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Bulletin No. 266

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 Revised UK Stewardship Code

24 October 2019 - The United Kingdom (UK) Financial Reporting Council (FRC) has launched a substantial revision to the UK Stewardship Code (the Code). The aim of the new Code is to establish a clear benchmark for stewardship in the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Key changes in the new Code include:

- an extended focus that includes asset owners, such as pension funds and insurance companies, and service providers as well as asset managers;
- a requirement to report annually on stewardship activity and its outcomes. Signatories' reports will show what has been done in the previous year, and what the outcome was,

including their engagement with the assets they invest in, their voting records and how they have protected and enhanced the value of their investments;
- signatories will be expected to take environmental, social and governance factors, including climate change, into account and to ensure their investment decisions are aligned with the needs of their clients;
- signatories are now expected to explain how they have exercised stewardship across asset classes beyond listed equity, such as fixed income, private equity and infrastructure, and in investments outside the UK; and
- signatories are required to explain their organisation's purpose, investment beliefs, strategy and culture and how these enable them to practice stewardship. They are also expected to show how they are demonstrating this commitment through appropriate governance, resourcing and staff incentives.

The new Code also expects signatories to work together with regulators and industry bodies to identify and respond to the risk of market and systemic failure.

The new Code takes effect on 1 January 2020. The Code was last revised in 2012.

View:

- *The UK Stewardship Code 2020*; and
- *Feedback Statement: Consulting on a revised UK Stewardship Code*.

1.2 Investors seek clearer reporting on climate-related issues

22 October 2019 - Companies are falling short of investors' expectations for clearer reporting on climate-related issues according to a new report *Climate-related corporate reporting: Where to next?* (the Report) from the UK FRC Financial Reporting Lab.

As economies increasingly transition towards low carbon and climate resilient futures, the Report highlights the gap between current reporting and investor expectations and calls on companies to bridge this gap.

The report provides practical guidance about where companies can improve their reporting. The Report also outlines what investors want to understand, questions companies should ask themselves, recommended disclosures, and a range of examples of the developing practice of climate-related reporting.

Earlier this year, the FRC published a statement outlining the responsibility of boards of UK companies to consider their impact on the environment and the likely consequences of long-term business decisions. Boards should, therefore, address and where relevant, report on the effects of climate change.

1.3 Basel Committee reports on Basel III implementation progress

16 October 2019 - The Basel Committee on Banking Supervision (the Committee) has issued the *Seventeenth progress report on adoption of the Basel regulatory framework* (the Progress Report). As noted by the Group of Central Bank Governors and Heads of Supervision, the Committee's oversight body, member jurisdictions are expected to ensure a full, timely and consistent implementation of the finalised Basel III reforms.

The Progress Report sets out the adoption status of Basel III standards for each Committee member jurisdiction as of end-September 2019. It includes the *Basel III: Finalising post-crisis reforms* published by the Committee in December 2017 and the finalised *Minimum capital requirements for market risk* in January 2019. These reforms will take effect from 1 January 2022.

Since the previous report, *Sixteenth progress report on adoption of the Basel regulatory framework*, published in May 2019, member jurisdictions have made further progress in adopting Basel III standards, notably the standard on interest rate risk in the banking book, the Net Stable Funding Ratio and the supervisory framework for measuring and controlling large exposures. However, the previous report also shows that a number of jurisdictions have yet to put these standards into effect.

The Committee will continue to closely monitor the implementation of Basel standards, including the finalised Basel III reforms.

1.4 Global M&A for third quarter 2019

16 October 2019 - The International Institute for the Study of Cross-Border Investment and M&A has published its quarterly review for the third quarter of 2019, *XBMA Quarterly Review Q3 2019* (the Review). Key highlights are:

- in Q3 2019, global mergers and acquisitions (M&A) volume was US$784 billion, reaching US$2.8 trillion for the year to date. Global M&A volume could, based on the current pace, exceed US$3.5 trillion in annual volume in 2019 for the fifth time in the last decade. But there are signs of a slow-down;
- M&A volume in the United States (US), the primary driver of global deal volume through the first two quarters of the year, slowed in Q3; despite that, year-to-date US M&A volume still matched the historically high volume in the first three quarters of 2018;
- mega deals (transactions valued at US$5 billion or greater) continued to prop up global M&A volume, with mega-deal transaction volume of nearly US$1.2 trillion in the first three quarters of 2019, on pace for US$1.6 trillion in 2019, which would equal the second largest annual volume in the last decade;
- after a slow start to 2019, European M&A volume increased 32% quarter-over-quarter, and year-to-date European M&A volume was roughly on pace with the average volume of European M&A in the first three quarters of each year over the last decade;
- cross-border M&A volume was US$313 billion in Q3 2019, a modest increase over Q2 2019, and US$842 billion for the year to date. Cross-border M&A volume is on pace to reach US$1.1 trillion but to represent only 30% of global M&A volume, which would be the smallest proportion of global M&A volume since 2013; and
- several significant deals were announced in Q3 2019, including London Stock Exchange's $27 billion acquisition of Refinitiv and the US$25 billion Reverse Morris Trust transaction between Mylan and Pfizer.

Click here to see the Review.

1.5 Legislation to end grandfathered commissions

15 October 2019 - The Federal Parliament has passed legislation ending grandfathered conflicted remuneration, Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019 No. 87 (Cth) (the legislation), for financial advice. Conflicted remuneration is where the payment of a benefit to a financial adviser may incentivise them to recommend a financial product to a consumer that may not be in their best interests.

One of the recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was to end the payment of grandfathered conflicted remuneration to financial advisers. Grandfathered conflicted remuneration can compromise the quality of advice as financial advisers may be unwilling to switch consumers into newer, better products if it means the adviser will lose their entitlement to grandfathered conflicted remuneration.

Under the legislation, grandfathered conflicted remuneration will be banned from 1 January 2021 and product issuers will be required to rebate the amounts to consumers.

To support this legislation and facilitate the transition, the government has directed the Australian Securities and Investments Commission (ASIC) to monitor and report on the extent to which product issuers are acting to end the grandfathering of conflicted remuneration in the period between 1 July 2019 and 1 January 2021.

1.6 FSB reports on implementation of OTC derivative reforms

15 October 2019 - The Financial Stability Board (FSB) has published its annual progress report on the implementation of the agreed G20 reforms to over-the-counter (OTC) derivatives markets, *OTC Derivatives Market Reforms: 2019 Progress Report on Implementation* (the Report). Overall there has been limited additional implementation of the reforms between end-November 2018 and end-September 2019.

The Report notes the following progress:

- **trade reporting**: 23 out of 24 member jurisdictions have comprehensive requirements in force, an increase of one during the reporting period. Jurisdictions report efforts to reduce reporting barriers and masking relief, wider use of the legal entity identifier in trade reporting, and streamlining reporting processes and trade repository operations. Authorities are increasingly aggregating data from multiple trade repositories;
- **central clearing**: 18 jurisdictions have in force comprehensive standards/criteria for determining when standardised OTC derivatives should be centrally cleared. In a few of these 18 jurisdictions, a wider range of products is now subject to mandatory clearing. Central counterparties (CCPs) have been active, with some CCPs filing for authorisation to clear transactions involving new asset classes in a number of jurisdictions, and other CCPs withdrawing from certain market segments;

- **margin requirements**: 16 jurisdictions have in force comprehensive margin requirements for non-centrally cleared derivatives, which represents an increase of one during the reporting period. Estimates of collateralisation rates are available in 10 of these 16 jurisdictions and continue to increase, particularly in credit and equity derivatives;
- **higher capital requirements for non-centrally cleared derivatives**: interim higher capital requirements for non-centrally cleared derivatives are in force in 23 of the 24 FSB member jurisdictions. Only seven jurisdictions (albeit four more than at end-November 2018) have implemented the final capital requirements, both due to have been implemented by January 2017;
- **platform trading**: comprehensive platform trading requirements are in force in 13 jurisdictions, a number which has remained unchanged during the reporting period; and
- **cross-border coordination and issues**: one jurisdiction started exercising deference during the reporting period with regard to foreign jurisdictions' regimes. Several other jurisdictions extended deference to further jurisdictions.

1.7 ACSI Governance Guidelines updated

11 October 2019 - The Australian Council of Superannuation Investors (ACSI) has released its updated *ACSI Governance Guidelines* (the Guidelines) in the wake of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

The Guidelines are used to assess the governance practices of the ASX300 and assist in voting recommendations. ACSI members include 39 institutional investors and asset managers.

In the Guidelines, ACSI has made a number of updates. Key changes include:

- **accountability**: reinforce the importance of the board demonstrating accountability;
- **risk management**: stress the need to incorporate environmental, social and governance (ESG) issues into risk frameworks and highlight the board's role in ensuring management is operating within the risk profile;
- **remuneration**: address the disconnect between investors and companies on variable pay; reinforce the concept of "reasonableness" and the relevance of the board's track record in exercising discretion; ask boards to regularly assess the effectiveness of their remuneration structures and make meaningful disclosures;
- **culture**: reiterate the importance of corporate culture and the expectation that companies should articulate and disclose their values to underpin the desired culture; emphasise the board's role in overseeing corporate culture;
- **social licence to operate**: reinforce the view that acting in the best interests of the company requires the board to consider the interests of a broad range of stakeholders and ask companies to articulate how they do this; and
- **diversity**: restate the view that companies should set a time frame within which they will achieve gender balance on their boards.

1.8 New financial adviser disciplinary system

11 October 2019 - The government is accelerating the establishment of a new disciplinary system and single disciplinary body for financial advisers as recommended by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

The government will work towards establishing the new body in early 2021, subject to the passage of legislation which will be introduced into Parliament next year.

The new body will replace the role of code monitoring bodies which were due to be established by industry associations under professional standards reforms.

A *Code of Ethics* (the code) will be applied by law from 1 January 2020, and financial advisers will be expected to meet the code's ethical standards. Australian Financial Services licensees will also be required to take reasonable steps to ensure their representatives comply with the code. ASIC will be able to take action against licensees that fail to do so.

Treasury will begin engaging with the professional associations, consumer representatives and other stakeholders to consult on the new system. Roundtables will be held later this year to consider policy design and how to best transition to the new system.

These changes will not impact clients who seek access to redress through the Australian Financial Complaints Authority.

1.9 Report sets out governance of key OTC derivatives data elements

9 October 2019 - A new report identifies key criteria, functions and bodies for the governance arrangements for a set of critical data elements for OTC derivative transactions reported to trade repositories, excluding the Unique Transaction Identifier (UTI) and the Unique Product Identifier (UPI).

The report, *Governance arrangements for critical OTC derivatives data elements (other than UTI and UPI)*, published by the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO), is a further step towards fulfilling the G20's commitment to report all OTC derivatives contracts to trade repositories.

The move aims to improve transparency, mitigate systemic risk and prevent market abuse. Aggregating the data reported across trade repositories will help ensure that authorities have a comprehensive overview of the OTC derivatives market and its activity.

Outlined in *Governance arrangements for the UPI* (the Report), in coordination with the FSB, in its capacity as the international body in charge of defining governance arrangements for the UTI and UPI, the Report concludes that the Legal Entity Identifier Regulatory Oversight Committee is best positioned to take on the role of the international governance body for critical data elements by mid-2020, subject to some necessary adjustments to its own governance. In the interim, the FSB will perform this role.

The CPMI and IOSCO also recommend that jurisdictions take steps to implement the governance arrangements across jurisdictions within three years from the publication of the Report.

The CPMI and IOSCO as well as the FSB have in recent years published reports to lay the foundation for the harmonisation work on key OTC derivatives data elements for meaningful aggregation on a global basis, including the 2014 FSB study *Feasibility study on approaches to aggregate OTC derivatives data* (the Feasibility Study).

Following the Feasibility Study, the FSB asked the CPMI and IOSCO to develop global guidance on the harmonisation of data elements reported to trade repositories and important for the aggregation of data by authorities, including the UTI and UPI.

The report, which is the final part of CPMI and IOSCO's response to that mandate, complements the *Technical Guidance: Harmonisation of the Unique Transaction Identifier*, the *Technical Guidance: Harmonisation of the Unique Product Identifier* and the *Technical Guidance: Harmonisation of critical OTC derivatives data elements (other than UTI and UPI).*

1.10 IOSCO publishes updates to peer reviews of regulation of MMFs and securitisation

2 October 2019 - The Board of IOSCO has published two update reports entitled *Update to the IOSCO Peer Review of Regulation of Money Market Funds* (the MMF Report) and *Update to the IOSCO Peer Review of Implementation of Incentive Alignment Recommendations for Securitisation* (the Securitisation Report).

The update reports summarise IOSCO's ongoing efforts to monitor implementation of reforms for money market funds (MMF) and securitisation since IOSCO published its two peer reviews in September 2015. The update reports describe progress by IOSCO members in FSB jurisdictions in adopting legislation, regulation and other policies covering MMF and securitisation, which are G20 priority reform areas. The update reports set out the background, methodology and findings that were reported to the G20 Leaders in 2018 and 2019 and were included in the relevant annual reports on *Implementation and Effects of the G20 Financial Regulatory Reforms*.

The MMF Report covers three topics (valuation, liquidity management and MMFs that offer a stable net asset value) and finds that most jurisdictions have implemented the fair value approach for the valuation of MMF portfolios, but progress in liquidity management is less advanced and less even.

The Securitisation Report covers two topics (incentive alignment arrangements and disclosure requirements) and finds that, overall, progress remains mixed across participating jurisdictions in implementing the recommendations for incentive alignment for securitisation.

The update reports also take note of new regulations yet to come into force or to be applied in various jurisdictions - an indication that implementation of IOSCO's recommendations may be more complete in future implementation monitoring exercises.

1.11 Consultation on removing the exemption for funeral expenses policies

1 October 2019 - The government has released for consultation draft regulations and legislation to remove the exemption in the Corporations Act 2001 No. 50 (Cth) for funeral expenses policies so that they are treated the same as other financial products.

The removal of this exemption will ensure that consumers have appropriate protections when taking out funeral expenses policies to help fund the costs associated with a funeral.

In particular, the government is acting on the evidence presented to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry that many indigenous people living in regional and remote communities are being misled and pressured into funeral expenses policies.

These draft regulations will improve consumer outcomes by requiring providers of funeral expenses policies to hold an AFS Licence and be fully regulated by ASIC.

Providers of funeral bonds, who operate under the exemption, will also be required to hold a licence. The draft regulations, however, will not require funeral directors to hold a licence when distributing a funeral bond in conjunction with the arrangement of a prepaid funeral, cremation, or burial service.

The exposure draft materials are available on the Treasury website.

1.12 IOSCO publishes framework to enhance investor education initiatives

30 September 2019 - The Board of IOSCO has published the *Core Competencies Framework on Financial Literacy for Investors* (the Framework) to assist members, investor education providers and other stakeholders in their efforts to develop and implement investor education initiatives.

The Framework provides guidance to users on the content of investor education programs and indicates which areas could be assessed as part of an evaluation strategy.

The objective of the Framework is to better prepare investors to navigate an increasingly complex investing environment. It seeks to equip investors with core competencies that enable them to make informed decisions about how to diversify investments, reduce risk or choose suitable investments, among other things. The Framework also describes the knowledge, attitudes and behaviours that retail investors should attain for each core competency to enhance their financial literacy.

The Framework builds on and complements the Organisation for Economic Co-operation and Development (OECD) and the International Network on Financial Education (INFE) *Core Competencies Framework on Financial Literacy for Adults* and the IOSCO *Strategic Framework for Investor Education and Financial Literacy*. It encourages users to build investors' competences based on the following seven areas:

- **basic investing principles and concepts**: the broad underlying principles of investing;
- **investment product attributes**: key features such as product structure and fees as well as the potential risks of various investment products;
- **buying/selling process of investment products**: the competencies applicable during the process of selecting investment products, financial service providers and platforms for buying and selling investment products;
- **owning investment holdings**: the competencies applicable to monitoring and managing investments;
- **investor rights and responsibilities**: investor rights and responsibilities and investor protection measures such as complaint and redress procedures;

- **behavioural biases related to investing**: the emotional or cognitive biases that may affect investors when making investment decisions; and
- **investment scams and frauds**: the common features of investment scams and the ability to avoid being a victim of scams and frauds.

Finally, the Framework provides illustrative examples of selected competencies, which are intended to be general and universally applicable.

To prepare the Framework, IOSCO drew on the results of a survey it distributed among members of its Committee on Retail Investors and the OECD/INFE.

1.13 Audit firm transparency reports not visible enough and ineffective

26 September 2019 - Transparency reporting by UK accountancy firms performing audits is currently ineffective, with a lack of awareness amongst investors and Audit Committee Chairs that the reports even exist and that many of the reports are being used as a marketing exercise, according to a review from the UK FRC, *Transparency Reporting AQR Thematic Review*.

While mandatory Transparency Reports broadly contain the required information, for those aware of the reports, there is a view they are too long and overly positive to be useful. The FRC is concerned that many firms treat the reports wrongly as a marketing tool which damages their perception among stakeholders and limits their usefulness.

Other findings of the review include:

- 84% of Audit Committee Chairs were not even aware of Transparency Reports;
- 15% of reports were not found on firms' websites; and
- 5 of the 33 firms reviewed did not prepare a report at all.

The FRC is calling on firms to reduce the length of their Transparency Reports and explain within them the challenges they are facing in seeking to deliver consistently high-quality audits, along with their assessment of how successful they are being at meeting those challenges.

Sitting alongside the reports on audit quality that the FRC publishes, Transparency Reports by the firms should provide stakeholders with important information about each firm's quality processes and initiatives to improve audit quality.

The FRC review of Audit Firms' Transparency Reporting can be viewed here.

1.14 SEC adopts new rule to modernise regulation of exchange-traded funds

26 September 2019 - The US Securities and Exchange Commission (SEC) has announced that it has voted to adopt a new rule and form amendments that are designed to modernise the regulation of exchange-traded funds (ETFs), by establishing a clear and consistent framework for the vast majority of ETFs operating today. The adoption will facilitate greater competition and innovation in the ETF marketplace, leading to more choice for investors. It also will allow ETFs to come to

market more quickly without the time or expense of applying for individual exemptive relief. In addition, the SEC voted to issue an exemptive order that further harmonises related relief for broker-dealers.

ETFs are hybrid investment products not originally allowed under US securities laws. Their shares trade on an exchange like a stock or closed-end fund, but they also allow identified large institutions to transact directly with the fund. Since 1992, the SEC has issued more than 300 exemptive orders allowing ETFs to operate under the *Investment Company Act of 1940 (US)*. ETFs have grown substantially in that period, and today there are approximately 2,000 ETFs with over US$3.3 trillion in total net assets. Investors use ETFs for a variety of purposes, including core components of long-term investment portfolios, investment of temporary cash holdings, and for hedging portfolios.

ETFs relying on the rule and related exemptive order will have to comply with certain conditions designed to protect investors, including conditions regarding transparency and disclosure. To help create a consistent ETF regulatory framework, one year after the effective date of the rule, the SEC is rescinding exemptive relief previously granted to certain ETFs, including those that will be permitted to operate in reliance on the rule. The rule and form amendments will be effective 60 days after publication in the US Federal Register, but there will be a one-year transition period for compliance with the form amendments.

View:

- *Final Rule*; and
- *Exemptive Order*.

1.15 SEC proposes amendments to enhance retail investor protections

26 September 2019 - The US SEC has announced that it has voted to propose amendments to *Rule 15c2-11* (the Rule) under the *Securities Exchange Act of 1934 (US)* , which sets out certain requirements with which a broker-dealer must comply before it can publish quotations for securities in the OTC market. The proposed amendments are designed to modernise the Rule, which was last substantively amended in 1991, and to enhance investor protection by requiring that current and publicly available issuer information is accessible to investors. The proposed amendments would provide greater transparency to the investing public by requiring that information about the issuer and the security be current and publicly available before a broker-dealer can begin quoting that security.

Securities that trade on the OTC market are primarily owned by retail investors. Because broker-dealers play an integral role in facilitating investor access to OTC securities and serve an important gatekeeper function under the Rule, it requires that a broker-dealer review basic information about an issuer before quoting securities to investors in the OTC market. The Rule's exceptions, however, permit broker-dealers to continue to publish quotations when there is no current information about the issuer available to the public or the broker-dealer. The SEC is concerned that, in today's OTC market, market participants can take advantage of these exceptions to the detriment of retail investors.

Therefore, the SEC is proposing to limit eligibility for some of the exceptions where an issuer's information becomes unavailable to the public or is no longer current. The proposed amendments would also add new exceptions for broker-dealers quoting certain OTC securities that may be less susceptible to fraud or manipulation.

The public comment period will remain open for 60 days following publication of the proposal in the US Federal Register.

1.16 SEC adopts new rule to allow all issuers to "Test-the-Waters"

26 September 2019 - The US SEC has announced that it has voted to adopt a new rule that extends a "test-the-waters" accommodation - currently a tool available to emerging growth companies - to all issuers. Under the new rule, all issuers will be allowed to gauge market interest in a possible initial public offering or other registered securities offering through discussions with certain institutional investors prior to, or following, the filing of a registration statement.

Under the rule:

- there are no filing or legending requirements;
- the communications are deemed "offers"; and
- issuers subject to *Regulation Fair Disclosure* (Regulation FD) will need to consider whether any information in a test-the-waters communication would trigger disclosure obligations under Regulation FD or whether an exemption under Regulation FD would apply.

The new rule is one of several SEC initiatives that build on the *Jumpstart Our Business Startups Act (US)* provisions intended to encourage companies to access public markets.

The new rule will become effective 60 days after publication in the US Federal Register.

1.17 IOSCO reviews member efforts to deter mis-selling of complex financial products

26 September 2019 - IOSCO has published a Thematic Review on Suitability Requirements with respect to the Distribution of Complex Financial Products report (the Thematic Review) indicating that most of the participating jurisdictions have implemented the necessary rules aimed at preventing the mis-selling of complex financial products, consistent with IOSCO standards.

The Thematic Review was conducted by the IOSCO Assessment Committee (AC), with the participation of 29 IOSCO members from both developed and emerging market jurisdictions. A Thematic Review offers a snapshot of implementation of IOSCO Principles, which enables the AC to identify gaps in implementation and examples of good practice.

The AC reviewed implementation of the nine Principles set out in the 2013 IOSCO report *Suitability Requirements With Respect To the Distribution of Complex Financial Products* (the Report). The nine Principles are aimed at promoting robust customer protection by preventing the mis-selling of complex financial products. The Principles focus on the application of suitability and related disclosure requirements to intermediary services, including selling, advising, recommending and managing discretionary accounts or portfolios, as well as the regulator's role in supervision and enforcement.

The Report includes several findings and observations from the Thematic Review, including for instance, that most jurisdictions have standards for how to treat customers fairly and for addressing conflicts of interest. In addition, the majority of jurisdictions require intermediaries to distinguish between complex and non-complex products despite the fact that what constitutes a complex financial product differs among jurisdictions. Notably, none of the participating jurisdictions reported having a suitability regime specifically for complex products.

The Report found that with respect to customer classification, most jurisdictions allow intermediaries to classify certain types of customers as "non-retail" (or its equivalent), based on the nature of the entity or specified monetary thresholds alone. However, these practices do not consider the complexity and riskiness of different products, as required by the Principles.

The Thematic Review also found that FinTech developments related to digital advisors and online platforms have created new suitability-related challenges.

In light of the findings and observations, the Report indicates that jurisdictions must have effective supervisory and enforcement mechanisms to support suitability regimes for complex products and to ensure that intermediaries take corrective action where their behaviour falls short of supervisory or regulatory expectations. The Report also urges jurisdictions to consider enhancing disclosure requirements to help customers make informed investment decisions and understand the advice they receive from intermediaries.

1.18 New financial conduct regime to be introduced in New Zealand

25 September 2019 - Customers can expect fairer treatment from banks, insurers and other financial service providers as the New Zealand government moves to introduce a new regime to regulate financial conduct.

The measures the government is introducing include:

- a new conduct licensing system for banks, insurers and non-bank deposit takers such as credit unions;
- the new regime requiring these entities to meet high standards of customer treatment; and
- a ban on incentives which are based on meeting sales targets.

The new regime will be backed by strong enforcement tools, including giving the Financial Markets Authority (FMA) the ability to direct licensed institutions to change behaviour, improve their systems and processes, as well as suspend or vary the conditions of a licence. Financial institutions will face strong financial penalties for breaching their obligations under the regime.

The new financial conduct regime will:

- create a conduct licensing regime for banks, insurers and non-bank deposit takers regarding their general conduct. These institutions will be licensed by the FMA;
- require licensed institutions to meet a fair treatment standard (for example, to pay due regard to the needs and interests of customers and treat them fairly);

- require licensed institutions to implement effective policies, processes, systems and controls to meet the fair treatment standard;
- create obligations for financial institutions in relation to how they design their remuneration and any other sales incentives, and how they must manage the risks those incentives create;
- prohibit sales incentives based on volume or value targets (for example, soft commissions such as overseas trips, bonuses for selling a certain number of financial products, leader boards, and performance management based on the volume of sales). This prohibition will apply to banks, insurers, non-bank deposit takers and their intermediaries; and
- make licensed entities accountable for sales to consumers by the entities' contracted intermediaries who are not financial advice providers (non-adviser intermediaries include car dealers, retailers selling add-on finance and insurance, and travel agents or airlines selling travel insurance).

More information is available here.

1.19 Assessment of ASX clearing and settlement facilities

24 September 2019 - The Reserve Bank of Australia (RBA) has released the September 2019 *Assessment of the ASX Clearing and Settlement Facilities* (the Assessment). The Assessment concludes that the Australian Security Exchange's (ASX's) clearing and settlement (CS) facilities "observed" or "broadly observed" all relevant requirements under the RBA's Financial Stability Standards (the FSS) as at 30 June 2019, with the exception of the standard relating to general business risk, which was rated as "partly observed" in each facility.

On balance, the RBA has concluded that the facilities have conducted their affairs in a way that causes or promotes overall stability in the Australian financial system. However, the facilities will need to place a high priority on addressing the recommendations related to general business risk. The RBA has made a number of other recommendations for the ASX CS facilities to address in order to observe or continue to observe the FSS.

The Assessment also describes progress made by the ASX CS facilities in addressing recommendations of the 2018 *Assessment of ASX Clearing and Settlement Facilities*, including to strengthen ASX's technology governance and management of operational risk via its Building Stronger Foundations program.

1.20 Launch of United Nations Environment Program Principles of Responsible Banking

23 September 2019 - In a global initiative led by the United Nations Environment Program, the Principles for Responsible Banking (the Principles) were launched by 130 banks from 49 countries, representing more than US$47 trillion in assets, during the annual United Nations General Assembly.

The Principles provide the framework for a sustainable banking system, and help the industry to demonstrate how it makes a positive contribution to society.

The six Principles are as follows:

- **Alignment** - align business strategy to be consistent with and contribute to individuals' needs and society's goals, as expressed in the *Sustainable Development Goals*, the *Paris Climate Agreement* and relevant national and regional frameworks;
- **Impact & Target Setting** - continuously increase positive impacts while reducing the negative impacts on, and managing the risks to, people and environment resulting from activities, products and services;
- **Clients & Customers** - work responsibly with clients and customers to encourage sustainable practices and enable economic activities that create shared prosperity for current and future generations;
- **Stakeholders** - proactively and responsibly consult, engage and partner with relevant stakeholders to achieve society's goals;
- **Governance & Culture** - implement the commitment to the Principles through effective governance and a culture of responsible banking; and
- **Transparency & Accountability** - periodically review individual and collective implementation of the Principles and be transparent about and accountable for positive and negative impacts and contribution to society's goals.

View:

- the *Principles Signature Document*, containing the six Principles and their Preamble;
- the *Principles for Responsible Banking: Key Steps to be Implemented by Signatories*, detailing key steps regarding impact analysis, target setting and implementation, and accountability that banks need to take to ensure the effective implementation of the Principles;
- the *Reporting and Self-Assessment Template*, which guides banks' transparency on their progress in implementing the Principles and on their impacts; and
- the *Guidance Document*, which will support banks in their implementation of the Principles and point to relevant resources, tools, frameworks and good practices.

1.21 APRA finalises its cross-industry amendments to margin requirements for non-centrally cleared derivatives

19 September 2019 - The Australian Prudential Regulation Authority (APRA) has released its response to submissions on amendments to its margin requirements for non-centrally cleared derivatives.

The changes to *Prudential Standard CPS 226 Margining and risk mitigation for non-centrally cleared derivatives* (CPS 226) will apply to all authorised deposit-taking institutions, general insurers, life insurers and registrable superannuation entity licensees.

APRA is proceeding with its revisions to accommodate the Basel Committee on Banking Supervision (BCBS) and IOSCO decision to delay the final implementation phase for margin requirements by one year to 1 September 2021. APRA has also made other amendments in response to clarifications made by the BCBS and IOSCO.

APRA will add the UK's Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) to the list of foreign bodies eligible for substituted compliance with APRA's margin requirements in CPS 226, provided that the PRA and FCA's margin requirements remain substantially unchanged following Brexit.

Copies of the response letter and final revised standard can be found on the APRA website.

1.22 Shareholders of US public target companies challenge 82% of M&A deals in 2018

17 September 2019 - Shareholders of US public target companies challenged 82% of M&A deals valued over US$100 million in 2018, consistent with the previous year, according to a new Cornerstone Research report, *Shareholder Litigation Involving Acquisitions of Public Companies - Review of 2018 M&A Litigation* (the Report). A total of 142 proposed deals valued over US$100 million had associated lawsuits in 2018, compared to 115 in 2017, reflecting a parallel rise of M&A activity and shareholder lawsuits during the year.

The Report also found that the impact of the Delaware Court of Chancery's decision in 2016 in *In re Trulia, Inc. Stockholder Litigation 129 A.3d 884* (*Trulia*) appears to have stabilised. Increased judicial scrutiny of proposed settlements of stockholder merger litigation culminated in the 2016 *Trulia* decision, which diminished the acceptability of disclosure-only settlements in merger objection cases.

In the years before *Trulia*, shareholders litigated around 90% of M&A deals valued over $100 million. In 2016, the year of the Chancery Court's *Trulia* decision, that rate declined to 71%. In 2017 and 2018, however, the litigation rate rebounded to 82%, but was still below pre-2015 levels.

The lower propensity to challenge M&A deals still prevails, according to the Report. The number of lawsuits per challenged M&A deal has remained around three since *Trulia*, compared to the 2009 to 2015 average of 4.7 lawsuits per deal.

In terms of litigation outcomes, the rate of resolution prior to deal closing has declined steadily from 68% in 2012 to a 10 year low of 33% in 2018. Also, 70% of M&A litigation was voluntarily dismissed in 2018, down slightly from 72% in 2017. Between 2009 and 2015, the annual rate of voluntary dismissal was 30% or lower.

1.23 How to build regulation into blockchain finance

16 September 2019 - The Bank for International Settlements has published a working paper which examines how blockchain-based financial markets can be regulated and supervised.

The paper, *Embedded supervision: how to build regulation into blockchain finance*, argues that asset tokenisation and underlying distributed ledger technology open up new ways of supervising financial risks. It then puts the case for "embedded supervision", i.e. a framework that allows compliance with regulatory goals to be automatically monitored by reading the market's ledger, thus reducing the need for firms to actively collect, verify and deliver data.

1.24 ISS announces results of global benchmark policy survey

11 September 2019 - Institutional Shareholder Services Inc. (ISS), a provider of corporate governance and responsible investment solutions to financial market participants, has released the results of its annual global benchmark policy survey. In total, ISS received 396 responses to this year's survey, including from 128 institutional investor representatives and 227 corporate executives. Corporate directors, corporate consultants, academics, trade associations, and other non-investor entities made up the rest.

Questions covered a broad range of topics, including: questions on the global perspective on board gender diversity, director overboarding, and director accountability relating to climate change risk; combined chairman and chief executive officer (CEO) roles and the sun-setting of multi-class capital structures in the US; and the display of Generally Accepted Accounting Principles metrics in one part of the ISS pay-for-performance quantitative model as a point of comparison to Economic Value Added for companies in the US and Canada.

Key findings from this year's survey include:

- **Board Gender Diversity (Global)**: responses to ISS' question about views on the importance of gender diversity on boards showed that majorities of both investors (61%) and non-investors (55%) agreed that board gender diversity is an essential attribute of effective board governance regardless of the company or its market. Among those who did not agree with that view, investors tended to favour a market-by-market approach and non-investors tended to favour an analysis conducted at the company level;
- **Director Overboarding (Global)**: investors and non-investors diverged on the question of measurement of how many boards is too many for an individual director. A plurality (42%) of investor respondents selected four public-company boards as the appropriate maximum limit for non-executive directors. A plurality of investor respondents (45%) also responded that two total board seats is an appropriate maximum limit for CEOs (i.e., the CEO's "home" board plus one other). A plurality of non-investors responded that a general board seat limit should not be applied to either non-executives (39%) or CEOs (36%), and that each board should consider what is appropriate and act accordingly;
- **Climate Change Risk Oversight (Global)**: a majority (60%) of investor respondents answered that all companies should be assessing and disclosing climate-related risks and taking actions to mitigate them where possible. 35% of investor respondents answered "maybe" to the following statement about how companies should approach this issue: each company's appropriate level of disclosure and action will depend on a variety of factors including its own business model, its industry sector, where and how it operates, and other company-specific factors and board members. Only 5% of investors indicated that the possible risks related to climate change are often too uncertain to incorporate into a company-specific risk assessment model. Non-investor responses to those same three issues were 21%, 68% and 11% respectively. The actions that investors considered most appropriate for shareholders to take at companies assessed to not be effectively reporting on or addressing their climate-related risks were engagement with the company (96 responses), and considering supporting shareholder proposals on the topic (94 responses). Based on the number of non-investor responses, these two options were also ranked first and second in popularity by non-investors;
- **Mitigating Factors for Companies with Zero Women on Boards (US)**: ISS announced in 2018 that it is introducing a new US Benchmark Voting Policy for 2020 to generally vote against or withhold from the chair of the nominating committee (or other directors on

a case-by-case basis) at companies when there are no women on the company's board, but with some mitigating factors that may be taken into account. Respondents this year were asked whether ISS should consider other mitigating factors, beyond a firm commitment to appoint a woman in the near-term and having recently had a female director on the board, when assessing such companies. Investor respondents were less likely than non-investor respondents to say that other mitigating factors (such as adopting an inclusive "Rooney Rule" style procedure for candidate searches or maintaining an active recruitment process despite the absence of a boardroom vacancy) should be considered and may be sufficient to avoid a negative recommendation on directors;

- **Combined CEO/Chair (US)**: Investor respondents cited poor company responsiveness to shareholder concerns as the most commonly chosen factor that strongly suggested the need for an independent board chair. This was followed by governance practices that weaken or reduce board accountability to shareholders (such as a classified board, plurality vote standard, lack of ability to call special meetings and lack of a proxy access right). For non-investors, the most commonly chosen factor was a poorly-defined lead director role, followed by poor company responsiveness to shareholder concerns.

Geographically and as in past years, the majority (60%) of the respondents to the online survey - 234 in all - represented organisations based in the US. 86 respondents were based in Continental Europe or the UK and 29 respondents were based in Canada. Responses came in from at least 20 organisations based in Asia. Most investor respondents had a market focus that goes beyond their own home country.

View the *2019 Global Policy Survey: Summary of Results*.

1.25 OECD reports more efforts needed to boost trust in business and finance

9 September 2019 - Policy makers should step up their efforts to bolster public trust in finance to reduce the risks of contagion if economic growth and financial returns continue to fall, according to a new OECD report.

The *OECD Business and Financial Outlook 2019: Strengthening Trust in Business* (the Outlook) explores potential risks that could erode trust in the financial sector in the future. These include the abundant issuance of sovereign, corporate and bank debt, which has supported post-crisis growth but has raised concern over potential risks of excessive debt as the credit cycle matures.

The Outlook provides policy makers with concrete considerations for action in five areas:

- financial markets;
- financial institutions - such as banks and pension funds;
- company liability - i.e. trust in companies to obey the law;
- the level playing field, focusing on the rising importance of state-owned enterprises and their associated conduct risks; and
- online markets.

The Outlook is the first outcome of the OECD's Trust in Business Initiative which will further develop the link between trust and business performance and provide a platform for cooperation between governments, business and civil society.

1.26 New Centre for Corporate Law research publications

Members of the Centre for Corporate Law at Melbourne Law School have recently published the following research publications:

- *The Reach of Constitutional Conflicts Provisions: How do Companies Contract out of the General Law Duties?* (2019) by Rosemary Teele Langford and Ian Ramsay;
- *The Hayne Royal Commission - Just Another Piece of Official Discourse?* (2019) by George Gilligan;
- *FinFuture: The Future of Personal Finance in Australia* (2019) by Christoph Breidbach, Chris Culnane, Andrew Godwin, Carsten Murawski and Cynthia Sear;
- *Court Review of the Decisions of the Australian Financial Complaints Authority and its Predecessors* (2019) by Ian Ramsay and Miranda Webster;
- *The 'Creditors' Interests Duty': When Does It Arise and What Does It Require?* (2019) by Rosemary Teele Langford and Ian Ramsay;
- *Director Restriction: An Alternative to Disqualification for Corporate Insolvency* (2019) by Michelle Welsh and Helen Anderson;
- *The Distinctive Features of Women in the Australian Bankruptcy System: An Empirical Study* (2019) by Lucinda O'Brien, Ian Ramsay and Paul Ali; and
- *Removal of Directors of Public Companies by Shareholders: When do Companies Contract Out of the Corporations Act?* (2019) by Rosemary Teele Langford and Ian Ramsay.

2. Recent ASIC Developments

2.1 Report on consumer outcomes from total and permanent disability insurance

17 October 2019 - A review by ASIC has found significant industry-wide problems with the design of total and permanent disability (TPD) insurance and the claims handling process that mean many consumers cannot rely on this cover when they need it most. Over 12 million Australian workers automatically pay for TPD cover through their superannuation to provide financial protection when they are so sick or injured that they can never work again. ASIC expects industry to make prompt changes to ensure this cover provides real value.

ASIC's review found that:

- nearly half a million Australians, often working in casual roles or high-risk occupations, are covered by a very narrow TPD policy definition that only pays out in the most catastrophic circumstances, if they are unable to perform several "activities of daily living" (known as ADL cover), such as feeding, dressing or washing themselves;
- three out of five, or 60% of claims assessed under this narrow cover are declined. This is five times higher than the average declined claim rate for all other TPD claims (12%);
- poor claims handling processes contributed to some consumers withdrawing their claims: one in eight, or 12% of claims lodged with insurers did not proceed to a decision; and

- insurers lacked key claims data to help them effectively manage the risk of consumer harm - including being able to identify the value of products to consumers and key friction points in their claims handling processes.

ASIC collected data on 35,000 TPD claims and commissioned consumer research. The review identified that insurer practices such as difficult lodgement processes, poor communication practices, multiple requests for medical assessments, and excessive delays were just some of the problems consumers found during the claims assessment process. Each of these issues presented a hurdle to making a successful claim, and ASIC is concerned that insurers had limited insights about the reasons for withdrawn claims, showing poor oversight of their products.

The granularity of ASIC's data collection allowed ASIC to conduct industry-wide statistical modelling that, to its knowledge, has not been undertaken in the Australian life insurance market before. This modelling showed that for claims where a decision has been made, AMP, Asteron (formerly Suncorp Life) and Westpac had declined claim rates higher than expected. The declined claim rate for Asteron was almost double what ASIC predicted.

ASIC expects insurers and trustees to take steps to implement changes to their claims handling practices and to redesign TPD products so that they offer significantly better value for consumers.

ASIC also expects insurers to invest in data resources and improve the quality of their data. This includes collecting data on outcomes for different types of TPD cover including claims assessed under restrictive definitions such as ADL. ASIC and APRA will continue to work together to improve the public reporting of life insurance data.

View:

- *REP 633 Holes in the safety net: A review of TPD insurance claims* (REP 633); and
- *Executive summary to REP 633*.

2.2 Relief from financial adviser compliance scheme obligations

15 October 2019 - ASIC has announced that it will make a legislative instrument to provide relief to AFS licensees from financial adviser compliance scheme obligations, following a government announcement.

On 11 October 2019 the government announced that it would accelerate the establishment of a single disciplinary body for financial advisers. This disciplinary body will displace the role of compliance schemes in monitoring and enforcing the *Financial Planners and Advisers Code of Ethics 2019* (the Code).

As a result, compliance scheme applicants have withdrawn their applications to ASIC for approval of their compliance schemes. This means the compliance scheme regime will not be able to proceed at this time.

ASIC will take immediate action to provide certainty for AFS licensees that they will not be in breach of the law because their financial advisers were not able to register with an ASIC-approved compliance scheme by 1 January 2020, as originally required.

ASIC will grant a three year exemption to all AFS licensees from the obligation in the Corporations Act 2001 No. 50 (Cth) to ensure that their financial advisers are covered by a compliance scheme, and from the associated notification obligations.

AFS licensees will still be required to take reasonable steps to ensure that their financial advisers comply with the code from 1 January 2020, and advisers will still be obliged to comply with the Code from that date onwards. ASIC may take enforcement action where it receives breach reports. ASIC will make a public announcement when the legislative instrument providing the exemption takes effect.

2.3 Report on the effectiveness of disclosure

14 October 2019 - In a joint report, *REP 632 Disclosure: Why it shouldn't be the default* (REP 632) ASIC and the Dutch Authority for the Financial Markets looked at the effectiveness of disclosure for financial products on consumer outcomes. REP 632 covers a decade of case studies across a broad range of financial products and services in Australia, the Netherlands, the UK and the US. It finds that reliance on mandated disclosure and warnings has often proved ineffective, and at times even backfired contributing to more consumer harm.

REP 632 highlights that the limits of disclosure are not new. Once considered the backbone of consumer protection regulation in the *1997 Financial Systems (Wallis) Inquiry*, disclosure's effectiveness has been questioned and discounted by both the *2014 Financial Systems (Murray) Inquiry* and more recently the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

REP 632 also reveals how firms can work around and undermine disclosure. It identifies unnecessary product complexity and "sludge" that can get in the way of consumers switching products or making complaints. For example, in one of the 33 supporting case studies, only two fifths of Australian consumers given a "simple" key fact sheet (KFS) selected the objectively best home insurance product. Whilst almost three fifths of consumers given the KFS or longer product disclosure statement selected suboptimal products.

Key limits of disclosure identified in REP 632, and supported by 33 case studies, include that:

- **disclosure does not "solve" the complexity in financial services markets** (8 case studies from Australia and the Netherlands about insurance, investments, financial advice and credit);
- **disclosure must compete for consumer attention and influence** (12 case studies from Australia, the Netherlands, the US and the UK about credit, insurance, investments, superannuation and banking);
- **one size disclosure does not fit all - the effects of disclosure are different from person-to-person and situation-to-situation** (4 case studies from Australia and the Netherlands about investments, insurance and superannuation);
- **in the real world, disclosures can backfire in unexpected ways** (3 case studies from the Netherlands, US and the UK about financial advice, credit and investments); and
- **and a warning about warnings** (6 case studies from Australia, the Netherlands, US and the UK about credit, financial advice and investments).

REP 632 also identifies that these limitations are not confined to longer forms of disclosure, or traditional paper-based disclosure, but also apply to warnings and "simplified" disclosure.

Going forward ASIC is taking a more consumer outcome-focused approach, making the most of ASIC's enhanced regulatory tool kit. This includes the use of new product intervention powers when warranted and setting expectations for firms to deliver good consumer outcomes under their design and distribution obligations.

According to REP 632, mandated disclosure still has an important role to play. It contributes to market transparency and can enhance competition. But its value as a consumer protection tool cannot be assumed.

View REP 632.

2.4 Report on director and officer oversight of non-financial risk

2 October 2019 - In the report *Corporate Governance Taskforce: Director and officer oversight of non-financial risk report* (the Report), ASIC urges companies to apply a greater focus and sense of urgency to the oversight and management of non-financial risk.

Focusing primarily on the oversight and management of compliance risk, ASIC's Report found:

- all too often, management was operating outside of board-approved risk appetites for non-financial risks, particularly compliance risk. Boards need to actively hold management accountable for operating within stated risk appetites;
- reporting of risk against appetite often did not effectively communicate the company's risk position. Boards need to take ownership of the form and content of information they are receiving so that they can adequately oversee the management of material risks;
- material information about non-financial risk was often buried in dense, voluminous board packs. It was difficult to identify key non-financial risk issues in information presented to the board. Boards should require reporting from management that has a clear hierarchy and prioritisation of non-financial risks; and
- the effectiveness of board risk committees (BRCs) could be improved. BRCs should meet more regularly, devote enough time and be actively engaged to oversee material risks in a timely and effective manner.

The Report is based on ASIC's direct review of seven large financial institutions, 60 interviews with directors and officers, an extensive documentation review, and external resources.

ASIC's Corporate Governance Taskforce (the Taskforce) is one of ASIC's new supervisory initiatives and is part of its focus on more intensive supervisory approaches. The Taskforce is conducting pro-active and targeted reviews into the corporate governance practices of Australia's large listed companies. The focus of the Taskforce's work is to identify good and poor practices and recommend improvements to lift corporate governance standards.

View:

- the Report; and

- the speech by ASIC Chair James Shipton, *Launch of ASIC's report on director and officer oversight of non-financial risk*.

2.5 Consultation on reforms to sale of add-on financial products sold with cars

1 October 2019 - ASIC has released a consultation paper on a proposal to use its product intervention power to reform the sale of add-on financial products by car yards.

ASIC is taking this action to address ongoing concerns about consumer harms from the sale of add-on insurance and warranty products by caryards.

Consultation Paper 324 Product intervention: The sale of add-on financial products through caryard intermediaries (CP 324) seeks views on the following proposals:

- introducing a deferred sales model-applying a deferred sales model to sales of add-on insurance products and warranties by caryards, other than comprehensive or compulsory third party insurance, and manufacturers' warranties provided with new cars. This would apply to all sales where finance is arranged for motor vehicles, including by car dealers, finance brokers and salary packaging firms;
- complementing the deferred sales model with additional obligations - this would include other requirements such as:
  - the use of "knock out" questions to prohibit sales where the product has low or no value; and
  - prohibiting the sale of warranties that provide low levels of cover (where the maximum amount that can be claimed is $2000 or less).
- Monitoring the impact of these proposals - If ASIC makes an intervention order it proposes to collect data from insurers and warranty providers, so that it can monitor whether the interventions are operating as intended.

The product intervention power allows ASIC to intervene where financial products have resulted in or are likely to result in, significant consumer detriment. It allows ASIC to directly confront, and respond to, business models that cause, or create a risk of consumer detriment, in the financial sector.

ASIC's work complements the concurrent consultation by the Commonwealth Treasury: see Reforms to the sale of add-on insurance products.

View:

- CP 324; and
- CP 324: draft instrument *ASIC Corporations (Product Intervention - Add-on Insurance and Extended Warranties) Instrument*.

2.6 Report on corporate finance regulation - January to June 2019

23 September 2019 - ASIC's latest report on its oversight of corporate finance activity between January to June 2019 has been published and includes an update on specific focus areas for the next six months.

REP 630 ASIC regulation of corporate finance: January to June 2019 (REP 630) provides statistical data, and includes relevant guidance, about ASIC's regulation of:

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

REP 630 also discusses key concerns arising from practices in these areas, including the conduct that has caused ASIC to intervene, its response to issues identified in transactions during the period, and offers insights into future areas of focus.

Key observations and recommendations for better practice are summarised below:

Fundraising

- ASIC requested additional or amended disclosure in more than a quarter of all prospectuses lodged during the period. Consistent with prior periods, ASIC remains concerned about inadequate or unclear disclosure of business models, use of funds and risks disclosure;
- ASIC observed an increase in the number of initial public offerings by technology development and service companies that are relatively early stage and loss making. In many instances, ASIC sought corrective and additional disclosure in relation to revenue growth and customer numbers which appears to be a considerable focus area in prospectuses for such types of issuers; and
- issuers that engage marketers to promote offers are reminded that they should actively monitor marketing and promotional activities and materials to ensure that it is not misleading or deceptive.

Experts

- ASIC surveillance of independent expert licensees during the period identified that several experts did not maintain or had inadequate internal documentation of internal processes relating to the preparation of expert reports.

M&As

- on four occasions during the past 12 months, ASIC either withheld no-objection letters or intervened to oppose the approval of a scheme of arrangement. ASIC will closely scrutinise schemes of arrangements involving practices it considers are contrary to the principles underlying the regulation of takeovers and which undermine the integrity of the scheme process;
- ASIC recommends that directors who will receive benefits under a scheme consider potential conflicts of interest when considering whether to make a recommendation and carefully disclose such considerations in the scheme documentation; and
- in addition to matters concerning disclosure and offer structuring, ASIC also identified concerns with practices during transactions that affect the integrity of the markets in

which they take place, including matters pertaining to substantial holding disclosure and takeover bid minimum acceptance conditions.

Corporate Governance

- ASIC continues to maintain a focus on climate risk disclosure, and ASIC outlines its recent efforts to clarify policy in relation to the disclosure of risks and opportunities associated with climate-change.

2.7 Remake of instrument about departed former temporary residents' unclaimed superannuation disclosure

19 September 2019 - ASIC has remade *ASIC Class Order [CO 09/437]* Departed former temporary residents superannuation - Disclosure relief, which was due to expire on 1 October 2019.

The new instrument, *ASIC Corporations (Unclaimed Superannuation - Former Temporary Residents) Instrument 2019/873*, will continue to provide relief for trustees of regulated superannuation funds from certain obligations in the Corporations Act 2001 No. 50 (Cth). Specifically, it will provide relief from the requirement to notify and give exit statements to departed former temporary residents when their superannuation benefits are paid to the Australian Taxation Office under Part 3A of the Superannuation (Unclaimed Money and Lost Members) Act 1999 No. 127 (Cth).

The relief is conditional on:

- specified information for temporary residents being included in product disclosure documentation and on the fund's website; and
- the trustee providing reasonable assistance if the former temporary resident asks the trustee about their interest in the fund.

The new instrument continues the effect of the previous instrument with one minor amendment - the website disclosure must now be on the website of the fund rather than the trustee's website.

The relief was remade after a public consultation process through the release of *Consultation Paper 318 Remaking ASIC class order on departed former temporary residents' superannuation: [CO 09/437]* (CP 318). However, ASIC did not receive any submissions in response to CP 318.

View:

- *ASIC Corporations (Unclaimed Superannuation - Former Temporary Residents) Instrument 2019/873*; and
- CP 318.

2.8 ASIC lodgement requirements for liquidators

19 September 2019 - ASIC has re-issued *Information Sheet 29 External administration, controller appointments and schemes of arrangement - most commonly lodged forms* (INFO 29) to help liquidators comply with their lodgement requirements.

INFO 29 reflects the changes made to the Corporations Act 2001 No. 50 (Cth) by the Insolvency Law Reform Act 2016 No. 11 (Cth) and follows liaison with the Australian Restructuring Insolvency Turnaround Association about the revisions.

INFO 29 contains 13 updated flowcharts to help external administrators, controllers and scheme administrators meet their obligations and outlines ASIC's expectations for forms commonly lodged with ASIC and certain publication requirements when:

- an external administrator (liquidator, voluntary administrator or deed administrator) has been appointed to a company;
- a controller (receiver, receiver and manager, controller or managing controller) has been appointed over company property; and
- an administrator of a scheme of arrangement has been appointed.

It provides guidance to external administrators on:

- using ASIC's flowcharts for form lodgements, to help understand when certain forms must be lodged;
- using the registered liquidator portal, which is the fastest and most accurate way of lodging forms if you are a registered liquidator;
- using the ASIC published notices website for notices; and
- specific commonly lodged forms.

3. Recent ASX Developments

3.1 Consultation response - Simplifying, clarifying and enhancing the integrity and efficiency of the ASX listing rules

On 10 October 2019, the ASX released its final response to submissions on the ASX's 28 November 2018 consultation paper, *Simplifying, clarifying and enhancing the integrity and efficiency of the ASX listing rules*, proposing a broad range of changes to the ASX Listing Rules (Listing Rules) and related guidance. The changes are designed to improve disclosures to the market, make the Listing Rules easier to understand and comply with, and enable the ASX to better monitor and enforce compliance with the Listing Rules.

Accompanying the final response are mark-ups of the final changes the ASX is making to the Listing Rules and related guidance which address the feedback received in consultation submissions, together with a mark-up comparing the final rule and guidance note changes to the consultation version. Copies of these documents can be accessed on the Public Consultations page on the ASX Website.

Subject to the necessary regulatory approvals, with two exceptions, the final rule changes and revised Listing Rule Appendices and Guidance Notes will come into effect on 1 December 2019. The first exception is for changes to *Listing Rule 1.1 condition 13* and *Listing Rule 12.6* which will come into effect on 1 July 2020. The second exception is for changes to the *Appendix 4C* and

Appendix 5B Quarterly Cash Flow Reports, which will come into effect for the quarter beginning 1 January 2020.

3.2 Public consultation - ASX 24 Bond Futures Roll

On 3 October 2019, ASX released a consultation paper, *ASX 24 Bond Futures Roll*, outlining potential changes to the contract specifications and order management functionality for the 3 and 10 Year Bond Futures Roll (the Bond Roll). The purpose of the consultation is to identify opportunities to improve the efficient functioning of the Bond Roll for a broad range of market users. The following four options are outlined in the consultation paper:

- reduction in the minimum tradeable tick increment for the Bond Roll;
- increase to the maximum allowable order size;
- development of Good Till Cancelled spread order functionality; and
- use of Pre-trade Risk Management tools.

Written submissions are requested by Tuesday 3 December 2019.

3.3 Monthly Activity Reports

On 3 October 2019, the ASX released the ASX Monthly Activity Report for September 2019.

4. Recent Takeovers Panel Developments

4.1 Benjamin Hornigold Limited 09 - Panel declines to conduct proceedings

30 September 2019 - The Takeovers Panel (the Panel) has declined to conduct proceedings on an application dated 13 September 2019 from Benjamin Hornigold Limited in relation to its affairs.

The application concerned whether the following transactions (separately and together with transactions the subject of the declaration in Benjamin Hornigold Limited 05, 06 & 07, see TP19/50) rendered Benjamin Hornigold a less attractive acquisition target and made it less likely to attract competing proposals from potential acquirers, in essence operating as a lock-up device:

- the novation of a loan arrangement between Benjamin Hornigold (as lender) and Genesis Proprietary Trading Pty Ltd (Genesis) (as borrower) for a loan amount of $800,000 on 7 May 2019 so that the amount outstanding (including accrued, unpaid interest) was transferred from Genesis to JB Financial Group Pty Ltd (JB Financial Group); and
- the variation of a loan agreement between Benjamin Hornigold (as lender) and JB Financial Group (as borrower) for the purpose of allowing JB Financial Group to purchase 100% of the shares of Genesis to extend the date of repayment to 11 September

2020 and remove Benjamin Hornigold's right to convert outstanding monies under the loan into Genesis shares (see TP19/54).

The Panel considered there was no reasonable prospect that it would grant any substantive relief having regard to (among other things) the quantum and effect of the above transactions and the effect of developments since (including the close of the takeover bid by John Bridgeman Limited for all of the securities in Benjamin Hornigold on 13 September 2019 and the orders of the Panel in Benjamin Hornigold Limited 05, 06 & 07 (see TP19/57). Accordingly, the Panel declined to conduct proceedings.

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

4.2 Pacific Energy Limited - Panel declines to make declaration

25 September 2019 - The Panel has declined to make a declaration of unacceptable circumstances in response to an application dated 13 September 2019 from QGIF Swan Bidco Pty Ltd (QIC Bidco) (see TP19/53).

On 24 July 2019, Pacific Energy Limited (Pacific Energy) announced that it had entered into a scheme implementation deed (QIC SID) with QIC Bidco to acquire Pacific Energy by way of scheme of arrangement for a total cash value of $0.975 per share (inclusive of a $0.015 final dividend).

On 9 September 2019, Pacific Energy received a competing proposal from APC Bidco Pty Ltd (established by the OPTrust/ICG Consortium (Consortium)) for a total cash value of $1.085 per share (inclusive of a $0.015 final dividend), conditional upon entry into a deed with the Consortium (APC Proposal Deed). On 10 September 2019, Pacific Energy entered into the APC Proposal Deed pursuant to which, subject to certain qualifications, the Consortium would become entitled to receive a break fee of $2.5 million from Pacific Energy in the event Pacific Energy did not enter into a scheme implementation deed with the Consortium by 12 noon (WST) on Tuesday, 17 September 2019 (APC Break Fee).

On 16 September 2019, following the exercise of QIC Bidco's matching right under the QIC SID, Pacific Energy announced that it recommended that all its shareholders vote in favour of a revised QIC Bidco offer for a total cash value of $1.085 per share (inclusive of a $0.015 final dividend). Accordingly, the APC Break Fee has been triggered.

QIC Bidco submitted that entry into the APC Proposal Deed was unacceptable because (among other things) it constituted a breach of the QIC SID (denying QIC Bidco the full benefit of its matching right) and the APC Break Fee imposed an impermissible payment trigger and caused a diminution in the value of Pacific Energy with the effect of making the company less attractive to an acquirer and less likely to attract competing proposals.

The Panel considered that (among other things):

- as a result of entering into the APC Proposal Deed, Pacific Energy facilitated a rival proposal leading to a materially higher offer; and
- in substance the break fee under the APC Proposal Deed was not anti-competitive or coercive.

On the basis of the above, the Panel decided not to make a declaration of unacceptable circumstances.

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

5. Recent Research Papers

5.1 The public sector duty of care and diligence

Every Australian jurisdiction has imposed a duty of care and diligence on directors and other officials of public sector entities. This duty is modelled on the duty applicable to directors and officers of corporations and plays a significant role in setting governance standards in the public sector. The article examines the interpretation of the duty and its effectiveness in setting governance standards across the public sector. It argues that there is evidence of an emerging community expectation that entities which carry out governmental functions or manage public resources should be required to take reasonable care and diligence in the exercise of those functions, but that this standard has received only incomplete recognition in Australian legislation. The article argues further that the public sector duty of care presents significant difficulties in interpretation given that some of the key concepts relating to the private sector duty are not readily translatable to the public sector and that the mechanisms for enforcement in every jurisdiction are inconsistent, ineffective and lack a clear policy rationale. The consequence is that the duty of care and diligence does not play a significant role in setting governance standards in the public sector.

View *The Public Sector Duty of Care and Diligence*.

5.2 Directors' duty to act in the best interests of the corporation: "Hard cases make bad law"

Directors' statutory duty to exercise their powers "in the best interests of the corporation (company)" can be found in s. 181(1)(a) of the Corporations Act 2001 No. 50 (Cth). On numerous occasions the courts, both in the UK and Australia, have held that there is also a common law duty for directors to exercise their powers "in the best interests of the corporation as a whole" and that "the corporation" means "the corporators (shareholders) as a general body". In this article, the focus is on these phrases and the aim is to establish whether these phrases create potentially competing duties for directors. The various interpretations of these duties have resulted in considerable complexity and legal uncertainty as far as directors' duties are concerned. The UK case of *Greenhalgh v Arderne Cinemas Ltd* [1946] 1 All ER 512 and the Australian High Court case of *Ngurli Ltd v McCann* [1953] HCA 39 are analysed and their impact on many other cases dealt with in some detail.

Throughout this article the significance of the corporation as a separate legal entity is emphasised and it is argued that directors owe their duties towards the corporation as a separate legal entity. It follows that directors can no longer prioritise shareholder interests unless these interests align with the best interests of the corporation as a separate legal entity. Several other third party interests are represented in the corporation as a separate legal entity and it will depend on the particular circumstances to what extent these interests need to be considered when directors fulfil their duties towards the corporation.

View *Directors' Duty to Act in the Best Interests of the Corporation: 'Hard Cases Make Bad Law'*.

5.3 Disclosure overload? Lessons for risk disclosure & ESG reporting reform from the regulation S-K concept release

In 2018 and 2019, the US SEC released the first new rules to emerge from a decades-long project to "modernize and simplify" the disclosure obligations that apply to publicly traded companies. Most are pragmatic fixes that should make disclosure more user-friendly for investors and cheaper for companies. Largely missing, however, are any changes to the basic rules governing how companies provide information to investors about risk, including emerging "environmental, social, and governance" (ESG) risks. In part, this is because of persistent concerns that such reforms will result in costly over-disclosure that will overload investors and obscure useful information. Using data from nearly 300 public comments submitted during the SEC's own review of its reporting framework, this study challenges some of these key objections to ESG disclosure reform. As the first comprehensive empirical analysis of the public comment data across over 140 questions raised by the SEC, it also offers a valuable resource for current policy debates and sheds light on fundamental issues that will shape the future of risk disclosure reform.

View *Disclosure Overload? Lessons for Risk Disclosure & ESG Reporting Reform from the Regulation S-K Concept Release*.

5.4 Sustainability in corporate law

Over a quarter of total assets under management is now invested in socially responsible companies. This marks an astounding repudiation of Wall Street's get-rich-fast mentality, as well as a direct challenge to corporate law's reigning mantra of profit maximisation above all. Yet, this new direction has gained followers not only among progressive academics, but also among conservative corporate law scions and financial industry CEOs. To understand this phenomenon and its implications for corporate law, the authors argue that it offers companies a superior tool in mitigating risk. The authors compare sustainability to compliance, corporate law's only risk mitigation device, and argue that its informality and broad scope, coupled with direct engagement with stakeholders, can deliver significant benefits in preventing or weathering a corporate collapse.

These benefits, though important to all shareholders, are particularly valuable for large asset managers, who have come to dominate public companies' shareholding structure in the last decade. Because of their contractual commitments to their clients, asset managers like BlackRock, State Street, and Vanguard, cannot easily diversify their holdings from such risks. They are forced to continue holding stocks after severe drops in price until they are thrown out of an index, to invest in industries in the throes of significant crisis, and to suffer externalities imposed to other companies during a corporate collapse.

To address these pitfalls, asset managers have struck an unexpected alliance with sustainability heads and other like-minded officers, often below the "C-suite", to engineer change in the companies they invest. They have backed these officers with public statements and through their engagement efforts. Moreover, they have supported governance reforms that enhance sustainability's visibility within the company. For example, they demanded that board committees specifically undertake the task of overseeing sustainability and fought for changing board composition to include directors with competence in sustainability.

Delaware courts, the authors argue, should recognise sustainability's benefits in mitigating risk. By failing to establish an appropriate sustainability function, directors and managers are unnecessarily exposing their shareholders to increased risk. If their failure is due to bad faith, they should be found in violation of their duty of loyalty to shareholders. To satisfy the good faith requirement, boards should ensure that their company has a well-running ESG function with proper board oversight, that their ESG function targets a reasonable set of priorities, and that it reaches out to stakeholders to inform its initiatives and proposals. This governance reform, the authors conclude, is essential to allow sustainability to reach its full potential.

View *Sustainability in Corporate Law*.

5.5 Rethinking the law on shareholder-initiated resolutions at company general meetings

Recent concerns about the need for improved corporate accountability raise questions about the role of shareholders in corporate governance. One aspect of these discussions is the capacity of shareholders in general meetings to propose non-binding advisory resolutions concerning governance or social matters. Since *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34 in 1906, courts have held that if a company's constitution gives directors the power of company management, shareholders cannot interfere with the exercise of that power. The Federal Court affirmed this in *Australasian Centre for Corporate Responsibility v Commonwealth Bank of Australia* [2016] FCAFC 80. This paper re-examines the case law, particularly in its application to advisory resolutions, and recommends the introduction of a broad statutory authority for non-binding advisory resolutions. The paper argues that this is an important step towards improved corporate accountability and responsible shareholder engagement.

View *Rethinking the Law on Shareholder-Initiated Resolutions at Company General Meetings*.

6. Recent Corporate Law Decisions

6.1 Best to be cautious? High Court decision on the operation of s. 260A and what constitutes financial assistance

(By Kate Hilder and Mark Standen, MinterEllison)

Connective Services Pty Ltd v Slea Pty Ltd [2019] HCA 33 (9 October 2019) High Court of Australia, Kiefel CJ, Gageler, Keane, Gordon, and Edelman JJ

(a) Summary

The case concerns the scope of the implied prohibition in s. 260A(1) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) against financial assistance by a company to acquire shares in the company where the financial assistance is said to materially prejudice the interests of the company or its shareholders.

In a unanimous judgment, the High Court (the Court) held that by bringing and funding legal proceedings in its own name and with the aim of enforcing the pre-emptive rights of some shareholders against a fellow shareholder (by compelling one shareholder to offer shares to the other shareholders), the company (Connective Services Pty Ltd) did contravene s. 260A(1) of the Corporations Act.

The Court held that financial assistance need not involve any diminution or depletion of assets, but rather is a commercial/financial question. "The financial assistance need not involve a money payment by the company to the person acquiring the shares. Any action by the company can be financial assistance if it eases the financial burden that would be involved in the process of acquisition or if it improves the person's 'net balance of financial advantage' in relation to the acquisition".

The Court held that "if a company wishes to bring proceedings to enforce pre-emptive rights in its constitution, for the benefit of some of its shareholders but at the company's expense, then the company is liable to be enjoined from doing so unless the assistance is approved by shareholders under s. 260B, or unless the company can satisfy the court that bringing the proceedings at its own expense does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors".

(b) Facts

Slea Pty Ltd (Slea) was one of three shareholders in a mortgage aggregation business called Connective Services Pty Ltd (Connective Services). Connective Services' constitution included a pre-emption clause requiring that shareholders offer their shares to their fellow Connective Services shareholders before the shares could be transferred to any other party.

Slea entered into an agreement to transfer its shares to a third party, Minerva Financial Group (without complying with this pre-emptive rights provision). To prevent this, Connective Services commenced proceedings to compel Slea to offer its shares to the other Connective shareholders. Slea then sought an injunction under s. 1324 of the Corporations Act, to restrain Connective Services from prosecuting the proceedings on the basis that the proceedings contravened the prohibition against financial assistance in s. 260A(1) of the Corporations Act.

(c) Decision

The Court held that the legal proceedings brought by Connective Services against Slea to enforce a pre-emptive rights provision for the benefit of the other Connective Services shareholders at Connective's expense, did constitute "financial assistance" and issued the injunction.

Further, the Court found that "if a company wishes to bring proceedings to enforce pre-emptive rights in its constitution, for the benefit of some of its shareholders but at the company's expense, then the company is liable to be enjoined from doing so unless the assistance is approved by shareholders under s. 260B, or unless the company can satisfy the court that bringing the proceedings at its own expense does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors".

Section 260A(1) of the Corporations Act provides that a company may financially assist a person to acquire shares in the company only if giving the assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors.

The Court considered that the three elements necessary to establish a contravention of s. 260A(1) of the Corporations Act (relevant to the case in question) are:

- financial assistance given by the company;
- to acquire shares or units of shares in the company; and
- which materially prejudices the interests of the company or its shareholders or its ability to pay its creditors.

(i) Clarification: what is "financial assistance"?

The Court held that financial assistance need not involve any diminution or depletion of assets, but rather is a commercial/financial question. "Financial assistance need not involve a money payment by the company to the person acquiring the shares. Any action by the company can be financial assistance if it eases the financial burden that would be involved in the process of acquisition or if it improves the person's 'net balance of financial advantage' in relation to the acquisition. For instance, the assistance might involve the company paying a dividend by means other than by payment of cash, issuing a debenture, granting security, or agreeing to pay consultancy fees'" the Court held.

(ii) Approach to determining whether there has been "material prejudice"

The Court held that "the issue of material prejudice to the interests of the company or its shareholders or creditors requires an assessment of and comparison between the position before the giving of the financial assistance and the position after it to see whether the company or its shareholders or its ability to pay its creditors is in a worse position".

"It does not assist to gloss the concept of material prejudice by the introduction of further concepts, which themselves require further explanation, such as whether there has been a diminution of the assets of the company, whether there has been a transaction, or whether there was a net transfer of value to the person acquiring the shares".

(iii) To acquire shares or units of shares

The Court held that "the words 'to acquire' require a sufficient link between the financial assistance and the acquisition of the shares or units of shares. Section 260A(1) does not require that an acquisition actually take place, since the provision can be contravened and injunctions can be ordered before any acquisition actually takes place. In this sense, 'to acquire', like the express words of the predecessor section s. 205(1) of the Corporations Act, includes conduct that is in connection with the process of an acquisition of the shares or units of shares and not limited to conduct for the purpose of acquisition. Acquisition also has broad connotations. It does not require a transaction or transfer. It includes acquisitions by issue or transfer or any other means".

(iv) Onus was on Connective Services to prove that there was no "material prejudice"

Section 1324(1B)(a) of the Corporations Act provides that where the ground relied on in an application for an injunction under s. 1324 of the Corporations Act is an alleged contravention of

s. 260A(1)(a) of the Corporations Act, the Court must assume that the conduct constitutes or would constitute a contravention of s. 260A(1)(a) of the Corporations Act unless the company or person proves otherwise.

In this case, Connective Services was required to disprove that its conduct constituted a contravention of s. 260A(1) of the Corporations Act. The Court held that it ultimately did not do so. The Court reasoned that if the other two Connective Services shareholders had brought proceedings against Slea to vindicate their pre-emptive rights, and the proceedings were funded by Connective Services, then it would have constituted financial assistance (in contravention of 260A(1)) because it would have eased the financial burden incurred in the process of the acquisition of the shares by those shareholders.

As it was, the Court held that the commencement of the pre-emptive rights proceedings by Connective Services was financial assistance within the meaning of s. 260A(1) of the Corporations Act and that Connective Services "did not discharge their onus of proving that there was no material prejudice to the Connective companies or their shareholders".

(v) Best to exercise caution

The judgment states that "if a company wishes to bring proceedings to enforce pre-emptive rights in its constitution, for the benefit of some of its shareholders but at the company's expense, then the company is liable to be enjoined from doing so unless the assistance is approved by shareholders under s. 260B, or unless the company can satisfy the court that bringing the proceedings at its own expense does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors".

6.2 The Court is reluctant to impose fiduciary obligations if inconsistent with the parties' contractual rights and obligations

(By Lauren Musgrave, Corrs Chambers Westgarth)

Eaton v Rare Nominees Pty Limited [2019] QCA 190 (13 September 2019) Supreme Court of Queensland, Court of Appeal, Philippides and McMurdo JJA and Davis J

(a) Summary

Mr Eaton, the sole director of E-Coastal Developments Pty Ltd (E-Coastal) appealed against a judgment of the District Court of Queensland, which arose out of a dispute regarding the payment of entitlements to the respondent, Rare Nominees Pty Ltd (Rare) under a joint venture agreement (JVA). At first instance, Dorney QC DCJ found that E-Coastal owed fiduciary duties to Rare under the JVA, and that it had breached these duties. His Honour also found that Mr Eaton was liable to Rare pursuant to the second limb of *Barnes v Addy* (1874) LR 9 Ch App 244 (*Barnes v Addy*) and ordered Mr Eaton to pay to Rare the sum of $226,000.55 inclusive of interest.

Mr Eaton appealed these findings. The Queensland Court of Appeal (the Court) found that the trial judge had erred in concluding that E-Coastal owed fiduciary duties to Rare under the JVA. The Court found that the trial judge had failed to give proper weight to the consideration that any fiduciary relationship had to accommodate the terms of the JVA so as not to be inconsistent with them.

(b) Facts

E-Coastal entered into a JVA with the respondent, Rare, for the development of a parcel of land (the Project). Under the JVA, Rare advanced money to the Project and Mr Eaton in return made "Contributors' Entitlements" to Rare. The JVA provided that the relationship between the parties to the JVA was to be "contractual only" and expressly excluded duties of a fiduciary nature.

The Project progressed but no payments of "Contributors' Entitlements" were advanced to Rare. By the time of trial, E-Coastal had gone into liquidation and, as such, Rare sought relief solely against Mr and Mrs Eaton. At first instance Dorney QC DCJ found that under the JVA, E-Coastal owed fiduciary duties to Rare, which it had breached in utilising E-Coastal funds to pay for matters outside the ambit of the development costs of the JVA or in preference to making Contributors' Entitlements to Rare.

Mr Eaton appealed the primary judgment on three grounds, being that the trial judge had erred:

- in his construction of the term "Receipts" in the JVA;
- in finding that there was a breach of fiduciary duty by E-Coastal; and
- in finding that Mr Eaton was liable pursuant to the second limb of *Barnes v Addy*.

(c) Decision

The Court allowed ground two of the appeal and set aside the judgment of the primary judge.

(i) Breach of fiduciary duty

The trial judge had considered four factors in finding that a fiduciary relationship had existed between the parties:

- the level of trust placed in E-Coastal by Rare;
- that the rights to inspect and require information under the JVA were rendered nugatory in light of Mr Eaton's lies and denials;
- that E-Coastal had "almost total" control to elect whether it would discharge its obligation to pay "Contributor's Entitlements"; and
- that the purpose behind the JVA was to achieve an entitlement protected from "commercial risks".

Philippides JA questioned these findings but found that, in any case, none of the four factors identified could overcome the "critical impediment" provided by the contractual provisions of the JVA. Her Honour considered that the parties gave express and detailed attention in the JVA to the relationship between them and the ways in which their mutual obligations were to be circumscribed and limited. Against this background, it was "difficult to see that there could be said to have been a basis for the imposition of a fiduciary duty of the nature found by the trial judge arising as a matter of a reasonable expectation of loyalty".

Her Honour also found that the reliance by the trial judge on *Ross River Ltd v Waveley Commercial Ltd* [2013] EWCA Civ 910 was misplaced as it was a case where the fiduciary duties found were observed, on appeal, to be "consistent with" the relevant JVA. This was not the case here.

Philippides JA considered the statement of principle in *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1, where the majority referred to Mason J's finding in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 that "it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of all parties" and that the "fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them", and further that "the fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction".

Her Honour also noted extra-judicial comments from Gageler J to the effect that ".whether a relationship is fiduciary is a question of attributing a legal character to the relationship which has been formed in fact. a contractual description can sometimes be used as a shorthand description of the incidents of the relationship or transaction into which contracting groups have in fact entered".

Having considered these authorities, Philippides JA found that the trial judge had erred in finding that a fiduciary relationship arose in the present case. The trial judge should have given proper weight to the critical consideration that any fiduciary relationship in the present case had to accommodate the terms of the JVA so as not to be inconsistent with them. Here, the trial judge had super-imposed the fiduciary relationship so as to alter the operation the JVA was intended to have according to its true construction.

McMurdo JA and Davis J concurred with Philippides JA.

(ii) The second limb of *Barnes v Addy*

The trial judge found that Mr Eaton was a "knowing participant" in a "dishonest and fraudulent design" and a knowing assistant to E-Coastal's breaches of fiduciary duty. Mr Eaton appealed this finding on the basis that Rare did not adequately particularise the alleged "dishonest and fraudulent design".

Davis J considered the content of the pleading. While it is a settled principle that dishonesty and fraud must be clearly pleaded and particularised and the statement of claim "could have been clearer", it did enough to put Mr Eaton on notice of the allegations against him and he was cross-examined on these issues. As such, Davis J and McMurdo JA refused this ground of appeal.

(iii) Meaning of receipts

Mr Eaton also submitted that the trial judge had erred in finding that "Receipts" included money which it did not physically receive. The appellant submitted that the term "Receipts" in the contract was a reference to profits, and therefore that expenses which were recovered would not be "Receipts".

Davis J and McMurdo JA agreed with the trial judge's finding on this point and found that there was nothing in the JVA to suggest that any payment due to Rare was to be calculated by striking a profit. As such, they rejected this ground of appeal.

6.3 Relevant considerations of the Court in convening a scheme meeting and approving distribution of explanatory materials

(By Joshua Travers, MinterEllison)

In the matter of Villa World Limited [2019] NSWSC 1207 (11 September 2019) Supreme Court of New South Wales, Black J

(a) Summary

Villa World sought orders to convene a meeting of its members and distribute explanatory materials to shareholders in relation to a scheme of arrangement that proposed the acquisition of its ordinary shares by AVID Property Group Australia Pty Limited (AVID).

The Supreme Court (the Court) set out the relevant considerations in the exercise of its discretion and in particular, discussed whether directors should make a recommendation about a proposed scheme to shareholders in circumstances where a personal benefit is involved, or otherwise remain silent.

In finding there to be no reason that the scheme should not be put to Villa World's shareholders, the Court determined the directors should share their recommendation with shareholders and made orders convening the meeting and approving the distribution of explanatory materials.

(b) Facts

Villa World Limited (Villa World) is an east coast residential property developer that also derives income through joint ventures, equity accounted investments and development management fees. AVID is a national property developer owned by international institutional investors, with a substantial portfolio of residential and industrial projects.

On 19 August 2019, Villa World sought orders under ss. 411 and 1319 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) that it convene a meeting of its members to vote on a scheme of arrangement. The scheme proposed a cash acquisition of all its ordinary shares by AVID. Villa World had announced its entry into a Scheme Implementation Agreement with AVID to the ASX on 8 July 2019.

Villa World relied on a range of affidavit evidence to exhibit:

- that the acquisition was to be for $2.345 per share, subject to adjustment for any dividend or distribution paid by it following the proposal;
- that it was permitted to pay a final or special dividend prior to implementation which may reduce the scheme consideration;
- expert opinion that the scheme was fair and reasonable and in the best interests of its shareholders; and
- correspondence from ASIC advising it would not oppose the scheme.

(c) Decision

(i) Uncontroversial elements

The Court referred to Villa World's submissions in setting out that the Court may order a scheme meeting to be convened if it is satisfied that, citing *Re Atlas Iron Ltd* [2016] FCA 366 at [30]; *Re DUET Finance Ltd* [2017] NSWSC 415 at [15]; *Re BIS Finance Pty Ltd* [2017] NSWSC 1713 at [20]:

- Villa World is a Part 5.1 body;
- the scheme is an "arrangement" under s. 411 of the Corporations Act and is *bona fide* and properly proposed;

- the explanatory materials provide proper disclosure to shareholders; and
- ASIC had a reasonable opportunity to examine the scheme and was given 14 days' notice of the first hearing date.

The Court was satisfied in each of these regards.

(ii) Whether the Court would be likely to approve the scheme on second hearing

The Court gave consideration to a further element: that "the Court will not ordinarily convene a scheme meeting unless the scheme is of such a nature and cast in such terms that, if it receives the statutory majority at the meeting, the Court would be likely to approve it on the hearing of an application that is unopposed", citing *F T Eastment & Sons Pty Ltd v Metal Roof Decking Supplies Pty Ltd* (1977) 3 ACLR 69 at 72; *Australian Securities Commission v Marlborough Gold Mines Ltd* (1993) 177 CLR 485 at 504; *Re Associated Advisory Practices Limited* [2013] FCA 761 at [22].

The Court accepted that the scheme, if passed by the requisite majorities of shareholders, would in this case be likely to be approved by the Court, given that:

- Villa World's board unanimously supported the scheme;
- the proposed consideration exceeded Villa World's previous share price; and
- an independent expert report concluded that the scheme was fair and reasonable and in the best interests of Villa World's shareholders.

Four matters were discussed as "commonplace" in schemes and relevant for the Court's discretion under s. 411(1) of the Corporations Act:

- any performance risk in respect of a bidder's obligation to pay consideration;
- that exclusivity provisions (for example, "no talk" and "no due diligence" restrictions) are disclosed in the explanatory material and negotiated at arm's length;
- break fees will be permitted unless the amount could influence the scheme meeting. The fee should be fairly disclosed and not exceed 1% of equity value; and
- deemed warranties providing that shares are free from encumbrances and third party rights or interests are also common and should be fairly disclosed.

In each of these regards, the Court was satisfied that there was no reason not to convene the scheme meeting or approve the explanatory material.

(iii) Consideration as to whether director should make a recommendation

One issue was raised in relation to the "Villa World Performance Rights" and an associated issue around the CEO and Managing Director's recommendation in respect of the scheme. At the outset, the Court noted that holders of the performance rights were not caused to be a different class of shareholder, given there was no distinction between the rights of shareholders or any inability to consult together in deciding whether to approve the scheme, citing *Sovereign Life Assurance Company v Dodd* [1892] 2 QB 573 at 583; *Re Opes Prime Stockbroking Limited* [2009] FCA 813 at [64]; *Re Foster's Group Ltd (No 2)* [2011] VSC 547 at [38]-[43]; *Re Ardent Leisure Limited* [2018] NSWSC 1665 at [25].

His Honour turned to consider submissions made by Villa World that, citing *Re SMS Management & Technology Ltd* [2017] VSC 257 (*Re SMS*); *Re Nzuri Copper Ltd* [2019] WASC

189 at [88]; *Re Ruralco Holdings Ltd* [2019] FCA 878 at [28] (*Re Ruralco*); *Re Kidman Resources Ltd* [2019] FCA 1226 at [115]:

"Where a director will receive a substantial benefit in relation to the scheme that other shareholders will not receive, then that benefit should be fully and prominently disclosed as a matter for shareholders to take into account when considering that director's recommendation"

Agreeing with Villa World, the Court preferred this approach stemming from *Re SMS*, as opposed to a director instead declining to make a recommendation, referring to *Re Gazal Corporation Ltd* [2019] FCA 701 at [30].

This was for three reasons:

- directors should make a recommendation (and give reasons for doing so) particularly because it would be inconsistent to on the one hand, support a scheme as a board member and on the other, decline to make a recommendation to shareholders (referring to r. 8301(a) of Schedule 8 of the [Corporations Regulations 2001 No. 193 (Cth)]);
- shareholders benefit from recommendations and disclosure to enable them to properly assess the weight to be given (referring in particular to *Re Ruralco*); and
- where directors were involved in the company's decision about a scheme, there would then be "little utility and real inconsistency" in them not sharing their recommendation with shareholders.

(iv) Conclusion

Ultimately the Court found there to be no reason that the scheme should not be put to shareholders or be approved at the second hearing with the necessary approvals.

(v) Orders

Accordingly, orders were made convening the scheme meeting and approving the distribution of the explanatory material to Villa World shareholders.

6.4 Director recommendations in schemes of arrangements

(By Panashi Devchand, Herbert Smith Freehills)

[*Re Mod Resources Ltd; Ex Parte Mod Resources Ltd* [2019] WASC 326] (10 September 2019) Supreme Court of Western Australia, Vaughan J

(a) Summary

In *Re Mod Resources Ltd; Ex Parte Mod Resources Ltd* [2019] WASC 326, Vaughan J considered the appropriateness of two executive directors joining in a unanimous board recommendation to support a scheme of arrangement where the directors may have received an employment retention bonus if the scheme was implemented.

The role of target directors who stand to receive a bonus on implementation of a scheme of arrangement (or have some other interest in the outcome of the scheme) has been considered by a number of courts around the country in recent months. Vaughan J noted that although there is a divergence of views on this issue, this case was not an appropriate occasion to enlarge or seek to reconcile that debate.

(b) Facts

MOD Resources Ltd (MOD) entered into a scheme implementation deed with Sandfire Resources NL (Sandfire) under which it was proposed that Sandfire would acquire 100% of the issued share capital of MOD by way of scheme of arrangement.

This case was the first court hearing in relation to the scheme.

One of the key issues considered by the court was the fact that two of MOD's executive directors may have received an employment retention bonus if the scheme was implemented. The bonus was not simply payable on implementation of the scheme, but depended on the director continuing his employment with MOD following implementation of the scheme.

(c) Decision

Vaughan J acknowledged that there was a divergence of views as to the appropriateness of a director joining in a unanimous board recommendation to support a scheme where the director has an additional and different interest to the members in the approval of the scheme. Vaughan J referred to O'Callaghan J's decision in *Re Kidman Resources Ltd* [2019] FCA 1226, where his Honour expressed disagreement with Farrell J's decisions in *Re Gazal Corporation Ltd* [2019] FCA 701 and *Re Ruralco Holdings Ltd* [2019] FCA 878.

However, Vaughan J's view was that this case was not an appropriate occasion to enlarge or seek to reconcile that debate. His Honour also noted that his view on this issue was already described in *Re Nzuri Copper Ltd; Ex parte Nzuri Copper Ltd* [2019] WASC 189 at [83] to [89] and *Re Navitas Ltd; Ex parte Navitas Ltd* [No 2] [2019] WASC 218 at [31] to [38].

Ultimately, on the particular facts of this case, Vaughan J was satisfied with the two MOD executive directors joining in the unanimous board recommendation of the scheme for three reasons:

(i) Potential bonuses were relatively modest and not simply based on approval of the scheme

Implementation of the scheme was a necessary pre-condition for payment of the bonus, but payment also depended on the director continuing in employment. Vaughan J emphasised that there are good commercial reasons why such a benefit might be offered to key executives of a target company following a change of control. His Honour also acknowledged that restricting a target company from being able to offer incentives to retain key executives may be disadvantageous to shareholders.

(ii) Scheme implementation deed expressly dealt with the form of the recommendation

The scheme implementation deed expressly dealt with the directors obtaining legal advice as to their ability to join a board recommendation for the scheme. The deed allowed a director to decline to join in the recommendation if, after receiving legal advice, the director reasonably determined that he or she should not provide (or continue to maintain) any recommendation.

Vaughan J was also satisfied that the directors did, in fact, take independent legal advice as to the relevant factors to be considered in relation to the scheme based on recent judicial guidance regarding material personal interests and conflicts of interest. His Honour found that it was only on receipt of this advice that the directors resolved to recommend the scheme.

(iii) Scheme booklet contained fulsome disclosure of each director's interest

Each reference in the scheme booklet to the board's unanimous recommendation had an asterisk directing the reader's attention to disclosure of the nature and extent of the potential bonus the two MOD executive directors stood to receive if the scheme was approved. On the basis of this disclosure, Vaughan J was satisfied that shareholders would be able to come to an informed view regarding the unanimous board recommendation.

6.5 Legal phoenix: restructuring sale as an uncommercial and voidable transaction

(By Jennifer Chen, Ashurst)

ACN 093 117 232 Pty Ltd (in liq) v Intelara Engineering Consultants Pty Ltd (in liq) [2019] FCA 1489 (6 September 2019) Federal Court of Australia, Derrington J

(a) Summary

The case related to a "phoenix" transaction where directors of a company experiencing financial difficulties created a new corporation to transfer a portion of its assets and employees to, effectively reprioritising the secured creditors over their employees. The Federal Court (the Court) found this transaction to be voidable, and made an order that the transferred employees could prove in the winding up of the original company for their outstanding entitlements.

(b) Facts

The company, ACN 093 117 232, formerly known as Intelara Pty Ltd (Intelara), and wholly owned by Intelara Holdings Pty Ltd (Intelara Holdings), operated an engineering consultancy business. It had a number of lending and banking facilities provided by the National Australia Bank which were personally guaranteed by the directors of Intelara. Intelara begun experiencing financial difficulties from early 2014.

On 7 December 2015, the directors restructured Intelara using a "legal phoenix" following the advice from a restructuring consultant. A new corporation was established to which some assets and employees of the existing business were transferred for the purchase price of $1. The new corporation had the same directors and shareholders as the existing business. A liquidator was then appointed to wind up Intelara. The transfer of employees and their entitlements from Intelara to Intelara Engineering meant that funds recovered by the liquidator of Intelara were used to repay its bank debt and discharge the security held, including the personal guarantees of the directors, rather than paying employee entitlements as they had been transferred to Intelara Engineering.

In January 2016, Intelara Engineering sold its assets to Intelara Holdings, but did not transfer the employment of its employees (only the directors). The day after the sale, Intelara Engineering was wound up, and unable to pay the employee entitlements which it had assumed on 7 December 2015 from Intelara.

In November 2018, the Court appointed a special purpose liquidator (SPL) to investigate and pursue any claims arising in relation to the asset sale agreement. Here, the SPL sought declarations under the voidable transactions regime of the [Corporations Act 2001 No. 50 (Cth)] (the Corporations Act).

Section 500(2) of the Corporations Act requires leave to be granted for proceedings against a company that is being wound up. In this instance, the Court was satisfied that leave was clearly warranted as the proceedings raised a serious matter of corporate conduct, and it was a good claim which justified the granting of relief. Further, Intelara Engineering did not oppose leave being granted, and the proceedings would not interfere with the orderly winding up of the company.

Intelara Engineer's liquidator was aware of the proceedings and chose not to defend them. This was not an issue as per *Speedo Holdings BV v Evans (No 2)* [2011] FCA 1227, the Court was satisfied that the allegations made in the plaintiff's statement of claim were sufficient to support the relief claimed.

(c) Decision

Derrington J made the declarations sought, namely that the asset sale agreement was:

- an uncommercial transaction pursuant to s. 588FB of the Corporations Act;
- an insolvent transaction pursuant to s. 588FC of the Corporations Act;
- an unreasonable director-related transaction pursuant to s. 588FDA of the Corporations Act; and
- a voidable transaction pursuant to s. 588FE of the Corporations Act.

Because the transaction was found to be voidable, the Court had the power to and did make an order under s. 588F(1)(g) of the Corporations Act that former employees who had been transferred under the asset sale agreement may prove in the winding up of Intelara for the entitlements owing to them as if their employment had been terminated at the time of winding up.

The Court noted that while courts may sometimes be reluctant to grant declarations in the absence of an active contradictor in the proceedings, this was not the case here due to the cogent evidence adduced by the liquidator and the fact that many of the facts relied upon were admitted by the directors in the course of public examinations.

(i) Uncommercial transaction

Section 588FB of the Corporations Act provides that a transaction of a company is an uncommercial transaction if, and only if, it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction, having regard to:

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

The Court noted that Intelara's assets were transferred for effectively nil consideration even though there was some value in Intelara given that Intelara Engineering was able to pursue the work in progress. The transaction had no real benefit for Intelara or its employees, and indeed it may have disadvantaged employees because it was clear that Intelara Engineering would not have the capital to satisfy employee entitlements. Conversely, the transaction provided substantial benefit to the directors by reason of the release of their personal guarantees. The Court stated that a reasonable person would only have entered into the transaction to reorganise the company's liabilities for the purpose of conferring a benefit on a third party (the directors) if the third party provided substantial consideration for the benefit received, which the directors did not do here. Instead, what occurred was a reordering of priorities to ensure the creditors and directors would be paid out ahead of the employees. Accordingly, the transaction was uncommercial because a reasonable person would not have entered into it.

(ii) Insolvent transaction

Section 588FC of the Corporations Act provides that a transaction of a company is an insolvent transaction if, and only if, it is an uncommercial transaction of the company and the transaction is entered into when the company is insolvent. This was clearly satisfied on the facts.

(iii) Unreasonable director-related transaction

Section 588FDA of the Corporations Act defines a number of transactions as being an unreasonable director-related transaction, including if the transaction is a conveyance, transfer or other disposition by the company of property of the company made to a director or for the benefit of a director of the company, and a reasonable person in the company's circumstances would not have entered into the transaction having regard to the benefits and detriments of the transaction to the company.

The Court clearly found that the transaction was for the benefit of the directors who are directors of both Intelara and Intelara Engineering. While the directors did not directly receive company assets, the Court took the view that the legislation was broad enough to include the release of the directors' obligations under their personal bank guarantees to be sufficient to satisfy the benefit test. A reasonable person would not have entered into the agreement having regard to the absence of benefits to the company (indeed, the detriments from prioritising interests of directors over interests of employees) and the benefits conferred on the directors for no consideration.

(iv) Voidable transaction

Section 588FE of the Corporations Act states that a transaction of a company may be voidable in a number of different scenarios including:

- if it is an insolvent transaction and an uncommercial transaction, and it was entered into during the two years ending on the relation-back day (7 Dec 2015 here) (s. 588FE(3) of the Corporations Act);
- if it is an insolvent transaction and a related entity of the company is a party to it (Intelara Engineering) and it was entered into during the four years ending on the relation-back day (s. 588FE(4) of the Corporations Act); or
- if it is an unreasonable director-related transaction of the company and it was entered into during the four years ending on the relation-back day or after that day but on or before the day when the winding up began (s. 588FE(6A) of the Corporations Act).

The Court found for all of the above on the facts.

6.6 Shareholder oppression in quasi-partnership companies

(By Pei Xuan Liu, King & Wood Mallesons)

In the matter of Mosman & Co Pty Limited [2019] NSWSC 1155 (5 September 2019) Supreme Court of New South Wales, Rees J

(a) Summary

This case concerns an oppression suit brought by a minority shareholder against the majority (and only other) shareholder of a private, "quasi-partnership" company. The plaintiff alleged that as a result of the acts of the majority shareholder, the conduct of the company's affairs was oppressive (within the meaning of s. 232(e) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act)) against the minority shareholder, entitling the plaintiff to relief under s. 233 of the Corporations Act.

Affirming several established principles regarding oppression, Rees J held that the critical inquiry is whether objectively, in the eyes of a commercial bystander, there has been unfairness. In the present case, her Honour found that a situation of commercial unfairness had arisen: the majority shareholder used his voting power, contrary to the terms of the Shareholders' Agreement, to exclude the minority shareholder from participation in the Company's management; and did not give the minority shareholder the opportunity to remove his capital on reasonable terms. Accordingly, Rees J granted relief in favour of the plaintiff.

(b) Facts

In 2013, Damian Cameron (Plaintiff) and Bill Koutrodimos (Second Defendant) agreed to establish a real estate business and incorporated Mosman & Co Pty Limited (the Company, or First Defendant), with each making equal capital contributions to the business. The Plaintiff and Second Defendant were appointed Company directors and held shareholdings of 30% and 70%, respectively, to reflect their relative experience. The wife of the Second Defendant, Connie Koutrodimos, also worked in the business.

The relationship between members was governed by a Shareholders' Agreement. Relevantly, the clauses effectively provided that each member had to be represented on the board, and only the member appointing a representative could remove their representative and appoint a replacement. Resolutions had to be decided by the majority, which in the case of two members, meant unanimity.

After two years of operation, relations between the Plaintiff and Second Defendant began to deteriorate over the payment of "back-pay" to Mrs Koutrodimos. In 2016, the Plaintiff transferred funds from the Company's bank account to his personal credit card in an apparent attempt to reimburse himself for business expenses before the back payment of Mrs Koutrodimos' wages. Following this, the Plaintiff's access to the Company's bank account and records was removed and he was removed as a director in a manner not envisaged by the Shareholders' Agreement. The Second Defendant then paid himself a salary, increased that paid to his wife and sold the Company's only asset, the rent roll, without consulting the Plaintiff.

In October 2016, the Plaintiff incorporated a new company and began operating a separate real estate business, DC Property Agents. Eleven clients sought to terminate their agreements with the Company to move to DC Property Agents but were advised by the Second Defendant that their notices of termination were void. The Second Defendant offered to pay the Plaintiff his share of proceeds from the rent roll sale, but only after deducting damages that he considered had been caused by the Plaintiff's breach of directors' duties in securing business formerly managed by the Company.

The Plaintiff:

- claimed that the conduct of the Second Defendant amounted to oppression in the conduct of the First Defendant's affairs (within the meaning of s. 232(e) of the Corporations Act); and
- accordingly, sought an order under s. 233(1)(d) of the Corporations Act, requiring that the Second Defendant purchase the Plaintiff's 30% shareholding in the Company at a proper value.

Further, the Plaintiff sought an order that the Company repay his director's loan, which the Defendants accepted that the Plaintiff was entitled to.

(c) Decision

Rees J held that the conduct of the Company's affairs by the Second Defendant amounted to oppression of the minority shareholder, entitling the Plaintiff to relief.

(i) Oppression claim under s. 232 of the Corporations Act

Applicable legal principles

Rees J endorsed established principles on oppression, affirming that:

- the critical inquiry is whether objectively, in the eyes of a commercial bystander, there has been unfairness. Conduct that is manifestly prejudicial to and discriminatory against a member is not, of itself, oppression - the relevant conduct must be so unfair that reasonable directors who consider the matter would not have thought the decision fair;
- the oppression provisions should be interpreted broadly. Maxims in this area are of limited assistance and a case should be considered on its own facts and circumstances;
- irreconcilable differences in a quasi-partnership company do not of themselves constitute oppression or unfair prejudice but the destruction of a personal relationship establishes a basis for granting relief in the usual case, unless the person excluded from participation in management as a consequence of the breakdown was also responsible for it (citing *Fexuto Pty Ltd v Bosnjak Holdings Pty Ltd* (2001) 37 ACSR 672 (*Fexuto)*); and
- the plaintiff's conduct is relevant to determining whether oppression is made out: it may render the defendant's conduct, even if prejudicial, not unfair or otherwise affect the relief which the court thinks fit to grant.

Findings on the present facts

Rees J held that a situation of commercial unfairness had arisen. The majority shareholder used his voting power, contrary to the terms of the Shareholders' Agreement, to exclude the minority shareholder from participation in the Company's management; and did not give the minority shareholder the opportunity to remove his capital on reasonable terms.

Several factors were relevant to her Honour in her determination:

1. The arrangement that both members contribute equally to the cost of the business, but one member be the majority shareholder created potential for the majority shareholder to oppress the minority shareholder. The Shareholders' Agreement contained provisions directed at protecting

the Plaintiff's minority interest, but these were nullified by the Second Defendant's acts. These acts included:

- calling a meeting and passing a resolution to remove the Plaintiff as director and proceeding as the sole director when the Shareholders' Agreement envisaged the representation of all members on the board; and
- not allowing the Plaintiff (a much younger and less experienced director) to have his solicitor present at the meeting.

2. The Plaintiff showed a demonstrable increase in experience and willingness to participate in the business over time. Accordingly, the present case is distinguishable from *Re R A Noble & Sons (Clothing) Ltd* [1983] BCLC 273. There, the prejudicial conduct consisted of one director running a quasi-partnership company virtually as his own, and it was held that the conduct was not unfair because the plaintiff had not shown any interest in being involved in management or decision making.

3. The Second Defendant was in a position of conflict of interest between his obligations to the members as a Company director, and his personal loyalties to his wife. Her Honour noted instances where:

- the Second Defendant paid his wife back-pay even though members had yet to receive a distribution after 16 months, the Plaintiff had not agreed to payment and his wife had no clear entitlement to the back-pay (contractual or otherwise); and
- the Second Defendant instigated the payment of salary to himself and an increased salary for his wife after he became the sole Company director.

4. The Second Defendant resisted the Plaintiff's efforts to obtain financial information about the Company from the Company's accountant, who was also the Second Defendant's personal accountant. From this, her Honour inferred that the Second Defendant did not want to give the Plaintiff proper opportunity to consider the information.

5. The Second Defendant arranged to sell the Company's only asset, the rent roll, without consulting the Plaintiff or making reasonable efforts to reach agreement on how the sale proceeds would be divided between them.

6. The Second Defendant and his wife acted to exclude the Plaintiff from the management of the business, including by removing the Plaintiff's access to the Company's bank account, accounting system, files and his authority with the Rental Bond Board.

7. There were irreconcilable differences in a quasi-partnership company. Following *Fexuto*, this establishes a basis for granting relief unless the person excluded from participation in management because of the destruction of the personal relationship was also responsible for it. Her Honour did not consider the Plaintiff responsible in this case.

8. The Plaintiff contributed to the disharmony between himself and the Second Defendant, including by withdrawing funds from the Company's bank account without discussing it with the Second Defendant and being inconsistent in his responses regarding the back-pay.

9. The Second Defendant made offers to pay out the Plaintiff's 30% interest in the assets of the company. However, these offers were subject to onerous conditions unilaterally imposed by the Second Defendant. In particular, the Second Defendant calculated and deducted losses when there was no established basis for attributing those losses to the Defendant.

(ii) Appropriate relief under s. 233 of the Corporations Act

Rees J granted:

- a declaration that the Second Defendant engaged in oppressive conduct in the conduct of the affairs of the First Defendant (within the meaning of s. 232 of the Corporations Act);
- an order that the Second Defendant purchase the Plaintiff's shares in the First Defendant (valued to equal 30% of the Company's net assets); and
- an order that the Defendants pay the Plaintiff the director's loan.

6.7 Application for leave to manage companies: protection of the public interest

(By Davina Khoo, DLA Piper)

Minus, in the matter of ABCD Corporation Pty Ltd [2019] FCA 1523 (5 September 2019) Federal Court of Australia, Jagot J

(a) Summary

Derek Michael Minus (the applicant), sought leave from the Federal Court (the Court) under s. 206G(1) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) to manage four proprietary companies: APLUS Pty Ltd (APLUS), Dispute Resolution Associates Pty Ltd (DRA), ABCD Corporation Pty Ltd (ABCD), and Mediation & Arbitration Centre Pty Ltd (MEDARB), (collectively the companies). The applicant was subject to a bankruptcy order, and automatically disqualified from being involved in the management of a company under s. 206B(3) of the Corporations Act.

ASIC intervened in the proceedings, filing submissions to the effect that the applicant should only be granted leave to manage ABCD, on the condition that ABCD not engage in any trading activity in any capacity other than as trustee of the Minasian Superannuation Fund. There was also contention between the parties as to the status of some of the companies, but these were ultimately resolved by information provided by ASIC.

Jagot J granted Mr Minus leave to manage the four companies, but upheld that part of ASIC's submission imposing the condition upon Mr Minus' management of ABCD.

(b) Facts

The case concerned questions of fact more so than questions of law. The factual issues queried the applicant's history in running companies, and the legal and financial timelines of these companies. Jagot J noted the law at the heart of this matter is uncontroversial, citing *In the matter of Carey* [2011] FCA 235 which held that s. 206G of the Corporations Act is in place to protect "the public from the activities of the dishonest, unscrupulous, untrustworthy, irresponsible or merely incompetent" managers.

ASIC identified six reasons why the applicant should not be granted leave to manage the companies other than to conditionally manage ABCD:

- lack of specificity as to the circumstances in which the applicant became bankrupt;
- lack of evidence around three of the companies the applicant sought to manage;

- lack of proposed supervision of the applicant;
- inaccurate information as to whether the companies were solvent and trading;
- omissions from the applicant's affidavit; and
- lack of hardship that the applicant may suffer in the case of an adverse finding in this matter.

First, ASIC claimed that the applicant was vague in elucidating the circumstances in which he became bankrupt. However, Jagot J was satisfied that the reasons underlying the applicant's bankruptcy were ultimately made clear in the course of the proceedings. The applicant was held to be knowingly concerned in all aspects of the conduct of a corporate respondent in using certain domain names for websites in another proceeding for contraventions of ss. 18 and 29 of the *Australian Consumer Law* in Schedule 2 of the Competition and Consumer Act (2010) 1974 No. 51 (Cth) surrounding false, misleading and deceptive conduct. His websites used various bar association trademarks without consent, however Jagot J did not view this as dishonest or unethical behaviour. The applicant was unable to pay the legal costs for the order made against him, and was rendered bankrupt. The Court was satisfied by the information provided as to the circumstances in which the applicant became bankrupt.

Second, ASIC contended that there was a paucity of evidence concerning the three companies other than ABCD that the applicant sought to manage. However, the applicant produced sufficient evidence in his submissions regarding the time periods that the companies had been in existence, the shareholdings of the companies and his role as a director. The Court was again satisfied by the information provided by the applicant during the hearing.

ASIC's third submission was that the applicant had not proposed any kind of supervisory conditions for himself. The applicant stated that his trustee in bankruptcy holds the shares in APLUS, and that DRA and MEDARB are wholly owned subsidiaries of APLUS. As such, he will be subject to the control of his trustee in bankruptcy. The applicant's trustee in bankruptcy has specifically said that there is no objection to the applicant performing this role. ASIC contended that the Court could not be satisfied that the protection of the public could be achieved. However, Jagot J found to the contrary. Her Honour deduced that the applicant's practise as a barrister evinced his character as a fit and proper person. Her Honour also referenced the applicant's extensive public service work, such as being a Chartered Arbitrator of the Chartered Institute of Arbitrators, and his appointment as the Commonwealth Government's Franchising Mediation Adviser for the *Franchising Code of Conduct*. Jagot J also noted the lack of evidence as to the applicant abusing a corporate structure to the disadvantage of investors, shareholders, and others.

ASIC also drew the Court's attention to the fact that the applicant gave evidence that the companies were "still solvent and trading", despite the fact that only one of the companies was trading. Jagot J understood the applicant's error not to be due to deliberate deception, but rather an issue of "loose language". This issue was found not to weigh against the applicant.

ASIC's fifth contention was that there were a number of matters not mentioned in the applicant's affidavit. In his first affidavit, the applicant said that there were no criticisms made of him personally in the decision of Greenwood J in the Federal Court, nor in the decision of Street J to order the sequestration of his estate. The applicant also stated that he was not found to have acted dishonestly or corruptly, and was not found guilty of any misconduct or criticised in relation to antithetical or discreditable behaviour. However, ASIC drew the Court's attention to numerous judgments which spoke to the applicant's failure to take personal responsibility for his actions, absence of candour, and knowledge of false, misleading and deceptive conduct. Despite this evidence, Jagot J held that the criticisms of the applicant did not weigh materially against him.

The sixth issue raised by ASIC was that the applicant's evidence was silent as to any hardship that may be suffered if he was barred from managing APLUS, DRA and MEDARB. Upon examining the applicant's evidence, the Court held that while the applicant can earn an income in his capacity as a sole trading barrister, mediator, and arbitrator, the companies earn an income for his family. Additionally, the companies require someone familiar with their day-to-day management to continue in the role to advance the services provided. Despite the statutory prohibition contemplating that there will be hardship to the offender, Jagot J held that the other matters in this instance weighed in favour of granting the applicant the dispensation.

(c) Decision

Jagot J acknowledged the applicant's history as a company director, the nature and interconnectedness of the companies, the size of the companies, and the lack of history of causing loss to the public. Accordingly, her Honour ordered that the applicant be granted leave to manage the four companies. However, leave was granted subject to ABCD Corporation Pty Ltd not engaging in any trading activity in any capacity other than as trustee of the Minasian Superannuation Fund.

6.8 Company and director fined over misleading article regarding investment strategy

(By Nik Lukic, King & Wood Mallesons)

Australian Securities and Investments Commission v Port Philip Publishing Pty Ltd [2019] FCA 1483 (29 August 2019) Federal Court of Australia, O'Callaghan J

(a) Summary

ASIC commenced civil penalty proceedings in the Federal Court (the Court) against Port Phillip Publishing Pty Ltd (PPP), an online financial publisher and Australian financial services licence (AFSL) holder, and its director and CEO, Kristan Sayce (Sayce).

ASIC alleged contraventions of the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) (the ASIC Act) and the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) regarding an article promoting an investment strategy which, according to PPP, consumers could adopt to "piggyback", or mimic the performance of, the Australian Government's Future Fund. The article said that the investment strategy would generate monthly income of $540 to $6,667, and consumers could access the promoted investment strategy by purchasing a detailed guide from PPP for $49.

ASIC alleged that the article and guide were misleading and deceptive because consumers could not mimic the performance of the Future Fund by adopting the promoted investment strategy, and the testimonials contained in the article were false. PPP agreed to pay a $600,000 penalty to settle the case, and the parties agreed that a $50,000 penalty and a disqualification period of 12 months from managing corporations was appropriate for Sayce's contraventions.

(b) Facts

The proceeding concerned two publications made by PPP, which, it was agreed between the parties, constituted contraventions of the Corporations Act by PPP and contraventions of the ASIC Act by both PPP and Sayce. The first publication was a letter titled "Everyday Australians

Now Legally "Piggybacking" "the Future Fund" . and collecting extra monthly income injections of $540 right up to $6,667" (the Promo Letter). The second was a document entitled "Your Quick Start Guide to "Piggybacking" the Future Fund" (the Guide).

The idea of the Promo Letter was Sayce's, and Sayce had commissioned a copywriter employed by PPP to prepare the Promo Letter. He directed the copywriter to convert an American promotion published by a related entity of PPP in the US titled "Americans Now Legally Piggybacking Canadian Social Security . And Collecting Extra Monthly Checks from $400 to $4,700" into an Australian version. At the same time, Sayce commissioned Editor A to prepare the Guide.

The Promo Letter and the Guide were directed at retired investors and investors approaching retirement. They promoted an investment strategy which involved investing in a portfolio of seven specific listed investment companies and exchange traded funds which was said to "mimic" the Future Fund. This contained testimonials from various investors which related to the returns that was supposedly achieved through the Investment Strategy, and purported that subscribers could obtain similar returns.

(c) Decision

PPP contravened the ASIC Act due to representations made in the Promo Letter and the Guide. The representations made by PPP in the Promo Letter related to: the expertise and opinions of the author, Matthew Hibbard, the extent of research conducted by Hibbard in relation to the investment strategy, and the income that could be obtained by adopting the investment strategy.

PPP misled consumers as the Promo Letter represented that Hibbard was a retirement-income expert, when he was not. Further, Hibbard did not conduct the 900 hours of research related to the investment strategy that the Promo Letter claimed he had conducted. The printed article didn't actually represent Hibbard's opinion, rather it was copied from an American promotion from a related entity of PPP.

The Promo Letter represented that investors could receive regular, monthly income, which was misleading as the securities and listed entities that were part of the investment strategy only paid dividends on a quarterly or half-yearly basis.

The Promo Letter contained testimonials related to returns supposedly achieved through the investment strategy. Sayce knew that the income quoted by Investors A, B and C in the testimonials related to their investment in shares generally and could not have related to the investment strategy. These testimonials represented that investors could receive regular monthly income of between $540 to $6,667. However, this was misleading as it did not disclose that in order to generate such returns, investors had to invest approximately $154,286 and $1.9 million respectively, and the investors who produced the testimonials never adopted the investment strategy. Rather, these investors held a portfolio that only contained some of the securities that were promoted by the investment strategy, and they generated their returns through their own portfolio.

The Promo Letter and Guide contained information about the investment strategy that was misleading, as the consumers could not mimic the performance of the Future Fund for the following reasons:

- the Future Fund has access to strategies and markets that are unavailable to an individual investor;
- the Future Fund is highly diversified globally whereas the investment strategy is highly concentrated in Australian equities;

- the Future Fund has access to global managers; and
- the investment strategy was more heavily weighted in favour of growth assets than defensive assets, as compared to the Future Fund.

O'Callaghan J agreed with the parties submission that, having regard to the maximum penalty, the nature and seriousness of PPP's conduct, the involvement of senior management, the poor compliance practices in relation to the publication of the Promo Letter and the Guide (which are now rectified) and the need for specific and general deterrence, the penalty of $600,000 proposed by the parties was appropriate. The Court also ordered PPP appoint an independent external compliance consultant to establish a Compliance, Education and Training program.

ASIC and Sayce agreed that a disqualification order was appropriate to achieve the objectives of personal and general deterrence, and that Sayce's conduct fell into the lowest category identified by Santow J in *Re HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2002) 42 ACSR 80 at [56]. This category requires a disqualification period of less than three years. The parties agreed that a $50,000 penalty and a disqualification period of 12 months from managing corporations was appropriate for Sayce's contraventions, to which O'Callaghan J agreed.

6.9 Let's work together, but not today: the Federal Court declines to issue a letter of request to the New Zealand High Court seeking cross-border cooperation

(By Brett Cook and Bianca Fernandez, Clayton Utz)

Kelly, in the matter of Halifax Investment Services Pty Ltd (in liquidation) (No 5) [2019] FCA 1341 (22 August 2019) Federal Court of Australia, Gleeson J

(a) Summary

The Federal Court of Australia (the Court) declined to make an order for the issuance of a letter of request to the High Court of New Zealand (NZHC) requesting that it act in aid of and be auxiliary to the Court in relation to certain matters concerning the liquidation of Halifax Investment Services Pty Ltd (in liquidation) (Halifax AU).

Although the Court noted that the case presented as a classic candidate for cross-border cooperation between courts to facilitate the fair and efficient administration of the winding up of Halifax AU and its New Zealand related entity, Halifax New Zealand Limited (Halifax NZ), the application was held to be premature on the basis that the *ex parte* nature of the application did not allow all parties an opportunity to provide their views regarding the most efficient and effective way of proceeding.

The Court did, however, make certain orders, including a declaration that the liquidators of Halifax AU were and will continue to be justified in using and applying certain funds to pay the trading and administration expenses of Halifax AU.

(b) Facts

The first and second plaintiffs in the proceeding are the liquidators of Halifax AU and Halifax NZ, of which Halifax AU owns 70% of the shares. Whilst the respective administrations were conducted independently, they were run largely in conjunction due to the "significant cross-over of investors between the two entities".

The proceeding concerned two applications made by the liquidators for:

- an order, pursuant to s. 581(4) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), that the Court issue a letter of request to the NZHC; and
- judicial advice in connection with the use of funds to pay Halifax AU's ongoing trading and administration expenses, pursuant to s. 90-15 of the *Insolvency Practice Schedule (Corporations)*, being Schedule 2 to the Corporations Act.

It was the liquidators' case that, prior to the appointment of administrators, the funds held by each of Halifax AU and Halifax NZ were part of what Brereton J, in the case of *In the matter of BBY Limited (Receivers and Managers appointed) (in liquidation) (No 3)* [2018] NSWSC 1718 at [8], called a "deficient mixed fund". The deficient mixed fund arose as a result of, amongst other things:

- the inter-account transfers of funds between many of the accounts held in the name of Halifax AU and Halifax NZ in respect of all investment platforms operated by both entities. Accordingly, there was an extensive commingling of funds in many accounts which Halifax AU and Halifax NZ held on trust for investor clients; and
- the withdrawal and use of funds that were held on trust for investor clients for non-client purposes (e.g. corporate expenses).

In those circumstances, any tracing of the commingled funds to any entitlement on the part of individual clients was not feasible and, following the realisation of investments, it was likely that each of Halifax AU and Halifax NZ would hold funds that were the subject of claims by the other or the other's investors.

(c) Decision

The substantive relief to be sought by the liquidators was in respect of the difficult questions that arise in relation to the distribution of funds which will be held on trust, following the realisation of the investments as part of the liquidation. The key question for the Court would be whether there should be a "pooling" of the commingled funds and, if so, what distributions should be made to the clients on behalf of whom those funds are held.

(i) The application for a letter of request

It was the liquidators' intention to bring a parallel application to the NZHC in their capacity as liquidators of Halifax NZ, seeking directions and judicial advice on questions mirroring those arising in the proceeding (the proposed NZ application).

The liquidators argued that it was not feasible for the matters to be heard separately, on the basis that the respective applications sought judicial advice or directions in respect of the same commingled pool of funds. For this reason, the liquidators argued that it was appropriate for the Court to issue a letter of request to the NZHC, so as to enable the proceeding and the proposed NZ application to be resolved in an effective way.

The power to issue a letter of request under s. 581(4) of the Corporations Act arises where:

- there is a court of a country other than Australia that has jurisdiction in external administration matters;

- there is an external administration matter in relation to which a request may be made; and
- the proposed request is to act in aid of, and be auxiliary to, the Court in an external administration matter.

Gleeson J accepted that the Court had the requisite power to request the NZHC hear the application for a pooling order in the proposed NZ application concurrently with the application for a similar order in the proceeding, as all elements of s. 581(4) of the Corporations Act had been satisfied, and that the NZHC appeared to have power to accede to such request.

It was also accepted that cross-border cooperation between the courts would protect the interests of all relevant persons in the winding up of Halifax AU and Halifax NZ, particularly the investor clients of both entities who may have claims against the commingled funds held by Halifax AU.

However, in the exercise of its discretion, the Court took issue with the *ex parte* nature of the application. Gleeson J noted that cooperation between courts will generally occur within a framework that has been previously approved by the court and is known to the parties in the particular proceeding. In the Court's view, the parties who will respond to the liquidators' application should be identified, the issues between them and the liquidators defined, and their views sought as to the most efficient and effective way of proceeding, prior to any formal request being made by the Court to the NZHC. Accordingly, the Court declined to make the order, but noted that the liquidators may make a further application for an order pursuant to s. 581(4) of the Corporations Act in due course.

(ii) The application for judicial advice

The funds to which the liquidators already had access were either identifiable trust moneys i.e. they could be traced to individual investors, or commingled trust funds. The Court held that the liquidators would be justified in using commingled trust funds to meet the ongoing trading expenses of Halifax AU.

The liquidators submitted that the 13 accounts they proposed to access funds from were the only accounts that had significant cash balances and did not contain traceable or partially traceable funds.

The Court accepted that the proposed expenditure would be incurred for the purpose of protecting funds. As the likely benefit to investors was not estimated, the Court referred to the estimated dividend provided in January 2019 and was satisfied that the costs of maintaining the investor platforms was proportional to the benefits that will accrue to investors. The Court considered limiting the use of only some of the nominated 13 accounts, but decided against it so as to provide the liquidators with maximum flexibility to act in the best interests of investor creditors.