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Bulletin No. 259

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1. Recent Corporate Law and Corporate Governance Developments

1.1 Funding announced for ASIC, APRA and Federal Court

23 March 2019 - Treasurer Josh Frydenberg has announced that the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) will be provided with increased funding in the 2019-20 Commonwealth Budget.

ASIC will be provided with more than $400 million in funding, representing on average a 25% increase in its annual funding compared to 2017-18. APRA will be provided with more than $150 million in funding, representing on average a 30% increase in its annual funding compared to 2017-18.

The ASIC funding will support:

- an accelerated enforcement strategy;
- expanded regulation of financial services in accordance with the recommendations in the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission) - specifically, in relation to credit, financial advice and insurance;
- enhanced on-site supervision of larger institutions;
- ASIC's expanded role as the primary conduct regulator for superannuation; and
- ASIC's new role in administering a conduct-focused accountability regime.

The funding for ASIC builds on the additional $70.1 million provided by the federal government in August 2018.

The APRA funding will:

- extend the Banking Executive Accountability Regime (BEAR) to all APRA-regulated entities including insurers and superannuation funds;
- boost supervision intensity across APRA-regulated entities, including a strong focus on underperforming superannuation funds and members outcomes; and
- enhance the supervisory framework for governance, culture and remuneration applying to all APRA-regulated entities, including through building internal technical expertise and

accessing technical specialists outside of APRA, supporting APRA's response to key areas of concern raised in the final report of the Royal Commission.

The funding for APRA builds on the $58.7 million provided by the federal government in November 2018 to increase the number of frontline supervisors and enhance APRA's ability to identify and address new and emerging risk areas.

In addition, funding of $35 million for the Federal Court of Australia was announced to support the extension of its jurisdiction to corporate crime.

1.2 APRA to increase scrutiny of climate risks after releasing survey results

20 March 2019 - APRA will increase its scrutiny of how banks, insurers and superannuation trustees are managing the financial risks of climate change to their businesses.

Releasing the results of its first climate risk survey of regulated entities, APRA called on entities to move from gaining awareness of the financial risks to taking action to mitigate against them.

APRA surveyed 38 large banks, insurers and superannuation trustees last year to assess their views and practices related to climate-related financial risks. The survey found a substantial majority of regulated entities were taking steps to increase their understanding of the threat, including all of the banks, general insurers and superannuation trustees surveyed.

Other key findings included that:

- a third of respondents believed climate change was a material financial risk to their businesses now and a further half thought it would be in future;
- a majority of banks considered climate-related financial risks as part of their risk management frameworks; and
- reputational damage, flooding, regulatory changes and cyclones were nominated as the top climate-related financial risks.

Respondents also described the strategic opportunities they had identified from the transition to a low carbon economy, including developing innovative products and services, and meeting the growing demand for green investment opportunities.

The Information Paper - Climate change: Awareness to action also contains a stocktake of actions and initiatives underway in Australia and internationally in response to growing awareness of the physical, transitional and liability risks of climate change.

1.3 Consultation on enforceable financial services industry code of conduct provisions

18 March 2019 - The federal government has released a consultation paper on making provisions of financial services industry codes of conduct more enforceable and providing both the regulator and consumers with more powers to hold financial services firms to account for misconduct.

This includes amending the law to allow:

- ASIC to approve codes for a wider range of entities than currently possible;
- ASIC-approved codes to include 'enforceable code provisions', contravention of which constitutes a breach of the law and with remedies modelled on those in the Competition and Consumer Act (2010) 1974 No. 51 (Cth); and
- ASIC to take into account whether particular provisions of an industry code have been designated as enforceable code provisions in determining whether to approve a code.

Through these changes, it will also be made clear that certain promises made in codes are enforceable against financial services firms by consumers.

The consultation paper is available on the Treasury website.

1.4 Parliamentary Committee report on franchising

14 March 2019 - The Parliamentary Joint Committee on Corporations and Financial Services (the Committee) has published its report, Fairness in Franchising.

The report notes that franchising is a large part of the Australian economy and is estimated to contribute approximately 9% of gross domestic product. Yet franchising exhibits a substantial disparity in power between franchisors and franchisees and evidence to the inquiry indicated that problems, including exploitation in certain franchise systems, are systemic. The Committee received evidence that far too many franchisors are abusing the power imbalance between themselves and their franchisees and how the abuse of contractual power can manifest in a franchise agreement.

Further, the Committee also received evidence that pointed to shortcomings in the current regulatory responses, such as the duty to act in good faith and the unfair contract terms provisions. To deal with these problems, the committee has proposed substantial changes to the Franchising Code of Conduct (the Franchising Code), to the sections of the Oil Code of Conduct (the Oil Code) that relate to franchising, as well as to the responsibilities and powers of the regulator.

The recommendations made by the Committee include:

- that the federal government establish an inter-agency Franchising Taskforce to examine the feasibility and implementation of a number of the committee's recommendations. The Franchising Taskforce should include representatives from the Department of the Treasury, the Department of Jobs and Small Business and, where appropriate, the Australian Competition and Consumer Commission (ACCC);
- improved disclosure, including:
  - a requirement to provide the disclosure document in electronic form;
  - requirements around the provision of earnings and financial information when franchises are sold or transferred; and
  - greater clarity, consistency and accountability with respect to the use and reporting of marketing funds;
- mandatory disclosure in percentage terms of all supplier rebates, commissions and other payments in relation to the supply of goods or services to franchisees;

- that the whistleblower protection regime recommended in the Committee's report on Whistleblower Protections apply to franchisees and their employees, and that breaches of the Franchising and Oil Codes by franchisors be included in the definition of disclosable conduct;
- that the Franchising Taskforce examine the appropriateness of making unfair contract terms in franchise agreements illegal and for civil penalties to be established;
- a significant addition to the Franchising Code to give franchisees the right to exit franchise agreements under certain conditions, which vary according to the situation;
- that the Franchising Taskforce consider greater transparency around the allocation (if any) of goodwill in franchise agreements, as well as protections for franchisees when required to undertake significant capital expenditure near the end of the term of a franchising agreement;
- that the federal government implement the ACCC's proposal for a class exemption to make it lawful for all franchisees to collectively bargain with their franchisor regardless of their size or other characteristics. The Committee recommends that franchisees be empowered to undertake collective action, such as joint negotiation, mediation and arbitration to resolve problems and disputes;
- that the dispute resolution scheme under the Franchising Code include binding arbitration with the capacity to award remedies, compensation, interest and costs. Further, the Franchising Code be amended to allow a mediator or arbitrator to undertake multi-franchisee resolutions when disputes relating to similar issues arise;
- that civil pecuniary penalties and infringement notices should be made available for all breaches of the Franchising and Oil Codes. Further, the penalty amounts should be similar to the penalties currently available under the *Australian Consumer Law* to ensure meaningful deterrence;
- that the ACCC be given an intervention power to identify and act on the marketing and sales of franchises where a franchisor shows a track record of systemic churning and/or burning. Churning refers to the repeated sale at a single site of a failed franchise to a new franchisee. Burning refers to continually opening new outlets, some of which are unlikely to be viable, to profit from upfront fees, while leaving existing outlets to struggle and close; and
- improvements to the education and advice available for franchisees, including that the ACCC develop a FranchiseSmart website for franchises along the lines of the ASIC MoneySmart service. The Committee also considers that franchisees need to develop far greater awareness around the risks and responsibilities of being a franchisee. This includes pre-entry education and seeking appropriate advice about the franchise agreement, but also extends to financing, and the implications of retail lease arrangements.

1.5 New audit regulator proposed for the UK

11 March 2019 - The UK Government has published a consultation paper regarding a new regulator for the audit and accounting sector in response to the Independent Review led by Sir John Kingman. In line with the review's recommendations, the Financial Reporting Council (FRC) will be replaced with a new regulator called the Audit, Reporting and Governance Authority.

Specifically, the new regulator will:

- be a statutory body with powers to direct changes to accounts to be made, rather than applying to court to do so, and to undertake comprehensive reviews with greater transparency; and
- regulate the largest audit firms directly (rather than being delegated).

There will also be larger sanctions available in cases of corporate failure, including new powers to require rapid explanations from companies and in the most serious cases publish a report about the company's conduct and management.

View the Independent review of the Financial Reporting Council: initial consultation on recommendations.

1.6 ACSI announces enhanced gender diversity policy

7 March 2019 - The Australian Council of Superannuation Investors (ACSI) has published an updated gender diversity policy, aimed at increasing the appointment of women to corporate boards.

In 2015, ACSI and its members adopted a gender diversity target - for women to occupy 30% of board positions in ASX200 listed Australian companies. In 2017, ACSI implemented a policy of recommending a vote at company annual general meetings against the election of directors in companies with poor gender diversity.

The policy is being extended to ASX200 boards with only one woman director and to ASX201-300 boards.

1.7 Findings from FCA cryptoassets consumer research

7 March 2019 - The UK Financial Conduct Authority (FCA) has published two research reports examining UK consumer attitudes to cryptoassets, such as Bitcoin or Ether. The research includes qualitative interviews with UK consumers and a national survey.

The qualitative research indicated some potential harm, including that many consumers may not fully understand what they are purchasing. For example, several of those interviewed talked of wanting to buy a 'whole' coin, suggesting they did not realise they could buy part of a cryptoasset. Despite this lack of understanding, the cryptoasset owners interviewed were often looking for ways to "get rich quick", citing friends, acquaintances and social media influencers as key motivations for buying cryptoassets.

Both the survey and qualitative research found that some cryptoasset owners made their purchases without completing any research beforehand.

However, despite the general poor understanding of cryptoassets amongst UK consumers, findings from the survey suggest that currently the overall scale of harm may not be as high as previously thought.

The research findings included that:

- 73% of UK consumers surveyed don't know what a 'cryptocurrency' is or are unable to define it - those most aware of them are likely to be men aged between 20 and 44;
- the researchers estimate only 3% of consumers surveyed had ever bought cryptoassets;
- of the small sub-sample of consumers who had bought cryptoassets, around half spent under £200 - a large majority of these said they had financed the purchases through their disposable income;
- Bitcoin appears to be the favourite cryptoasset for consumers with more than 50% of the cryptoasset owner survey sub-sample reporting to have spent their money on this product, while one in three (34%) chose Ether.

The FCA has previously warned that cryptoassets, including Bitcoin for instance, are highly volatile and risky. Many tokens (including Bitcoin and 'cryptocurrency' equivalents) are not currently regulated in the UK. This means that the transfer, purchase and sale of such tokens currently fall outside FCA regulatory remit. This means it is unlikely that consumers will be entitled to make complaints to the Financial Ombudsman Service or to be protected by the Financial Services Compensation Scheme if things go wrong.

The FCA is working with the UK government and Bank of England, as part of a UK Cryptoassets Taskforce, to understand and address the harms from cryptoassets and encourage innovation in the interests of consumers. The FCA is currently consulting on guidance to clarify the types of cryptoassets that fall within the existing regulatory perimeter. Later this year the FCA will consult on banning the sale of certain cryptoasset derivatives to retail investors. HM Treasury is also exploring legislative change to potentially broaden the FCA's regulatory remit to include further types of cryptoassets.

1.8 FRC consults on stronger going concern standard for auditors

4 March 2019 - The UK Financial Reporting Council (FRC) has proposed to increase the work required of auditors when assessing whether an entity is a going concern.

The consultation on revisions to *International Standard on Auditing (ISA) (UK) 570 Going Concern* follows concerns about the quality and rigour of audit and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after as well as findings from recent FRC enforcement cases.

The FRC proposes:

- auditors make greater effort to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement;
- improved transparency with a new reporting requirement for the auditor to provide a conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect; and
- a stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern.

View the Exposure Draft and Consultation Document.

1.9 APRA announces policy priorities for 2019

28 February 2019 - APRA has released its annual Policy Priorities document, outlining its areas of intended policy focus over the next 12 to 18 months.

As well as building on several substantial pieces of work commenced last year, APRA's near term policy agenda will be shaped by its response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission). It also takes into account major developments, including other inquiries, new legislation such as the Banking Executive Accountability Regime (BEAR), and important industry trends.

The document also outlines APRA's policy priorities for each of the industries it regulates.

For authorised deposit-taking institutions (ADIs), APRA will undertake work including:

- progressing changes to the ADI capital framework, designed to embed the Basel III reforms, make the framework more flexible and internationally comparable, and ensure ADIs remain on track to meet the "unquestionably strong" capital ratio benchmarks; and
- updating prudential standard APS 220 on credit risk management, including recommendations relating to valuations as recommended by the Final Report of the Royal Commission.

For superannuation, APRA's plans include:

- ensuring superannuation trustees are prepared to implement the new member outcomes assessments from 1 January 2020 (including any amendments required by legislative changes);
- completing the post-implementation review of the prudential framework introduced in response to 2013's Stronger Super reforms, and consulting on proposals to address areas where changes are needed; and
- updating the superannuation data collection, with a particular focus on expanding the information collected on choice products.

For general, life and private health insurance, APRA intends to:

- consult industry on plans to apply the capital framework for life and general insurance to private health insurance (PHI), as part of Phase Three of APRA's PHI Roadmap; and
- release a discussion paper examining how the prudential framework for insurance may need to be modified in light of the new accounting standard, AASB 17.

Separately, and as previously announced, APRA is reviewing its approach to enforcement in light of the BEAR and the CBA Prudential Inquiry, as well as the Royal Commission's observations that APRA should develop a stronger appetite for formal enforcement action. APRA intends to publish a new enforcement strategy shortly after the final review is presented to APRA Members.

1.10 FSB consultation on the effects of financial regulatory reforms on SME financing

25 February 2019 - The Financial Stability Board (FSB) is consulting on the effects of financial regulatory reforms on the provision of financing to small and medium-sized enterprises (SMEs). The evaluation forms part of a broader FSB examination of the effects of post-crisis reforms on financial intermediation. More details on the evaluation and a summary of the views expressed by some stakeholders can be found in the note with the key takeaways of a roundtable held by the FSB on this topic in December 2018.

As part of this evaluation, the FSB invites feedback from stakeholders including SMEs, financial institutions and trade associations on the following issues:

- what have been the main trends in SME financing (i.e. types of financing, volumes, prices and maturities) since the financial crisis?;
- how do these trends differ across jurisdictions (e.g. advanced vs emerging market economies) and sectors (e.g. high-tech vs traditional firms), as well as by firm size (micro vs small vs medium-sized firms) and age (e.g. start-ups vs mature firms)?;
- what have been the main drivers of the observed trends in SME financing in recent years? How do they differ across jurisdictions, sectors, size and age of firms?;
- have financial regulatory reforms such as Basel III affected bank financing to SMEs (e.g. in terms of loan volumes, prices, maturities and collateralisation)? If so, how? How important have been their effects *vis-à-vis* other types of bank lending and compared to the main drivers identified in the second point above?;
- how does the impact (if any) of financial regulatory reforms vary across banks operating in different geographies and with different size and business models?;
- what other G20 financial reforms or other domestic financial regulations (if any) may have impacted financing to SMEs and how?;
- have financial reforms prompted a shift in the provision of SME financing, e.g. between banks and other financial institutions (substitution effects)? If so, how?; and
- are there any other issues or relevant factors that should be considered as part of the evaluation?

1.11 Government response to Financial Services Royal Commission recommendation on insurance claims handling

4 February 2019 - The federal government has released its response to the recommendation made in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry's (the Royal Commission) final report to remove the exclusion of insurance claims handling from the definition of "financial service".

The Royal Commission recommended that the handling and settlement of insurance claims be included in the definition of financial service and stated that it should not be unreasonable to ask an insurer to handle claims efficiently, honestly and fairly.

The federal government is supportive of this recommendation and has published a consultation paper.

View the Consultation paper on insurance claims handling.

2. Recent ASIC Developments

2.1 Remake of 'sunsetting' class order about warrants and out of use notices

18 March 2019 - ASIC has remade Class Order [CO 08/781] Warrants: Out-of-use notices, which is due to expire on 1 April 2019.

The new instrument, ASIC Corporations (Warrants: Out-of-use notices) Instrument 2019/148, continues to provide issuers of warrants relief from the requirement in the Corporations Act 2001 No. 50 (Cth) to notify ASIC when a warrant ceases to be available in certain circumstances. The relief is provided only to issuers of warrants offered under a Product Disclosure Statement (PDS) or Supplementary PDS covering two or more warrant products.

Under the new instrument, a warrant issuer will only need to lodge an out-of-use notice with ASIC when all the warrants to which the PDS or Supplementary PDS relates are no longer available.

The new instrument will continue the effect of the previous instrument with some minor amendments, which include simplifying the drafting to give greater clarity.

The relief was remade following ASIC's public consultation in *Consultation Paper 307 Remaking ASIC class order on warrants: out-of-use notices: [CO 08/781]*.

2.2 Report on corporate finance regulation - July to December 2018

15 March 2019 - ASIC has published its tenth report on the regulation of corporate finance issues. The latest report covers the period from July to December 2018 and provides an update on specific focus areas for the next six months.

Report 612: ASIC regulation of corporate finance: July to December 2018 (REP 612) provides statistical data and includes relevant guidance about ASIC's regulation of:

- fundraising transactions;
- mergers and acquisitions;
- experts; and
- corporate governance issues.

REP 612 explains the approach ASIC takes in these areas, including the conduct that has caused ASIC to intervene, ASIC's response to novel issues seen in transactions during the period, as well as offering insights into future areas of focus.

REP 612 also discusses ASIC's key concerns and expectations regarding financial information presented in prospectuses, on-market buy-backs and expert valuations.

2.3 Update on further reviews into fees-for-no-service failures

11 March 2019 - ASIC has released an update on the fees for no service (FFNS) further review programs undertaken by six of Australia's major banking and financial services institutions.

ASIC's ongoing supervision of the review programs undertaken by AMP, ANZ, CBA, Macquarie, NAB and Westpac (the Institutions) has shown that most have yet to complete further reviews - i.e. reviews to identify systemic FFNS failures beyond those already identified and reported to ASIC since 2013.

The main reasons for delays by the Institutions are:

- poor record-keeping and systems within the Institutions, which mean that in many cases they have been unable to access customer files for review;
- failure by some Institutions to propose reasonable customer-centric methodologies to identify and compensate customers despite ASIC's clear articulation of expectations (for example, ASIC rejected a few of the methodologies such as a requirement for customers to "opt-in" to the review and remediation program, and a proposal to assess if there had been a "fair exchange of value" with customers instead of assessing whether customers received the specific services they paid for); and
- some Institutions have taken a legalistic approach to determination of the services they were required to provide (for example, ASIC's view is that if the agreement requires an annual review, the mere offer of an annual review is not sufficient).

ASIC's large-scale FFNS supervisory work includes overseeing:

- the Institutions' programs to compensate customers impacted by the reported failures to provide advice services paid for by customers (the Compensation Programs); and
- the Institutions' reviews to determine whether there were further systemic FFNS failures beyond those already identified and reported to ASIC (the Further Reviews).

Under the Compensation Programs, AMP, ANZ, CBA, NAB and Westpac have collectively paid or offered approximately $350 million in compensation to customers who were charged financial advice fees for no service at the end of January 2019. Additionally, the Institutions have provisioned more than $800 million towards potential compensation for further systemic FFNS failures. However, these reviews are incomplete.

Along with supervision of the Compensation Programs and Further Reviews undertaken by the Institutions, ASIC is also conducting a number of FFNS investigations and plans to take enforcement action against licensees that have engaged in misconduct.

View the Report card of further reviews undertaken by the institutions.

2.4 Consultation on coverage of ePayments Code review

6 March 2019 - ASIC has released a consultation paper (CP 310) seeking feedback on the proposed coverage of its review of the ePayments Code (the Code).

ASIC is undertaking a review of the ePayments Code to ensure it continues to be effective and relevant to consumers and Code subscribers.

The review will focus on testing the effectiveness of the following areas in the Code:

- complaints handling;
- unauthorised transactions;
- data reporting; and
- mistaken internet payments.

The review will also consider options for future-proofing the Code.

Since ASIC's previous review of the Code in December 2010, there have been significant developments in the payments environment. These include changes to the ways consumers make payments (with the declining use of cash and the increasing availability and use of mobile payments technology). The current wording of the ePayments Code may not adequately cater for these developments, and this may have implications for the Code's ongoing effectiveness and relevance.

Another area that ASIC explores in CP 310 is the extent to which the Code's protections should be available to small business consumers.

View:

- CP 310 Review of the ePayments Code: Scope of the review;
- The ePayments Code; and
- List of current Code subscribers.

2.5 Report on licensing and professional registrations

28 February 2019 - ASIC's latest report on its assessment of licensing and professional registration applications (excluding applications to be registered as a liquidator) shows that less than half of the 2,879 applications considered during July 2017 to June 2018 were approved.

During 2017-18, 12 Australian financial services (AFS) licences and 12 credit licenses were suspended and approximately 15% of the 191 AFS licences and 319 credit licences were cancelled at the initiation of ASIC.

ASIC's report provides insights about the regulatory and policy issues that impact ASIC's licensing and registration application related activities, including key reforms and administrative refusals by ASIC Hearings Delegates and the Administrative Appeals Tribunal (AAT).

In 2017-18, ASIC considered approximately 2,879 applications, with 60% relating to AFS licence applications, 29% relating to credit licence applications and the remaining 11% relating to professional auditor registrations.

Of the 2,879 total applications, 48% (1,383) were approved, with 62% of those applications approved in a form other than applied for by the applicant. Of the 1,383 approvals, 44% were AFS licence approvals and 52% were credit licence approvals.

ASIC assessed 329 applications for professional registration of auditors, of which 59% were approved (comprising 4% of all approvals).

View Report 611 Overview of licensing and professional registration applications: July 2017 to June 2018.

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3. Recent ASX Developments

3.1 Public consultation - Guidance Note changes for ASX Clear, ASX Settlement, ASX Clear (Futures) and Austraclear participants

On 8 March 2019, the Australian Securities Exchange (ASX) released a consultation paper seeking stakeholder input on ASX's proposal to update Guidance Note 1 (Admission as a Participant) and Guidance Note 10 (Business Continuity and Disaster Recovery) in relation to cyber resilience.

ASX has taken steps to update its guidance on business continuity and disaster recovery and is asking participants to provide comments on the updated guidance, in particular, if the proposed transition arrangements are sufficient for participants to align their current business continuity arrangements with the updated guidance in Guidance Note 10.

ASX is also proposing to clarify the risk management framework obligations in Guidance Note 1 to specifically incorporate cyber risk as a key consideration. ASX is asking participants whether they agree with the proposal not to impose prescriptive requirements on how participants should manage cyber risk and instead to require participants to align their cyber resilience arrangements to one or more of the latest global or national cyber standards and guidance.

The consultation paper is available on the ASX website.

3.2 Corporate Governance Principles and Recommendations - 4th Edition

On 27 February 2019, the ASX Corporate Governance Council (the Council) published the following documents:

- the fourth edition of its Corporate Governance Principles and Recommendations;
- a Consultation Response summarising the main submissions the Council received during the consultation on the fourth edition and explaining the changes made to produce the final version;
- a mark-up comparing the final version of the fourth edition to the consultation version; and

- a mark-up comparing the fourth edition to the third edition.

All ASX listed entities are required to report against the recommendations in the Principles and Recommendations on an annual basis under the ASX listing rules. The fourth edition of the Principles and Recommendations will take effect for an entity's first full financial year commencing on or after 1 January 2020. As with previous editions, the Council encourages listed entities to adopt the fourth edition earlier.

The release of the fourth edition of the Principles and Recommendations follows an extensive public consultation process that began in May 2018. The Council received 92 non-confidential and 10 confidential submissions in response to its consultation paper. Copies of the non-confidential submissions are available on the ASX website.

ASX will conduct a national roadshow to promote and explain the changes in the fourth edition. Dates and venues are available at Corporate Governance Roadshow.

3.3 ASX Settlement Operating Rules and ASX Clear Operating Rules and Procedures amendments - Removal of Registered Holder Collateral Cover Authorisation (RHCCA) forms

ASX has obtained regulatory clearance to implement the amendments to the ASX Settlement Operating Rules and ASX Clear Operating Rules and Procedures outlined in the Response to Consultation available here on the removal of RHCCA forms released on 7 September 2018.

The amendments, which became effective on 1 March 2019, remove the RHCCA form for Client Accounts and also enable a third party to take a security interest over collateral and excess cash where prescribed conditions are met.

A notice is available on the ASX website.

3.4 Reports

On 5 March 2019, ASX released the ASX Monthly Activity Report for February 2019.

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4. Recent Takeovers Panel Developments

4.1 Finders Resources Limited 03R - Federal Court decision and variation of orders

18 March 2019 - The Federal Court of Australia has dismissed an application by Eastern Field Developments Limited for judicial review of a decision of the Takeovers Panel (see *Eastern Field Developments Limited v Takeovers Panel* [2019] FCA 311).

The Takeovers Panel has varied its final orders dated 6 June 2018 to:

- give Taurus Funds Management Pty Ltd until 25 March 2019 to publish the notices required by Order 33; and
- change the "Effective Date" (defined in Order 37) to 18 March 2019, to coincide with the lifting of the stay of the Takeovers Panel's orders.

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

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5. Recent Research Papers

5.1 Disregarding the Salomon principle: An empirical analysis, 1855-2014

For over a century UK courts have struggled to negotiate a coherent approach to the circumstances in which the *Salomon* principle - that a corporation is a separate entity - will be disregarded. Empirical analysis can facilitate our understanding of this mercurial area of the law. Examining UK cases from 1885 to 2014, the authors created a final dataset of 213 cases coded for 15 different categories. Key findings confirm historical patterns of uncertainty and a low but overall fluctuating disregard rate, declining recently. Criminal/fraud/deception claims link strongly to disregard outcomes. Private law rates are low but tort claims have a higher disregard rate than contract. Individual shareholders are more susceptible to disregard than corporate shareholders. The English Court of Appeal plays a key role in successful disregard claims particularly in tort. In general, while disregard rates were very context specific, concerns about the diminished sanctity of the *Salomon* principle may be overblown.

Disregarding the *Salomon* Principle: An Empirical Analysis, 1855-2014

5.2 General principles of EU corporate and insolvency law

Within the EU, several directives have been enacted with the aim of harmonising company law rules and principles. Differences, however, persist, as national rules implementing harmonising directives react with other domestic institutional settings and with the whole social and legal environment of each member states. As a consequence, the 'law in action' might depart across the EU, even concerning harmonised rules. Nevertheless, it is possible to identify some standard features of company law across most of the jurisdictions of advanced capitalism, including EU countries, such as limited liability and shares' commodification; yet these common elements do not stem from 'top-down' harmonisation in the EU but from the historical development of companies over the last two centuries. Insolvency proceedings are even more country-specific than company law, as these rules have a significant re-distributive impact on a broad range of stakeholders of the company, such as employees, creditors, and customers. Therefore, insolvency regimes are strictly related to political balances and national social security policies. The political relevance of insolvency law explains why the European Union has not yet enacted any harmonising measures and is only encouraging a convergence of national laws through a non-binding recommendation.

General Principles of EU Corporate and Insolvency Law

5.3 Corporate management in the age of AI

Recent media reports and press releases have created the impression that Artificial Intelligence (AI) is on the verge of assuming an important role in corporate management. While, upon closer inspection, it turns out that these stories should not always be taken at face value, they clearly highlight AI's growing importance in management and hint at the enormous changes that corporate leadership may experience in the future. This article attempts to anticipate that future by exploring a thought experiment on corporate management and AI. It argues that it is not an insurmountable step from AI generating and suggesting expert decisions (which is already common today) to AI making these decisions autonomously. The article then proceeds based on the assumption that next-generation AI will be able to take over the management of business organisations and explores the corporate law and governance consequences of this development. In doing so, the article focuses on the fundamental areas of corporate leadership/management structures, managerial liability, and the corporate purpose. It also considers the phenomenon of algorithmic entities and leaderless entities.

Corporate Management in the Age of AI

6. Recent Corporate Law Decisions

6.1 Federal Court considers meaning of 'carrying on business in Australia' and applies informal service rule to a foreign corporation

(By Julian Vertoudakis, Herbert Smith Freehills)

TCL Airconditioner (Zhongshan) Co Ltd v Castel Electronics Pty Ltd [2019] FCA 257, Federal Court of Australia, McKerracher J, 1 March 2019

(a) Summary

This case provides a useful illustration of the circumstances in which a foreign company will be considered to be carrying on a business in Australia and appears to be the first application of the "informal service rule" to a foreign company.

(b) Facts

TCL Airconditioner (Zhongshan) Co Ltd (TCL) and Castel Electronics Pty Ltd (Castel) entered into a general distribution agreement (the GDA) in 2003 under which TCL appointed Castel as the exclusive distributor of its air-conditioning products in Australia.

Castel eventually terminated the GDA on the basis of repudiation by TCL and was awarded damages and costs in two separate arbitral awards, which were registered in 2012 as judgments in the Federal Court (see *Castel Electronics Pty Ltd v TCL Air Conditioner (Zhongshan) Co Ltd (No 2)* (2012) 232 FCR 311).

Castel purported to serve TCL with a statutory demand under s. 585 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) in relation to the judgment debt, which TCL resisted on the basis that it was not a Part 5.7 body (as it did not 'carry on a business in Australia') and that service had not been validly effected.

(c) Decision

(i) Carrying on business in Australia

To be considered a Part 5.7 body which could be validly served with a demand under s. 585(a) of the Corporations Act, TCL was required to have been 'carrying on a business' in Australia. Relevantly, s. 21(2) of the Corporations Act provides that:

A reference to a body corporate carrying on business in Australia, or in a State or Territory, includes a reference to the body:
(a) establishing or using a share transfer office or share registration office in Australia, or in the State or Territory, as the case may be; or
(b) administering, managing, or otherwise dealing with, property situated in Australia, or in the State or Territory, as the case may be, as an agent, legal personal representative or trustee, whether by employees or agents or otherwise.

McKerracher J noted that s. 21(2) of the Corporations Act is an inclusive list and accordingly leaves scope for the application of general law concepts relating to the carrying on of business, including that (see *Tiger Yacht Management Limited v Morris* [2019] FCAFC 8):

- whether a company is carrying on business in Australia is a question of fact;
- a company may be carrying on business in Australia even though it does not have an identifiable place of business in Australia and/or the bulk of its business is conducted elsewhere;
- the words 'carrying on' imply the repetition of acts and activities possessing something of a permanent character;
- the activities undertaken by the company must form a commercial enterprise; and
- a company will be carrying on business in Australia if it is represented by agents able to bind it to contracts, but not necessarily if the agent's power is restricted to forwarding proposals to the company for its consideration.

McKerracher J held that as the GDA did not create an agency relationship between Castel and TCL, its terms were relevant to but not determinative of whether TCL carried on a business in Australia and the "real test is what TCL was actually doing, if anything, in Australia".

McKerracher J concluded that TCL was not merely a disinterested exporter of goods from China but "had an actual and real business presence in Australia" on the basis that:

- the GDA contained terms requiring Castel to use its best efforts to promote the sale of TCL products;
- contracts entered into by Castel and TCL were accepted in Australia and deemed to be governed by Australian law;
- the sales of air-conditioning units in Australia benefited TCL;
- TCL influenced the marketing of the products by providing its own branding materials;
- TCL retained control over the retail price of the products sold by Castel;
- TCL guaranteed the air-conditioner compressors for five years and the entire unit for one year and agreed to rectify faults at its own cost for all units with faults exceeding a specified percentage; and
- TCL employees travelled to Australia on an annual basis to meet with Castel representatives to protect and improve TCL's goodwill in Australia (although this fact would not of itself result in TCL carrying on a business in Australia).

This decision serves as a reminder that foreign companies may be held to carry on business in Australia even where substantially all of the manufacture and sale of goods occurs overseas. Irrespective of what is written in the contract between buyer and seller, the substance of the arrangements and the degree of control and supervision exercised by the company over the goods will be determinative of whether the company is considered to carry on a business in Australia.

(ii) Service

Section 585(a) of the Corporations Act 2001 (Cth) creates a presumption that a Part 5.7 body is unable to pay its debts if a debt remains unpaid 3 weeks after the service of a demand on the body at its principal place of business, by delivery to a director/secretary, or in a manner approved by a court. Castel sent such a demand to TCL both at an address in Queensland and by its solicitors, Norton Rose Fulbright.

In obiter, McKerracher J applied the 'effective informal service rule' described by Palmer J in *Woodgate v Garard Pty Ltd* (2010) 239 FLR 339 as the principle that irrespective of whether service of a process has occurred in accordance with a procedure set by law, the service is effective if the serving party can prove that the document "actually came to the attention of an officer of the company who was either expressly or implicitly authorised by the company to deal directly and responsively with the document or documents of that nature".

McKerracher J distilled this principle to the statement that "the essential factor is whether ... the notice came to the attention of the person to be served" and inferred that Norton Rose Fulbright had been acting on the instructions of TCL in responding to the s. 585 demand and accordingly that the demand had come to the attention of TCL.

According to McKerracher J, this case represents the first application of the 'effective informal service rule' to a foreign company.

6.2 Winding up refused when alternate remedies available in oppressive conduct dispute

(By Isaac Buckland, MinterEllison)

In the Matter of Wyndham Park Estate Pty Ltd [2019] VSC 92, Supreme Court of Victoria, Sifris J, 28 February 2019

(a) Summary

This case concerned rival claims of oppressive conduct between two company directors with a 50% share in the company, the third defendant Wyndham Park Estate Pty Ltd (WPE). The first plaintiff, Antonio Di Gioacchino (Antonio) offered a buy-out of the first defendant, Umberto Di Gioacchino (Umberto). The first defendant, however, sought the winding up of WPE and vesting of the Di Gioacchino Unit Trust (the DGW Trust). Both the plaintiff and the first and second defendants sought relief pursuant to s. 233 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) in relation to the conduct of the affairs of WPE. It was found that winding up of a solvent company was to be a remedy of last resort and in this situation a buy-out was a far more appropriate remedy.

(b) Facts

Antonio and Umberto were both directors of WPE which acted as trustee of the DGW Trust. The unitholders of the DGW Trust were their corporate entities, the second plaintiff (Hydrill Pty Ltd) and the second defendant (Di Gioacchino & Sons Pty Ltd). WPE did not trade or carry on business. Aside from cash in the sum of $9,000 and an amount being held in a solicitors trust of $143,958, its main asset comprised of the holdings of 500,000 units in the Bundaberg BGC 2011 Trust (the Bundaberg Trust). The estimated value of WPE's interest in the Bundaberg Trust was between $500,000 and $600,000. WPE receives dividends from the Bundaberg Trust of less than 10% of the total units. It had no liabilities of any substance. The assets and liabilities of WPE and the DGW Trust were assessed and calculated by an expert, Mr Paul Lom. This dispute was dealt with under the Oppression Program recently introduced by the Court.

The plaintiffs' primary prayer for relief was an order that they buy the defendants' shares in WPE and units in the DGW Trust. The plaintiffs submitted that if the parties were unable to resolve the matter by mediation within 21 days, they should purchase the shares and units held by the defendants for $320,101 (the Buy-Out) and that the remaining claims of the plaintiffs be referred to an Associate Judge for hearing and determination.

The plaintiffs also sought orders for an accounting of any monies due to them by Umberto. Antonio also maintained and pursued a claim for remuneration based upon alleged misleading and deceptive conduct by the defendants or on a *quantum meruit* basis. The defendants were primarily seeking the winding up of WPE and the vesting of the DGW Trust.

Both sides alleged wrongdoings by the other. These allegations established both deadlock and the necessary conduct so as to enliven the jurisdiction under s. 232 of the Act. This section of the Corporations Act provides that the Court may make an order under s. 233 if "the conduct of the company's affairs" are "contrary to the interests of members as a whole". Neither party submitted that the jurisdiction had not been enlivened, and as such, the Court could make orders under s. 233 of the Corporations Act. This section provides for orders that the Court can make in situations of oppressive conduct of affairs. Relevant to this matter, the Court considered an order for the company be wound up, and an order for the purchase of any shares by any member or person.

(c) Decision

On 20 February 2019, Sifris J delivered his ruling. The orders were that if the matter was not resolved by mediation within 21 days, the Buy-Out was to go ahead but at a value determined by Mr Paul Lom. The defendants asked that more details were necessary to enable consideration to be given to an application for leave to appeal.

While the defendants had consistently sought a winding up, it was noted that their only opposition to a buy-out by the plaintiffs was that the amount offered was too low and that the amount did not reflect the true value of the shares and units.

Sifris J stated that there was sufficient common ground and agreed facts to conclude, without a trial, that the jurisdiction having been enlivened, and therefore the only question was one of the appropriate remedy. His Honour believed that the defendants were acting unreasonably in pursuing a winding up when a buy-out at value was available and in circumstances where they did not wish to acquire the shares and units.

(i) Jurisdiction under s. 233 of the Corporations Act

While the assumption that jurisdiction has been enlivened was not in question, Sifris J examined s. 232(d) of the Corporations Act in relation to the oppressive conduct allegations. Sifris J relied on the cases of *Re H R Harmer Ltd* [1959] 1 WLR 62 and *Exton v Extons Pty Ltd* (2017) 53 VR 520 to support the conclusion that the state of affairs within WPE was contrary to the interests of the members of the company, even if the numerous other allegations that make up the oppressive conduct were not established at trial.

His Honour found that, while there may have not been commercial unfairness in the traditional sense, the company was in a state of deadlock and could not maintain a proper corporate governance regime.

In particular, each party complained that the other party failed to convene a meeting of directors or pass a resolution in respect of whether the 2016 income tax returns for the WPE and DGW Trust should be lodged with the Australian Tax Office.

(ii) What is the appropriate remedy?

The orders the Court may make, once the oppression jurisdiction of s. 232 of the Corporations Act is enlivened, are contained in s. 233. Sifris J was of the opinion that the defendants were not entitled to the relief they sought due to the circumstances of the case.

Sifris J referenced the case of *Exton v Extons Pty Ltd* (2017) 53 VR 520, and relied on his own judgment in that case to state that Courts are extremely reluctant to wind up solvent companies, and that such an action should only be used as a last resort.

Sifris J found that there was relief entirely available and appropriate, that being a buy-out order in respect of both the shares and units. Once a proper value has been given to the shares and units, Sifris J considered this remedy to be entirely appropriate.

Sifris J stated that there was no particular reason for a winding up other than to resolve a deadlock between the parties, and to enable the parties to effectively go their own way. Sifris J drew attention to the fact that, as WPE and the DGW Trust were solvent and a buy-out remedy would remove the deadlock, an order for winding up was not appropriate.

Further, Sifris J concluded that the Court was not required to hear the matters which consisted of the allegedly oppressive conduct in order to determine what bearing that conduct would have on the value of the shares and units. Sifris J believed that the conduct subject to the alternative claims could be properly dealt with by Antonio once the control of the company passed to him.

(iii) The Civil Procedure Act 2010 (Vic)

Section 8(1)(a) of the Civil Procedure Act 2010 No. 47 (Vic) (the Civil Procedure Act) states that the Court "must seek to give effect to the overarching purpose in the exercise of its powers". Sifris J referred to ss. 19, 22, 23, 24 and 25 of the Civil Procedure Act as being instructive to the Court in relation to its overarching purpose in the exercise of its powers.

Sifris J found that the Court would not be achieving the overarching purpose by allowing a trial to proceed, in circumstances where it was not necessary to resolve the dispute or consider what final relief or value was appropriate in the circumstances.

The defendants complained that they were not given the opportunity to put on further material and be heard in relation to the form of relief. However, Sifris J noted that the defendants were given an opportunity to make submissions, and they took that opportunity.

6.3 Successful application by ASIC for inquiry into liquidator's conduct

(By Andrew Fong, King & Wood Mallesons)

Australian Securities and Investments Commission v Macks (No 2) [2019] SASC 17, Supreme Court of South Australia, Doyle J, 22 February 2019

(a) Summary

In March 2015, the Australian Securities and Investments Commission (ASIC) applied for a court inquiry into Macks' conduct as a liquidator. The application was made under s. 536 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) (now repealed and replaced by division 90 of the *Insolvency Practice Schedule (Corporations)*). The s. 536 proceedings were in abeyance for three years pending the outcome of an associated civil proceeding. Following the conclusion of those civil proceedings, which found that Macks had breached his duties as a liquidator, ASIC sought to amend its application under s. 536 to take account of the findings of those proceedings.

Although three years had elapsed since the initial application under s. 536 of the Corporations Act, and despite the fact that the liquidator had already been party to prior civil proceedings in relation to similar subject matter, Doyle J both permitted ASIC to amend its application and ordered an inquiry under s. 536.

His Honour also held that the findings made in the civil proceedings were admissible as evidence for the purpose of deciding whether to order the inquiry. However, importantly, his Honour held that those findings would not be admissible when substantively assessing the liquidator's conduct during the inquiry.

The case demonstrates that legislative mechanisms authorising enquiries to be made by a Court, being proceedings with a public purpose, will be considered and conducted separately from, and will not be taken to have been discharged or pre-empted by, the existence of prior private proceedings which may overlap with the proposed subject matter of the inquiry.

(b) Facts

Macks was appointed as the administrator and liquidator of two companies (the Companies) in December 2001. Viscariello was a shareholder and sole director of each of the Companies. In

February 2006, Viscariello sought damages and a declaration against Macks, alleging his misconduct as a liquidator. Ultimately, in December 2017, the Full Court of the Supreme Court of South Australia held, amongst other findings, that Macks had breached its duties as liquidator, including s. 180 of the Corporations Act (the decisions of the Full Court and of the judge at first instance will be referred to as the "Viscariello Proceedings").

In March 2015, ASIC had, prior to the resolution of the Viscariello Proceedings, separately applied under s. 536 of the Corporations Act for an inquiry into Macks' conduct as a liquidator. Section 536 permits the Court to inquire into the conduct of a liquidator and to take any action as the Court thinks fit. The inquiry may be initiated by the Court or ASIC, or by any person who makes a complaint to the Court or ASIC.

Following the appellate decision in the Viscariello Proceedings, ASIC applied in March 2018 to amend its s. 536 application. The amendment sought to, among other things, confine the scope of the inquiry to matters either upheld on appeal or unchallenged in the Viscariello Proceedings.

ASIC's application to amend the s.536 application raised the following three issues:

- whether the amendment should be denied and the s. 536 proceedings stayed;
- whether the s. 536 inquiry should be ordered; and
- whether findings from the Viscariello Proceedings would be admissible either in ordering the s. 536 inquiry or in its conduct.

(c) Decision

Doyle J permitted the amendment and ordered the s. 536 inquiry. However, his Honour also held that once the inquiry commenced, ASIC would not be permitted to use findings from the Viscariello Proceedings as proof of Macks' misconduct. This was on the basis of the rule in *Hollington v F Hewthorn & Co Ltd* [1943] KB 587 discussed below.

His Honour emphasised that s. 536 of the Corporations Act had a regulatory, supervisory and disciplinary purpose, intended to serve the public interest. It was not concerned with the vindication of private rights. The supervisory jurisdiction of s. 536 was to be broadly construed.

Doyle J also outlined the following three stages of conducting a s. 536 inquiry:

- the "first stage" is deciding whether an inquiry into the liquidator's conduct is warranted;
- the "second stage" is assessing the conduct; and
- the "third stage" is deciding what orders should be made in respect of any misconduct.

The threshold for a Court to order an inquiry at the "first stage" is a relatively low one, requiring only a "sufficient basis" or a "well-based suspicion". The Court retains the discretion as to both the decision to order an inquiry and the procedure of the inquiry.

Based on these principles, his Honour addressed the following issues.

(i) Amendment and stay of proceedings

Doyle J held that no explanation was required from ASIC for bringing its amendment application in March 2018, 3 years after its initial application. This was because the s. 536 proceedings were in abeyance pending the outcome of the appeal decision in the Viscariello Proceedings, which was delivered in December 2017.

Macks argued that the inquiry would have no utility, given that it would re-litigate matters raised in the Viscariello Proceedings, and no benefit would flow to the Companies.

Doyle J disagreed, noting that the Court was exercising a supervisory and disciplinary jurisdiction intended to protect the general public. This carried a significance which extended beyond the liquidation of the Companies or the private grievance with Viscariello. Doyle J also rejected Macks' contention that the proceedings were an abuse of process. His Honour found that it was entirely reasonable for ASIC to pursue the s. 536 disciplinary proceedings after, rather than concurrently with, the civil Viscariello Proceedings.

(ii) Order for an inquiry

His Honour found that there was a sufficient basis for inquiry which satisfied the relatively low threshold of the "first stage" of the s. 536 proceeding.

This sufficient basis comprised the evidence and findings made from the Viscariello Proceedings - or at least the underlying agreed facts - even though Macks would be entitled to challenge those findings during the inquiry. Noting that an order for an inquiry was discretionary, Doyle J decided that the relatively serious nature of the allegations, their arguable merit, and the assistance that ASIC - as opposed to an individual - could provide the Court, were factors favouring the discretion to order the inquiry.

His Honour also rejected the argument that an application by ASIC to the Companies Auditors and Liquidators Disciplinary Board for disciplinary relief under s. 1292 of the Corporations Act was more appropriate than a s. 536 inquiry.

(iii) Use of the Viscariello Proceedings during the inquiry

Doyle J held that, while the findings were admissible as part of the "first stage" assessment as to whether to order the inquiry, ASIC could not rely on findings already made in the Viscariello Proceedings at the "second stage" of the s. 536 inquiry.

Following the rule in *Hollington v Hewthorn*, his Honour was of the view that findings made in earlier civil proceedings were generally "not admissible in later civil proceedings involving one or more different parties".

However, in the context of the s. 536 inquiry, his Honour found that the rule in *Hollington v Hewthorn* did not apply to the first stage, which included the application to amend the s. 536 originating process. This was because only the fact of the earlier finding was relevant to determining whether there was a sufficient basis for an inquiry.

By contrast, at the second stage, the conduct underlying the earlier findings was the focus of the inquiry. Hence, it was more appropriate at the second stage that the rule in *Hollington v Hewthorn* excludes the admissibility of any earlier findings, although this would still depend on whether the alleged misconduct was complex or contested.

Neither Court in the Viscariello Proceedings made a declaration of contravention of a civil penalty provision under s. 1317E of the Corporations Act. Therefore, ASIC could not rely on s. 1317F, which effectively provides that a declaration under s. 1317E is conclusive evidence of the conduct constituting the contravention.

6.4 The long arm of the tax collector: Creditor's opposition sufficient to prevent compromise of proceedings by a liquidator

(By Camryn Cooper, Corrs Chambers Westgarth)

McDermott and Potts as Liquidators of Lonnex Pty Ltd (in liquidation) [2019] VSCA 23, Supreme Court of Victoria, Court of Appeal, Whelan AP, McLeish and Hargrave JJA, 19 February 2019

(a) Summary

Two companies sold their medical practices to a tax consolidation vehicle for approximately $40 million, and then forgave the purchase price by way of deed. When the companies were wound up, the liquidator sued the tax vehicle to have the forgiveness declared voidable because it was an uncommercial transaction. The liquidator then wished to settle those proceedings, which required the approval of the court.

The Supreme Court of Victoria refused to approve the settlement, principally because the creditors, which included the Federal Commissioner of Taxation, were opposed.

The liquidators appealed but the appeal was dismissed. The Court of Appeal said that the Court at first instance was right to consider the attitudes of creditors as one of several relevant factors.

(b) Facts

Lonnex Pty Ltd (Lonnex) operated two medical practices in Melbourne, and its related entity, Millennium Management Pty Ltd (Millennium), operated another two practices. In February 2011, Lonnex and Millennium established a tax consolidation group called Lonnex & Millennium Management Holdings Pty Ltd (LMMH).

Lonnex and Millennium sold their practices to LMMH and the purchase price was to be payable to the vendors by intercompany loan. Then, Lonnex and Millennium forgave the intercompany loans by entering into a deed of forgiveness and release. While most of the Lonnex and Millennium assets had effectively been transferred to LMMH, the companies retained some liabilities to the Federal Commissioner for Taxation and the Commissioner of State Revenue.

Lonnex and Millennium were wound up. The sole liquidator of Lonnex, Mr McDermott, caused Lonnex to sue LMMH seeking a declaration that the release of debts was uncommercial and so voidable. Following a mediation, McDermott and Potts, now joint liquidators of Lonnex, wished to settle the proceeding against LMMH. Doing so required the approval of the court under ss. 477(2B) and 511 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).

The liquidators made that application to Efthim AsJ in the Supreme Court of Victoria. His Honour noted that s. 511 of the Corporations Act had been replaced by ss. 90-15 and 90-20 of the Insolvency Law Reform Act 2016 No. 11 (Cth), but that the same principles applied. His Honour refused the application principally because it was opposed by the creditors of Lonnex, notably the Federal Commissioner for Taxation and the Commissioner of State Revenue. In particular, Lonnex owed more than $7.7 million to the Federal Commissioner for Taxation.

The liquidators appealed to the Court of Appeal.

Wheelan AP and McLeish and Hargrave JJA distilled the liquidators' arguments into the following four categories:

- first, that the lack of funding for the litigation should be an overriding consideration in determining the application for settlement (the funding issue;
- second, that Efthim AsJ erred in considering the commercial prudence of the settlement from the perspective of the creditors;
- third, that Efthim AsJ inappropriately criticised the confidential legal opinion tendered by the liquidators, which his Honour said was deficient because it did not evaluate and estimate the financial outcome of the Lonnex proceeding; and
- finally, that the proposed settlement would not be detrimental to the interests of the creditors, who would be entitled to reclaim the debt owed through the proceeding against Millennium.

(c) Decision

(i) The inquiries under ss. 477(2B) and 511

The Court of Appeal observed that a court is required to make a different inquiry under each of s. 477(2B) and 511 of the Corporations Act. Section 477(2B) requires the court only to be satisfied that there no bad faith, impropriety or error of law, whereas s. 511 requires that the liquidator's decision to enter into a compromise be "a proper one".

The inquiry under section 511 is broader in scope. The liquidators contended that Efthim AsJ had failed to sufficiently address the application under s. 477(2B). However, the Court of Appeal observed that, if a s. 511 inquiry (which should be conducted first) provided a basis for refusing the settlement, it was not necessary to extensively consider s. 477(2B). In the present case, Efthim AsJ considered that the creditors' opposition provided justification to refuse the application under both provisions.

(ii) The attitudes of the creditors

It followed that the Court of Appeal was required to consider whether the creditors' opposition was a sufficient basis to refuse the application. The Court of Appeal acknowledged that courts are generally poorly placed and not qualified to determine the prudence of business and commercial decisions. However, while courts are generally reluctant to interfere with the commercial decisions of liquidators, they are not precluded from giving directions to liquidators with respect to the compromise of legal proceedings.

The Court relied on Giles J's observation in *Re Spedley Securities Ltd (in liq)* (1992) 9 ACSR 83 at [85]-[86] that, in the context of an application pursuant to s. 377(1) of the Act:

"[the] court pays regard to the commercial judgment of the liquidator .That is not to say that it rubber stamps whatever is put forward by the liquidator but .commercial considerations play a significant part in whether a compromise will be for the benefit of creditors".

Accordingly, the Court of Appeal said that Efthim AsJ's decision to place weight on the wishes of the creditors was appropriate, as his Honour did not consider himself bound by those wishes and they were not irrational or unsupported by the evidence.

(iii) Other considerations

The Court of Appeal also considered the liquidators' asserted lack of funding to conduct the litigation as a basis on which settlement was to be preferred. The Court said that funding was a relevant but not "overriding factor". Where the funds used for the litigation are those of the creditor, as in the present case, the creditors' attitudes to the proposed settlement are of greater relevance.

The creditors' views were also relevant insofar as the Federal Commissioner contended that settlement of the proceedings against Lonnex could affect the proceedings against Millennium. The Commissioner said that if the Lonnex proceeding were settled, Millennium might seek to ascribe a higher market value to the Lonnex assets and, consequently, a lower market value to the Millennium assets. The Court of Appeal saw "considerable force" in this contention.

Finally, the Court of Appeal said it was appropriate for a liquidator to obtain legal advice in relation to the proposed compromise, including in relation to applications under ss. 511 and 477(2B) of the Corporations Act. The Court of Appeal held that the deficiencies in the legal opinion tendered by the liquidators were not, without more, a sufficient reason to reject the proposed compromise. Nonetheless, the Court of Appeal said that Efthim AsJ was correct to hold that the present advice failed to support the position that the compromise was proper.

It was ultimately open to Efthim AsJ to arrive at the decision to refuse the application for settlement, and the Court of Appeal dismissed the appeal.

6.5 Duty of directors to consider creditors' interests

(By Pei Xuan Liu, King & Wood Mallesons)

BTI 2014 LLC v Sequana SA [2019] EWCA Civ 112, England and Wales Court of Appeal, Civil Division), Longmore, David Richards and Henderson LJ, 6 February 2019

(a) Summary

On 6 February 2019, the English Court of Appeal delivered its judgment in *BTI 2014 LLC v Sequana SA*. Amongst other issues, the case considers the circumstances in which directors of a company begin to owe a duty to consider the interests of creditors, particularly in circumstances where the company is short of actual insolvency.

David Richards, Longmore and Henderson LJ held that such a "creditors' interests duty" may be triggered when a company's circumstances fall short of actual, established insolvency, but that the relevant test is not whether there is a real, as opposed to a remote, risk of insolvency. There is no single form of words that encapsulate the test for determining when a company's financial position is such that directors must act in the interests of creditors. Directors' duties to creditors may be triggered when a company's circumstances fall short of actual, established insolvency.

(b) Facts

(i) Historical relationship between the relevant companies

Beginning in the 1990s, a series of claims were made by the United States environmental regulatory authority against Appleton Papers Inc (API). These claims related to environmental damage to the Lower Fox River in Wisconsin, USA, alleged to have been caused by a paper coating business that API acquired in 1978. At the time of the acquisition, API was a wholly-owned subsidiary of BAT Industries Pty Ltd (BAT).

In 1989, the holding company of API was established. It was renamed Arjo Wiggins Appleton Limited (AWA) in 1990, following a demerger from BAT and a merger with a French paper manufacturer. In 2000, both API and AWA were acquired by Sequana S.A. (Sequana).

In 2001, Sequana sold API. By reason of a complex series of corporate transactions, AWA became subject to contingent indemnity liabilities in respect of the clean-up costs and damages arising out of the pollution of Lower Fox River. To pay this liability, AWA had the benefit of a guaranteed investment contract which would pay out a maximum of US$250 million (the Maris policy), certain historic insurance policies with an expected recovery, subject to litigation, of US$100 million and an inter-company debt owed by Sequana to AWA (the Sequana debt).

(ii) Subject of the dispute

In 2008 and 2009 respectively, AWA paid two dividends to its parent company, Sequana, both of which are the subject of this dispute:

- in December 2008, AWA's directors resolved to pay an interim dividend of EUR443 million to Sequana; and
- in May 2009, the directors of AWA resolved to pay a second interim dividend of EUR135 million to Sequana.

Both dividends were paid following a reduction of AWA's share capital under s. 642 of the *UK Companies Act 2006* (the Companies Act) and in each case were supported by a solvency statement from AWA's directors, signed pursuant to the Companies Act. The solvency statement stated that the directors were of the opinion that there was no ground, as at December 2008, that the company could be found to be unable to pay or otherwise discharge its debts. Further, each dividend was paid by way of set-off against the Sequana debt.

In broad terms, at the time the dividends were paid, AWA:

- had ceased to trade;
- had only one material liability being the contingent liability for the clean-up costs and damages of the Lower Fox River; and
- had, as material assets, only the Maris policy investment contract, historic insurance policies mentioned above and the intra-group Sequana debt owed by its parent company, Sequana.

(iii) Litigation history

In 2016, AWA brought claims against the directors of AWA in the High Court of Justice (Chancery Division). During the proceedings, BTI 2014 LLC (BTI) replaced AWA as claimant after AWA assigned the claims to BTI. BTI was a corporate vehicle set up by BAT for this purpose.

The claims sought to challenge each of the December 2008 and May 2009 dividends and were brought on the following three principal bases:

- the accounts on which AWA directors relied when resolving to pay the dividends had not been properly prepared. As such, the dividends were not lawfully paid in accordance with

the provisions in Part 23 of the Companies Act governing the payment of dividends (the "could not pay" claim);
- when AWA's directors resolved to pay the dividends to Sequana, due to the financial position of AWA, the directors of AWA owed a duty to consider the best interests of the company's creditors. By paying the dividends, the directors of AWA breached that duty (the "should not pay" claims); and
- in any event, the dividends were transactions at an undervalue within the meaning of s. 423 of the *UK Insolvency Act 1986* (the Insolvency Act) and were entered into for the dominant purpose of putting assets beyond the reach of BAT as a potential claimant against AWA.

At first instance, Rose J:

- dismissed BTI's claims in respect of the first ground, finding that neither of the two dividends contravened Part 23 of the Companies Act;
- dismissed BTI's claims in respect of the second ground. Rose J held that AWA could not be described as on the verge of insolvency or of doubtful solvency, or as being in a precarious or parlous financial state. On this basis, AWA was not in a situation where the directors were required to run the company in the interests of the company's creditors, rather that the company's shareholders; and
- held that a dividend is a transaction entered into at an undervalue within the meaning of s. 423(1) and that the dividend of May 2009 was entered into for the dominant purpose of putting assets beyond the reach of a potential claimant. However, no such finding could be made regarding the December 2008 dividend.

(c) Decision

BTI appealed in respect of the second and third grounds mentioned above, being respectively, the duty of directors to have regard to creditors' interests and the proper application of s. 423 of the Insolvency Act.

This case note solely considers the judgment of the Court of Appeal in respect of the second ground - that is, whether the directors of AWA had a duty to have regard to the interests of creditors and, if so, whether this duty was breached.

(i) When must directors begin to consider the interests of creditors?

Submission of BTI

BTI's primary submission was that directors owe a duty to consider the interests of creditors (a "creditors' interests duty") in any case where a proposal involves a real, as opposed to a remote, risk to creditors.

BTI submitted that this duty first arose at common law, and has since been codified in statute under s. 172(3) of the Companies Act. Section 172 states:

"(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to-
(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company. .
(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company".

BTI submitted that the duty under s. 172(3) was engaged because a real, as opposed to a remote, risk to BAT as a creditor was involved in the payment of the May 2009 dividend.

BTI argued that at the time this dividend was paid, AWA was not carrying on any business. Its only function by the end of 2008 was to cover the indemnity liability arising in respect of the Lower Fox River. For this purpose, it had three assets available to it: the Maris policy, the historic insurance policies and the Sequana debt. The effect of the May 2009 dividend was to reduce the Sequana debt from EUR138.2 million to EUR3.1 million. As a consequence, the assets available to meet the indemnity liability were reduced by that amount. The immediate effect of this arrangement was that Sequana would no longer be exposed to the risk that its debt to AWA would be called to fund indemnity payments.

Judgment of Lord Justice David Richards (Henderson and Longmore LJ concurring)

David Richards LJ, delivering the primary judgment with which Henderson and Longmore LJ concurred, dismissed BTI's claim. Following a comprehensive survey of English, Australian and New Zealand case law on the duty of directors to consider creditors' interests, David Richards LJ ultimately held that such a "creditors' interests duty" may be triggered when a company's circumstances fall short of actual, established insolvency but that the relevant test is not whether there is a real, as opposed to a remote, risk of insolvency. In the great majority of cases, the test is expressed in much less expansive terms.

David Richards LJ held that "for good reason", there is no single form of words that encapsulate the test for determining when a company's financial position is such that directors must act in creditors' interests. The creditors' interests duty may be triggered when a company's circumstances fall short of actual, established insolvency, at a point when there is more than a 'real risk' of insolvency.

Further, David Richards LJ concluded that having regard to both policy considerations and the construction of the Companies Act, it would not be appropriate for the courts to introduce such a test as a development of the common law. Relevantly, at [199] - [200], David Richards LJ considered that the reconciliation of the duty under s. 172(1) and the creditors' interests duty would, unless creditors' interests are paramount, present difficulties. If adopted, the test proposed by BTI would have a chilling effect on entrepreneurial activity, when such activity is the underlying purpose of most registered companies.

Accordingly, David Richards LJ concluded that BTI's appeal on the second ground should be dismissed.

Interestingly, in surveying judicial case law, David Richards LJ expressly acknowledged that there is no decision in any English authority which is clearly based on the proposition that a creditors' interests duty is triggered by anything short of actual insolvency. In all cases surveyed, the company was insolvent, as the directors knew or ought to have known, and in few (if any) cases does this seem to have been the subject of argument. However, in discussing the trigger for the creditors' interests duty, many of the cases go beyond actual insolvency to include something close to insolvency. David Richards LJ considered that the number of times that judges have assumed that something less than actual insolvency will trigger the duty carries weight.

6.6 Transfer of shares under a DOCA and terminating a liquidation: Federal Court provides guidance on what constitutes unfair prejudice to members

(By Paul James and Becci Robinson, Clayton Utz)

Tucker, in the matter of Black Oak Minerals Ltd (subject to Deed of Company Arrangement) (in liq) [2019] FCA 293, Federal Court of Australia, Banks-Smith J, 31 January 2019

(a) Summary

The case concerned an application by deed administrators for leave to transfer shares under s. 444GA of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) as part of a deed of company arrangement (DOCA) in conjunction with an application to terminate the winding up of the company. In her judgment, Banks-Smith J considers six matters in determining whether a share transfer would unfairly prejudice the interests of members of the company. The case also provides guidance on when the Court will grant a prospective order terminating the winding up of a company in circumstances where a DOCA is being implemented.

(b) Facts

Black Oak Minerals Ltd (Black Oak) was placed in voluntary administration pursuant to s. 436A of the Corporations Act on 27 November 2015 due to a lack of working capital required to continue the company's operations. Immediately after the appointment of voluntary administrators, Black Oak's secured creditor who was owed at least $28 million, Trailstone Netherlands I Coöperatief U.A (Trailstone), appointed receivers and managers over Black Oak.

On 15 March 2016, acting on the recommendations in the report (and subsequent supplementary report) to creditors issued by the administrators, the creditors unanimously resolved that Black Oak be wound up pursuant to s 439C of the Corporations Act and that the administrators were to be appointed as joint and several liquidators (Liquidators) of the company.

From November 2015 to July 2018, the receivers and managers realised the majority of assets in Black Oak that were subject to Trailstone's security interest (totalling approximately $11 million, with $2.370 million going to Trailstone). Unable to sell one of Black Oak's key assets, the Marda Gold Project, and due to a conflict of interest, the receivers and managers retired at the end of July 2018.

The Liquidators continued with the sale process of the Marda Gold Project and, on 12 September 2018, after receiving seven final offers to purchase the asset, signed a binding 'Exclusivity and Implementation Deed' with Ramelius Resources Limited (Ramelius) for the proposed acquisition of the Marda Gold Project (the Proposed Ramelius Acquisition).

The Court granted leave under s. 436B(2)(g) of the Corporations Act for the Liquidators to appoint themselves as administrators of the company. This was necessary because the Proposed Ramelius Acquisition was to occur through a DOCA, with Ramelius acquiring 100% of issued shares in Black Oak and all debts owed by Black Oak being compromised and released.

The key terms of the Proposed Ramelius Acquisition were that Ramelius would pay $13 million, with a deposit of $2 million in consideration. Trailstone was also to gift $200,000 to be paid to a creditors' trust for the benefit of the unsecured creditors. Under the Proposed Ramelius

Acquisition, the creditors' trust fund would be distributed to priority unsecured creditors (those with outstanding employee and leave entitlements). This was beneficial to the unsecured creditors because in a liquidation they would not receive a return as Trailstone would absorb all realisations as the secured creditor.

The creditors voted in favour of the DOCA and the DOCA was executed on 8 November 2018. In December 2018, the deed administrators filed an application for leave to transfer shares in Black Oak under s. 444GA of the Corporations Act and for termination of the winding up pursuant to Div. 9015 of Sch. 2 (Insolvency Practice Schedule (Corporations) (the IPS) to the Corporations Act.

(a) Decision

Her Honour considered the following three issues:

(i) Issue 1 - Transfer of the shares under s. 444GA

Pursuant to s. 444GA(3) of the Corporations Act, the Court was required to determine whether the share transfer would unfairly prejudice the interests of the members of the company. Her Honour cited the *Explanatory Memorandum to the Corporations Amendment (Insolvency) Bill 2017* in explaining that the intention behind the requirement that the transfer not unfairly prejudice shareholders is to direct the Court to consider the impact of a compulsory sale on shareholders where there may be some residual value in the company. Banks-Smith J also cited *Re Nexus Energy Ltd (Subject to Deed of Company Arrangement)* [2014] NSWC 1910; (2015) 105 ACSR 246 as authority for the proposition that the onus is on the administrators to prove that the transfer would not unfairly prejudice the company.

Banks-Smith J found that the transfer of shares would not unfairly prejudice the interests of Black Oak's members and granted leave to transfer the shares to Ramelius.

In her judgment, her Honour considered the following six matters canvassed by counsel for the administrators relevant to the application:

- Notice to shareholders: Sufficient opportunity was given to the shareholders to make submissions with respect to the application;
- Communications with ASIC: In correspondence between the deed administrators and ASIC provided to the Court, ASIC indicated that it did not oppose the transfer of shares or termination of the winding up. Although not binding on the Court, her Honour found ASIC's position to be persuasive;
- No cause to impugn Trailstone securities: Her Honour was satisfied that proper inquiries were undertaken with respect to the validity of Trailstone's securities and that nothing had been uncovered to suggest that the securities were at risk of being impugned;
- Current and residual value of shares: Given that Black Oak had approximately $39 million of liabilities (at least $28 million of which was owed to Trailstone) and on the basis of valuation evidence, there was no real prospect of there being residual value in Black Oak shares for its members;
- Issue raised by the Commonwealth Department of Jobs and Small Business in its role as administrator of the Fair Entitlements Guarantee Scheme (FEG) as to other circulating assets: FEG asserted that there may be assets subject to circulating security interests which if recovered may provide a better return to FEG. Her Honour did not give any weight to FEG's claim due to the absence of any probative evidence in support; and
- No potential actions of value against directors: Given the range of insolvency administrations over a period of years and the accompanying opportunities to raise or

uncover allegations of impropriety against company directors, at this stage, there was no potential benefit to shareholders from further inquiries into potential improprieties.

(ii) Issue 2 - should orders be made pursuant to s. 447A of the Corporations Act granting leave for the Administrators to execute all necessary share transfers?

Section 447A of the Corporations Act gives the Court a general power to make orders where a DOCA has been executed. Banks-Smith J cited *Cawthorn v Keira Constructions Pty Ltd* (1994) 13 ASCR 334 at 341 in describing the Court's powers under s. 447A as "plenary powers to do what is just in all the circumstances" and held that the Court did have the power to grant leave to transfer the shares in the company.

(iii) Issue 3 - should the winding up of Black Oak be terminated pursuant to Division 9015 of the IPS?

Banks-Smith J considered that the principles relevant to terminating a winding up order espoused in *Re Living Creatively Exhibitions Pty Ltd (in liq) (subject to Deed of Company Arrangement)* [2013] NSWSC 717 were satisfied. Namely, there was no appreciable risk that Black Oak would return to liquidation because the effectuation of the DOCA would release Black Oak from its liabilities, returning the company to a position of solvency as a wholly owned subsidiary of Ramelius.

Her Honour also accepted the applicant's submission that the present case should be distinguished from *Re Manband Pty Limited (in liquidation) (subject to deed of company Arrangement)* [2018] NSWSC 1282, where the Court refused to make a prospective order terminating the winding up of the company. Given that the terms of the DOCA did not create a risk that Black Oak would be removed from external administration prior to it being restored to solvency and the proximity of the effectuation of the DOCA to the proposed date of termination of the winding up, Banks-Smith J granted the prospective order terminating the winding up. Her Honour also considered that no significant risk arose from there being a short delay between making the orders (31 January 2019) and the termination of winding up taking effect (7 February 2019).

6.7 Court orders former sole director and shareholder to repay $5 million to liquidated companies

(By Daniel Komesaroff and Joely Wilkinson-Hayes, DLA Piper)

In the matter of Pulse Interactive Pty Ltd (in liquidation) [2019] NSWSC 22, Supreme Court of New South Wales, Rees J, 30 January 2019

(a) Summary

The Supreme Court of New South Wales responded to an application by the liquidator of three companies to recover over $4,000,000 from its former sole director and shareholder, Richard Friedrichs.

Mr Friedrichs was the sole director, secretary and shareholder of:

- Pulse Interactive Pty Ltd ("Pulse") (which operated eight "Yes Optus" franchise in the ACT and NSW);

- Amel Corporation Pty Ltd ("Amel Co") (which operated three "Yes Optus" franchise in NSW); and
- Amel Holding Pty Ltd ("Amel Holding") (which operated a number of "Just Cuts" in Queensland and NSW) (together, the Companies).

(b) Facts

Mr Friedrichs was the sole shareholder of the Companies. By 2011, the Companies were facing difficulties in relation to payroll tax. Mr Friedrichs became involved in a number of disputes with the Office of State Revenue (OSR). By April 2013, the OSR had issued a garnishee order to the Companies' bank in relation to unpaid tax liabilities. On 28 August 2013, the OSR advised that Amel Co owed $155,496.98 for payroll tax.

In late August, Optus offered to buy back its franchises from Pulse and Amel Co for $2,780,012 plus GST.

On 13 September 2013, the Companies applied to the OSR for exclusion from grouping on the basis that the companies were substantially independent. As part of that application, the Companies advised that outstanding lodgements for FY12 and FY13 would be submitted by 30 September 2013.

Accordingly, the companies prepared signed financial statements for the year ended 30 June 2013, which showed:

- marginal profits for Pulse and Amel Co and a loss for Amel Holding;
- dividends paid by Pulse and Amel Co;
- low net asset position for all Companies (including a negative position for Amel Holding); and
- the most significant asset for each company was a director's loan to Mr Friedrichs.

The liability for payroll tax was not included in the financial statements.

In early October 2013, the Companies' solicitors received notification that their liability for payroll tax for financial years FY08 to FY11 stood at $156,639.85 and that the Companies' returns for FY12 had not been lodged.

On 15 April 2014, the OSR notified the Companies of its decision not to exclude the Companies from grouping.

(i) Pulse and Amel Co

On 25 October 2013, Optus paid $1,284,824.49 to Pulse and $923,194.82 to Amel Co to buy back the franchises. The following day, Pulse paid $1 million and Amel Co paid $850,000 directly to Mr Friedrichs. After these transactions, both companies ceased trading. No payments were made to the Companies' creditors.

On 2 June 2014, Mr Friedrichs ceased to hold office in either Pulse or Amel Co, with Shane Cook appointed in his place. On 5 June 2014, both companies were put into liquidation by Mr Friedrichs.

Prior to liquidation, Mr Friedrichs met with chartered accountants.

Unsigned, draft financial statements from this meeting show:

- the proceeds from the sale of the franchises were recorded for Amel Co but not for Pulse;
- the director's loans were written off in the draft accounts of both liquidated companies;
- both companies showed an initial proposal to reduce the balances of the loans to nil debiting, *inter alia*, "goodwill on acquisition", effectively reducing the director's loan account to zero; and
- neither of these proposals were reflected in the general ledger.

The liquidator could find no evidence of repayments by Mr Friedrichs.

(ii) Amel Holdings

On 30 June 2014, Amel Holdings entered into a contract to sell its franchise for $415,000. On 22 July 2014, the settlement funds were received and Amel Holdings ceased to trade. On 5 August 2014, $214,940.38 of the settlement funds was paid to Mr Friedrichs. On 9 September 2014, a further $37,966.75 was paid out. No documents were found to explain the rationale for these payments. On 19 September, Mr Friedrichs was replaced as director. On 17 October 2014, Mr Friedrichs placed Amel Holdings into liquidation.

No draft financial statements were found for Amel Holdings, but a balance sheet as at June 2014 retained the director's loan and payroll liabilities, but wrote off goodwill on acquisition.

(iii) Post-liquidation

Proofs of debt were lodged by creditors (including the OSR, the Deputy Commissioner of Taxation, BMW Australia Finance and the Companies' accountant and solicitor) amounting to $1,709,963 for Pulse (including $131,913 said to by owed to Mr Friedrichs) $478,597 for Amel Co and $742,544 for Amel Holdings.

(c) Decision

An initial question for Rees J to answer was whether or not the draft financial statements formed part of the Companies' books for the purpose of s. 1305 of Corporations Act 2001 No. 50 (Cth) (the Corporations Act 2001). These question would answer whether or not the loans had been written off, or whether they remained outstanding as submitted by the Plaintiff.

Her Honour considered case law and held that the entries were different and inconsistent and thus lacked reliability. Effectively, the draft statements were "for discussion only and were not adopted or actioned". As such, Rees J found that the drafts did not evince the elimination of Mr Friedrichs' loans and as such, the loans were held to be outstanding as recorded in the financial statements signed on 1 October 2013 for Pulse Interactive and Amel Corporation and the balance sheet of Amel Holding of June 2014.

In addition, her Honour had to consider whether the payments made to Mr Friedrichs were voidable, being unreasonable director-related transactions and thus voidable under s. 588FDA(1)(c) of the Corporations Act.

In doing so, Rees J considered that:

- impropriety is not necessary to establish that a payment was unreasonable;
- the standard is objective;
- the inquiry is made with reference to the company's circumstances at the relevant time;

- normal commercial practice is relevant but not determinative; and
- a transaction of derivative benefit (to the Director) can still be for the benefit of the company.

In reaching her decision, her Honour agreed with the liquidator's submission that a reasonable person would not have made the payments as they were voluntary, in circumstances where the company had debts and only limited assets. The payments were of no benefit to the company which became insolvent because of the payments. It was only Mr Friedrichs who received a benefit.

As such, Rees J held that the liquidators' case was made out and ordered Mr Friedrichs to pay the liquidator a total of $5,306,037, including interest plus costs.

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7. Contributions

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