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1. Recent Corporate Law and Corporate Governance Developments

1.1 APRA releases consultation package on banking exemption orders and section 66 guidelines

On 19 April 2013, the Australian Prudential Regulation Authority (APRA) released a consultation package on proposed changes to exemption orders under the Banking Act 1959 (Cth) (the Banking Act) as well as revised guidelines on implementation of s. 66 of the Banking Act.

A number of institutions that undertake "banking business", as defined in the Banking Act, are currently exempt from the need to be authorised as deposit-taking institutions (ADIs). Such exemptions are generally historical in nature. The exemptions cover Registered Financial Corporations (RFCs) and religious charitable development funds, which are funds that have been set up to borrow and use money for religious and/or charitable purposes.

In December 2012, the Government announced that the Australian Securities and Investments Commission (ASIC) and APRA would consult on a number of proposals to strengthen the regulation of RFCs that issue debentures to retail clients. In this consultation package, APRA proposes to restrict the use of certain terms by RFCs, including the words "deposit" and "at-call", and to require all debenture offerings to have a minimum maturity of 31 days. These changes are intended to reduce the potential for retail investors to confuse debentures issued by RFCs with deposit products offered by ADIs.

APRA proposes that these new requirements would take effect from 1 July 2013. Any funds raised after that date would need to comply with the proposed requirements; existing retail debenture issues would be allowed a transition period of up to three years in which to become compliant.

APRA is also of the view that it is not appropriate to continue to exempt RCDFs from the need to be authorised under the Banking Act where they are offering products to retail investors. Accordingly, APRA is proposing that RCDFs wishing to continue to accept retail funding seek to become either an ADI or an RFC or operate a managed investment scheme. APRA proposes to withdraw the current exemption order for RCDFs that offer retail products from 28 June 2014. However, RCDFs that do not take funds from retail investors may continue to receive a Banking Act exemption.

APRA's proposals are also consistent with recent recommendations from the International Monetary Fund, in its 2012 Financial Sector Assessment Program (FSAP) review of Australia, that APRA tighten the conditions for exemption from the Banking Act.

APRA's guidelines on s. 66 of the Banking Act provide information on the use of restricted words and expressions. APRA has revised these guidelines in response to recent developments in the classification of ADIs.

The revised draft s. 66 guidelines are available on the APRA website.

1.2 IOSCO consults on regulation of retail structured products

On 18 April 2013, the International Organization of Securities Commissions (IOSCO) published a consultation report on "Regulation of Retail Structured Products", which analyses trends in the retail structured product market, and proposes a regulatory Toolkit for IOSCO members.

The retail structured products work responds to concern among IOSCO members about the regulatory challenges these products pose, particularly in the area of investor protection. In February 2012, IOSCO agreed to work on retail structured products:

- to understand and analyse the market, and related regulatory issues; and
- to develop guidance, if appropriate, on regulatory responses.

The Toolkit has five sections. They cover:

- a potential regulatory approach to retail structured products;
- potential regulation of the product design and issuance;
- potential regulation of product disclosure and marketing;
- potential regulation of the product distribution; and
- potential regulation of post-sales practices (that is, once the products are in the hands of investors).

The consultation paper and toolkit are available on the IOSCO website.

1.3 IMF global financial stability report

On 17 April 2013, the International Monetary Fund (IMF) published its latest Global Financial Stability Report.

The Report provides an assessment of the global financial system and markets, and addresses emerging market financing in a global context. It focuses on current market conditions, highlighting systemic issues that could pose a risk to financial stability and sustained market access by emerging market borrowers. The Report draws out the financial ramifications of economic imbalances highlighted by the IMF's World Economic Outlook. It contains, as special features, analytical chapters or essays on structural or systemic issues relevant to international financial stability.

In chapter 1, the IMF states that recent rallies in financial markets will not be sustained, and new risks are likely to emerge, unless policymakers address key vulnerabilities.

For example, bank balance sheet repair has not been completed and progress has been uneven, according to the IMF. Banking systems around the world are in different stages of repair.

The chapter shows that the process is largely completed in the United States, but not so in Europe. Many banks in the euro area periphery countries still need to make further progress in strengthening their balance sheets. And important banks in the core countries are still too dependent on wholesale funding markets. Furthermore, the global financial reform agenda is incomplete, prolonging regulatory uncertainty. This leaves banks less willing to lend.

The chapter also identifies new risks linked to easy monetary policies that were put in place to fight the crisis. These policies have been essential to support the economy. But their use over a prolonged period may create side effects, such as excessive risk taking and leverage, and asset bubbles.

The IMF states there are signs of new risks in the United Sates. US corporate fundamentals are strong, and leverage is in line with typical historical patterns. But corporate debt underwriting standards are weakening rapidly. In addition, continued low interest rates are prompting some pension funds and insurance companies to take further risks to close their widening funding gaps.

The report calls for renewed political commitment at the global and national level to complete and implement the financial regulatory reform agenda. Without greater urgency toward international cooperation and comprehensive bank restructuring, weak bank balance sheets will continue to weigh on the recovery and pose ongoing risks to global stability, according to the IMF.

Chapter 2 examines whether sovereign credit default swaps (SCDS) are good market indicators of sovereign credit risk, and finds that many of the negative perceptions surrounding their impact on financial stability are unfounded: SCDS markets do not appear to be more prone to high volatility than other financial markets. The results of the analysis do not support the need for a ban on "naked" SCDS protection buying, which went into effect in the European Union in November 2012.

Chapter 3 investigates the monetary policies pursued by four central banks (the Federal Reserve, Bank of England, European Central Bank, and Bank of Japan), including prolonged periods of low real policy interest rates and unconventional measures, including asset purchases. The policies appear to have lessened banking sector vulnerabilities and contributed to financial stability in the short term. However, policymakers should be alert to the possibility that risks may rise the longer these policies are maintained. Though not failsafe, targeted micro- and macro-prudential tools should be used to mitigate risks while allowing greater leeway for monetary policy to support the macro-economy.

The report is available on the IMF website.

1.4 IOSCO consults on principles for financial benchmarks

On 16 April 2013, the International Organization of Securities Commissions (IOSCO) published a consultation paper on "Principles for Financial Benchmarks", which seeks public comments on a set of high-level principles for benchmarks used in global financial markets.

Because of the wide diversity of benchmarks, IOSCO also is asking for public comment on a subset of more detailed principles for benchmarks having specific risks arising from their reliance on submissions and/or their ownership structure.

The principles form part of IOSCO´s efforts to enhance the integrity, the reliability and the oversight of benchmarks by establishing guidelines for benchmark administrators and other relevant bodies on governance, benchmark quality, quality of the methodology, and accountability mechanisms.

The IOSCO Board created a Task Force in September 2012 to develop these principles in light of investigations and enforcement actions regarding attempted manipulation of major interest rate benchmarks. Those investigations and enforcement actions raised concerns over the fragility of certain benchmarks, caused by vulnerabilities in their methodology, transparency and governance arrangements.

The consultation paper is available on the IOSCO website.

1.5 EC moves to enhance business transparency on social and environmental matters

On 16 April 2013, the European Commission (EC) announced an amendment to existing accounting legislation in order to improve the transparency of certain large companies on social and environmental matters. Companies concerned will need to disclose information on policies, risks and results as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity on the boards of directors.

Under the proposal, large companies with more than 500 employees would be required to disclose relevant and material environmental and social information in their annual reports. Concise information which is necessary for understanding a company's development, performance or position would be made available rather than a fully-fledged and detailed "sustainability" report. If reporting in a specific area is not relevant for a company, it would not be obliged to report but only to explain why this is the case. Furthermore, disclosures may be provided at group level, rather than by each individual company within a group.

Further information is available on the EU website.

1.6 FSB releases progress report on implementation of OTC derivatives market reforms

On 15 April 2013, the Financial Stability Board (FSB) published its fifth six-monthly progress report on the implementation of over-the-counter (OTC) derivatives market reforms.

This report takes stock of progress made by standard-setting bodies, national and regional authorities and market participants towards meeting the commitments made by G20 Leaders at the Pittsburgh 2009 Summit that:

- all standardized OTC derivative contracts be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs);
- that OTC derivative contracts be reported to trade repositories; and
- that non-centrally cleared contracts be subject to higher capital requirements.

While progress has been made toward meeting the G20 commitments, through international policy development, adoption of legislation and regulation, and expansion of infrastructure, no jurisdiction had fully implemented requirements by end-2012. Less than half of the FSB member jurisdictions currently have legislative and regulatory frameworks in place to implement the G20 commitments and there remains significant scope for increases in trade reporting, central clearing, and exchange and electronic platform trading in global OTC derivatives markets.

Jurisdictions will need to resolve a number of outstanding policy issues over the course of this year, including:

- uncertainties in the application of requirements in cross-border contexts;
- trade reporting and data access;
- central clearing and incentives; and
- organised platform trading.

Further international work should take place on:

- remaining issues around authorities' access to trade repository data, such as data standards; and
- the feasibility of a centralized or other mechanism to produce and share global aggregated data, taking into account legal and technical issues and the aggregated trade repository data that authorities need to fulfill their mandates and to monitor financial stability.

The progress report is available on the FSB website.

1.7 Authorities' access to trade repository data - consultative report issued by CPSS-IOSCO

On 11 April 2013, the Committee on Payment and Settlement Systems (CPSS) and the Board of the International Organization of Securities Commissions (IOSCO) released a consultative report titled "Authorities" access to trade repository data'.

Trade repositories (TRs) are entities that maintain a centralized electronic record (database) of OTC derivatives (OTCD) transaction data. TRs will play a key role in increasing transparency in the OTCD markets by improving the availability of data to authorities and the public in a manner that supports the proper handling and use of the data, while taking into account confidentiality requirements

The report seeks to provide guidance to TRs and authorities on the principles that should guide authorities' access to data held in TRs, as well as possible approaches to addressing confidentiality concerns and access constraints.

The consultative report is available on the IOSCO website.

1.8 FCA releases two papers on behavioural economics exploring how people make financial decisions

On 10 April 2013, the UK's new Financial Conduct Authority (FCA) released the first two papers in its occasional papers series.

The first paper, titled "Applying behavioural economics at the Financial Conduct Authority", focuses on how consumers choose and use financial products, and how behavioural biases can lead to firms competing in ways that are not in the interests of consumers.

The second paper, titled "Encouraging consumers to claim redress: evidence from a field trial", explores how best to encourage consumers to respond to customer contact letters.

The FCA is interested in behavioural economics as it can help the regulator understand the mistakes consumers make, how firms respond to these mistakes, how this affects competition, and what interventions the FCA might consider.

1.9 Approval of the FEX financial market and the LCH clearing and settlement arrangement

On 10 April 2013, the Australian Government announced that it had granted the Financial and Energy Exchange Global Pty Ltd (FEX) an Australian Market Licence allowing it to operate a new derivatives market in Australia.

The Government has also granted LCH Clearnet Limited (LCH) an Australian Clearing and Settlement facility licence to clear and settle contracts traded on the FEX market. The licence will also be the first non-ASX clearing licence in Australia in relation to a significant market.

The FEX market will expand the range of options for Australian market participants to trade or manage risks associated with various energy, commodity or environmental products.

The decision will provide a trading venue to trade specialised derivative products.

The announcement is available on the Financial Services Minister's website.

1.10 APRA releases consultation package on disclosure of composition of capital and remuneration

On 9 April 2013, the Australian Prudential Regulation Authority (APRA) released a consultation paper and draft prudential standard relating to Pillar 3 disclosures on the composition of capital and on remuneration by authorised deposit-taking institutions (ADIs) in Australia.

As part of the Basel III capital reforms released by the Basel Committee on Banking Supervision in

December 2010, ADIs will be required to disclose additional information on their capital adequacy and capital instruments. These disclosure requirements will, among other things, inform the market of the composition of ADIs' regulatory capital in a standard form that will allow market participants to compare the capital positions of banking institutions in different jurisdictions.

ADIs will be required to publish a reconciliation between their regulatory capital and financial statements. They will also need to disclose full details of the terms and conditions of each regulatory capital instrument and a summary of those instruments in a standard form.

In addition, APRA will be consulting on its proposed implementation of the Basel Committee's requirements for ADIs to disclose qualitative and quantitative information about their remuneration practices and aggregate remuneration data for senior managers and material risk-takers. APRA had foreshadowed these requirements, which take account of the Financial Stability Board's Principles for Sound Compensation Practices (2009), in a letter to ADIs in October 2011.

APRA is proposing that the requirements commence for the first reporting period on or after 30 June 2013.

The consultation paper and draft prudential standard are available on the APRA website.

1.11 Treasury releases discussion paper on the Financial Industry Supervisory Levy Methodology

On 5 April 2013, the Australian Treasury released a discussion paper seeking submissions on the design and operation of the Financial Institutions Supervisory Levy. The focus of the discussion paper is on the methodology used for the application of the levy.

In 1998, the Government introduced levy-setting arrangements to fund the activities of the then newly established Australian Prudential Regulation Authority (APRA). Since the introduction of the Financial Institutions Supervisory Levies Collection Act 1998 (Cth), the scope of the levy imposition has expanded to include a broader range of activities relating to the APRA-regulated financial services sector. Information on how the levy is used to fund various agencies and the activities they undertake is provided in the discussion paper.

In 2008-09, following a review of the design and operation of the financial industry supervisory levy, it was acknowledged that there would be merit in further reviewing the levy framework within four years on the expectation that sufficient time would have passed to assess the impact of the global financial crisis on the size and structure of the regulated sectors. An earlier review of the financial sector levy had been undertaken and a discussion paper released by Treasury in April 2005.

The discussion paper is separate to the annual "Proposed Financial Industry Levies" paper released in May each year. That paper generally focuses on how the levy for a particular year is calculated, whilst this discussion paper focuses on the methodology that is applied in calculating the levy.

The discussion paper is available on the Treasury website.

1.12 UK's Banking Standards Commission publishes report on the failure of HBOS

On 5 April 2013, the UK's Parliamentary Commission on Banking Standards published its fourth report, titled "'An accident waiting to happen': The failure of HBOS".

The report is divided into two volumes:

- Volume one contains the report and formal minutes; and

- Volume two contains oral and written evidence.

Amongst other things, the report is critical of the way in which the HBOS board operated, describing it as "a model of self-delusion, of the triumph of process over purpose", and with the failure of the regulatory system to impose sanctions that would have deterrent effect. The subject of sanctions will be further considered by the Commission in its final report.

A summary of the report is available on the UK Parliament's website.

1.13 BCBS progress report on implementation of the Basel regulatory framework

On 4 April 2013, the Basel Committee on Banking Supervision (BCBS) released an update regarding implementation of the Basel regulatory framework.

The report provides a high-level view of Basel Committee members' progress in adopting Basel II, Basel 2.5 and Basel III, as of end March 2013. It focuses on the status of domestic rule-making processes to ensure that the Committee's capital standards are transformed into national law or regulation according to the internationally agreed timeframes. The Committee believes that disclosure will provide additional incentive for members to fully comply with the international agreements.

The report is available on the BIS website.

1.14 SEC states that companies can use social media for announcements if investors are alerted

On 2 April 2013, the US Securities and Exchange Commission issued a report that makes clear that companies can use social media outlets like Facebook and Twitter to announce key information in compliance with Regulation Fair Disclosure (Regulation FD), so long as investors have been alerted about which social media will be used to disseminate such information.

The SEC's report of investigation confirms that Regulation FD applies to social media and other emerging means of communication used by public companies the same way it applies to company websites. The SEC issued guidance in 2008, clarifying that websites can serve as an effective means for disseminating information to investors if they have been made aware that is where to look for it. The report clarifies that company communications made through social media channels could constitute selective disclosures and, therefore, require careful Regulation FD analysis.

Regulation FD requires companies to distribute material information in a manner reasonably designed to get that information out to the general public broadly and non-exclusively. It is intended to ensure that all investors have the ability to gain access to material information at the same time.

The SEC's report of investigation stems from an inquiry the Division of Enforcement launched into a post by Netflix CEO Reed Hastings on his personal Facebook page stating that Netflix's monthly online viewing had exceeded one billion hours for the first time. Netflix did not report this information to investors through a press release or Form 8-K filing, and a subsequent company press release later that day did not include this information. Neither Hastings nor Netflix had previously used his Facebook page to announce company metrics, and they had never before taken steps to alert investors that Hastings' personal Facebook page might be used as a medium for communicating information about Netflix. Netflix's stock price had begun rising before the posting, and increased from $70.45 at the time of the Facebook post to $81.72 at the close of the following trading day.

The SEC did not initiate an enforcement action or allege wrongdoing by Hastings or Netflix.

Recognising that there has been market uncertainty about the application of Regulation FD to social media, the SEC issued the report of investigation pursuant to s. 21(a) of the *Securities Exchange Act of 1934*.

The report of investigation explains that although every case must be evaluated on its own facts, disclosure of material, nonpublic information on the personal social media site of an individual corporate officer - without advance notice to investors that the site may be used for this purpose - is unlikely to qualify as an acceptable method of disclosure under the securities laws. Personal social media sites of individuals employed by a public company would not ordinarily be assumed to be channels through which the company would disclose material corporate information.

SEC's report of investigation is available on the SEC website.

1.15 Introduction of UK's new financial regulatory framework

On 1 April 2013, the UK's new financial regulatory framework formally came into existence, with the creation of the Financial Policy Committee, the Financial Conduct Authority and Prudential Regulation Authority.

UK's Prudential Regulation Authority (PRA) became responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.

In total, the PRA regulates around 1,700 financial firms in the UK. The PRA's role is defined in terms of two statutory objectives: to promote the safety and soundness of these firms and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders.

The PRA has released two documents setting out its approach to banking and insurance supervision:

- The PRA's approach to banking supervision; and
- The PRA's approach to insurance supervision.

The PRA was created by the *Financial Services Act* (2012) and will be part of the Bank of England. The PRA works alongside the Financial Conduct Authority (FCA) creating a "twin peaks" regulatory structure in the UK.

1.16 APRA releases final reporting requirements for superannuation

On 28 March 2013, the Australian Prudential Regulation Authority (APRA) released a response paper and a package of 35 final reporting standards, reporting forms and instructions for APRA-regulated superannuation funds.

APRA's reporting requirements implement the transparency and accountability recommendations from the Government's Stronger Super reforms, and the proposals APRA previously consulted on in 2009. The new requirements also support the implementation of prudential standards, MySuper products and SuperStream. These revisions will be the first changes to the reporting requirements for superannuation since 2004.

The requirements in 24 of the final reporting standards will take effect from 1 July 2013, with the remaining 11 taking effect from 1 July 2014. The first publication using the new data will be published in late 2013, and APRA expects to consult with industry regarding its proposals for new publications in later this year.

The response paper and the 35 reporting standards, reporting forms and instructions are available on the APRA website.

1.17 Basel Committee releases consultative document on measuring and controlling large exposures

On 26 March 2013, the Basel Committee on Banking Supervision (BCBS) released a proposed supervisory framework for measuring and controlling large exposures.

The proposed new standard aims to ensure greater consistency in the way banks and supervisors measure, aggregate and control exposures to single counterparties. Acting as a backstop to risk-based capital requirements, the standard would supplement the existing risk-based capital framework by protecting banks from substantive losses caused by the sudden default of a counterparty or group of connected counterparties. The consultative paper would replace the Basel Committee's 1991 guidance "Measuring and controlling large credit exposures".

The proposed standard focuses on the concentration risk associated with the default of single private sector counterparties and would also apply to exposures to a group of connected counterparties. Its scope is comprehensive, covering direct exposures to counterparties across all operations and books, as well as exposures to providers of credit protection. By extending the scope of coverage to exposures to funds, securitization structures and collective investment undertakings, the Committee seeks to address concerns related to the shadow banking system. The Committee also aims to limit contagion between global systemically important banks (G-SIBs) by proposing a tighter limit on exposures between G-SIBs.

The consultative paper is available on the BCBS website.

1.18 Integrated reporting and business model reporting

On 26 March 2013, at the request of the International Integrated Reporting Council (IIRC), the International Federation of Accountants (IFAC), together with the Chartered Institute of Management Accountants (CIMA) and PwC, released a background paper, titled "Business Model", which highlights the business model as being at the heart of integrated reporting.

Currently, there is wide variation in how organisations define their business models and approach to disclosure. This highlights the need for a clear, universally applicable, international definition of a business model. The proposed definition and discussion in the paper aim to bridge the varied interpretations by highlighting common areas and ensuring a consistent application across industries and sectors.

The background paper found that, in a financial climate that has seen investors demand greater transparency, reporting on business models is currently inconsistent, incomparable, and incomplete because of a lack of consistent guidance.

The paper is available on the IFAC website.

1.19 FSA finalises proposals for the regulation and supervision of benchmarks

On 25 March 2013, the UK Financial Services Authority (FSA) finalised new rules and regulations for financial benchmarks. This follows the recommendations of the Wheatley Review of the London Inter-Bank Offered Rate (LIBOR).

Benchmarks have historically been set by the financial markets themselves, and existed outside of any regulatory regime. In the case of LIBOR, this industry-led approach has failed. On 2 July 2012, the Chancellor of the Exchequer commissioned Martin Wheatley, CEO designate of the Financial Conduct Authority (FCA), to undertake a review of the structure and governance of LIBOR and the corresponding criminal sanctions regime.

On 28 September 2012 "The Wheatley Review of LIBOR" was published, which included a 10-point plan for comprehensive reform of LIBOR, including that LIBOR activities should be brought within the scope of statutory regulation. The UK Government subsequently inserted provisions into the *Financial Services Act 2012* to allow the regulation of activities in relation to benchmarks. The legislation commenced on 1 April 2013. Initially, the only specified benchmark will be LIBOR.

Following a consultation, the FSA has now finalized proposals for the regulation and supervision of specified benchmarks, such as LIBOR, implementing a key recommendation of the Wheatley Review.

The key proposals include:

- benchmark administrators will be required to corroborate submissions and monitor for any suspicious activity;
- those submitting data to benchmarks will be required to have in place a clear conflicts of interest policy and appropriate systems and controls; and
- two new significant influence controlled functions created under the FSA's Approved Persons Regime for the administrator and submitting firms.

Further information is available on the FSA website.

1.20 UK Trades Union Congress launches Trade Union Share Owners

On 25 March 2013, the UK Trades Union Congress (TUC) and its two largest affiliated unions, Unite and UNISON, announced the launch of Trade Union Share Owners, a new group which "aims to put union values at the heart of the world of corporate governance, with a new approach to the way in which their investments are voted on at company AGMs".

Henceforth, at any AGM of a FTSE350 company where either the TUC staff pension fund or those of its two biggest unions hold shares, the group will work with shareholder advisory group PIRC to ensure that their funds take a common voting position in accordance with a new set of policy guidelines drawn up by the TUC. The three organisations will start out with over £1bn of assets between.

The trade union voting and engagement guidelines contain a variety of policy positions including:

- moves to limit the growing gap in the pay of those at the very top and bottom of companies, with the aim of achieving a 20:1 pay ratio, and for pay increases to directors to mirror those being offered to ordinary employees;
- persuading all companies to become living wage employers on the basis that decent wages lower staff turnover and absence rates, and lead to a more motivated, productive workforce;
- encouraging companies which are keen to include worker representatives in their corporate governance structures;
- at least a quarter of the board positions to be held by women;
- all board vacancies to be advertised, rather than people simply being invited to join; and
- a limit to the number of board positions that directors can hold. Where individuals are

unable to devote enough time to their role, their re-election should be opposed.

Further information is available on the TUC website.

1.21 Basel Committee releases for consultation supervisory guidance on external audits of banks

On 21 March 2013, the Basel Committee on Banking Supervision (BCBS) released for consultation supervisory guidance on "External audits of banks", along with a letter to the International Auditing and Assurance Standards Board (IAASB).
The consultative paper aims to enhance and supersede the existing guidance that was published by the Basel Committee in 2002 on the relationship between banking supervisors and banks' external auditors, and in 2008 on external audit quality and banking supervision. The evolution of bank practices and the introduction of new standards and regulations over the last 10 years warranted a revision of the Committee's supervisory guidance. In addition, the recent financial crisis has highlighted the need to improve the quality of external audits of banks.

The proposed enhanced guidance sets out supervisory expectations of how:

- external auditors can discharge their responsibilities more effectively;
- audit committees can contribute to audit quality in their oversight of the external audit;
- an effective relationship between external auditors and supervisors can lead to regular communication of mutually useful information; and
- regular and effective dialogue between the banking supervisory authorities and relevant audit oversight bodies can enhance the quality of bank audits.

The Committee's letter to the IAASB calls for enhancing the International Standards on Auditing (ISAs) to include more authoritative guidance relating to the audit of banks. It sets out specific areas where the Committee believes the ISAs should be improved.

1.22 IOSCO consults on regulatory issues raised by changes in market structure

On 21 March 2013, the International Organization of Securities Commissions (IOSCO) released a Consultation Report on "Regulatory Issues Raised by Changes in Market Structure", which identifies possible outstanding issues and risks posed by existing or developing market structures. It also provides recommendations to address these potential risks.

In the report, IOSCO seeks to gather evidence and views for developing recommendations that promote market liquidity and efficiency, price transparency, and investors' execution quality in a fragmented environment. The report proposes possible policy options and regulatory tools to cope with the potential drawbacks arising from market fragmentation.

The report concludes that securities regulators bear the responsibility for striking an appropriate balance between a market structure that promotes competition among markets, and one that minimizes the potentially adverse effects of fragmentation on market integrity and efficiency, price formation, and best execution of investor orders.

The report makes recommendations to monitor the impact of fragmentation on the following areas:

- market integrity and efficiency;
- trade information;
- on order handling rules and best execution;

- on access to liquidity; and
- market efficiency and resilience.

The consultation report is available on the IOSCO website.

1.23 Government introduces legislation on retail corporate bonds

On 20 March 2013, the Australian Government introduced legislation into Parliament to further encourage the development of Australia's retail corporate bond market.

The Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013 will amend the Corporations Act 2001 (Cth) to:

- introduce a two-part simple corporate bonds prospectus - the new prospectus reduces the current compliance costs associated with the offer of simple corporate bonds to retail investors both in the first issuance and in subsequent tranches;
- modify the current director's liability that is attached to the offer of simple corporate bonds and to clarify the defenses provided in respect to director's liability that apply to all offers of securities; and
- allow for simple corporate bonds to be transferred from the wholesale to the retail market, in line with the approach adopted for retail trading in Commonwealth government securities, through the introduction of simple corporate bond depository interests.

The Bill is available on the ComLaw website.

2. Recent ASIC Developments

2.1 Release of policy on cooperation and third enforcement report

On 9 April 2013, ASIC released its approach on dealing with people who cooperate with its investigations.

Key points:

- it is ASIC policy to encourage and fully recognize cooperation;
- ASIC's guide increases the public's understanding of how ASIC works; and
- latest enforcement figures show half involved cooperation.

INFO 172 follows releases on ASIC's information gathering powers, public comment and enforceable undertakings, surveillance work, and claims of legal professional privilege.

Cooperating with ASIC may benefit a person or company in many ways. For example, cooperation will be relevant to ASIC's decision on the type of enforcement action to pursue or remedy to seek and ASIC will give due credit for cooperation in proceedings that ASIC commences.

ASIC enforcement report - July to December 2012

ASIC released the third of its six-monthly enforcement reports, detailing enforcement outcomes achieved in the period 1 July 2012 to 31 December 2012.

The report summarises ASIC's actions against a range of gatekeepers in the Australian financial system, such as financial advisers, auditors and directors. ASIC focuses on four key attributes of gatekeepers: competence, diligence, honesty and independence.

During the period, 44 of the 88 enforcement outcomes achieved in the market integrity, corporate governance and financial services areas involved cooperation between the person concerned and ASIC.

Examples of cooperation include early guilty pleas, negotiated outcomes and enforceable undertakings.

Further information is available on the ASIC website.

2.2 Release of information sheets on Stronger Super provisions

On 5 April 2013, ASIC released four information sheets covering aspects of the Stronger Super reforms, including providing intra-fund advice and disclosure requirements associated with the reforms.

Information Sheet 168 "Giving and collectively charging for intra-fund advice" explains:

- what intra-fund advice is;
- the restrictions on collectively charging for advice;
- MySuper and conflicted remuneration;
- how the Future of Financial Advice (FOFA) reforms and other advice laws apply to intra-fund; and
- what records must be kept.

Information Sheet 167 "Disclosure requirements for superannuation trustee: s29QC" (INFO 167) covers the new s. 29QC of the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act). That is, a super trustee must use the same calculation when providing information to a person or on a website as it does when giving the same or equivalent information to the Australian Prudential Regulation Authority under a reporting standard.

Information Sheet 169 "Notifying members about superannuation transfers: Accrued default amounts (MySuper transition)" (INFO 169) addresses requirements under s. 29SAA(3) of the SIS Act and regulations where a super trustee must provide a notice to a fund member with an "accrued default amount" regarding an intended transfer or attribution to a MySuper product in the same fund, or to another fund within specific timeframes.

Information Sheet 90 "Notifying members about superannuation transfers without consent" (INFO 90), which explains the requirements for disclosure to members where there is a "significant event" or "material change" regarding their super fund, has also been updated. However, this does not reflect a substantive shift in policy by ASIC.

This information sheet has been updated in part to reflect the Stronger Super changes but also to recognise the fact that the Stronger Super reforms may result in an increase in successor fund transfers more generally and updating this guidance is timely.

Further information is available on the ASIC website.

2.3 Consultation on trade reporting obligations for OTC derivatives

On 28 March 2013, ASIC released draft rules addressing the mandatory trade reporting obligations for over-the-counter (OTC) derivatives such as interest rate swaps.

The proposals are the next step in Australia meeting its G20 commitments to OTC derivatives reform, and follows ASIC consulting on proposals for the licensing and regulation of derivative trade repositories.

Consultation Paper 205 "Derivative transaction reporting" (CP 205) proposes rules governing the reporting of OTC derivative transactions to derivative trade repositories. CP 205 covers issues such as which institutions will need to report to trade repositories, what information will need to be reported, and when the reporting obligation will start for different classes of reporting entities.

The rules aim to comply with internationally-agreed standards on transaction reporting developed by the International Organization of Securities Commissions (IOSCO) and the Committee on Payment and Settlement Systems (CPSS).

Under ASIC's proposals:

- major financial institutions (being those with at least $50 billion of notional outstanding positions in OTC derivatives on 30 September 2013) would be subject to a reporting obligation in some asset classes from 31 December 2013; and
- other smaller financial institutions would be subject to a reporting obligation in some asset classes from 30 June 2014.

CP 205 also proposes a reporting obligation on entities that do not hold an Australian financial services (AFS) licence using OTC derivatives from the end of 2014, but further public consultation and an ASIC rule change will be needed before this obligation could take effect, as set out in the draft rules.

The consultation paper is available on the ASIC website.

2.4 Regulatory framework finalised for retail trading of Commonwealth Government Securities

On 27 March 2013, ASIC announced that it had amended existing market integrity rules and related guidance to help with the introduction of retail trading of Commonwealth Government Securities (CGS) depository interests on the Australian Securities Exchange (ASX).

The rules are one element of the regulatory framework for the retail trading of CGS depository interests on public exchanges. The Australian Government has previously announced that it is encouraging retail investors to trade CGS.

ASIC has updated Regulatory Guide 223 "Guidance on ASIC market integrity rules for competition in exchange markets" (RG 223) to reflect these changes. RG 223 provides guidance on how market operators and market participants can comply with their obligations under the competition market integrity rules.

The package of document released by ASIC consists of:

- amending instrument - ASX market integrity rules;
- amending instrument - Competition market integrity rules;
- amended competition market integrity rules regulatory guide (RG 223); and
- Report 332 "Response to submissions on CP 181 Retail trading in Commonwealth Government Securities" (REP 332).

2.5 Release of guidance for operating and financial reviews

On 27 March 2013, ASIC released a regulatory guide to improve disclosure in annual reports of listed entities.

The operating and financial review (OFR) forms part of a listed entity's annual report and contains information investors would reasonably require to make an informed assessment of the entity's operations, financial position, business strategies and future prospects. It is a key part of annual disclosure by a listed entity.

ASIC believes OFRs can be improved and has released Regulatory Guide 247 "Effective disclosure in an operating and financial review" (RG 247) with the purpose of lifting the standard of disclosure.

The guide aims to:

- promote better communication of useful and meaningful information to shareholders; and
- assist directors in understanding the OFR requirements.

ASIC's proposed guidance is not intended to add unnecessary length to annual reports, but rather is intended to promote more meaningful information and analysis for investors.

RG 247 also includes guidance on:

- appropriate standards of disclosure through the inclusion of worked examples;
- the use of the "unreasonable prejudice" exemption from disclosing specific business strategies and prospects; and
- presentation of the analysis and narrative relating to operations and financial position.

The regulatory guide is available on the ASIC website.

2.6 Consultation on risk management for responsible entities

On 21 March 2013, ASIC released a consultation paper and proposed regulatory guidance on risk management practices for responsible entities in the managed funds sector.

Consultation Paper 204 "Risk management systems of responsible entities" (CP 204) and the proposed guidance are based on many current practices of responsible entities, including:

- ensuring risk management systems comprise processes to identify, assess and treat risks;
- ensuring these processes are suitable for individual business objectives and operations;
- ensuring that risk management systems address all material risks, including strategic, governance, operational, investment and liquidity risks; and
- reviewing risk management systems regularly, and no less than annually, for appropriateness, effectiveness and relevance to individual businesses.

The consultation paper is available on the ASIC website.

3. Recent ASX Developments

3.1 Draft Code of Practice

On 10 April 2013, ASX released its draft Code of Practice for Clearing and Settlement of Cash Equities in Australia for industry consultation.

ASX is developing the Code following an announcement by the Deputy Prime Minister and Treasurer on 11 February 2013, to defer a decision on any licence application from a central counterparty seeking to compete in the Australian cash equity market, thereby retaining the current market structure for the clearing and settlement of cash equities for the next two years.

The draft Code sets out ASX's commitment to:

- establish an ongoing advisory forum that allows users and stakeholders to provide input to the Boards of ASX Clear and ASX Settlement;
- transparent and non-discriminatory pricing of clearing and settlement services; and
- transparent and non-discriminatory terms of access to clearing and settlement services.

The Code will be supported by a dedicated section on ASX's website that will provide detailed information on ASX's clearing and settlement services and performance. The website will also contain information on the topics discussed at the industry stakeholder forum (the Forum). The full website will be developed by the end of August 2013, and an outline of the site is provided as part of the consultation process.

The Forum will consist of representatives from ASX customers and a broad range of other stakeholder groups. It is proposed that Forum members will be appointed for an initial two-year period.

The consultation paper and the draft Code are available on ASXGroup.com.au.

More information on the Code is available at http://www.asx.com.au/cs/index.htm, a new section of the ASX web site dedicated to the Clearing and Settlement of Cash Equities in Australia.

3.2 Reports

On 5 April 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 March 2013.

4. Recent Takeovers Panel Developments

4.1 World Oil Resources Limited

On 4 April 2013 and 12 April 2013, the Takeovers Panel announced that it had made a declaration of unacceptable circumstances and final orders in relation to an application dated 14 March 2013 by Holdrey Ptd Ltd, as trustee for the Don Mathieson Family Trust, in relation to the affairs of World Oil Resources Limited.

(a) Background

On 25 February 2013, Holdrey announced its intention to make an off-market takeover bid for all the issued shares of World Oil at 1.3 cents per share.

The Holdrey bid is subject to conditions including that:

none of the following events happen in the period commencing on the Announcement Date and ending at the end of the Offer Period: . (d) WLR or a subsidiary of WLR issuing any shares or granting an option over its shares or agreeing to make such an issue or grant such an option.

On 12 March 2013, World Oil announced a 1-for-2 non-renounceable rights issue at 1.3 cents per share to raise approximately $2.5 million.

The announcement of the rights issue did not include adequate disclosure and triggered a condition of the Holdrey bid and constitutes a frustrating action.

The application also raised allegations of association between various shareholders of World Oil.

(b) Declarations and orders

On 4 April 2013, the Panel announced that it considered the circumstances were unacceptable because the rights issue was not subject to shareholder approval or any mechanism that minimised the potential for the rights issue to frustrate the Holdrey bid. There was also inadequate disclosure of the effects or relative merits of the rights issue.

The Panel made orders that if World Oil proceeds with the rights issue announced on 12 March 2013, or announces another rights issue, such issue must be subject to shareholder approval.

On 12 April 2013, the Panel made a further declaration of unacceptable circumstances in relation to the association between various World Oil shareholders.

Holdrey applied to the Panel for a declaration of unacceptable circumstances and made submissions, including that various shareholders of World Oil - Rokeba Nominees Pty Ltd (13.97%), Templefield Pty Ltd (3.59%), Bisan Limited (2.56%), Elken Tower Pty Ltd (3.85%), Ariel Nominees Pty Ltd (2.56%) and New Hopetoun Pty Ltd (2.56%) - may be associates and may have acquired shares in breach of s. 606 of the Corporations Act 2001 (Cth) (the Act).

The Panel considers that:

- Maurice Silman and Ariel Silman;
- Maurice Silman and Ezra Silman; and
- Maurice Silman and Bisan

are associated:

- under s. 12(2)(b) for the purpose of controlling or influencing the composition of World Oil's board or the conduct of World Oil's affairs; and
- under s. 12(2)(c) in relation to the affairs of World Oil.

Accordingly, Maurice Silman, Rokeba and Templefield have voting power of 29.10% in World Oil shares and acquired this power otherwise than as permitted under Chapter 6 of the Act.

The Panel made orders, the effect of which includes:

- shares in World Oil acquired by Rokeba Nominees Pty Ltd, Templefield Pty Ltd and Bisan Limited that represent in excess of 20% of the total voting power in World Oil (Sale Shares) are to be vested for sale by ASIC;
- until the Sale Shares are sold, the ability of Rokeba, Templefield and Bisan to vote additional shares in which they have voting power is scaled back. This is so that the associated parties' voting power does not exceed 20% of the total votes that may be cast after the application of these orders;
- limitations on the associated parties relying on the "creep" exception;
- for the purposes of calculating entitlements to subscribe for new shares under the rights issue announced by World Oil on 12 March 2013, the Sale Shares and the shares excluded from voting must be disregarded; and
- the associated parties must give notice of their substantial holding in World Oil within 2 business days of the date of the orders.

5. Recent Research Papers

5.1 The importance of cost-benefit analysis in financial regulation

This paper reviews the role, history, and application of cost-benefit analysis in rulemaking by US financial services regulators. The authors recommend that all financial services regulators should apply rigorous cost-benefit analysis to improve rulemaking and put in place more effective regulations. These steps also promote good government and improve democratic accountability.

There is widespread agreement that ineffective and outdated financial regulation contributed to the financial crisis. As regulators seek to address that, they must take every reasonable step to ensure that their proposals work. This starts with grounding all proposals in an economic analysis to better achieve the desired benefits and better understand the possible consequences and costs that may result from their actions.

The paper is available on the SSRN website.

5.2 The European single supervisory mechanism

The European Banking Union needs a single supervisor. Therefore, the establishment of the Single Supervisory Mechanism (SSM) is the first fundamental step in centralising powers over the banking sector within the Euro Area. This article examines the significant legal issues raised by the creation of the SSM as reflected in the legislative proposals put forward by the European Commission and the Council, in the light of policy considerations and political pressures. In particular, the article analyses the role of the ECB as prudential supervisor, including its scope and powers, its interaction with national supervisory authorities, governance arrangements, independence and accountability.

The article also considers the implications for the non-Euro Area Member States which opt into the SSM, the Member States which choose not to participate (in particular the UK), the European Banking Authority and the European Systemic Risk Board. The article concludes by attempting a first evaluation of the emerging SSM, taking into account that many details remain to be refined. The short term challenge for the SSM will be to build up its institutional capacity. In the longer term, the SSM's performance could be affected by its own institutional design (forged under legal constraints and political compromise) and by the arduous process of completing the single regulatory rulebook for the European Union.

The paper is available on the SSRN website.

5.3 Industry expertise of independent directors and board monitoring

Does industry experience affect the monitoring effectiveness of independent directors? On the one hand, prior industry experience provides independent directors industry-specific knowledge and expertise critical for understanding and evaluating managerial decision making, thereby enhancing their monitoring capability. On the other hand, independent directors with prior experience in the firm's industry may be socially connected with or sympathetic to the firm's management, thus impairing their monitoring incentives. The authors test these competing hypotheses in a variety of firm polices and decision making.

Specifically, they find that the presence of independent directors with industry experience on a firm's audit committee significantly curtails firms' earnings management via abnormal accruals and reduces both ex ante and ex post probabilities of firms committing financial fraud. In addition, a greater representation of independent directors with industry expertise on a firm's compensation committee reduces CEO excess compensation and a greater presence of such directors on the full board increases the CEO turnover-performance sensitivity and improves acquirer returns from diversifying acquisitions. Overall, the evidence is the consistent with the hypothesis that having relevant industry expertise enhances independent directors' ability to perform their monitoring function. As such, the study sheds new light on the determinants of board effectiveness and provides important policy implications for the design of corporate boards.

The paper is available on the SSRN website.

5.4 Hedge fund governance

This article provides the first comprehensive scholarly analysis of the internal governance of hedge funds. Hedge fund governance consists of the funds' underlying legal regime and the practices they adopt in response to lacking permanent capital and to reduce agency costs. Hedge fund governance is important because better governance can improve investor returns and help managers raise and retain capital. The author argues that hedge fund governance is best understood as a type of responsive managerialism. It is a type of managerialism because applicable law and contracting structures give managers uniquely wide-ranging control over the fund and its operations. Hedge fund governance is also uniquely responsive, however, because managers must continually satisfy investors due to their ability to shut down a fund by withdrawing their capital.

In addition to their underlying legal regime, the primary components of hedge fund governance are investors with a strong propensity to exercise their short-term redemption rights, managers with high pay-performance sensitivity, investor demand for quality governance, and close monitoring by short-term creditors and derivatives counterparties. Overall, the author finds that hedge fund managers are not systematically ripping off investors because hedge fund governance devices keep agency costs relatively low.

Nonetheless, there is still plenty of room for hedge fund governance to improve. Accordingly, the article provides a normative framework and principles for improving hedge fund governance by striking a better balance between governance devices that are investor-friendly and those that empower managers. The author's analysis suggests that the areas in which hedge fund governance needs the most improvement are performance reporting (valuation) and the timing of performance-fee calculations. Importantly, the analysis also suggests that investors are often better off with less transparency, higher fees, and less access to their capital.

The paper is available on the SSRN website.

5.5 Moore's Law vs Murphy's Law: Algorithmic trading and its discontents

Financial markets have undergone a remarkable transformation over the past two decades due to advances in technology. These advances include faster and cheaper computers, greater connectivity among market participants, and perhaps most important of all, more sophisticated trading algorithms. The benefits of such financial technology are evident: lower transactions costs, faster executions, and greater volume of trades. However, like any technology, trading technology has unintended consequences. In this paper, the authors review key innovations in trading technology starting with portfolio optimization in the 1950s and ending with high-frequency trading in the late 2000s, as well as opportunities, challenges, and economic incentives that accompanied these developments. They also discuss potential threats to financial stability created or facilitated by algorithmic trading and propose "Financial Regulation 2.0," a set of design principles for bringing the current financial regulatory framework into the Digital Age.

The paper is available on the SSRN website.

6. Recent Corporate Law Decisions

6.1 Classification as a de facto or shadow director - disqualification orders made

(By Sophie McNaught and Kate Johnson, King & Wood Mallesons)

Secretary of State for Business Innovation and Skills v Chohan [2013] EWHC 680 (Ch), England and Wales High Court (Chancery Division), 26 March 2013

The full text of this judgment is available at:

http://www.bailii.org/ew/cases/EWHC/Ch/2013/680.html

(a) Summary

This case considers disqualification orders under s. 6 of the *Company Director Disqualification Act 1986* (UK) (the Act) against a de facto or shadow director for conduct when operating an insolvent company.

The Act requires the plaintiff (in this case, the UK Secretary of State for Business Innovation and Skills) to prove that the defendant, Mr Chohan, was:

- a director;
- of a company which became insolvent; and
- his conduct as a director (either taken alone or together with his conduct as a director of any other company or companies) makes him unfit to be concerned in the management of a company.

Elements one and three were in issue in this case.

Justice Hildyard compared the characteristics of de facto and shadow directorships, ultimately concluding that the two are not mutually exclusive. The court was satisfied that Mr Chohan was a director for the purpose of the Act and did not need to decide which classification would be more appropriate.

On the issue of unfitness to hold office, the Court considered:

- Mr Chohan's breaches of regulations; and
- that Mr Chohan procured payments for his own benefit out of the company, UKLI Limited (UKLI), from funds improperly raised from investors.

Although the investment scheme run by UKLI (which the Court found to be unlawful) was devised by experienced lawyers, that fact did not relieve Mr Chohan of responsibility. The scheme could have been lawful in theory, but its implementation caused it to be unlawful in fact. Accordingly, the Court disqualified Mr Chohan for a period of 12 years.

(b) Facts

On 21 November 2008, UKLI, a land bank business, went into liquidation with a deficiency in excess of £70 million. The Secretary of State brought proceedings against six directors seeking their disqualification. Before the trial date, all but one of the defendants agreed to give disqualification undertakings. Therefore, the trial only proceeded against Mr Chohan.

UKLI's business model involved selling large land sites in smaller parcels to the public with a view to obtaining planning permission over the smaller parcels and increasing the value of the land. In 2006, the Financial Services Authority investigated UKLI's scheme and determined that it was an unlawful collective investment scheme in contravention of the financial services legislation.

Mr Chohan was not a de jure director at the relevant times, but the plaintiff alleged that Mr Chohan was a de facto or shadow director of UKLI. Mr Chohan disputed that he was, or acted as, a director in the relevant periods. He submitted that he had previously resigned as a director (upon facing disqualification proceedings for his involvement in another company) and took no role in the management of the company.

(b) Decision

(i) De facto vs shadow directors

Justice Hildyard outlined ten indicia of a de facto directorship, holding that not all indicia need to be established to prove that a person is a de facto director.

Earlier authorities held that to be a de facto director, the person in question must have undertaken functions that could properly only be discharged by a director. The Court rejected that view in this case, instead treating it as a useful indicator.

Similarly, while previous authorities had considered that the categories of de facto and shadow directors were mutually exclusive (one acting openly with apparent authority and the other "lurking in the shadows"), Justice Hildyard held that a person may act as both and the same sort of evidential indicia are likely to be relevant.

Classification as a de factor or shadow director is ultimately a question of fact. Justice Hildyard held that Mr Chohan had a combination of direct and indirect influence over the financial and operating decisions during the relevant period, and the Court found that such influence was largely unaffected by his formal resignation as a de jure director.

Further, Mr Chohan was "plainly in a fiduciary position", whether he was classified as a shadow director, a de facto director or both.

(ii) Land banking scheme

The Court determined that the scheme operated by UKLI, in the manner in which it was promoted and operated, was a collective investment scheme which was prohibited pursuant to the financial services legislation. It was relevant for the Court to consider the role Mr Chohan played in relation to the prohibited activities.

While the construction of the scheme was "largely left to the lawyers", in regard to Mr Chohan's culpability, the Court held that he:

- was well aware of the collectivized nature of what was offered and the FSA's concerns;
- sanctioned and encouraged UKLI and those to whom he entrusted day to day management to proceed nonetheless and notwithstanding the risks; and
- acted in that regard as if he were the company's managing or predominant director.

(iii) Loans and dividend allegations

The Court found that Mr Chohan improperly advanced over £12 million of unsecured loans to entities which he either owned or controlled and paid dividends of approximately £1,336,433 which made it impossible for UKLI to pay its debts when they fell due.

Justice Hildyard expressed some caution about relying upon untested evidence used to support the claims, but nevertheless held no reservations in finding that even if some of the transactions were valid commercial decisions, Mr Chohan did not act in the best interests of UKLI.

(iv) Unfit to be concerned in the management of the company

Schedule 1 of the Act sets out the relevant considerations to determine whether a director is "unfit", but it is not an exhaustive list. Unfitness is a factual question requiring a "value judgment".

Justice Hildyard stressed that although the public interest in a finding of unfitness is to prevent managers from hiding behind the veil of limited liability, it would be improper for the court to make a determination based upon whether the defendant is likely to behave wrongly in the future. It is a penalty for past misconduct and the Court must consider the defendant's personal responsibility. Also, considering that the long established purpose of limited liability is to encourage economic growth through appropriate risk taking, the Court will not punish ordinary commercial misjudgment.

The Court held that, having regard to both the land banking scheme and the loans and dividend allegations, Mr Chohan had sufficiently departed from the standards expected of him to make him unfit to be concerned in the management of the company.

Accordingly, the Court disqualified Mr Chohan for a period of 12 years, having regard to, among other things, the seriousness of Mr Chohan's conduct, the fact that Mr Chohan was subject to a previous disqualification order and the very substantial amounts of money invested in UKLI and lost by investors.

6.2 When are profits available for dividends - mandatory rights of distribution

(By Hael Musa and Kate Johnson, King &Wood Mallesons)

Sumiseki Materials Co Ltd v Wambo Coal Pty [2013] NSWSC 235, Supreme Court of New South Wales, Hammerschlag J, 25 March 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/235.html

(a) Summary

This case considers the interpretation of an article in Wambo Coal Pty Ltd's (Wambo) constitution (Constitution) governing the payment of dividends to Sumiseki Materials Co Ltd (Sumiseki) as owners of class B shares in Wambo.

In particular, the Supreme Court considered the terms of article 2.1B of the Constitution, which provided for Sumiseki to receive a payment of a percentage of the "profit of [Wambo] available for dividend purposes" in a given year based on the accounts of Wambo.

Sumiseki argued that under article 2.1B of the Constitution profits were available for the purpose of dividends if the profits in the accounts were capable of being lawfully distributed to shareholders. Wambo submitted that profits were only available for dividends after the directors have first determined whether any part of the profits in the accounts should be used for other purposes.

The Court agreed with Sumiseki's approach on the facts. It held that the terms of the Constitution indicated that the parties intended for Sumiseki to be entitled to a fixed and mandatory dividend that could not be fettered by the discretion of the directors of Wambo. Accordingly, the Court issued a monetary verdict in respect of unpaid dividends owing on the B class shares.

(b) Facts

In late 2000, Sumiseki entered into a series of agreements with Wambo in relation to a management buy-out of Wambo stock. Sumiseki subscribed for debenture stock in Wambo, which was cancelled and substituted for debenture stock issued by Hunter Coal Pty Ltd (Hunter) to Sumiseki. Under these arrangements, Hunter owed Sumiseki $50 million on the debenture stock.

Hunter and umiseki also entered into a Profit Interest Agreement whereby Sumiseki could forgive up to 50% of the $50 million payable under the debenture stock in exchange for a Profit Interest for each $1 million forgiven. "Profit Interest" was defined as "the right to receive from Hunter an amount equal to the profit of Wambo available for dividend purposes in a year ended 30 June".

In about May 2001, a Restructure Agreement was entered into under which a portion of the debt owed to Sumiseki was cancelled for the issue of new class B shares for $25 million. The B Class shares carried a right to receive dividends equal to 25% of Wambo's profit after tax. Amendments were made to the Constitution to permit the issue of class B shares to Sumiseki. In particular, a new article 2.1B was inserted into the Constitution recognising the rights of class B shareholders. As a result of this arrangement, Hunter held all the ordinary shares in Wambo and Sumiseki held all of the B class shares.

In 2006, there was a complex restructure that resulted in Peabody Australia Mining Limited (PAML) acquiring a 100% shareholding in Hunter with the downstream impact resulting in PAML holding all the ordinary shares in Wambo. Until the introduction of PAML, Sumiseki had been treated as being entitled to be paid a fixed and mandatory dividend once profits were legally available for distribution. However, from September 2008 Wambo and PAML formed the view that payment of dividends on the B class shares was a matter entirely within the discretion of Wambo directors. They had relied on external legal and accounting advice as support for this view.

On 27 March 2010, ambo entered into a new loan agreement with PAML to carry out capital works (Loan Agreement). Under the terms of the Loan Agreement, Wambo was prevented from distributing any dividends if certain ratios under the Loan Agreement were not met. For the period of 2009 to 2011, on four occasions, Wambo did not distribute any dividends on the class B shares to Sumiseki. Its justification given for this was that it did not satisfy the debt covenants in the Loan Agreement.

Sumiseki, among other things, sought from the Supreme Court:

- a declaration that article 2.1B of the Constitution entitled it to a fixed and mandatory dividend, once profits were legally available for distribution;
- a declaration that article 2.1B of the Constitution does not permit Wambo directors to exercise discretion in relation to the payment of class B dividends;
- a monetary order in respect of unpaid dividends; and
- an order under s. 233(1)(b) of the Corporations Act 2001 (Cth) (the Act) that article 2.1B of the Constitution be amended to reflect that directors cannot exercise discretion in relation to the issuing of class B dividends.

(c) Decision

(i) Construing the terms of article 2.1B of the Constitution

This issue was whether article 2.1B could be construed as permitting directors to exercise discretion in relation to the payment of dividends or whether it entitled shareholders to a dividend once the profits were legally capable of being distributed. Hammerschlag J held that this was to be determined by an objective assessment of the terms of the Constitution.

Hammerschlag J held that article 2.1B of the Constitution was mandatory and did not give directors a discretion in relation to the payment of dividends on B class shares. He noted that the opening words of article 2.1B "[d]espite any provision in this constitution to the contrary" was intended to expressly exclude the other provisions in the constitution which granted directors discretion in relation to the payment of the dividends. Wambo and PAML argued that the use of the language in articles 2.1B (d) and (e) (profits of the company available for dividend purposes) impliedly conferred discretion on the directors to use profits for other purposes. However, the Court held that this submission was unsustainable as this interpretation contradicted the express opening words of article 2.1B.

Furthermore, Hammerschlag J compared the rights of class B shareholders with ordinary shareholders. He held that under article 2.1A, ordinary shareholders were entitled to receive dividends "as determined form time to time" but the wording of article 2.1B contained no such language. Hammerschlag J also noted that article 2.1B contained a formula for determining objectively the dividends payable to class B shareholders, and interpreting the clause to give directors a discretion to devote some of the profit determined by that formula to other purposes would render the formula useless.

Hammerschlag J granted a declaration to the effect that article 2.1B entitled Sumiseki to a fixed and mandatory dividend and that this payment was not a matter within the discretion of Wambo directors. He also issued a monetary order with respect to the unpaid dividends.

(ii) Order amending the Constitution under section 233(1)(b) of the Act

Sumiseki argued that both Wambo's failure to pay dividends and its decision to enter into the Loan Agreement amounted to oppressive conduct to Sumiseki within the meaning of ss. 232(a) and (e) of the Act. Sumiseki sought an order under s. 233(1)(b) of the Act that the Constitution be amended to reflect that the right to dividends on B class shares was mandatory.

Wambo and PAML argued that the conduct was not oppressive as Wambo had a commercial justification for not paying the dividends and entering into the Loan Agreement. In relation to the payments of dividends, it argued that the payments were not possible considering its financial needs and the constraints in its Loan Agreement. Wambo's justification in entering into the Loan Agreement was that it would not have been able to raise the funds in the external funding market on the same terms that it had with PAML. However, Hammerschlag J held that the evidence established that the primary goal of PAML and Wambo was to thwart the payment of dividends to Wambo, which was contrary to the legitimate expectations of Sumiseki. The means they used to achieve this was by Wambo committing itself to a loan which incorporated burdensome covenants that were not in its interests. Hammerschlag J held that the conduct "smacks of commercial unfairness".

As a result, the Court permitted an amendment of the Constitution under s. 233(1)(b) of the Act. The Court also held that an amendment was necessary to ensure that third parties relying on the Constitution were not misled as to the operation of article 2.1B. Therefore, the Constitution was modified with effect as from 29 June 2001 to clarify that the right to receive dividends on the B class shares was mandatory and not subject to any discretion of the directors as to whether to distribute available profits.

6.3 When will an assignment of a chose in action be absolute?

(By Charmaine Panickar, Minter Ellison)

Austino Wentworthville Pty Limited v Metro Australia Limited [2013] NSWCA 59, New South Wales Court of Appeal, Beazley P, Meagher JA and Barrett JA, 22 March 2013

The full text of this judgment is available at:
http://www.austlii.edu.au/au/cases/nsw/NSWCA/2013/59.html

(a) Summary

This case demonstrates the analysis that a Court may undertake in determining whether an assignment of rights by an assignee is an absolute assignment, and not simply an assignment by way of charge only. A finding of an absolute assignment can be significant, as in this instance, where a company was held to be disentitled from being admitted as a creditor in winding up proceedings as it was found to have assigned the whole of its rights and interests to a third party.

(b) Facts

On 31 August 2012, the first respondent, Metroland Australia Limited (Metroland), became subject to voluntary administration under Part 5.3A of the Corporations Act 2001 (Cth) (the Corporations Act). The second respondent, Mr David Levi, was appointed as administrator of Metroland.

At a meeting of creditors of Metroland held on 5 October 2012, Mr Levi admitted the appellant, Austino Wentworthville Pty Limited (Austino), as a creditor of Metroland in the sum of $353,312.18 and Austino voted against a resolution for the adoption of a deed of company arrangement. Austino maintained that for voting purposes, it should have been regarded as a creditor in the sum of $2,826,496 instead of $353,312.18 and had this been so, the resolution would have been opposed by a majority by value of the creditors who voted and the outcome would have depended on the exercise of a casting vote by Mr Levi.

On 19 October 2012, Austino sought relief against Metroland and Mr Levi, including an order pursuant to s. 1321 of the Corporations Act that Mr Levi's decision to admit Austino's proof of debt be modified so that Austino was recognised as a creditor in the sum of $2,826,496.

The primary judge, Brereton J, found that because of a deed of assignment made in April 2011 between Austino (assignor) and Bank of China (BOC) (assignee), Austino was not a creditor of Metroland at all, by virtue of an effective assignment having occurred under s. 12 of the Conveyancing Act 1919 (NSW) (the Conveyancing Act). Austino appealed that decision to the Court of Appeal.

(c) Decision

The Court of Appeal unanimously dismissed the appeal (Beazley P and Meagher JA agreeing with

Barrett JA's reasons), finding that Austino was not a creditor of Metroland because its chose of action had been assigned to BOC by way of the deed of assignment.

For an assignment of a debt or legal chose in action to be absolute or "effectual in law" under s. 12 of the Conveyancing Act, the following elements must be made out:

- there must be a written instrument;
- it must be executed by the assignor; and
- express notice of the assignment must be given to the debtor.

The Court considered English cases dealing with the equivalent statutory provision and drew the following relevant principles:

- an "absolute" assignment is one that is unconditional and does not attempt to affect part only of the chose in action;
- the fact that an assignment otherwise absolute is accompanied by an express proviso for redemption, an implied right of redemption or the creation of a trust in respect of future proceeds does not deprive it of its absolute character;
- an assignment by way of charge has the effect of giving a right of payment out of the subject matter assigned without outright transfer of that subject matter - e.g. a transfer of a right to be paid out of a particular fund or of so much of a debt as is sufficient to satisfy a future indebtedness; and
- the character of the assignment must be ascertained from the terms and effect of the instrument, according to the construction of it as a whole.

The Court then approached the dispute as a question of construction of the relevant deed of assignment. It was common ground that if the deed of assignment produced a legal assignment by Austino to BOC of the chose in action owed by Metroland to Austino, the appeal must be dismissed.

The Court made the following findings:

- there is no difference in meaning between the words "I assign" and "I assign absolutely"; whether an assignment is absolute in nature is a matter of construction of the instrument as a whole. In the absence of any words indicating the assignment was conditional, this pointed to an intention that the assignment should be absolute;
- use of the words "the Assignee is forthwith subrogated to all rights of the Assignor" and "the Assignor, as beneficial owner, assigns to the Assignee", in the circumstances, did not convey something less than full ownership of the rights, nor did it detract from the quality of the assignment as an absolute one; and
- the deed of assignment was executed and delivered, which meant that written notice of the absolute assignment had been given to Metroland by virtue of a "Notice to Debtors" addressed to Metroland that was contained in a schedule to the deed of assignment.

In light of these findings, the Court held that all the elements of an absolute assignment pursuant to s. 12 of the Conveyancing Act had been satisfied.

6.4 Transactions voidable as "unreasonable director-related transactions"

(By Lucinda Carter, DLA Piper Australia)

Andrew Fielding as Liquidator of Lyngray Developments Pty Ltd v Dushas [2013] QCA 55, Supreme Court of Queensland Court of Appeal, McMurdo P, White JA and Daubney J, 22 March 2013

The full text of this judgment is available at:

http://www.sclqld.org.au/qjudgment/2013/QCA/055

(a) Summary

The Court considered a series of payments made by a director to her daughter's (the respondent) mortgage account as rent for premises. The Court found that a reasonable person in the Company's circumstances would not have entered into any of the transactions. The transactions were therefore voidable and the respondent was ordered to pay to the Company 75% of the impugned payments, representing the amount paid in excess of the actual value to the Company resulting from the payments.

(b) Facts

The applicant is the liquidator of Lyngray Developments Pty Ltd (in liq) (the Company). The Company was ordered to be wound up on 25 January 2007. Ms Lynette Gray was the sole director of the Company. The respondent, Sasha Dushas, is Ms Gray's daughter. The respondent owned a property which was mortgaged to ANZ Bank. Between June 2002 and September 2005, the Company made 29 payments totalling $81,260.30 to the respondent's mortgage account.

The applicant brought proceedings contending that 22 of those payments were voidable as "unreasonable director-related transactions", totalling $59,758.

At first instance, the primary judge dismissed the application of the liquidator, holding that the impugned transactions were not unreasonable director-related transactions. The liquidator applied for leave to appeal the decision of the primary judge.

(c) Decision

The application for leave to appeal was granted. The Court set aside the order of the lower court and declared that each of the 22 payments totalling $59,758 made by the Company to the respondent were voidable under s. 588FE(6A) of the Corporations Act 2001 (Cth) (Corporations Act). The respondent was ordered to repay $44,818.50 to the Company pursuant to s. 588FF.

The Court considered two main questions:

- whether the impugned transactions were unreasonable director-related transactions; and
- whether, in exercising its discretion under s. 588FF, it should order the respondent to make a payment to the company equal to some or all of the money that the company paid under the impugned transactions.

(i) Whether the impugned transactions were unreasonable director-related transactions

The statutory tests for determining whether a transaction was an "unreasonable director-related transaction" are set out in s. 588FDA of the Corporations Act:

(1) A transaction of a company is an unreasonable director-related transaction of the company if, and only if:

(a) the transaction is:

i. a payment made by the company; or
ii. a conveyance, transfer or other disposition by the company of property of the company; or
iii. the issue of securities by the company; or
iv. the incurring by the company of an obligation to make such a payment, disposition or issue; and

(b) the payment, disposition or issue is, or is to be, made to:

i. a director of the company; or
ii. a close associate of a director of the company; or
iii. a person on behalf of, or for the benefit of, a person mentioned in subparagraph (i) or (ii); and

(c) it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction, having regard to:

i. the benefits (if any) to the company of entering into the transaction; and
ii. the detriment to the company of entering into the transaction; and
iii. the respective benefits to other parties to the transaction of entering into it; and
iv. any other relevant matter.

The Court found that there was no issue in the present case that each of the impugned payments was a payment made by the Company and to a "close associate of a director" of the Company for the purposes of ss. 588FDA(1)(a) and (b).

Section 588FDA(1)(c) calls for an assessment of whether a reasonable person in the Company's circumstances would not have entered into the transaction, and requires that assessment to be made with regards to the factors outlined therein.

The Court found the following:

- benefits: the evidence supported a finding that the Company derived some benefit from the impugned transactions in the sense that Ms Gray permitted the Company to use part of the house for its operations;
- detriment: the Company suffered detriment of being deprived of the funds paid to the respondent's mortgage account;
- other parties' benefits: the respondent received the benefit of payments into her mortgage account and Ms Gray received the benefit of a house to live in; and
- other matters: there were other relevant matters, namely:
    - the fact that the respondent was a close blood relative;
    - the "extremely suspicious" circumstance of Ms Gray using the Company's funds to pay personal and living expenses;
    - Ms Gray's own evidence that the money in question was paid "in lieu of her taking a regular wage or drawing"; and
    - the fact that the payments continued even after the Company had ceased to trade.

The Court found that the impugned payments involved a depletion of the Company's assets, with benefits received by the director and her daughter. The Court struggled to identify real benefit to the Company owing to the un-particularised evidence about its use of part of the house. In these circumstances, it was held that a reasonable person in the Company's circumstances would not have entered into any of the transactions constituted by the impugned payments. The transactions, therefore, were voidable as "unreasonable director-related" transactions of the company under s. 588FE(6A).

(ii) Whether the court should exercise its discretion under section 588FF

Section 588FF(1)(a) of the Corporations Act provides that where, on the application of a company's liquidator, a court is satisfied that a transaction of the company is voidable because it is an unreasonable director-related transaction of the company, the court may make an order directing a person to pay to the company an amount equal to some or all of the money that the company has paid under the transaction.

Section 588FF(4) only allows the court to order recovery of the difference between:

(a) the total value of the benefits provided by the Company; and
(b) the value (if any) that it may be expected that a reasonable person in the Company's circumstances would have provided having regard to the matters referred to in s. 588FDA(1)(c).

The total value of the benefits provided under the impugned payments was $59,758. Determining the amount referred to in (b) was considered to be more difficult. The following factors were considered:

- despite the fact that the property was specified as the Company's principal place of business only from 31 January 2005 and the Company's incomplete accounts only recorded rental payments from September 2004, the Court was satisfied that the Company conducted its business from the rented premises throughout the period of the impugned payments;

- while the Company ceased to trade on 1 April 2005, it was reasonable for the Company to maintain business premises whilst it concluded its operations; and
- the Company's accounts recorded only 25% of the rental as attributable to the Company's use, which the Court found appeared to be broadly consistent with the unchallenged evidence of the respondent and Ms Gray as to the significant extent of the use of the premises for Company purposes.

The Court was satisfied that a reasonable person in the Company's circumstances may be expected to have provided 25% of the value of the impugned transactions for the company's use of the property.

Thus, the Court exercised its discretion under s. 588FF(1) to order that the respondent pay the Company an amount of 75% of the impugned payments, being $44,818.50.

6.5 Court may appoint a provisional liquidator where there is evidence that a company being wound up has contravened the Corporations Act

(By Jonathan Hon, Ashurst Australia)

Australian Securities and Investments Commission v ActiveSuper Pty Ltd (No 2) [2013] FCA 234, Federal Court of Australia, Gordon J, 19 March 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/234.html

(a) Summary

The Australian Securities and Investments Commission (ASIC) sought the appointment of a provisional liquidator to MOGS Pty Ltd (MOGS), with specified powers and for the provisional liquidator to report to the Court and to ASIC. The application was made pursuant to s. 474(2) of the Corporations Act 2001 (Cth) (the Act).

ASIC submitted that there was substantial evidence that MOGS had committed, or been knowingly concerned in, a number of contraventions of the Act including breaches of s. 1041H(1) (misleading and deceptive conduct in respect of a financial product or service), s. 911A(1) (provision of financial services without a relevant licence) and s. 727(1) (offering securities without a current disclosure document lodged with ASIC).

ASIC sought the appointment of a provisional liquidator:

- to secure and preserve MOGS' assets pending the final hearing and determination of ASIC's winding up application against MOGS; and
- to empower an independent expert and officer of the Court to investigate MOGS' affairs and report back to the Court.

Gordon J considered the legal principles regarding the appointment of a provisional liquidator under s. 472(2) of the Act and held that there was a reasonable prospect that a justifiable lack of confidence in the conduct and management of MOGS, and a case for winding up of MOGS on the just and equitable ground, would be made out at trial. Therefore, Gordon J appointed a provisional liquidator to MOGS with specified powers and for the provisional liquidator to report to the Court and to ASIC.

(b) Facts

MOGS is an Australian company, who initially traded in its own right, but accepted the position of trustee of the MOGS Unit Trust on 1 January 2011. Since that date, its sole business has been conducted as a trustee of the MOGS Unit Trust. Neither ASIC nor MOGS had adduced evidence of MOGS acting as trustee of the MOGS Unit Trust. The evidence was unclear whether the transactions undertaken by MOGS were undertaking by MOGS as trustee of the MOGS Unit Trust or in its own rights. MOGS had not informed the Court that it was a trustee of the MOGS Unit Trust, had not provided the Court with a copy of the MOGS Unit Trust Deed and had not identified the unitholder of the MOGS Unit Trust. Above all, the MOGS Trust Deed provided for the automatic removal of MOGS as trustee of the MOGS Unit Trust when a petition for its winding up was presented against it. This proceeding, an application for the winding up of MOGS on the just and equitable ground under s. 431(k) of the Act, was filed and served in December 2012. It was uncertain whether MOGS continued to be the trustee of the MOGS Unit Trust, but it still engaged in large continuing commercial transactions with third parties in its capacity as trustee of the MOGS Unit Trust.

ASIC also alleged that MOGS was involved in the misuse of funds obtained from Australian investors and there was evidence regarding the raising of those funds, the loan agreements, the receipt of those funds by MOGS and MOGS' subsequent use of the funds.

ASIC relied upon five grounds as justifying the appointment of a provisional liquidator to MOGS:

- in excess of $4 million raised from Australian investors and paid to MOGS appeared to have been dissipated by MOGS and both the receipt and dissipation of those funds require investigation;
- MOGS had engaged in transactions with no apparent commercial purpose, failed to comply with its obligations and there were accounting inconsistencies and inaccuracies for which there was no or no satisfactory explanation;
- MOGS had contravened the law including by maintaining inadequate accounts and records;
- the information provided by one of the defendants lacked veracity; and
- MOGS appeared to be insolvent.

(c) Decision

Gordon J stated that the appointment of a provisional liquidator pending the determination of a winding up application is a drastic intrusion into the affairs of the company and will not be done if other measures would be adequate to preserve the status quo. Therefore, an application must show:

- some good reason for intervention prior to the final hearing of the winding up application; for example, an applicant may show that the appointment is needed in the public interest or to preserve the status quo or to protect the company's assets or affairs; and
- there is a reasonable prospect that a winding up order will be made on the application to wind up the company.

Having regard to the above facts and circumstances of MOGS, Gordon J came to the conclusion that there are no other measures that would be adequate to preserve the status quo. In the circumstances, there was a reasonable prospect that a winding up order would be made. The Court could not ascertain MOGS' current legal and factual status, including its financial standing, and the basis on which it concurrently conducts the business of MOGS. MOGS' failure to provide satisfactory answers to direct questions about its current status itself raised suspicions. Gordon J held that it was appropriate, and in the public interest, to appoint a provisional liquidator to MOGS. There was a need for an independent examination of the state of accounts of the company and its activities by someone other than the directors.

6.6 Court of Appeal refuses to "rubber stamp" agreed penalties

(By Lauren Faba, Herbert Smith Freehills)

ASIC v Ingleby [2013] VSCA 49, Supreme Court of Victoria, Court of Appeal, Weinberg and Harper

JJA and Hargrave AJA, 19 March 2013

The full text of this judgement is available at:

http://www.austlii.edu.au/au/cases/vic/VSCA/2013/49.html

(a) Summary

The Victorian Court of Appeal overturned the decision of Robson J in *ASIC v Ingleby* [2012] VSC 332 and imposed the original agreed penalty of $40,000 and a disqualification period from managing corporations of 15 months.

The central issue considered by the Court of Appeal was whether the court should effectively rubber-stamp an agreed penalty arrangement arrived at by the parties or whether it should use its discretion to impose an amount it views as appropriate.

The Court of Appeal was highly critical of the approach to agreed penalties adopted by the Full Federal Court in *NW Frozen Foods Pty Ltd v ACCC* (1996) 71 FCR 285 (NW Frozen Foods) and *Minister for Industry, Tourism and Resources v Mobil Oil Australia Pty Ltd* [2004] FCAFC 72 (Mobil Oil). In these cases, the courts took the approach that if the agreed penalty amount proposed by the parties falls within the acceptable range, the court will not depart from the agreed amount.

The Court of Appeal held that the approach in NW Frozen Foods and Mobil Oil represents bad law for the following reasons:

- the approach treats the trial judge as exercising an appellate role;
- the approach imposes an unwarranted constraint upon the broad discretion that the legislature has vested in judges charged with the task of imposing proper penalties; and
- the approach can lack transparency and can reinforce the perception that negotiated penalties are not adequately grounded in fact and legal principle.

The Court of Appeal found that Robson J placed too much reliance on a "plainly inadequate" statement of agreed facts and consequently imposed a penalty that was too lenient. However, despite its criticism of the NW Frozen Foods and Mobil Oil approach, the Court of Appeal regarded itself bound to go no further than the penalty agreed between the parties by way of negotiated settlement, as Ingleby had chosen not to participate in the appeal and was entitled to assume that the Court of Appeal would not go beyond the penalty proposed or, at least, would not do so without giving him an opportunity to be heard regarding the matter. The Court of Appeal imposed the original agreed penalty of $40,000 and a disqualification period from managing corporations of approximately 15 months.

(b) Facts

(**i) Background**

Paul Ingleby (Ingleby), Chief Financial Officer of AWB Limited (AWB), admitted to breaching his obligations under s. 180(1) of the Corporations Act 2001 (Cth) in failing to act with due care and diligence in relation to AWB's supply of wheat to Iraq pursuant to AWB contracts with the Iraqi Grain Board (IGB) under the United Nation's "Oil for Food" program. Under the guise of these contracts, AWB had fraudulently facilitated payments to the Saddam Hussein regime.

(ii) Trial decision

ASIC and Ingleby made a joint submission to the court to approve a negotiated settlement to resolve the claims against Ingleby. The parties proposed that Ingleby pay a civil pecuniary penalty of $40,000 and be disqualified from managing corporations for 15 months (*ASIC v Ingleby* [2012] VSC 332).

Robson J noted that authorities established that the Court should not generally depart from the parties' agreed penalty (*ASIC v Ingleby* [2012] VSC 339 at 58). However, Robson J nevertheless found that the agreed penalty proposed was too harsh. In coming to this decision, Robson J relied on the agreed statement of facts submitted by the parties and found that the evidence produced therein did not justify the agreed penalty. The agreed facts suggested that although Ingleby was negligent in failing to observe the degree of care and skill a reasonable officer would observe in his situation, his actions did not involve any deliberate wrongful act, dishonesty or moral turpitude (*ASIC v Ingleby* [2012] VSC 339 at 49). Accordingly, Robson J did not endorse the agreed penalty and instead imposed a lesser penalty of $10,000 coupled with disqualification from managing corporations for approximately 4 months.

ASIC sought a review of the decision in the Court of Appeal. The central issue considered by the Court of Appeal was whether the Court should effectively rubber stamp an agreed penalty arrangement between the parties or whether it should use its discretion to impose an amount it views as appropriate.

(c) Decision

The Court of Appeal overturned the decision of Robson J and imposed the original agreed penalty of $40,000 and a disqualification period from managing corporations of approximately 15 months.

The Court of Appeal ultimately found that Ingleby's indifferent conduct was incompatible with his role as CFO and warranted a higher penalty than that imposed at trial. The Court found that Robson J placed too much reliance on a "plainly inadequate" statement of agreed facts and consequently imposed a penalty that was too lenient (Hargrave AJA at 101). Weinberg JA stated that the agreed penalty did not fully reflect the agreed facts and Robson J ought to have insisted upon a fuller and more realistic set of facts. The agreed facts suggested that Ingleby played an insignificant part in the entire enterprise, however Harper JA found that the agreed statement of facts was deficient as it failed to explain how Ingleby could remain ignorant of the serious fraud being committed by others in AWB when it is clear that Ingleby held a position which placed on him the authority and responsibility to inquire into AWB's conduct in its trade with Iraq and made him privy to a number of indicators which ought to have put him on notice that inquiry should be made. In fact, the statement of agreed facts stated that Ingleby had co-authorised the payments pursuant to AWB contracts with the IGB.

(i) Consideration of the NW Frozen Foods and Mobil Oil decisions - "bad law"

In coming to its decision, the Court considered the approach to agreed penalties adopted in NW Frozen Foods and Mobil Oil and concluded that it was not bound to follow the decisions of other intermediate appellate courts which it regards as "plainly wrong" (Weinberg JA at 28).

Weinberg JA observed that it has become increasingly common for proceedings brought by regulators to be resolved between the parties by way of negotiated settlement. In these instances, the regulator and the defendant approach the court with an agreed statement of facts and an agreed penalty seeking the court's approval to convert the agreed penalty into formal court orders. Weinberg JA observed that courts have generally been reluctant to depart from penalties that the regulators and the parties have agreed between themselves, save in circumstances where the proposed penalty is so obviously beyond the permissible range. This was the approach adopted in NW Frozen Foods and Mobil Oil.

The Full Federal Court in NW Frozen Foods set a precedent that where the court is presented with a joint submission by the parties as to the appropriate level of penalty:

"the Court ... does not ask whether it would without the aid of the parties have arrived at the precise figure they have proposed, but rather whether their proposal can be accepted as fixing an appropriate amount" (NW Frozen Foods, at 290-1).

Weinberg JA acknowledged the public policy reasons behind this approach. For example, it results in predictability, saves both the regulator and the defendant the cost and uncertainty of contested litigation and saves valuable court time. Notwithstanding these advantages, Weinberg JA expressed concern about the use of negotiated settlements and was of the opinion that these cases were wrongly decided.

The approach in these cases requires the court to ask whether the agreed figure falls within the range of penalties reasonably available. Weinberg JA criticised this as being an "appellate question, and not a first instance question" (Weinberg JA at 29). Weinberg JA noted this approach effectively meant that:

"if the judge is unable to say that the agreed penalty is 'wholly outside' the range of appropriate amounts, he or she is bound to impose that penalty irrespective of whether it is considered appropriate. That is, in my view, a fundamental departure from the judicial function in relation to sentencing, and one that simply ought not to be countenanced" (Weinberg JA at 29).

Weinberg JA stressed that it is not the role of the court to merely rubber stamp agreed penalties and was of the opinion that the penalty proposed by the parties should be regarded as nothing more than a submission without any binding force even if it is considered to be "within the range". This approach would recognise the breadth of the discretion vested in courts and the important role that courts must play in ensuring that serious contraventions of regulatory statutes are adequately denounced and punished.

Weinberg JA also criticised the decisions for the lack of transparency of negotiated settlements that may reinforce a perception that negotiated penalties are not adequately grounded in fact and legal principle. Weinberg JA expressed reservations as to the accuracy and sufficiency of the statement of agreed facts which are presented to the court for the purpose of fixing a penalty. He noted that his doubts came to fruition in this case, where the trial judge was presented with a set of agreed facts that were impossible to reconcile with what the documentary evidence showed to be the true role played by Ingleby. The Court found that the statement of agreed facts did not present an accurate assessment of Ingleby's role in the enterprise and were a "less than a desirably sound basis upon which to reach important decisions about appropriate penalties" (Harper JA at 73). Consequently, the Court of Appeal stressed the importance of a courts taking great care when asked to endorse an agreed penalty not to simply "rubber stamp" them and to check that facts have been fully and accurately presented.

6.7 Can sole directors and shareholders claim against their company for breach of statutory duty resulting in personal injury in circumstances where the injury occurred because of a breach of duty on their part?

(By David Miller, DLA Piper Australia)

Brumder v Motornet Services and Repairs Ltd [2013] EWCA Civ 195, England and Wales Court of Appeal (Civil Division), 14 March 2013

The full text of this judgment is available at:

http://www.bailii.org/ew/cases/EWCA/Civ/2013/195.html

(a) Summary

The appellant, a sole director and sole shareholder of a company claimed damages for personal injury against his company for breach of its statutory obligation. The only way the company could discharge its statutory obligation was through the appellant. Having found that the appellant himself owed a duty to ensure the company discharged its duty, the court found against the appellant based on a common law defence which holds that it is open for an employer to prove that the employee was wholly to blame.

(b) Facts

This was an appeal from the Brighton County Court by Peter Brumder (the appellant), the sole director and shareholder of the first respondent, Motornet Service and Repairs Ltd (the company). The second respondent was the insurance company Aviva Insurance Ltd. The appellant was injured while working on machinery for the company. The judge at first instance found that:

- the company was in breach of its statutory obligation; and
- the defect in the machinery was causative of the injury and therefore there was primary liability on the part of the company; but
- the appellant, who had not given any consideration to his duty of reasonable care, skill and diligence to the company to ensure its statutory obligations were complied with, was 100% contributory negligent under the relevant legislation, the *Law Reform (Contributory Negligence) Act 1945*.

It was not disputed that the appellant should have been, but was not, aware of his duties in relation to ensuring the company complied with its statutory duty. The court found that, as a matter of fact, the injury would not have occurred if the appellant had properly discharged his duty to the company.

It was common ground on appeal that the company's statutory duty was absolute and continuing, and, that since the judge at first instance made a finding of primary responsibility on the part of the company, a finding of 100% contributory negligence on the part of the appellant was unavailable because the legislation presupposes fault on both parties.

(c) Decision

The court dismissed the appellant's claim. Lord Justice Beatson expressed the issues to be as follows:

- if the company can rely on the complete defence identified in *Ginty v Belmont Building Suppliers Ltd* [1959] 1 All ER and *Boyle v Kodak* [1969] 1 WLR 661, the appeal should be dismissed; and if not
- the extent to which the company's liability should be reduced to account for the appellant's contributory negligence.

The court found that the company was entitled to rely on the defence and that therefore there was no need to consider contributory negligence.

(i) The defence in Ginty and Boyle

The defence applies where the act or omission of the claimant himself or herself has the legal result that the defendant is in breach of a statutory duty. Ginty and Boyle both involved the *Provision and Use of Work Equipment Regulations 1998* (the Regulations). The Regulations were held to impose an absolute and continuing duty on both employer and employee to comply with their requirements so that in those cases both employer and employee were in breach of the same duty under the same Regulations. Therefore, the question was whether the principle underlying the defence to the employer's liability under statutory regulations applies directly or analogically to provide a defence where the claimant is in breach of a duty, but not the same duty as the defendant has breached.

(ii) Can the Ginty and Boyle defence apply?

The court found that there is a strict approach taken to the defence. The onus is on the employer to prove that he did all he could to ensure compliance with the duty. Only if the employer does, will he have a defence against the injured employee whose act or omission put the employer in breach of the Regulation. Crucially, the court noted that the circumstances of the case must fit within one of the key underlying principles of the defence. The relevant underlying principle is the principle that a person cannot derive any advantage from his own wrong.

In finding that the defence was available, the court noted the following:

- the relevant duty owed by the appellant was the statutory and common law duty to exercise skill, care and diligence;
- it was not determinative that this duty is different to the statutory duty owed by the company;
- it will be assumed that the company has done all it can to comply with its duty since it can only act through the appellant;
- where, as is the position of the appellant, a director/claimant has paid no attention whatsoever to health and safety issues, and has abrogated his responsibilities as owner and director of the company for them, he will be in breach of his duty; and
- the consequence of this is that the appellant is a wrongdoer and falls within the relevant underlying principle for the defence; the principle that a person cannot derive any advantage from his own wrong.

As Lord Justice Beatson noted, "I do not consider that it lies in the mouth of a claimant who is the defendant's sole director and shareholder, and through whom the company must act, to assert that the company has not proved that it has done all it could to ensure compliance when it is only through the claimant director's acts that the company can act".

6.8 Airtrain scheme of arrangement "back on track" with supplementary disclosure

(By Clayton Barrett and Christian Dawson, Clayton Utz)

Airtrain Holdings Limited, in the matter of Airtrain Holdings Limited [2013] FCA 209, Federal Court of Australia, Reeves J, 12 March 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/209.html

(a) Summary

In a Federal Court of Australia decision to order that meetings of shareholders of Airtrain Holdings Limited (Airtrain) be convened to consider three interdependent schemes of arrangement, Reeves J commented on a number of matters affecting the approval of the scheme:

- where a material error had been discovered after the initial approval of the explanatory statement and an attempt made to address the error by an amendment before despatch, the Court declined to retrospectively approve the amended explanatory statement and decided that the preferable course was for Airtrain to provide a supplementary explanatory statement to shareholders;
- the three schemes were so similar that it was appropriate to distribute an identical explanatory statement to all three classes of shareholder, even though the rights held by each class were sufficiently different as to warrant a separate scheme meeting for each class;
- a break fee of $1.1m was not considered excessive having regard to it being within the Takeover Panel's 1% guideline and having been properly weighed up by the Board in light of the structure of Airtrain's shareholdings and indications of support for the scheme from the majority of the three classes of shareholders;
- an independent expert's report was not needed, having regard to the information already to be provided to shareholders, the infrequent trading of Airtrain shares and the absence of reliable transaction comparisons;
- an exclusivity provision in the implementation agreement did not interfere with the fiduciary duties owed by the directors of Airtrain as it met the requirements set out by Santow J in *Re Arthur Yates & Co Ltd* (2001) 36 ACSR 758; and
- s. 411(17) of the Corporations Act 2001 (Cth) (Corporations Act) was not required to be considered by the Court until the second hearing of the matter.

(b) Facts

Airtrain is the holding company for Airtrain Citylink Ltd, which holds the concessions to the Brisbane Rail Link, connecting the airport terminals and rail network, until 2036. Airtrain has 65 fully-paid shareholders, comprising of three classes of shares:

- 125,200 Class A;
- 24,000 Class B; and
- 101,200 Class C.

Airtrain entered into an implementation agreement with USS Axle Pty Ltd (USS Axle) to propose a scheme of arrangement under which USS Axle would acquire 100% of the issued share capital of Airtrain (Scheme). Under the Scheme, participating members were to be paid $437.50 for every share held at the record date. The Scheme was to be achieved by three interdependent schemes of arrangement, with one scheme for each of Airtrain's three classes of shares.

In accordance with s. 411(4)(a) of the Corporations Act, Airtrain proposed to hold a separate meeting for each class of its shares. To enable Airtrain to hold such meetings, Court consent must be obtained in accordance with s. 411(1) of the Corporations Act.

(c) Decision

The question before Reeves J was whether it was appropriate to convene meetings of the shareholders of Airtrain and to distribute the requisite documentation. His Honour gave those orders.

(i) Supplementary explanatory statement

Airtrain initially obtained the Court's approval of an explanatory statement which provided that:

"Airtrain will not be making any payment or giving any benefit to any current member of the Airtrain Board, the company secretary or any executive officer as compensation for loss of, or as consideration for, or otherwise in connection with, their resignation or retirement from office, if the Schemes become Effective and the Airtrain Board is reconstituted".

The day after the Court approved the explanatory statement, Airtrain learned that its company secretary's employment contract contained a "payout clause" that entitled him to terminate his employment and receive up to one year's salary if a third party acquired all of Airtrain's issued share capital.

Airtrain sent out an amended form of the explanatory statement to shareholders, adding the matter as a qualification to the existing unqualified statement:

"except if the company secretary exercises his existing right to elect to terminate his employment as a consequence of the Schemes becoming Effective and to receive 12 months' salary (less tax and reduced by any other redundancy payment) as compensation".

Reeves J declined to retrospectively approve the amended explanatory statement and decided that the preferable course was for Airtrain provide a supplementary explanatory statement to shareholders that "contained a clear and comprehensive explanation" of the payout clause.

His Honour considered that the amended form of wording in the explanatory statement previously sent did not frankly and fully disclose all of the relevant information concerning the payout clause. The structure of the amended clause was potentially misleading because an unequivocal statement at the outset that there were no payments was followed by a statement "buried in the middle of the paragraph to the opposite effect". It also did not disclose the potential amount of the payout or that USS Axel would bear that amount.

It was also relevant to Reeves J that the cost of providing a supplementary explanatory statement was not significant given the small number of shareholders and that Airtrain would not need to alter its shareholder meeting arrangements.

(ii) Three schemes and one explanatory statement

Reeves J determined that, as all three classes of shareholders had different rights attaching to their shares but their entitlements under the Scheme were the same, it was appropriate to have three separate schemes (and therefore three separate meetings) and to distribute an identical explanatory statement to all shareholders.

The rights attaching to shares in each class were sufficiently different to warrant a separate scheme, as although rights to voting, dividend and return of capital were the same, each class had different rights as to the appointment and removal of directors and different requirements for a quorum at a directors' meeting. The Airtrain constitution required class approval to vary those class rights.

(iii) Break fee

Under the implementation agreement, if the Scheme was not approved by shareholders, Airtrain was liable to pay a break fee of $1.1 million to USS Axle. In accepting the imposition of the break fee, Reeves J, considered that the Board had properly weighed up factors relevant to the break fee, being that it was within the Takeover Panel's 1% guideline, the structure of Airtrain's shareholdings (where no single shareholder could deliver the necessary votes to approve the Scheme and a small number of shareholders could defeat it), indications of support for the scheme from the majority of the three classes of shareholders and that Airtrain could easily cover the break fee from its existing cash reserves.

(iv) No independent expert's report

Airtrain contended, and Reeves J accepted, that it was not necessary to provide an independent expert's report.

The main reasons were:

- Schedule 8, item 8303 of the Corporations Regulations 2001 (Cth) did not require such a report (as neither USS Axle owned shares in Airtrain nor were any of its directors also on the board of Airtrain);
- shareholders would otherwise receive ample information, including audited balance sheets for the previous 2 years, an unaudited balance sheet for the previous half-year and a comparison of the proposed premium against Airtrain's net assets;
- there had only been 8 share transfers in the past 2 years comprising 1.1% of issued capital and there were no reliable transaction comparisons (limiting the reference points for any independent analysis); and
- there was significant shareholder support for the Scheme and most of the shareholders were sophisticated or professional investors.

(v) Exclusivity provision

The implementation agreement included exclusivity provisions which restricted Airtrain from soliciting competing offers (no shop) or negotiating a competing agreement (no talk). The "no talk" restriction did not apply where there was an unsolicited approach by a third party and the directors of Airtrain determined in good faith that the offer was superior and had received legal advice that failing to respond would constitute a breach of directors' duties.

In applying the test of Santow J in *Re Arthur Yates & Co Ltd* (2001) 36 ACSR 758, Reeves J considered that:

- the exclusivity period was clearly defined and reasonable in length;
- the exception to the "no talk" provision enabled the directors of Airtrain to meet their fiduciary duties; and
- the explanatory statement adequately presented the exclusivity provision to shareholders.

The exclusivity provision therefore did not interfere with the directors' fiduciary duties.

(vi) Application of section 411(17) of the Corporations Act

Section 411(17) of the Corporations Act relevantly provides that "[t]he Court must not approve a compromise or arrangement" except where it is satisfied that the scheme has not been proposed to avoid the takeover provisions in Chapter 6 or ASIC has provided a "no objection" letter in respect of the scheme.

Reeves J declined to follow the approach in *Mincom Limited v EAM Software Finance Pty Ltd* [2007] QSC 37 and confirmed the approach in subsequent cases that the issue of s. 411(17) of the Corporations Act should be addressed at the second hearing of the matter in the light of the circumstances that exist at that time.

6.9 Civil proceedings stayed pending the completion of criminal investigation

(By James Claridge, Herbert Smith Freehills)

Australian Securities and Investments Commission in the matter of Northwest Resources Limited v Craigside Company Limited BVI company number 74124 and Others named in the Schedule [2013]

FCA 201, Federal Court of Australia, Jagot J, 11 March 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/201.html

(a) Summary

Jagot J ordered a stay of civil proceedings relating to alleged breaches of the Corporations Act 2001 (Cth) (the Corporations Act) until ASIC decides whether to bring a criminal prosecution in relation to the same subject matter. In the event that ASIC decides to initiate a prosecution, the stay order will continue until the conclusion of the prosecution. Jagot J held that allowing the civil proceedings to continue may seriously prejudice the interests of the defendants in any subsequent criminal prosecution.

(b) Facts

ASIC sought declarations that Mr Merity and Mr Nedderman had breached ss. 671B and 672B of the Corporations Act. The relevant provisions are contained in Chapter 6C of the Corporations Act and require a person to disclose information about "substantial holdings" or "relevant interests and instructions" following an ASIC direction. The impugned conduct relates to the holding of shares by the first defendant, Craigside Company Limited, in the fourth defendant, Northwest Resources Limited. Contraventions of ss. 671B and 672B of the Corporations Act are offences of strict liability.

In addition to seeking declarations of contravention, ASIC is currently continuing a long-running investigation in relation to suspected breaches of s. 671B and the related party interest provisions in ss. 205G and 208 of the Corporations Act. ASIC has acknowledged that the conduct of Mr Merity forms part of its investigation and has conceded the possibility that it may seek to prosecute Mr Merity in the future. Although ASIC's investigation is not currently focused on the conduct of Mr Nedderman, it has refused to rule out the prospect that he will also be prosecuted.

Mr Merity and Mr Nedderman made interlocutory applications seeking a stay of the current civil proceedings until ASIC decides whether or not to bring criminal prosecutions in relation to the same or similar subject matter. In the event that a prosecution is brought by ASIC or the Commonwealth Director of Public Prosecutions, Mr Merity and Mr Nedderman sought a stay of the civil proceedings until the final determination of the prosecution.

(c) Decision

After balancing the competing interests of ASIC and the defendants, Jagot J exercised the court's discretion to stay the civil proceedings as the risk of prejudice to Mr Merity and Mr Nedderman was held to outweigh the interest of ASIC in the proceeding being heard and determined in the ordinary course.

Jagot J applied the reasoning of Finkelstein J in *Australian Securities and Investments Commission v HLP Financial Planning (Aust) Pty Ltd* (2007) 164 FCR 487 and Dodds-Streeton J in *Websyte Corp Pty Ltd v Alexander* (No 2) [2012] FCA 562 in holding that where facts are in dispute and a criminal prosecution is "on the cards", there is a risk that the defendants' legitimate interests in subsequent criminal prosecution may be compromised. ASIC's acknowledgement of a possible prosecution against Mr Merity clearly demonstrates that a prosecution is "on the cards" in relation to him. Furthermore, Jagot J rejected ASIC's argument that a prosecution was not "on the cards" in respect of Mr Nedderman merely because he is not presently under investigation.

Jagot J at [21]-[22], took into account the following factors in considering the interests of Mr Merity and Mr Nedderman:

- the risk that ASIC may obtain indirect evidence through the civil proceedings which may prejudice Mr erity and Mr Nedderman in any future prosecution;
- the acute pressure faced by Mr Merity and Mr Nedderman in deciding whether to file evidence in the civil proceedings knowing that they may incriminate themselves in respect of a future prosecution; and
- the expense, inconvenience and significant burden of defending civil proceedings while being at risk of being later prosecuted in respect of the same subject matter.

In addition, Jagot J cited with approval comments made by Finkelstein J in *Australian Securities and Investments Commission v HLP Financial Planning (Aust) Pty Ltd* (2007) 164 FCR 487 at [59], warning that the law may be brought into disrepute if declarations are made which are subsequently falsified by the acquittal of a defendant in criminal proceedings.

ASIC sought to rely on remarks made by Wootten J in *McMahon v Gould* (1982) 7 ACLR 202 at 206 which emphasise the grave nature of an order staying proceedings and the heavy burden carried by the defendant in establishing that it is just and convenient to interfere with the plaintiff's ordinary rights.

Jagot J accepted that although a stay should not be granted merely because a contravention also involves an offence, there is nothing in the judgment of Wootten J in *McMahon v Gould* (1982) 7 ACLR 202 to prevent the grant of a stay in the circumstances of this case.

Jagot J ordered that the civil proceedings be stayed until 7 days after ASIC notifies Mr Merity and Mr Nedderman that it will not institute a criminal prosecution. In the event that ASIC provides written notification of its intention to bring a prosecution, the stay will continue until a further order is made.

6.10 Considerations as to when a responsible entity may redeem units of a registered management investment scheme

(By Helen Miller, Minter Ellison)

Re Real Estate Capital Partners Managed Investments Limited as Responsible Entity of the Real Estate Capital Partners USA Property Trust [2013] NSWSC 190, Supreme Court of New South Wales, White J, 6 March 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/190.html

(a) Summary

This case considers whether the court should provide judicial advice, requested in accordance with s. 63 of the Trustee Act 1925 (NSW), that a responsible entity of a listed managed investment scheme may redeem the units of unitholders who request redemption of their units. Section 63 enables a trustee to request judicial advice.

The court ultimately granted the judicial advice requested, finding that the redemption of the units was within the terms of the trust deed, that the responsible entity was not required to act in accordance with a resolution of the unitholders and did not contravene s. 606 (which prohibits the acquisition of voting shares in certain situations) or s. 601GA(4) of the Corporations Act 2001 (Cth) (the Corporations Act).

(b) Facts

The plaintiff, Real Estate Capital Partners Managed Investments Limited (RMIL), is the responsible entity of Real Estate Capital Partners USA Property Trust (Trust), a registered management investment scheme, whose units are quoted on the ASX.

Despite approving a resolution to sell the vast majority of the trust assets, leaving cash as the only valuable trust asset, a resolution to distribute the net assets of the trust to the unitholders and that the trust be delisted was rejected by 57% of unitholders by value (but approved by 77% of unitholders by number).

A unitholder who held approximately 34% of the units called a meeting to replace RMIL as the responsible entity of the trust. Subsequently, RMIL commenced the process to exercise their discretion under the constitution of the Trust to redeem the units of unitholders who request redemption subject to obtaining any necessary waivers under the ASX Listing Rules and satisfactory judicial advice.

The ASX granted the requested waiver (subject to conditions) from listing rule 10.1 which requires the responsible entity to ensure that it, or any of its child entities, not acquire a substantial asset from or disposes of a substantial asset without the approval of holders of the entity's ordinary securities. The conditions included that RMIL must "accept the redemption request of every unitholder lawfully entitled to request redemption".

The plaintiff commenced proceedings to obtain the judicial advice. Twenty per cent of unitholders had requested that their units be redeemed.

The proposal to redeem the units of unitholders who requested redemption was opposed by unitholders holding 43% of the units on the following grounds:

- the redemption contravened s. 606 (which prohibits the acquisition of voting shares in certain situations) of the Corporations Act as it would result in the voting power of certain unitholders increasing from its current 20% (s. 606 Issue);
- RMIL did not have the power under the trust deed to proceed as the redemption offer contravened clause 7.11 of the trust deed because the ASX waiver obliged RMIL to accept any redemption requests while clause 7.11 of the trust deed required RMIL to retain a discretion as to whether to accept a redemption request (Powers in Trust Deed Issue);
- as the resolution to distribute the assets of the Trust had been rejected it was improper for RMIL to seek to achieve the same result through the redemption of units (Improper Conduct Issue); and
- the redemption contravened s. 601GA(4) of the Corporations Act as the trust deed did not set out adequate procedures for making and dealing with withdrawal requests which must be fair to all members (s. 604GA(4) Issue).

(c) Decision

White J granted the judicial advice requested by the plaintiff and held that it had the power to redeem the units if requested and that it would be justified in exercising its power do so.

In reaching this decision, White J discussed the following issues.

(i) Section 606 Issue

Section 606(1) of the Corporations Act prohibits the acquisition of a relevant interest in issued voting shares if it would result in a person's voting power increasing to above 20% or increasing from a starting point that is above 20% and below 90%. It was argued that the redemption would result in RMIL acquiring a relevant interest in voting units which would result in the voting power of certain unitholders increasing from a starting point that is above 20%.

White J held that as a result of s. 608(8) of the Corporations Act (which sets out when a person may have a relevant interest) RMIL acquired a "relevant interest" at the time the units were issued.

This was because:

- each unitholder had a relevant interest in the units issued to that holder;
- the holder had been given an enforceable right by another person (RMIL) in relation to the securities (the right to have RMIL give due consideration to a redemption request which is conferred by the trust deed);
- the words "in relation to" are wide and the right to have a redemption request considered is a right "in relation to" the units sought to be redeemed; and
- if the right is enforced (i.e. the unitholder obliges RMIL to give due consideration to the request), RMIL would have the power to dispose of the units by agreeing to the redemption.

Consequently, the redemption of the units does not trigger s. 606(1) of the Corporations Act as the redemption of the units would not result in RMIL acquiring a relevant interest.

White J commented that while it was not necessary for him to determine whether s. 606 of the Corporations Act applied at all to the redemption of units by the responsible entity of a registered managed investment scheme, it was at least possible that it did not.

(ii) Section 604GA(4) Issue

Under s. 604GA(4) of the Corporations Act, if the unitholders are to have the right to withdraw from the trust, the trust deed must:

- specify the right;
- if the right may be exercised when the scheme is liquid set out adequate procedures for making and dealing with withdrawal requests;
- if the right may be exercised when the scheme is not liquid, provide for the right to be exercised in accordance with Part 5C.6 and set out any other adequate procedures that are required; and
- contain procedures that are fair to all unitholders.

While White J acknowledged the procedures in the trust deed regarding the redemption of units could be improved, he held that was a different question as to whether the procedures were adequate and fair.

Furthermore, it was held that even if the procedures in the trust deed had not complied with s. 604GA(4), it would not have resulted in the procedures being ineffective. The requirements in s. 604GA are the requirements for registration by ASIC and there is nothing in s. 604GA that results in the deed being ineffective if it does not meet the requirements.

(iii) Powers in Trust Deed Issue

White J held that the mandatory conditions of the ASX waiver did not mean that RMIL would be acting beyond the powers conferred by the trust deed. It would be acting under the trust deed having decided that it would be appropriate to give effect to such conditions.

(iv) Improper Conduct Issue

White J held that absent a requirement in the trust deed (which was not present), a trustee is not required to act in accordance with the views of the majority of beneficiaries. The unitholder rejection of the resolution to distribute the net assets of the trust had no impact on the RMIL's exercise of its powers under the trust deed.

6.11 Creditors can make a statutory demand for a portion of a debt

(By David Wright, Ashurst Australia)

Commonwealth Bank of Australia v Garuda Aviation Pty Ltd [2013] WASCA 61, Supreme Court of Western Australia Court of Appeal, McLure P, Pullin and Newnes JJA, 6 March 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/wa/WASCA/2013/61.html

(a) Summary

The Court of Appeal in Western Australia has held that a creditor's statutory demand issued under s. 459E(1) of the Corporations Act 2001 (Cth) (the Act) can be for a portion of a debt.

(b) Facts

In late October 2007, Commonwealth Bank of Australia (CBA) loaned Garuda Aviation Pty Ltd (Garuda) US$27 million to enable it to purchase an aircraft. The loan was secured by a mortgage over the aircraft.

Following defaults by Garuda under the loan agreement and the chattel mortgage, CBA made a demand on Garuda declaring all monies owing or payable under the loan agreement to be immediately due and payable. On 29 September 2011, CBA served a statutory demand on Garuda for the payment of over US$2 million. This amount was the undisputed portion of a total debt in excess of US$6 million.

Garuda filed an application under s. 459G of the Act to have the statutory demand set aside. At first instance, Master Sanderson of the Supreme Court of Western Australia set aside CBA's statutory demand based on the fact that it was for a part of a debt, not for the whole debt.

CBA appealed the decision of Master Sanderson.

(c) Decision

The Court of Appeal overturned the decision of Master Sanderson. Justice Newnes (with whom President McLure and Justice Pullin agreed) held that CBA's statutory demand was valid even though it was for a portion of a debt. The Court held that a creditor may serve a statutory demand for a portion of a debt under s. 459E(1) of the Act when that portion is undisputed and exceeds the statutory minimum.

(i) The legislation

Section 459E(1) of the Act enables a party to serve a statutory demand for a debt that is due and payable, provided that the debt exceeds the statutory minimum. The failure of a company to comply with a statutory demand creates a rebuttable presumption of insolvency under s. 459C(2)(a).

(ii) Interpretation of section 459E(1)

The Court's decision rested on the proper construction of s. 459E(1) of the Act. Justice Newnes considered both the text and purpose of the legislation, and held that s. 459E did not preclude a statutory demand for a portion of a debt.

His reasoning can be summarised as follows:

- the words "a demand relating to.[a] debt" in s. 459E(1) should be construed more widely than simply a demand for the "whole" amount of the debt;
- the word "debt" is not inflexible and should be applied to the relevant legislation in a "practical and commonsense fashion";
- a practical construction of the legislation should give effect to the purpose of the statutory demand procedure, which aims to provide a quick and convenient method of resolving the issue of a company's insolvency;
- a dispute relating to one part of the debt should not preclude a creditor from serving a statutory demand for the part of the debt that is not in dispute, so long as that amount exceeds the statutory minimum; and
- a presumption of insolvency under s. 459C(2)(a) can be established by a company's inability to pay a portion of a debt, so long as that portion is undisputed and exceeds the statutory minimum.

(iii) Existing case law

At first instance, Master Sanderson set aside CBA's statutory demand because he felt bound to follow the Supreme Court of South Australia's decision in *Candetti Constructions Pty Ltd v M & I Samaras* (No 1) Pty Ltd [2011] SASC 165 (Candetti). Justice Blue in that case held that a statutory demand under s. 459E(1) could not be made for an "undissected portion" of a debt. The Court of Appeal respectfully noted that Candetti was wrongly decided and should not be followed.

(iv) Requirements for serving a statutory demand

Based on the Court's reasoning, a creditor may issue a statutory demand for a portion of a debt so long as:

- the debt is described in clear and unambiguous terms;
- there is no genuine dispute over the existence or amount of that portion of the debt;
- the debt exceeds the statutory minimum (being $2,000 under s. 9 of the Act); and

- the statutory demand does not constitute an abuse of process.

In relation to the last point, Garuda argued that if a statutory demand could be served for part of the debt, it would be open to a creditor to make a series of demands for different portions of a larger debt. The Court rejected this argument, noting that unless there were good reasons for making the separate demands, they may constitute an abuse of process and could be set aside under s. 459J(1)(b) of the Act.

6.12 When will a Court terminate the winding up of a company which has entered into a deed of company arrangement?

(By Courtney Locke, Minter Ellison)

In the matter of Plaza West Pty Limited (in liquidation) (subject to deed of company arrangement) [2013] NSWSC 168, Supreme Court of New South Wales, Black J, 6 March 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/nsw/NSWSC/2013/168.html

(a) Summary

This case demonstrates the process undertaken by the Court in deciding whether to make an order that the winding up of a company should be stayed indefinitely or terminated. In this case, the liquidators of the company sought an order that the winding up be stayed or terminated as the company had entered into a deed of company arrangement.

(b) Facts

The plaintiffs, the liquidators of Plaza West Pty Limited (in liquidation) (subject to deed of company arrangement) (the Company) sought an order under s. 482(1) of the Corporations Act 2001 (Cth) (the Corporations Act) that the winding of the Company be stayed indefinitely or terminated. Section 482(1) of the Corporations Act provides that the Court may, at any time during the winding up of a company, make an order staying the winding up indefinitely or for a limited time or terminating the winding up. Section 482(1A)(a) of the Corporations Act provides that an application for an order under s. 482(1) of the Corporations Act may be brought by the liquidator, a creditor or a contributory of the company. Consequently, the liquidators of the Company had standing to bring the application.

The business of the Company involved substantial property development. The Company incurred a range of difficulties in respect of this development and liquidators were appointed by resolution of the Company's members on 10 July 2012.

On 14 December 2012, a proposal for a deed of company arrangement was put forward by the Company's sole director. Subsequently, the liquidators resolved to appoint a voluntary administrator of the Company pursuant to s. 436B of the Corporations Act, which provides that a liquidator may appoint an administrator if the liquidator thinks that the company is insolvent, or is likely to become insolvent at some future time.

On 30 January 2013, a meeting of the Company's creditors approved entry into a deed of company arrangement. The deed of company arrangement was executed on 14 February 2013 and an addendum was executed on 20 February 2013. The addendum provided for the payment of the liabilities, remuneration and expenses of the liquidators. The Court noted that the original deed of company arrangement and the addendum could be read together as a deed of company arrangement executed in accordance with s. 444B of the Corporations Act.

As a result of the Company's entry into a deed of company arrangement, the liquidators made an application under s. 482 of the Corporations Act which provides that the Court can make an order staying or terminating the winding up of a company.

(c) Decision

Black J noted that where an application is made to stay or terminate the winding up of a company which is subject to a deed of company arrangement, s. 482(2A) of the Corporations Act sets out the matters which the Court must have regard to, specifically:

- any report given to the Court by the administrator or former administrator of the company, liquidator or former liquidator of the company, or ASIC that contains an allegation that an officer of the company has engaged in misconduct;
- any report that has been lodged with ASIC by the administrator or former administrator of the company, or liquidator or former liquidator of the company that contains an allegation that an officer of the company has engaged in misconduct;
- the decision of the company's creditors to resolve that the company execute a deed of company arrangement;
- the statement setting out the administrators' opinion on whether it would be in the creditors' interests for:
    - the company to execute a deed of company arrangement;
    - the administration to end; and
    - the company to be wound up;
- whether the deed of company arrangement is likely to result in the company becoming or remaining insolvent; and
- any other relevant matters.

Black J noted that the relevant matters for consideration on an application to stay or terminate a winding up were identified in the cases of *Mercy & Sons Pty Ltd v Wanari Pty Ltd* [2000] NSWSC 756; (2000) 157 FLR 107; 35 ACSR 70, *Re Nardell Corporation Pty Ltd* [2004] NSWSC 281; (2004) 49 ACSR 110 and *Vero Workers Compensation (NSW) Ltd v Ferretti Pty Ltd* [2006] NSWSC 292; (2006) 57 ACSR 103 as including:

- the interests of the Company's creditors, including future creditors;
- the interests of the liquidator, particularly with regard to costs; and
- the interests of contributories and the interests of the "public", including the public interest in matters of commercial morality and the public interest that insolvent companies should be wound up.

Black J was satisfied that the interests of the Company's present creditors would be served by the termination of the winding up to facilitate the entry into the deed of company arrangement. Black J noted that the Company's administrators had provided two reports which detailed the potential outcomes of a liquidation on the one hand and the deed of company arrangement on the other, including the prospects of recoveries in a liquidation. The administrators' report noted that the recoveries in a liquidation would depend on funding for litigation which neither the Company's major third party creditor or litigation funder were willing to provide. Conversely, the deed of company arrangement provided for an outcome consistent with the upper range of potential recoveries in a liquidation and the Company's largest third party creditor seconded the resolution to execute the deed of company arrangement along with all creditors except for one which abstained from voting.

When considering the interests of future creditors, Black J noted that the Company had taken substantial steps to restore its solvency by increasing its share capital and allocating shares to several related parties in partial or complete satisfaction of debts owed by the Company. The liquidators' report also considered that on termination of the liquidation, the Company would have an excess in value of assets over liabilities. Further, the liquidators' report expressed the view that the Company would meet the test of solvency under s. 95A of the Corporations Act which provides that a company is solvent if, and only if, it is able to pay all of its debts, as and when they become due and payable.

Black J distinguished between cases where the Courts have declined to terminate the winding up where a company's solvency is only supported by contractual arrangements with related parties which may be vulnerable to variation and the present case where the Company's solvency was supported by the capitalisation of debt which meant that the value of the Company's assets would significantly exceed the amount of its debt. Consequently, Black J was satisfied that the interests of future creditors were not at risk such that the Court should decline to order the termination of the winding up.

In relation to public interest considerations, Black J commented that a Court may decline to make an order terminating a winding up where there is serious impropriety in the conduct of the company's affairs or significant risk to future creditors. In this case, the liquidators' report suggested that the company may have traded whilst insolvent but that the directors and former directors would have "significant" statutory defences should an action for insolvent trading be commenced. Further, the liquidators' report adopted the preliminary view that there was no evidence of any breaches of directors' duties, falsification of books, false or misleading statements, false information or other possible offences by the directors. Black J did not consider that these matters or the Company's proposed future operations indicated that there would be a risk to future creditors or the public from terminating the winding up.

Black J was also satisfied that the winding up was not contrary to the liquidators' interests as the deed of company arrangement provided for the payment of the liquidators' fees. The termination of the winding up was also held to be in the interests of the Company's three contributories.

As Black J was satisfied that the matters set out in s. 482(2A) had been sufficiently addressed, an order was made that pursuant to s. 482(1) of the Corporations Act the winding up of the Company be terminated. There was no order as to costs, with the intention that each party bear their own costs of the proceedings.

6.13 Adjournment of winding up application refused despite tax appeal on foot

(By John O'Grady and Vee Vien Tan, Corrs Chambers Westgarth)

Deputy Commissioner of Taxation v Bayconnection Property Developments Pty Limited (No 2) [2013] FCA 208, Federal Court of Australia, Robertson J, 11 March 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/208.html

(a) Summary

In this proceeding, Robertson J refused an application by the four plaintiff corporations (the Plaintiffs) for an adjournment of a winding up application brought against them by the Deputy Commissioner of Taxation (the Deputy Commissioner). His Honour refused the adjournment despite the Plaintiffs' pending appeal to the Federal Court of Australia (Court) against a decision by the Administrative Appeals Tribunal (the Tribunal) to affirm tax assessments made by the Commissioner of Taxation (the Commissioner) in relation to the Plaintiffs.

His Honour held that great weight must be given to the clear legislative policy giving priority to the recovery of tax revenue, notwithstanding that the Plaintiffs had an appeal under Part IVC of the Taxation Administration Act 1953 (Cth) (the Taxation Administration Act) on foot. The Plaintiffs therefore needed to show that their case on appeal was more than merely arguable.

His Honour observed that the Plaintiffs' grounds for appeal were limited to questions of law. On consideration of these grounds, his Honour was not persuaded that they were reasonably arguable. His Honour noted that even if he was wrong and the grounds for appeal were reasonably arguable, the grounds were not strong. If the Plaintiffs' pending appeal had any merits, they were outweighed by the strength of the public interest in recovering tax revenue.

His Honour therefore ordered that the Plaintiffs be wound up.

(b) Facts

The Plaintiffs were four corporations - Bayconnection Property Developments Pty Ltd, Voca Pty Ltd, Catarina Gardens Pty Ltd and Mira Investments Pty Ltd - that had previously been issued statutory demands by the Commissioner. The Plaintiffs failed to comply with the statutory demands and applied to the Tribunal for a review of the Commissioner's tax assessments. In particular, the Plaintiffs objected to the Commissioner's assessment that the Plaintiffs were not entitled to input tax credit claims made by each of the Plaintiffs over tax periods ranging from February 2005 to January

2009.

Pending the outcome of the Tribunal's decision, Robertson J adjourned an application by the Deputy Commissioner to wind up the Plaintiffs. Subsequently, the Tribunal affirmed the Commissioner's decision with respect to the Plaintiffs' tax assessments. The Plaintiffs then lodged an appeal to the Court from the decision of the Tribunal.

In this proceeding, the Plaintiffs sought a further adjournment of the Deputy Commissioner's winding up application pending the Plaintiffs' appeal to the Court. The Plaintiffs did not dispute that they had failed to comply with the Deputy Commissioner's statutory demands and that the Court was required to presume that each of the Plaintiffs was insolvent in accordance with s. 459C(2)(a) of the Corporations Act 2001 (Cth) (the Corporations Act). The Plaintiffs contended that they would show on appeal to the Court that they had no debt to the Commonwealth. The Plaintiffs also made submissions that:

- there would be irreversible consequences if the Plaintiffs were not allowed to proceed with the appeal;
- there was no public interest in winding up the Plaintiffs because there would be no prejudice to the Deputy Commissioner in connection with any more ongoing debts as the Plaintiffs had not been trading since 2007;
- the Deputy Commissioner was in breach of his obligation to act as a model litigant under the *Legal Services Directions 2005 (Cth)* (the Legal Services Directions); and
- if the Plaintiffs were wound up, a director of some of the Plaintiffs (Ms Caporale) would be precluded from being a director of any corporation and this would be detrimental to her and to the Plaintiffs.

(c) Issues

The key issue was whether the Court should exercise its discretion under s. 459A of the Corporations Act to grant the Plaintiffs an adjournment of the application to wind up the Plaintiffs in insolvency. The onus was on the Plaintiffs to persuade the Court that the adjournment should be granted.

(d) Judgment

His Honour held that great weight must be given to the clear legislative policy enacted by Parliament which gives priority to the recovery of taxation revenue, notwithstanding that the Plaintiffs had an appeal under Part IVC of the Taxation Administration Act on foot. His Honour observed that:

- it is too narrow a view of the Court's discretion that the winding up application should be adjourned because Part IVC proceedings are pending or because on review of those proceedings there appears to be an arguable case;
- in cases where the Court considers that it is in a position to assess the merits of pending Part IVC proceedings and that it is appropriate to do so, the weight to be attached to those merits will vary according to the relative strength of the merits but the Plaintiffs, as taxpayers, would need to have a case on appeal that was more than merely arguable;
- irrespective of the merits of pending Part IVC proceedings, a stay will not usually be granted where the taxpayer is party to a contrivance to avoid liability to pay tax; and
- more weight would be given to the merits factor if the case is one where the Deputy Commissioner has abused his position.

When his Honour first granted the Plaintiffs an adjournment of the winding up application pending the outcome of the Tribunal's decision, his Honour had held that each of the Plaintiffs had an arguable case which extended to the facts in the proceedings before the Tribunal. His Honour found that it was most significant that the Plaintiffs' grounds of appeal were now limited to questions of law.

His Honour considered each ground of appeal. Ultimately, his Honour found that none of the grounds for appeal were reasonably arguable. His Honour noted that even if he was wrong and the grounds for appeal were reasonably arguable, the grounds were not strong.

Additionally, his Honour also observed that:

- only the Commonwealth (and not the Plaintiffs) has standing to raise the matter of the Deputy Commissioner's compliance or otherwise with the Legal Services Directions;
- the Plaintiffs' input tax claims were entirely without foundation; and
- no weight should be given to Ms Caporale's potential preclusion from being a director of any corporation as such a preclusion is not automatic.

His Honour was therefore not persuaded that the merits of the Plaintiffs' arguments on appeal outweighed the strength of the clear legislative policy giving priority to the recovery of taxation revenue. Consequently, his Honour refused to grant the Plaintiffs a further adjournment of the winding up application and ordered that the Plaintiffs be wound up.

6.14 Leave to bring an appeal in derivative proceedings under section 237 of the Corporations Act refused

(By Katrina Sleiman and Ben Williams, Corrs Chambers Westgarth)

Wood v Links Golf Tasmania Pty Ltd (No 2) [2013] FCA 143, Federal Court of Australia, Gordon J, 27 February 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/cth/FCA/2013/143.html

(a) Summary

The plaintiffs, Peter Wood (Wood) and Justin Hetrel (Hetrel) are former directors of the defendant, Links Golf Tasmania (the Company). Wood and Hetrel (together, the Applicants) sought, and obtained, leave pursuant to s. 237 of the Corporations Act 2001 (Cth) (Act) to conduct proceedings on behalf of the Company against another former director (Sattler) and his family company (the Derivative Proceeding). The Company was largely unsuccessful in the Derivative Proceeding.

In the current appeal proceeding, the Applicants sought further leave under s. 237 to conduct an appeal from that decision. Justice Gordon refused to grant leave, finding that such a grant of leave was not in the best interests of the Company.

(b) Facts

The Company was largely unsuccessful in the Derivative Proceeding, although it was awarded equitable compensation on two limited aspects. The Company was ordered to pay 85% of Sattler's costs of the Derivative Proceeding and the Applicants were ordered to indemnify the Company for half of those costs.

At the same time, orders were made in the proceeding pursuant to which the Applicants sought (and obtained) the original grant of leave (the Leave Proceeding) amending earlier orders as to costs. The original order that the Company pay the Applicants' reasonable costs of the Derivative Proceeding was amended such that the Applicants became liable for 40% of their own costs of the Derivative Proceeding.

The Applicants appealed from the orders in the Leave Proceeding as well as seeking leave under s. 237 in this appeal proceeding. While leave had been granted in the Derivative Proceeding, the appeal proceeding being a fresh proceeding, the Applicants required a further grant of leave.

(c) Decision

Section 237 of the Act provides that, relevantly, the Court must grant an application for leave to bring proceedings if it is satisfied that:

(a) it is probable that the company will not itself bring the proceedings;
(b) the applicant is acting in good faith;
(c) it is in the best interests of the company;
(d) there is a serious question to be tried; and
(e) the applicant gave written notice to the company.

The Court was satisfied that criteria (a) and (e) were satisfied by a letter from the Applicants' solicitors to the Company attaching a draft notice of appeal and seeking its consent to institute the appeal together with a letter from the Company's solicitors indicating that it did not consent to the appeal.

(i) Best interests

In deciding whether a grant of leave is in the best interests on a company, relevant considerations include the company's size and character, the effect of the litigation on its business, the alternatives available and whether the defendant is likely to be able to satisfy any judgment. The court must weigh the prejudice to the company from an adverse costs order against the benefit of a successful claim, which means that the strength of the claim is relevant.

The Company made the submission, which was accepted by Justice Gordon, that in circumstances where the litigation to date had resulted in the Company owing up to $1.15 million to its solicitors and up to $600,000 to Sattler for his costs, the best interests criteria would only be made out if the Company would not be liable for the costs of the appeal or an adverse costs order.

To that end, the Applicants undertook to indemnify the Company in relation to any costs order against it, provide security for Sattler's costs and pay for the Company's costs of the appeal. In addition, the Applicants' solicitors undertook not to enforce payment of any fees owed to them by the Applicants in the earlier proceedings and the other appeal proceedings until the Applicants had paid any costs order made against them in the appeal proceeding.

Justice Gordon considered several possible scenarios:

- if the Company was unsuccessful, the Applicants' financial position was insufficient to meet Sattler's costs of the appeal;
- if the Company was unsuccessful, and the Applicants succeeded in their appeal in the Leave Proceeding, they might be able to meet the Sattler's costs of the appeal but that would come at the expense of exposing the Company to a higher liability in the Leave Proceeding; and
- even if the Company was successful, the matter would be remitted for further trial and the outcome would be uncertain.

Against those risks, Justice Gordon considered the potential benefits to the Company of a successful appeal. Her Honour held that the Applicants needed to demonstrate an entitlement to monetary compensation and not merely nominal damages. Two arguable benefits - the rectification of the share register and an adjustment of the costs order - were given little or no weight as the rectification was a nominal benefit and the costs order not a significant one.

Justice Gordon found that the potential benefit from an equitable compensation order was difficult to assess, particularly because a successful appeal would need to be remitted for, most likely, a long and expensive hearing. Having weighed the benefits and costs, her Honour found that the benefits did not outweigh the risk to the Company, and that the Applicants' undertakings were not sufficient to mitigate that risk. Leave was therefore refused as it was not in the best interests of the Company.

(ii) Serious question to be tried

While the Court did not need to consider whether there was a serious question to be tried, it considered the matter and found that there was. Justice Gordon noted that an application for leave under s. 237 in the context of an appeal was different to that of an original proceeding where merits of an action are wholly untested. The enquiry must address the orders and reasons for judgment and there may be findings of fact made by the primary judge that an appeal court would generally not overturn.

However, the Applicants merely need to establish that they have a "sufficiently cogent case" and need not establish that it is more probable than not that the appeal would succeed. Justice Gordon was satisfied that the Applicants met the relevant threshold.

(iii) Good faith

The Company submitted that the Applicants were not acting in good faith because they were pursuing remedies which would advance their interests as shareholders. However, Justice Gordon did not consider the Applicants' personal interests to be such that the application was an abuse of process, noting that an applicant is not disentitled from bringing a derivative action merely because they have an interest in the outcome.

Justice Gordon held that, while the Applicants did not provide sworn evidence as to their beliefs, that was not a requirement and her Honour was satisfied that they were acting in good faith.

6.15 Multiple derivative actions under UK law

(By Lucy Witheriff, Minter Ellison)

Universal Project Management Services Ltd v Fort Gilkicker Ltd [2013] EWHC 348 (Ch), England and Wales High Court (Chancery Division), Briggs J, 26 February 2013

The full text of this judgment is available at:

http://www.bailii.org/ew/cases/EWHC/Ch/2013/348.html

(a) Summary

This UK case considers whether an applicant can pursue a derivative action claim when it is not a shareholder in the company in which the cause of action is alleged to be vested, but is a member of a limited liability partnership which owns all the shares in that company.

The court ultimately granted permission for the claim to continue, finding that the enactment of the *Companies Act 2006* (UK) (Act) did not oust the common law position in relation to multiple derivative actions.

(b) Facts

The applicant, Universal Projects Management Services Ltd (UPMS), made an application for permission to continue a double derivative action.ve action.

UPMS (represented by its principal Dr Frischmann) and Mr Pearce, who is the second defendant, both held equal shares in a property development joint venture which was carried on through Askett Hawk Properties LLP (LLP). Dr Frischmann and Mr Pearce were equal shareholders and directors of Fort Gilkicker Limited (FGL). FGL is the first defendant to the claim.

On 7 July 2011, FGL entered into an option to acquire Fort Gilkicker (Land). In May and June 2012, a disagreement arose between Dr Frischmann and Mr Pearce. Consequently, it was alleged that while Dr Frischmann was away and without his knowledge, Mr Pearce allowed the option to expire, incorporated a new company called Fort Gilkicker Properties Limited (FGP) and purchased the land on the same terms which had previously been available to FGL. FGP, which was owned and controlled by Mr Pearce, is the third defendant to the claim.

UPMS claimed that Mr Pearce misappropriated a valuable business opportunity of FGL for his personal benefit, which breached his fiduciary duty to FGL.

(c) Decision

Before the introduction of the *Companies Act 2006*, derivative actions relating to companies were governed by principles of common law. Ordinary derivative actions were replaced by the statutory claim in Chapter 1 of Part 11 of the Act. However, the position regarding multiple derivative actions since the introduction the Act was unknown. Chapter 1 of Part 11 of the Act deals with derivative claims and proceedings by members and sets out the conditions for bringing a derivative claim, the procedural requirements and considerations which the court is required to take into account when deciding whether to permit a claim.

Briggs J considered the following questions:

- whether a multiple derivative action was known to English common law before the Act came into force; and
- if so, whether the multiple derivative action (of which the double derivative action is a sub-species) has survived the coming into force of the Act.

Briggs J answered the first question, regarding whether the common law permitted multiple derivative actions, in the affirmative. Briggs J had regard to Lord Millet's judgment in the case of *Waddington Ltd v Chan Chun Hoo Thomas* [2008] HKCU 1381. Briggs J made the following comments at [26]:

"In my judgement the common law procedural device called the derivative action, was at least until 2006, clearly sufficiently flexible to accommodate as the legal champion or representative of a company in wrongdoer control a would-be claimant who was either (and usually) a member of that company or (exceptionally) a member of its parent company where that parent company was in the same wrongdoer control".

The second question regarding the effect of the Act on multiple derivative actions was ultimately a question of statutory interpretation. The main source of disagreement stemmed from the restrictive definition of "derivative claim" in s. 260 of the Act. Section 260(1) of the Act states:

1) This chapter applies to proceedings in England and Wales or Northern Ireland by a member of a company -
a) in respect of a cause of action vested in the company; and
b) seeking relief on behalf of the company.
This is referred to in this Chapter as a "derivative claim".

Section 260(5) states that reference to a member of a company includes a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law. The Act essentially confers locus standi only upon a member of the relevant company.

Briggs J considered the recommendations from the Law Commission Report, which stated that the question of multiple derivative actions is best left to the courts to resolve. He also considered academic commentary regarding the effect of the Act on multiple derivative actions. It was ultimately decided that the *Companies Act 2006* did not take away multiple derivative actions.

The counsel for the second and third respondents submitted that a common law derivative action did not extend so far as to allow members of an LLP to bring proceedings on behalf of a company wholly owned by that LLP, as there is no statutory means for doing so. Briggs J did not find those objections to be persuasive.

It was ultimately held that there was a prima facie case to support the fact that wrong was done to FGL. The circumstances of the case sufficiently satisfied the exception to the rule in *Foss v Harbottle* (1843) 2 Hare 461.

Briggs J was not satisfied however that the alterative remedies suggested by the counsel for the respondents was sufficient to disallow a multiple derivative action. In relation to submissions regarding the fact that the parties should be left to resolve their differences through commercial negotiation without the need for the court's interference, Briggs J commented the best way forward would be for the court to give permission to continue the multiple derivative action and then stay proceedings for negotiation if necessary.

Permission to continue the claim of the multiple derivative action was granted.

6.16 What factors are taken into consideration when making an order for security for costs?

(By Rebecca Ebzery, Minter Ellison)

In the matter of Hyperion Technology Pty Ltd v Queensland Motorways Ltd [2013] QSC 20, Supreme Court of Queensland, Daubney J, 19 February 2013

The full text of this judgment is available at:

http://www.austlii.edu.au/au/cases/qld/QSC/2013/20.html

(a) Summary

This case focused on the factors that are given weight when deciding whether or not to award an order for security for costs, with particular focus placed on where there is a lengthy delay between the initiation of proceedings and the bringing of the application, or a financial imbalance between the two parties.

(b) Facts

The application, filed on 29 February 2012, was made by Queensland Motorways Ltd (defendant) against Hyperion Technology Pty Ltd (plaintiff) concerning security for costs in the proceedings. The litigation concerned an agreement entered into by the plaintiff and defendant for the supply and testing of eTAGs. Following repudiation of the contract by the defendant, the plaintiff claimed damages for costs incurred in performing the agreement, loss of opportunity to earn profits under the agreement and lost opportunity to sell eTAGs to other parties due to their consequent inability to establish a reputation in the market place.

Shortly after commencing proceedings, the parties proceeded to mediation on 1 November 2011, however the dispute remained unresolved. The plaintiff then proceeded to notify the defendant of its intention to amend their statement of claim in light of preliminary disclosure and matters arising from the mediation. The further amended statement of claim was served on 20 December 2011.

The defendant then raised concerns over the plaintiff's capacity to meet an order for costs. The plaintiff responded alleging that the delay in raising the issue of their financial capacity would cause them to suffer prejudice if an order for security of costs were made. The defendant disagreed, and subsequently filed the application. The plaintiff acknowledged that it would be unable to meet an adverse order for costs if it were unsuccessful at trial but maintained that the following factors weighed against the exercise of discretion by the court to make the order:

- delay by the defendant in not making the order for security for costs in a timely fashion;
- the application was oppressive because:
    - the financial imbalance between the parties would mean that the court should not make an order effectively shutting out small companies from litigating against large, well resourced companies; and
    - the defendant was aware prior to the dispute of the plaintiff's financial circumstances, making the granting of the order unreasonable and unjust in the circumstances;
- no security had, or could be reasonably expected to be offered by, shareholders or creditors of the plaintiff; and
- the financial state of the plaintiff was cause, either wholly or in part, by the defendant's repudiatory conduct.

(c) Decision

With respect to the delay, Daubney J noted that although there was a substantial delay of some 16 months between the commencement of the claim and bringing of the application by the defendant, it was caused largely by the mediation between the parties. Daubney J noted that it would have been inappropriate for the defendant, prior to mediation, to raise the issue of costs as it may have impinged on the efforts of the parties to participate in a meaningful mediation.

Following the mediation, Daubney J noted that the defendant did not delay in raising the issue and brought the application appropriately, and as such the case at hand was not one in which there was "no reasonable excuse for the defendant's delay, to which the plaintiff in no degree contributed".

Concerning the nature of the relevant financial standing of the parties, Daubney J held that it was not a factor to which he would ascribe much weight. Although large corporations should not be offered protection against litigation by smaller opponents, Daubney J noted they should not be exempted by being able to enforce costs provisions if appropriate.

Referring to the "special relationship", Daubney J distinguished the circumstances at hand from the authority relied on by the plaintiff which was a dispute between a holding and subsidiary company. Daubney J noted that the current transaction involved parties which were at arms-length, and did not involve any special relationship which is "relevant to the exercise of discretion in the present case".

The plaintiff contended that it would not be reasonable to expect a financially capable creditor to give security in this case. In addressing the argument, Daubney J made particular reference to a passage in *Bell Wholesale Co Ltd v Gates Export Corporation*, that "the principle at play is a simple one: those who stand to share the benefits of litigation cannot shirk its burdens". It was emphasised by the court that, although the plaintiff claimed impecuniosity, it had given no evidence to support the claim, and further there was no reason submitted to the court why a finance company ought not assume responsibility for the defendant's costs if the plaintiff was unsuccessful.

Daubney J noted that "the onus clearly rested on the plaintiff to persuade the court that its impecuniosity was caused by the defendant's conduct". As the onus was not discharged, the submission was not accepted. Further, the plaintiff's case rested on the assertion that the defendant caused the loss of opportunity to earn profits. There was nothing in the material submitted by the plaintiff to suggest anything done or omitted to be done by the defendant caused this, and so that argument was also rejected.

In line with the factors outlined above, and with the overarching contention that the plaintiff had not put forward any evidence to demonstrate that they were not capable of bearing the burden of costs, Daubney J found it was appropriate to exercise a discretion in the defendant's favour. Regarding quantum, Daubney J determined it was appropriate to provide for costs up to and including the first day of trial, resulting in a sum of $400,000, and further costs of and incidental to the application for security of costs.