the Facility Companies. Manormay also held all of the units in the four Facility Trusts on trust for the benefit of Mr Stephen George Snowden, Ken Yen Cheng (Kevin), Yiu Cheung Lui (Thomas) and Marie Leone.

Accordingly, the five aged care facilities were effectively beneficially owned as follows:

- Mr Stephen George Snowden - 51%;
- Ken Yen Cheng (Kevin) - 22%;
- Yiu Cheung Lui (Thomas) - 22%; and
- Marie Leone - 5%.

Kevin and Thomas were appointed as the directors of Manormay in 2011. However, in April 2012, Snowden had a falling out with Kevin and Thomas. In July 2012, Snowden discovered that Kevin and Thomas had transferred all of the shares held by Manormay in the Facility Companies to Lakeside Care Pty Ltd (Lakeside), a company controlled by Kevin and Thomas.

Because Manormay no longer owned the Facility Companies (which in turn controlled the facilities), Snowden had lost his 51% beneficial interest in the aged care facilities. Mr Snowden was later able to restore his interests in the aged care facilities by using powers of attorney he had previously obtained from both Kevin and Thomas to remove them as directors of Manormay and to transfer the shares in the Facility Companies from Lakeside back to Manormay.

However, the charges were still registered on the PPSR in favour of Lakeside. This became problematic when two of the aged care facilities were sold in order to repay part of a $7 million debt owed by Snowden to Westpac. Settlement of the sales was delayed as a result of the registered charges over Manormay's shares in the two relevant Facility Companies and Manormay's units in the two relevant Facility Trusts.

Accordingly, Mr Snowden applied to the Supreme Court to have the charges set aside and removed from the PPSR.

Kevin and Thomas were not represented at the hearing. However, Thomas' affidavit asserted that the transfer of shares in the Facility Companies to Lakeside had occurred pursuant to charges granted to Lakeside by Manormay. In particular, it was alleged that Manormay had granted charges over its shares in the Facility Companies as security for a $420,000 loan it obtained in April 2012 from Black Oak Capital Pty Ltd (Black Oak Capital), which was later assigned to Lakeside.

On the version of events asserted by Kevin and Thomas, Lakeside had transferred the shares to Lakeside eight days after Manormay received the loan monies from Black Oak Capital.

(c) Decision

Mr Snowden applied to the Supreme Court to have the charges set aside and removed from the PPSR on the basis that:

- there was no loan from Black Oak Capital to Manormay in April 2012;
- the loan and charge documents were a sham, in that they were actually created in September 2012 to "falsely represent" that a loan was granted in April 2012; and
- even if the documents were not a sham, the loan and charges should be set aside because Kevin and Thomas had breached their directors' duties by procuring the transfer of shares to a company they controlled.

Robson J held that Kevin and Thomas had:

- by procuring the loan agreement and charges over Manormay's shares in the Facility Companies, "exercised their powers ... to effectively misappropriate Mr Snowden's 51% interest in the aged care facilities and to give themselves complete control of and ownership of the business"; and
- breached their duties as directors of Manormay.

(i) Was the April 2012 loan and associated documentation a sham?

Robson J did not specifically determine whether the loan agreement and security documents were a sham. Instead, his Honour decided the more limited point that Kevin and Thomas did not inform Snowden of the restructure of the group, and that they had done so to deprive Snowden of his interest in the business. As a result of these findings, Robson J ordered that all of the charges be set aside and removed from the PPSR.

However, his Honour:

- quoted from a number of emails sent to and received by Black Oak Capital's and Kevin and Thomas' accountants and advisers, which appeared to disclose that the loan agreement between Black Oak Capital and Manormay was drawn up in September 2012, some five months after the date on which the loans were purportedly made; and
- noted that a PPSR search conducted on 29 October 2012 did not disclose the charges over Manormay's assets, but rather that a search conducted on 20 December 2012 after the proceeding had commenced did disclose the purported charges.

When read in conjunction with his Honour's decision and orders, a finding that the loan and charges were a sham seems implicit in Robson J's reasoning.

(ii) Had Kevin and Thomas breached the duties they owed as directors of Manormay Pty Ltd?

His Honour held that by permitting Manormay to enter the purported loan agreements, Kevin and Thomas deprived Manormay of its investments in the aged care business. The further result was

that Kevin and Thomas themselves received a benefit, through their holdings in Lakeside.

Accordingly, Robson J held - in terms almost amounting to condemnation - that Kevin and Thomas were in breach of their duties to Manormay:

"In my opinion, the actions of Kevin and Thomas are akin to a trustee that sells trust property to himself or herself. In such a case, "the sale is voidable by a beneficiary ex debito justitiae, however fair the transaction". In this case, the breach of trust is greater than postulated in the principle as I do not consider the transaction to have been fair to Manormay or to the beneficiaries of the unit trusts" (at [51])

As a result, his Honour held that Lakeside held "whatever benefit it received by reason of their actions as constructive trustee for Manormay".

5.15 ADJR Act no bar to Supreme Court staying disciplinary proceedings

(By Patrick Wong, Clayton Utz)

ML v Australian Securities and Investments Commission [2013] NSWSC 283, New South Wales Supreme Court, Rothman J, 3 April 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/283.html

(a) Summary

This decision clarifies that the jurisdiction to stay proceedings, ancillary to a criminal prosecution, is not ousted by the Administrative Decisions (Judicial Review) Act 1977 (Cth) (the ADJR Act). In practical terms this means that both Federal and State courts may stay disciplinary proceedings brought by ASIC, notwithstanding the limitations of s. 1337B of the Corporations Act 2001 (Cth) (the Corporations Act).

Regardless of the forum, the consideration of discretionary factors in this case illustrates that a stay will not be readily granted for disciplinary proceedings. This follows from the observation of the Court that ordinarily a party to such proceedings cannot be compelled to give evidence or disclose matters which may be unfairly prejudicial to impending criminal proceedings.

(b) Facts

The plaintiff was the subject of disciplinary proceedings brought by ASIC in the Companies Auditors and Liquidators Disciplinary Board (the Disciplinary Board). The allegations before the Board were that the plaintiff had fraudulently caused two payments totalling around $90,000 to be paid from funds held by his employer to discharge a personal tax liability.

The plaintiff unsuccessfully applied to the Disciplinary Board to have the proceedings suspended until after the determination of imminent criminal proceedings in relation to the same allegations. The plaintiff then applied for an order staying the disciplinary proceedings in the Supreme Court of New South Wales.

ASIC submitted that the proceedings of the Disciplinary Board could not be stayed by the Supreme Court as its jurisdiction over civil matters arising under the Corporations Act was subject to, and in this case denied, by s. 9 of the ADJR Act. ASIC essentially claimed that only the Federal Court had jurisdiction to review the decision of the Disciplinary Board not to suspend its proceedings.

The plaintiff submitted that the disciplinary proceedings abrogated his right to silence in relation to forthcoming criminal charges. This was because he would need to rebut the evidence of another witness. The plaintiff was also concerned that this witness would be able to modify and falsify evidence in the future based on the evidence given by the plaintiff in the disciplinary hearing. In short, the plaintiff wanted the witness to stay in the dark as to his response until the criminal trial.

(c) Decision

(i) Relevant provisions

The jurisdiction of the Supreme Court and Federal Court in relation to civil matters arising under the Corporations Act is provided by s. 1337B, which provides:

1. Jurisdiction is conferred on the Federal Court of Australia with respect to civil matters arising under the Corporations legislation.
2. Subject to s. 9 of [the ADJR Act], jurisdiction is conferred on the Supreme Court [of each State and Territory] with respect to civil matters arising under the Corporations Legislation ...

Section 9 of the ADJR Act provides:

Limitation of jurisdiction of State courts

1. Notwithstanding anything contained in any Act other than this Act, a [C]ourt of a State does not have jurisdiction to review:
    a. a decision to which this section applies that is made after the commencement of this Act;
    b. conduct that has been, is being, or is proposed to be, engaged in for the purpose of making a decision to which this section applies;
    c. a failure to make a decision to which this section applies; or
    d. any other decision given, or any order made, by an officer of the Commonwealth or any other conduct that has been, is being, or is proposed to be, engaged in by an officer of the Commonwealth, including a decision, order or conduct given, made or engaged in, as the case may be, in the exercise of judicial power ...

(ii) Jurisdiction to stay the disciplinary proceedings

The Court was prepared to assume that a decision of the Disciplinary Board was one to which s. 9 of the ADJR Act applied. ASIC's argument was then that the operation of s. 9(1) of the ADJR Act, in denying jurisdiction to review the decision, resulted in the Court lacking "jurisdiction to determine" the plaintiff's application.

Rothman J rejected the construction of s. 9 of the ADJR Act for which ASIC contended. Read in the context of the ADJR Act as a whole, and in particular ss. 5, 6 and 7, the operation of s. 9 was to deny the Supreme Court jurisdiction to review a decision otherwise capable of being reviewed under the ADJR Act, on such familiar grounds as denial of natural justice, procedural misconduct and error of law among others as set out in the ADJR Act ss. 5, 6 and 7.

The Court held that the plaintiff's application did not rely on the existence of a reviewable error in relation to the earlier decision of the Disciplinary Board. Instead the plaintiff relied on a jurisdiction of the Supreme Court for which it did not depend on s. 1337B of the Corporations Act, specifically the inherent jurisdiction of the Court to supervise the exercise of judicial power by the courts of the State, and to protect the integrity of the criminal justice system. As it was not in controversy in this proceeding that the Supreme Court has a general jurisdiction to stay proceedings of a tribunal to protect the criminal jurisdiction of the State, the Court held that the order sought by the plaintiff was within its jurisdiction.

(iii) Exercise of discretion to stay disciplinary proceedings

The Court ultimately declined to exercise its discretion to order the stay sought by the plaintiff, and in the process illustrated the practical difficulty that will typically attend an application to stay disciplinary proceedings.

The most substantial observation of the Court was in relation to the plaintiff's submission that the disciplinary proceedings denied a right of silence in relation to the impending criminal charges. As identified by the Court, disciplinary proceedings do not ordinarily permit the compulsion of a person to participate or give evidence. It was a matter for the plaintiff to decide whether to give evidence or state a potential defence to any related criminal charge. It was for the plaintiff to choose whether or not to give evidence in the disciplinary proceedings.

Further, to the extent that the plaintiff did choose to give evidence, the admissibility of any evidence garnered as a result would be subject to the usual tests of admissibility in any subsequent criminal proceeding, including preclusion of unfairly prejudicial evidence under s. 137 of the Evidence Act 1995 (NSW).

As to the submission of the plaintiff that his evidence would give a key witness a chance to modify evidence prior to a criminal trial, Rothman J cast such circumstances as giving rise to the "commendable position" of a "full dress rehearsal' for the witness" future cross-examination. Any influence that adverse findings of the disciplinary hearing may have on a jury could also be met by an order for the non-publication of the decision of the Disciplinary Board.

In the face of countervailing discretionary factors identified by the Court, including the public interest in conduct of disciplinary proceedings which protect the probity and integrity of a profession, as well as ASIC's entitlement to prosecute the disciplinary proceedings in the Disciplinary Board, a stay was denied.