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Bulletin No. 267

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 Corporate crime discussion paper

15 November 2019 - The Australian Law Reform Commission (the ALRC) has released Corporate Criminal Responsibility (the Discussion Paper).

Building on the work of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, the ALRC has found that Commonwealth criminal law as it applies to corporations is impenetrably complex and in need of significant reform. There is an overregulation by the criminal law of low-level contraventions and a failure to effectively use the criminal law for serious contraventions.

As a result, there is no principled regulation in any meaningful sense - diluting the efficacy of corporate criminal responsibility and undermining the rule of law.

The ALRC seeks stakeholder submissions on 23 proposals for reform to the Commonwealth's corporate criminal law regime, and asks 11 questions on particular areas of reform. The Discussion Paper addresses a number of aspects of corporate criminal liability, including:

- the principled division between criminal offences and civil penalty provisions;
- the method for attributing criminal liability to corporations;
- individual liability for corporate offences;
- deferred prosecution agreements;
- penalties and the sentencing process;
- illegal phoenix activity (deliberate liquidation with the intent to avoid creditors and continue operations through a new entity); and
- the implications of the transnational nature of business and extraterritorial offences.

On 10 April 2019, the ALRC received Terms of Reference from the Commonwealth Attorney-General, the Hon Christian Porter MP, to conduct the first comprehensive review of Australia's corporate criminal responsibility regime since the enactment of the *Criminal Code* in the Schedule (The Criminal Code) of the Criminal Code Act 1995 No. 12 (Cth).

The ALRC is seeking submissions to the Discussion Paper until 31 January 2020.

The Final Report is due to the Attorney-General on 30 April 2020.

1.2 Consultation on financial market infrastructure regulatory reforms

15 November 2019 - The Council of Financial Regulators (CFR) has released Financial Market Infrastructure Regulatory Reforms (the Consultation Paper), seeking comments on proposed financial market infrastructure regulatory reforms.

Financial market infrastructures include market operators, benchmark administrators, clearing and settlement facilities, and derivative trade repositories. These infrastructures provide critical services relied upon by investors and businesses in order to raise capital and finance, borrow and lend funds, invest in equities and debt securities, and manage the risks associated with their activities.

The Consultation Paper sets out three broad groups of reforms proposed by the CFR:

- **Enhancing the licensing regimes.** These reforms are designed to make sure that licensing regimes for financial market infrastructures are fit for purpose and effective into the future;
- **Enhancing supervision and enforcement.** These reforms will provide enhanced powers for the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia to support their supervision of financial market infrastructures, and their ability to take action to address any identified deficiencies; and
- **Crisis management and resolution.** This reform will introduce a resolution regime for clearing and settlement facilities.

The CFR is seeking comments on the proposals in the Consultation Paper. The closing date for submissions is 20 December 2019. Submissions can be sent to: fmiconsultation@cfr.gov.au.

1.3 Investors launch best-practice guide on combatting modern slavery

11 November 2019 - Investors have collaborated to produce a best-practice guide to reporting under the Modern Slavery Act 2018 No. 153 (Cth) (the Modern Slavery Act). Developed by the Australian Council of Superannuation Investors (ACSI) and Responsible Investment Association Australasia (RIAA), the best-practice guide builds on the Australian Government's guidance.

The Modern Slavery Act provides requirements for organisations in reporting the risks of modern slavery in their operations and supply chains. The ACSI/RIAA guide provides information for investors on how to incorporate investments into their modern slavery reporting and meaningfully address modern slavery risks.

View the ACSI/RIAA guide, Modern Slavery Reporting - Guide for Investors.

1.4 Financial Stability Institute paper: Climate risk assessment in the insurance sector

6 November 2019 - The Financial Stability Institute has published Turning up the heat - climate risk assessment in the insurance sector (the Paper), on climate risk assessment in the insurance sector.

To facilitate a better understanding in this area, the paper examines the different regulatory approaches currently in place relating to climate risk assessment, in particular through enterprise risk management frameworks. The Paper also describes how some supervisory authorities have undertaken climate risk assessment exercises, focusing on stress test and scenario analysis approaches.

In general, the Paper finds that risk quantification techniques and models that consider climate risks are more advanced for physical risks, but are still at an early stage for transition and liability risks. Looking ahead, there is room to enhance international cooperation among insurance supervisors, and within financial policy and regulatory forums to improve understanding of climate risks and their potential impact on firms, policyholders and financial stability.

Other key policy issues that require consideration include the impacts of climate risks on access and affordability of insurance products, and the potential use of capital requirements to address climate risks.

View the Paper.

1.5 SEC proposes rule amendments for proxy voting advice

5 November 2019 - The United States (US) Securities and Exchange Commission (SEC) has voted to propose amendments to its rules governing proxy solicitations to enhance the quality of the disclosure about material conflicts of interest that proxy voting advice businesses provide their clients. The proposal would also provide an opportunity for a period of review and feedback through which companies and other soliciting parties would be able to identify errors in the proxy voting advice. The review and feedback period would only be available to companies that file definitive proxy materials 25 days or more in advance of the relevant meeting. The SEC's proposal aims to enhance the accuracy and transparency of the information that proxy voting advice businesses provide to investors and others who vote on investors' behalf, and thereby facilitate their ability to make informed voting decisions.

The proposal will have a 60 day public comment period following its publication in the Federal Register.

View:

- Proposed Rule - Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice; and
- Fact Sheet - Proposed Rule Amendments for Proxy Voting Advice.

1.6 SEC proposes amendments to shareholder proposal rule

5 November 2019 - The US SEC has voted to propose amendments to the rule that governs the process for shareholder proposals to be included in a company's proxy statement.

The proposed amendments would change the criteria, including the ownership requirements, that a shareholder must satisfy to be eligible to require a company to include a proposal in its proxy statement. In the proposed amendments, the SEC has maintained the long-standing US$2,000 minimum ownership threshold. However, the proposed amendments would require that, in order to take advantage of that ownership threshold, a proponent must have held the shares for at least three years in order to demonstrate long-term investment in the company. The proposed amendments would also update the "one proposal" rule to clarify that a single person may not submit multiple proposals at the same shareholders' meeting on behalf of different shareholders.

In addition, the proposed rule would update, for the first time since 1954, the levels of shareholder support a proposal must receive to be eligible for resubmission at the same company's future shareholder meetings. Under the proposed amendments, for example, a proposal would need to achieve support by at least 5% of the voting shareholders in its first submission in order to be eligible for resubmission in the following three years. Proposals submitted two and three times in the prior five years would need to achieve 15% and 25% support, respectively, in order to be eligible for resubmission in the following three years.

The proposed amendments are based on the staff's experience reviewing shareholder proposals. In 2018 alone, almost 5,700 proxy materials were filed with the SEC, and the staff in the Division of Corporation Finance received more than 250 no-action requests relating to shareholder proposals. As explained in the proposing release, as part of their efforts to appropriately calibrate the resubmission thresholds, the staff conducted a review of shareholder proposals that ultimately received a majority of the votes cast on a second or subsequent submission between 2011 and 2018. Of those proposals that ultimately went on to receive majority support, 98% of the proposals started with support of over 5% of the votes cast in their first submission. Of the proposals that obtained majority support on their third or subsequent submissions, approximately 95% received support of over 15% on their second submission, and 100% received support of over 25% on their third or subsequent submission.

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

View:

- Proposed Rule - Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8; and
- Fact Sheet - Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8.

1.7 Australian Financial Complaints Authority 12 month review of activities

1 November 2019 - The Australian Financial Complaints Authority (AFCA) has been operational for 12 months, replacing three former external dispute resolution schemes, and has provided a review of its activities during its first 12 months.

Australians in dispute with their bank, insurance provider, super fund, or other financial firms have lodged 73,000 complaints with AFCA and have been awarded $185 million in compensation in the first 12 months of its operation.

Highlights of the first 12 months:

- 40% increase in complaints to AFCA compared to predecessors - 73,272 versus 52,232;
- complainants awarded $185 million in compensation;
- 77% of all complaints resolved, with the majority of those resolved in 60 days or less;
- 200 complaints received a day on average;
- credit complaints, insurance claims and financial hardship the biggest issues;
- 70% of complaints resolved in favour of the complainant;
- banks the most complained about financial institution followed by general insurers; and
- 11% of complaints made by people experiencing financial difficulty.

View Snapshot of AFCA's first twelve months.

1.8 UK Treasury report: Banks must do more for consumers exposed to economic crime

1 November 2019 - The United Kingdom (UK) Treasury Committee (the Committee) has published Economic Crime: Consumer View (the Report). In the first half of 2019, over £600 million was stolen from consumers. Key points from the Report include the following:

- fraud is the second most common crime type in England and Wales. There are two main types of economic crime affecting consumers: authorised push payments (APP), where the genuine customer processes a payment to another account which is controlled by a criminal, and unauthorised fraud, where the account holder does not provide authorisation for the payment to proceed and the transaction is carried out by a third party. Both in terms of financial losses and the variety of scams suffered by consumers, it's clear that economic crime is a serious and growing problem in the UK. To ensure a clear picture of the scale and types of economic crime facing consumers, the Financial Conduct Authority (FCA) should publish data on economic crime;
- at present, when a payment is sent, the initiator of the payment must give the payee's name, account number and sort code. The latter two are cross-referenced and confirmed with the receiving bank, but the payee's name is not. Confirmation of Payee, which is set to be introduced in March 2020, involves the payee's name also being confirmed. It is a serious failure that banks are not already doing this. The regulators should consider sanctioning any firm that misses the March 2020 deadline;
- the Contingent Reimbursement Model (CRM) is a voluntary financial services industry code which sets out how its signatories should reimburse money lost to consumers via APP fraud. The CRM is welcome and should now be made compulsory in legislation. This will not, however, provide any resolution to previous victims of such frauds. Financial firms have been warned since 2016 that they have been failing in their duty to protect customers by not linking information on account names to payments. Firms should strongly consider whether refusing to retrospectively reimburse customers who relied on the payee name is fair and just;
- Faster Payments are an instant transaction which are normally processed in seconds. Fraudsters rely on this speed to move money into a series of accounts before consumers and banks are aware. Very few first-time payments need to be received instantaneously. Therefore, there should be a mandatory 24 hour delay on all first-time payments,

providing time for consumers to consider if they are being defrauded. All future payments to the same account could flow at normal speed. If an initial payment was needed instantly, a customer could ring their bank and additional checks could be carried out for the funds to be released;

- money mules are individuals who allow their bank account to be used to move criminal funds. In 2018 there were around 40,000 cases that bore the hallmarks of money mule activity. For example, it was reported that students were selling their account log-in details to fraudsters who sought to evade the strict checking procedures when individuals try to open an account. Where groups of people who may be most susceptible to being persuaded to become money mules are identified, targeted information campaigns should be undertaken, for example, banks should work with universities to provide information for students;
- de-risking is where a bank ends its relationship with a customer it deems to be too high-risk. The Committee has been told that whole sectors have had their banking services withdrawn or refused in the first place without explanation and no avenue to query the decision. Banks must be as transparent as possible on de-risking to allow all individuals and firms the best possible chance of keeping their financial services. The FCA, which has at times appeared unable to act to prevent de-risking from happening, and the Financial Ombudsman Service should ensure that, where possible and appropriate, instances of de-risking where a customer cannot come to resolution with their banks are fully investigated and banking services returned as quickly as possible;
- the Committee has heard concerns about how law enforcement has been dealing with economic crime, and the lack of resources allocated to it. It is unacceptable that victims of potentially devastating crime can have their cases moved across law enforcement from pillar to post. It is welcome, therefore, that this is both a focus of the police, and its inspectorate. It is concerning that banks do not always appear to be reporting instances to the police where, for example, the bank has reimbursed the victim. The government should require all frauds to be reported regardless of their size, and whether or not a financial institution has reimbursed a consumer. It is not always clear to consumers whether a fraud should be reported to a bank, the police or Action Fraud, nor is it always clear what each entity would do with the information provided. This process needs clarifying for consumers; and
- when a firm concludes that a loss from an unauthorised fraud was down to the consumer's own "gross negligence", reimbursement is unlikely. Existing regulations do not define "gross negligence", allowing individual firms to set their own bar of what customer behaviour it deems to be grossly negligent. This could lead to a lack of consistency between how customers with the same circumstances are treated. The regulators should agree on an accepted definition of gross negligence and require firms to provide a list of "dos and don'ts" for customers to show how individual firms define proper account usage.

View:

- Report Summary;
- Report Conclusions and Recommendations; and
- Full Report.

1.9 Regulation of class action litigation

30 October 2019 - The Australian Industry Group (Ai Group), which is a peak employer organisation, has released a statement outlining its concerns with the growing number of class action claims by plaintiff law firms in Australia, typically backed by overseas litigation funders.

Based on the information that plaintiff law firms and litigation funders have publicly released, together with information provided by law firms involved in the proceedings, Ai Group has estimated that the amounts claimed against businesses in the class actions filed in the last financial year are well over $10 billion. Nearly all of these class actions are still before the courts.

Overseas litigation funding firms have moved into Australia. The Ai Group expressed its view that litigation funding arrangements are financial products and these arrangements need to be regulated like other financial products.

Ai Group has recommended that the Federal Government implement the following reforms:

- regulation of litigation funders through ASIC - litigation funding arrangements are financial products and there is no legitimate reason why these arrangements should not be subject to regulation like other financial products;
- imposing reasonable limits on returns to plaintiff lawyers and litigation funders - currently, some law firms and litigation funders are earning excessive profits from class actions, to the detriment of plaintiffs;
- exposing plaintiff lawyers and litigation funders to adverse costs orders for unsuccessful class actions - under the Fair Work Act 2009 No. 28 (Cth) (the Fair Work Act), costs orders are only able to be made in very limited circumstances and are relatively rare. This makes class action litigation relating to claims under the Fair Work Act very attractive to plaintiff law firms and litigation funders. Current class actions relating to claims under the Fair Work Act include claims that employees engaged as casuals are entitled to annual leave entitlements and claims that persons engaged as independent contractors are employees;
- prohibiting litigation funders exerting any control over the positions taken by, and the arguments pursued by, the lawyers in the proceedings - this is important to protect lawyers' duties to the court and their clients. A similar requirement applies in some other countries;
- increasing the current minimum number of plaintiffs - currently in Australia, a class action can be commenced if the lawyer acting for the lead plaintiff believes there are at least six other people who have a similar claim, even if no other person has given consent for a claim to be pursued on their behalf. This minimum number needs to be increased;
- implementing a "predominance rule" like that which operates in the US, whereby the common issues amongst the claims must predominate - at present in Australia, a class action can be pursued if there is one common issue of fact or law; and
- implementing a preliminary or certification hearing process, like that which exists in the US - this would require the plaintiffs to satisfy the court that the relevant requirements for pursuing a class action are satisfied, before the defendants are exposed to major costs.

1.10 Facilitating cross-border banking and payment services in Europe

29 October 2019 - The European Banking Authority (EBA) has published EBA Report on potential impediments to the cross-border provision of banking and payment services (the EBA Report), identifying potential impediments to the cross-border provision of banking and payment services in the European Union (EU). Developed under the EBA's FinTech Roadmap, the EBA

Report calls on the European Commission to facilitate cross-border access, including the update of interpretative communications on the cross-border provision of services and further harmonisation of consumer protection, conduct of business and the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 No. 169 (Cth) (the AML/CFT) requirements, in order to facilitate the scaling up of activity cross-border.

Digital solutions can increase choice by enabling consumers access to a wider population of providers of financial services. However, the full potential of these solutions has not yet been achieved in the EU, in part due to divergences in regulatory requirements and supervisory practices across the Member States. Identifying and resolving these issues is a necessary step to addressing barriers to market entry, supporting the scaling up of financial services across the EU, and improving the competitiveness of the EU Single Market.

The first important challenge is the identification of when a digital activity is to be regarded as a cross-border provision of services. Although this is a crucial element in determining which regulatory and supervisory frameworks apply, currently, competent authorities and firms lack clear guidance on how to classify cross-border activity under the freedom to provide services or right of establishment.

The second challenge stems from areas of EU law that are not fully harmonised or are not yet covered by EU law. In particular, the EBA identifies issues related to authorisations and licencing, consumer protection, conduct of business requirements and anti-money laundering and countering the financing of terrorism.

Left unaddressed these issues may impede institutions and other FinTech firms from providing banking and payments services cross-border within the EU. Therefore, the EBA recommends that the European Commission take action, including to update its interpretative communications to support the identification of cross-border services taking account of the digitisation of financial services and the development of legislative proposals to further harmonise requirements relating to consumer protection, conduct of business and the AML/CFT.

In accordance with the March 2018 European Commission FinTech Action Plan: For a more competitive and innovative European financial sector and the EBA FinTech Roadmap - Conclusions from the Consultation on the EBA's Approach to Financial Technology (Fintech), the EBA has been carrying out work to assess potential issues that firms, particularly those using digital means, may face when seeking to provide services cross-border. This work is intended to complement the work underway by the European Commission's Expert Group on Regulatory Obstacles to Financial Innovation, due to report in the coming months.

View:

- EBA Report; and
- EBA Report on potential impediments to the cross-border provision of banking and payment services: Frequently Asked Questions.

1.11 Big four accounting firms increase their market share of UK audits

28 October 2019 - The largest accountancy firms have increased their share of the UK audit market with 100% of FTSE 100 companies now audited by the Big Four, according to new research from the Financial Reporting Council.

The latest edition of Key Facts and Trends in the Accountancy Profession reveals the Big Four increased their combined "total fee income" by 4.7% to £10.95 billion and "audit fee income" by 1.7% to £2.1 billion. By contrast, total fee income at non-Big Four public interest entity audit firms fell by 8.1% and "audit fee income" fell by 6.3% (compared to a 3% increase in 2016/17).

The average audit fee income in 2018 for all firms with public interest entity clients per responsible individual was £1.46 million, an increase of £0.16 million (12.3%) from 2017.

The number of audit firms registered to carry out statutory audit work in the UK and the Republic of Ireland fell by 4.7% in 2017/2018, down from 5,660 to 5,394 audit firms. This is in part due to a decline in both the number of sole practitioner audit firms (down from 2,733 to 2,558) and firms with two to six principals (down from 2,618 to 2,534).

1.12 US agencies finalise changes to resolution plan requirements

28 October 2019 - The US Federal Reserve Board and the Federal Deposit Insurance Corporation (the FDIC) have announced that they have finalised a rule that modifies their resolution plan requirements for large firms. The rule retains resolution plan elements in place for the largest firms, while reducing requirements for smaller firms that pose less risk to the financial system.

Resolution plans, also known as living wills, describe a firm's strategy for orderly resolution under bankruptcy in the event of material financial distress or failure of the firm. Since the resolution planning requirements took effect in 2012, the largest firms have improved their resolution strategies and governance, refined their estimates of liquidity and capital needs in resolution, and simplified their legal structures. These changes have made the firms substantially more resilient.

The final rule is substantially the same as the proposal from earlier this year. It uses a separate framework developed by the banking agencies for application of prudential requirements, and establishes resolution planning requirements tailored to the level of risk a firm poses to the financial system. The final rule is consistent with the *Economic Growth, Regulatory Relief, and Consumer Protection Act 2018 (US)* and would affect domestic and foreign firms with more than US$100 billion in total consolidated assets.

For the most systemically important firms, the final rule would adopt the current practice of requiring resolution plans to be submitted on a two year cycle. The final rule would tailor the rule's requirements for firms that do not pose the same systemic risk as the largest institutions, requiring resolution plans to be submitted on a three year cycle. Both groups of firms would alternate between submitting full resolution plans and targeted resolution plans. Foreign firms with relatively limited US operations would be required to submit reduced resolution plans.

A targeted resolution plan would include core elements related to capital, liquidity, and plans for recapitalisation, as well as material changes to the firm and areas of interest identified by the agencies. Targeted resolution plans would not include certain areas if they are materially unchanged from one cycle to another, such as descriptions of management information systems and corporate governance systems. As a result, targeted resolution plans would give the agencies meaningful insight into the key vulnerabilities in a firm's resolution strategy.

Firms with less than US$250 billion in total consolidated assets that do not meet certain risk criteria would no longer be subject to the rule. These firms have simpler structures, engage more exclusively in traditional banking activity, and present less risk. These changes do not affect the resolution planning requirements under the FDIC's insured depository institution rule for large insured depository institutions, which is part of a separate rulemaking.

In a change from the proposal, only smaller and less complex firms could request changes to their full resolution plans and both agencies would need to approve those requests for them to become effective.

The rule will be effective 60 days after publication in the Federal Register.

View:

- Board Memo - Joint final rule regarding resolution plans;
- Federal Register notice - Resolution Plans Required;
- Summary Chart;
- Opening Statement by Chair Jerome H. Powell;
- Opening Statement by Vice Chair for Supervision Randal K. Quarles; and
- Statement by Governor Lael Brainard.

1.13 Inquiry into opportunities arising from FinTech and RegTech

23 October 2019 - The Senate Select Committee on Financial Technology and Regulatory Technology has published Issues Paper: Senate Select Committee on Financial Technology and Regulatory Technology (the Issues Paper) as part of its inquiry into the following matters:

- the size and scope of the opportunity for Australian consumers and business arising from FinTech and regulatory technology (RegTech);
- barriers to the uptake of new technologies in the financial sector;
- the progress of FinTech facilitation reform and the benchmarking of comparable global regimes;
- current RegTech practices and the opportunities for the RegTech industry to strengthen compliance but also reduce costs;
- the effectiveness of current initiatives in promoting a positive environment for FinTech and RegTech start-ups; and
- any related matters.

The Issues Paper is in two parts. The first part considers five factors that are relevant to determining Australia's competitive position to attract and maintain investment in technology, including FinTech and RegTech. These are capital and funding; tax; skills and talent; culture; and regulation. The second part of the Issues Paper lists questions under the headings "General questions for FinTech and RegTech companies in Australia", "Regulatory settings in Australia", "Integrating FinTech and RegTech solutions across the economy" and "Global comparisons and investment".

The Issues Paper is available on the Committee's website.

1.14 Regulators and government agencies annual reports 2018-2019

Several regulators and government agencies with responsibility for corporate law and corporate governance have recently released their annual reports for 2018-2019.

These include:

- Australian Accounting Standards Board and Auditing and Assurance Standards Board - 2018-19 Annual Reports;
- AFCA Annual Review 2018-19;
- Australian Financial Security Authority - Annual Report 2018/19;
- Australian Office of Financial Management - Annual Report 2018-19;
- Australian Prudential Regulation Authority - Annual Report 18/19;
- ASIC - Annual Report 2018-19;
- Commonwealth Director of Public Prosecutions - Annual Report 2018-19;
- Commonwealth Treasury Annual Report 2018-19;
- Companies Auditors Disciplinary Board - Annual Report for the year ended 30 June 2019;
- Financial Reporting Council - Annual Report 2018-19; and
- Takeovers Panel - Annual Report 2018-2019.

2. Recent ASIC Developments

2.1 Relief from financial adviser compliance scheme obligations takes effect

14 November 2019 - ASIC has taken action to provide certainty to Australian financial services (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 has granted 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.

ASIC's action follows a government announcement that it would accelerate the establishment of a single disciplinary body for financial advisers and the withdrawal of applications for ASIC approval of a compliance scheme. This disciplinary body will displace the role of compliance schemes in monitoring and enforcing the *Financial Planners and Advisers Code of Ethics 2019 (Cth)* (the Code).

The Code has been developed by the Financial Adviser Standards and Ethics Authority (FASEA). See FASEA's website for information and guidance on the Code.

View:

- ASIC Corporations (Amendment) Instrument 2019/1145;
- ASIC media release 19-280MR ASIC to provide relief from financial adviser compliance scheme obligations; and
- Joint media release from the Treasurer and the Assistant Minister for Superannuation, Financial Services and Financial Technology on 11 October 2019: Taking action on the Banking, Superannuation & Financial Services Industry Royal Commission - Recommendation 2.10: New financial adviser disciplinary system.

2.2 Guidance on companies' whistleblower policies and relief to small not-for-profits

13 November 2019 - ASIC has provided guidance to assist companies to meet their obligation to have a whistleblower policy. As part of the corporate sector whistleblower reforms, public companies, large proprietary companies, and proprietary companies that are trustees of registrable superannuation entities must have a whistleblower policy available to their officers and employees by 1 January 2020.

Regulatory Guide 270: Whistleblower policies (RG 270) helps these companies establish policies that support and protect whistleblowers. RG 270 sets out the components that a whistleblower policy must include to comply with the law. These include:

- types of matters covered by a policy;
- who can make and receive a disclosure;
- how to make a disclosure;
- legal and practical protections for disclosers;
- investigating a disclosure; and
- ensuring fair treatment of individuals mentioned in a disclosure.

RG 270 also provides good practice guidance to assist companies develop and implement policies that are tailored to their operations.

In addition to the release of RG 270, ASIC is granting relief to public companies that are not-for-profits or charities with annual revenue of less than $1 million from the requirement to have a whistleblower policy.

All companies are bound by the whistleblower protections in the Corporations Act 2001 No. 50 (Cth) from 1 July 2019, regardless of whether they are required to have a whistleblower policy.

RG 270 follows public consultation through ASIC Consultation Paper 321: Whistleblower policies (CP 321). ASIC received 40 submissions from a range of stakeholders including industry and professional bodies, academics, legal and consulting firms, not-for-profit organisations and members of the public.

ASIC plans to survey the whistleblower policies of a sample of companies next year to review compliance with the legal requirements.

View:

- RG 270;

- Report 635: Responses to submissions on CP 321 Whistleblower policies;
- CP 321; and
- ASIC Corporations (Whistleblower Policies) Instrument 2019/1146.

2.3 ASIC warns trustees on new rules for Putting Members' Interests First

30 October 2019 - ASIC has called on superannuation trustees to improve the standard of communication to fund members about important reforms impacting member insurance arrangements.

As a result of the recent Putting Members' Interests First (PMIF) reforms, by 1 December 2019 superannuation trustees are required to write to members with a balance of less than $6,000. These members must be notified that their insurance cover may cease from 1 April 2020 unless they opt-in to continue this cover.

ASIC has issued a letter to the superannuation industry about the PMIF reforms and ongoing communications about insurance in superannuation.

- Read the letter.

ASIC expects trustees to help their members understand the impact of the reforms on them and make good decisions by:

- providing balanced and factual communications, that include appropriate context about the reforms; and
- tailoring communications to the needs of their members.

A recent review by ASIC found that many superannuation trustees did not adequately communicate with members in a similar situation when they were about to be impacted by the Protecting Your Superannuation Package (PYSP) reforms.

ASIC has also provided consumer information on the PYSP and PMIF changes on its MoneySmart website accessible via the following link: Cancellation of insurance on inactive and low balance accounts.

ASIC intends to release further findings from its PYSP review work in early 2020.

Background

The reforms in the Treasury Laws Amendment (Putting Members' Interests First) Act 2019 No. 79 (Cth) are designed to protect low balance accounts and the superannuation savings of members aged under 25 from balance erosion due to insurance coverage they may not need. These reforms are due to take effect on 1 April 2020, with initial notices to be sent by 1 December 2019.

The reforms involve the following changes:

- insurance will be opt-in for members in a regulated superannuation fund with product balances below $6,000; and

- insurance will be opt-in for new members under 25 years old.

The member may elect in writing to take out or maintain insurance even if the member has an account balance with a superannuation fund that is less than $6,000 or the member is under the age of 25. There are some exclusions to these changes, including for members identified by their trustee as in dangerous occupations.

Key deadlines for action that trustees must adhere to are:

- trustees must identify members with balances less than $6,000 on 1 November 2019;
- by 1 December 2019, trustees must give notice to impacted members with balances less than $6,000, indicating that if their balance remains less than $6,000, their insurance cover will cease on 1 April 2020 unless there is an election in writing to maintain insurance; and
- by 1 April 2020, insurance is not to be provided to members who have an account balance less than $6,000 or for members under 25 years old, unless the member has elected in writing to take out or maintain insurance.

ASIC previously issued a media release and letter outlining the reforms set out in Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019 No. 16 (Cth) and ASIC's expectations in relation to member communications.

2.4 Extension of relief for portfolio holdings disclosure

29 October 2019 - ASIC has amended ASIC Class Order [CO 14/443] to provide legal certainty about the first reporting day for portfolio holdings disclosure, given the regulations setting out the required disclosures have not yet been made.

Most superannuation trustees, as part of portfolio holdings disclosure requirements, must provide information about fund holdings on the fund website. The first reporting date to identify the holdings of the fund was to be 31 December 2019, with disclosure required on the trustee's website no later than 90 days from this date. However, the regulations which set out the way in which this disclosure is to be organised have not been made.

The amendments made to [CO 14/443] defer the first reporting day to 31 December 2020. This will allow further time for the government to develop and make the regulations. It also provides industry with certainty about the commencement date and time to finalise their reporting processes and disclosures.

ASIC supports greater transparency about funds' portfolio holdings and encourages superannuation trustees to focus on designing website disclosure about holdings that is accessible and clear for their members. ASIC notes that a number of funds have already taken steps to increase transparency about their portfolio holdings even in the absence of an explicit legislative obligation to do so.

View:

- [CO 14/443] - Deferral of choice product dashboard and portfolio holdings disclosure regimes; and

- ASIC Corporations (Amendment) Instrument 2019/1056.

3. Recent ASX Developments

3.1 Amendments to the ASX Clear (Futures) Operating Rules - OTC Variation Margin Characterisation

On 22 October 2019, the Australian Securities Exchange (ASX) announced amendments to the *ASX Clear (Futures) Operating Rules and Handbook*. These amendments, which took effect on 28 October 2019, confirmed that over-the-counter (OTC) Open Market contracts are "settled to market" rather than "collateralised to market" by variation margin payments. These changes allow OTC Clearing Participants that are authorised deposit-taking institutions to take advantage of the lowest add-on factor in capital calculations where mark to market exposures on OTC interest rate swaps are settled daily.

More information about the amendments is available on the ASX website.

3.2 Monthly Activity Reports

On 6 November 2019, the ASX released the *ASX Monthly Activity Report* for October 2019.

4. Recent Takeovers Panel Developments

4.1 Donaco International Limited 02 - Panel declines to conduct proceedings

14 November 2019 - The Takeovers Panel (the Panel) has declined to conduct proceedings on an application dated 4 November 2019 from Donaco International Limited (DNA) in relation to its affairs (see TP19/64).

On 21 August 2019, Mr Patrick Tan and Mr Gerald Tan (together, the Requisitionists) provided a notice to DNA requesting that DNA hold a general meeting to consider the removal of all existing directors and the election of certain persons. On 21 September 2019, the Requisitionists provided a further notice to DNA also requesting that DNA hold a general meeting to consider the removal of all existing directors and the election of certain persons. DNA rejected both notices on the basis that they were invalid, but included the relevant resolutions on the agenda for DNA's annual general meeting to be held on 29 November 2019.

The application concerned whether the Requisitionists were associated with Somboon Sukcharoenkraisri (also known as Lee Bug Leng), Lee Bug Tong, Lee Bug Huy and certain other persons by reason of entering into a scheme for the purpose of controlling or influencing the composition of the DNA board and the conduct of DNA's affairs. The application submitted there were business relationships and previous dealings between the alleged associates and that they had contravened s. 606 of the Corporations Act 2001 No. 50 (Cth) and the substantial holding notice provisions.

The Panel considered that DNA did not provide a sufficient body of material to justify the Panel making further enquiries as to whether there were any associations.

The Panel concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances. Accordingly, the Panel declined to conduct proceedings.

The Panel will publish its reasons for the decision in due course on its website.

5. Recent Research Papers

5.1 Private equity's governance advantage: A requiem

Private equity's original purpose was to optimise companies' governance and operations. Reuniting ownership and control in corporate America, the leveraged buyout (or the mere threat thereof) undoubtedly helped reform management practices in a broad swath of US companies. Due to mounting competitive pressures, however, private equity is finding relatively fewer underperforming companies to fix. This is particularly true of US public companies, which are continuously dogged by activist hedge funds and other empowered shareholders looking for any sign of slack.

In response, private equity is shifting its centre of gravity away from governance reform, towards a dizzying array of new tactics and new asset classes. Large private equity firms now simultaneously run leveraged buyout funds, credit funds, real estate funds, alternative investments funds, and even hedge funds. The difficulty is that some of the new money-making strategies are less likely to be value increasing than governance and operational improvements. Moreover, they introduce new conflicts of interest and complexities that alter private equity's role in corporate governance. Private equity's governance advantage has always been to ensure that companies are the servant of only one master. Yet today the master itself may have divided loyalties and attention. With few gains left to be had from governance reforms, private equity is quietly distancing itself from the corporate governance revolution that it helped bring about.

View Private Equity's Governance Advantage: A Requiem.

5.2 Can ethics be taught? Evidence from securities exams and investment adviser misconduct

In this paper, the authors study the consequences of a 2010 change in the investment adviser qualification exam that reallocated coverage from the rules and ethics section to the technical material section. Comparing advisers with the same employer in the same location and year, the authors find those passing the exam with more rules and ethics coverage are one-fourth less likely to commit misconduct. The exam change appears to affect advisers' perception of acceptable conduct, and not just their awareness of specific rules or selection into the qualification. Those passing the rules and ethics-focused exam are more likely to depart employers experiencing scandals. Such departures also predict future scandals. The paper offers the first archival evidence on how rules and ethics training affects conduct and labour market activity in the financial sector.

View Can Ethics be Taught? Evidence from Securities Exams and Investment Adviser Misconduct.

5.3 Shareholder activism and firms' voluntary disclosure of climate change risks

This paper examines whether - in the absence of mandated disclosure requirements - shareholder activism can elicit greater disclosure of firms' exposure to climate change risks. The authors find that environmental shareholder activism increases the voluntary disclosure of climate change risks, especially if initiated by investors who are more powerful (institutional investors) or whose request has more legitimacy (long-term institutional investors). The authors also find that companies that voluntarily disclose climate change risks following environmental shareholder activism achieve a higher valuation, suggesting that investors value transparency with respect to climate change risks.

View Shareholder Activism and Firms' Voluntary Disclosure of Climate Change Risks.

5.4 Addressing the auditor independence puzzle: Regulatory models and proposal for reform

Auditors play a major role in corporate governance and capital markets. *Ex ante*, auditors facilitate firms' access to finance by fostering trust among public investors. *Ex post*, auditors can prevent misbehaviour and prevent financial fraud by corporate insiders. In order to fulfil these goals, however, in addition to having the adequate knowledge and expertise, auditors must perform their functions in an independent manner. However, auditors often find themselves in a situation where their actual independence or their independence in appearance is compromised (sometimes without a conscious decision or the auditor necessarily realising the problem). For example, non-audit services may contribute to such conflicts. Moreover, the mere fact that the audited corporation typically selects the auditor raises questions about whether the system is set up for truly independent audits.

Policymakers and scholars around the world have attempted to solve the auditor independence puzzle through a variety of mechanisms, including prohibitions of certain services, auditor rotation, and more recently breaking up of audit firms and the empowerment of shareholders. This paper argues that none of these solutions is entirely convincing. Drawing from the corporate governance, law and economics, and accounting literatures, this paper proposes a new model to strengthen auditor independence. The authors argue that future reform should emphasise three primary pillars for the benefit of public investors, but also for the promotion of firms' access to finance and the development of capital markets. First, in controlled firms, auditors should be elected with a majority-of-the-minority vote. Second, the role and composition of the audit committee are crucial to strengthen auditor independence. Third, policymakers must pay close attention to the internal governance and compensation systems of audit firms. The authors argue that increased transparency of audit firms is essential to enhance the independence and credibility of auditors.

View [Addressing the Auditor Independence Puzzle: Regulatory Models and Proposal for Reform].

5.5 Board's IT expertise and firm innovation

The authors examine the relationship between the board's information technology (IT) expertise and firm innovation. Using a novel hand-collected dataset from biographies of directors, they find that the board's IT expertise has a positive influence on firm innovation - measured in terms of research and development expenditures and patents applied. The board's IT expertise is one dimension among various existing governance mechanisms in a firm that can influence innovation. Studying the conditions under which the board's IT expertise matters, the authors analyse the cross-sectional variation in a firm's existing governance mechanisms with regards to innovation. Building on prior research, they identify three mechanisms that are associated with innovation - institutional ownership, classified board, and chief executive officer (CEO)/Chair duality. They find that the board's IT expertise can be a substitute for these governance mechanisms in driving innovation. The board's IT expertise also has a positive impact on innovation quality, as measured by patent related citations. The board's IT expertise can reduce information asymmetries even in relatively complex firms and can spur innovation. The authors present evidence that the type of IT directors on the board matters. In particular, innovation outcomes are primarily driven by outside/independent IT directors.

View [Board's IT Expertise and Firm Innovation].

5.6 Implementing strategies for the model law on cross-border insolvency: The divergence in Asia-Pacific and lessons for UNCITRAL

The United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (the Model Law) was conceived with the aim of providing a framework for States to obtain consistency in the recognition of foreign insolvency proceedings and granting relief in aid of the foreign courts. The Model Law has achieved moderate success internationally and four States in the Asia-Pacific, namely Australia, Singapore, Japan and Korea, have enacted legislation based on the Model Law. Scholars agree on the importance of consistent implementation of the Model Law in managing cross-border insolvency to achieve quick, certain, and predictable outcomes.

However, the Model Law's aims have not been completely met and existing accounts have pointed out that there is a lack of complete harmonisation for two reasons. First, States have not fully implemented the Model Law in their domestic law. Second, the judiciary in the States have not interpreted their legislation enacting the Model Law consistently. This lack of harmony is reflected in the fact that UNCITRAL recently felt the need to promulgate a supplemental Model Law on Recognition and Enforcement of Insolvency-Related Judgments.

In this paper, the authors examine the divergent implementation strategies of the Model Law in Australia, Singapore, Japan, and Korea, and explain the reasons for the divergence. In the case of

Japan and Korea, legal origins have been put forward as a reason for the divergence; as these two jurisdictions are not based on common law, they require greater local modification to assure the Model Law will fit into their legal systems. However, they argue that legal origins are incomplete reasons for the lack of uniformity. Instead, they argue that where States, like Australia and Singapore, are shifting from a moderately territorialist approach with cross-border insolvency to the modified universalist approach as envisaged by the Model Law, they are more likely to implement the Model Law in full. Where States start from an exclusively territorialist approach (such as Japan and Korea), they are likely to recognise foreign insolvency proceedings as a broad signal of their international commitment towards adopting global norms, but would demand changes to allow for some room to depart from all of the consequences of recognition of foreign proceedings, even in situations where there may be no real impediment for the Model Law to be implemented. However, insofar as Korea is concerned, there are signs that judicial attitudes are changing as the judiciary sees the benefits of the Model Law in cooperation and communication, and there may be a greater chance of implementation.

View Implementing Strategies for the Model Law on Cross-Border Insolvency: The Divergence in Asia-Pacific and Lessons for UNCITRAL.

6. Recent Corporate Law Decisions

6.1 Where is the line between general and personal financial product advice? ASIC's financial product advice test case has succeeded on appeal

(By Mark Standen, Michael Lawson, Martin Wright, Andrew Bradley, Kate Hilder, MinterEllison)

Australian Securities and Investments Commission v Westpac Securities Administration Limited [2019] FCAFC 187 (28 October 2019) Federal Court of Australia, Full Court, Allsop CJ, Jagot and O'Bryan JJ

(a) Summary

On 28 October, the Federal Court (the Court) handed down its decision in *Australian Securities and Investment Commission v Westpac Securities Administration Limited* [2019] FCAFC 187.

The Court was unanimous in allowing ASIC's appeal with costs, and dismissing the cross-appeal with costs. Their Honours, Allsop CJ, Jagot and O'Bryan JJ each provided separate reasons for their decision.

This is a significant and important decision for the financial services industry. It dramatically changes the characterisation of general and personal financial product advice and will significantly impact the way licensees interact with clients. As a result of this decision, financial institutions will need to review:

- their distribution models and channels;
- the scope of their licences and activities;
- marketing materials, online calculators and other tools; and
- the types of information gathered from clients.

The case largely concerns the question of what constitutes "personal", as opposed to "general" financial product advice under the [Corporations Act 2001 No. 50 (Cth)]() (the Corporations Act). This is important because providers of personal advice are required to act in the best interests of the customer and comply with additional disclosure requirements. If only general advice is given, the primary obligations on the provider of the advice are fewer.

In allowing ASIC's appeal, the Court found that superannuation switching marketing campaigns run by two Westpac subsidiaries, aimed at convincing customers to consolidate their superannuation accounts into a single Westpac-related account, did involve giving "personal advice" within the meaning of s. 766B(3) of the Corporations Act.

Flowing from the finding that personal financial product advice was provided, the Court found that Westpac failed to comply with other sections of the Corporations Act, including s. 961B (the best interests obligation).

The Court also agreed with the primary judge's view that Westpac failed to comply with s. 912A(1)(a) of the Corporations Act (obligation to "do all things necessary to ensure that the financial services covered by their licences were provided honestly, efficiently and fairly"), and in doing so lent weight to the emerging view that holders of an Australian Financial Service Licence (AFSL) are subject to an objective duty to act "fairly".

In a statement welcoming the decision ASIC said that it provides "clarity and certainty concerning the difference between general and personal advice for consumers and financial services providers". In a short statement acknowledging the decision, Westpac said it is "considering the decision".

(b) Facts

At first instance, the Court found that marketing campaigns implemented in 2014 and 2015 by Westpac subsidiaries (BT Funds Management Ltd (BTFM) and Westpac Securities Administration Limited) aimed at encouraging their customers to consolidate their external superannuation accounts into existing Westpac-related accounts (collectively, the BT accounts) involved the provision of general product advice, but that Westpac's conduct had breached s. 912A(1)(a) of the Corporations Act.

Section 912A(1)(a) of the Corporations Act states that holders of an AFSL must "do all things necessary to ensure that the financial services covered by their licences were provided honestly, efficiently and fairly".

However, the primary judge held that ASIC failed to make out its case that Westpac provided "personal advice" and that in consequence, ASIC failed to demonstrate alleged contraventions of ss. 912A(1)(b), 946A and 961B of the Corporations Act. ASIC subsequently appealed the decision.

(c) Decision

(i) When does marketing cross the line into financial product advice, and then into "personal advice"?

The appeal was largely concerned with the questions of whether Westpac's conduct (the marketing campaigns - primarily phone calls made by callers on behalf of Westpac to Westpac customers) involved:

- the provision of financial product advice within the meaning of s. 766B(1) of the Corporations Act; and
- if so, whether the advice was "personal advice" within the meaning of s. 766B(3) of the Corporations Act or "general advice" within the meaning of s. 766B(4) of the Corporations Act.

Ultimately, their Honours each held that Westpac's conduct (the marketing campaigns) did involve the giving of financial product advice, that this was personal advice, and that flowing from this, the conduct also contravened various provisions of the Corporations Act.

Separately, their Honours each separately agreed with the primary judge, that the conduct did constitute a breach of s. 912A(1)(a) of the Corporations Act.

(ii) Westpac's conduct did constitute financial product advice

Their Honours each agreed with the primary judge in concluding that Westpac's communications (primarily a sample of 14 calls to customers) involved the provision of financial product advice and was not simply marketing or advertising.

In reaching this conclusion, Allsop CJ, Jagot and O'Bryan JJ each rejected Westpac's argument that the whole of the communication needs to bear the character of advice for the statutory definition (s. 766B(1) of the Corporations Act) to be satisfied.

Jagot J stated "contrary to Westpac's case, not every statement of fact, sales message or expression of enthusiasm which a financial product issuer makes about its own financial products will involve financial product advice. More is required in the form of a recommendation or statement of opinion. In the present case Westpac's communications, in my view, fall well on the side of the line of financial product advice in distinction from mere marketing".

This is because "the clear message conveyed by the callers in each call was that Westpac was calling to help the customer by providing them with a service that would be in the customer's interest to accept. No reasonable customer would have expected that when Westpac said it was calling to help the customer, in fact, it was doing nothing more than helping itself to the customer's superannuation irrespective of the customer's best interests. Accordingly, the primary judge's conclusion at [260] that each customer received a recommendation that they should rollover their external accounts into their BT account is unassailable".

Both Allsop CJ and O'Bryan J reached similar conclusions.

Allsop CJ also emphasised in his reasons that because the "callers took the customers to the point of decision making over the phone in a call" having been given "helpful recommendations and statements of opinion (even of a general character)" for example, that the customer could potentially save on fees and that combining accounts made sense from a management point of view or would enhance manageability, the communications "can plainly be seen as a form of advice".

(iii) Westpac's conduct did involve the provision of "personal advice" within the meaning of s. 766B(3) of the Corporations Act

The primary judge held that "financial product advice" was not "personal advice" within the meaning of s. 766B(3)(a) of the Corporations Act because the advice was not given in circumstances where: (a) Westpac (through the callers) considered any/all of the customer's objectives, financial situation or needs; and (b) a reasonable person might expect Westpac (through the callers) to have considered the customer's objectives, financial situation or needs.

It followed from that conclusion that the financial product advice given by Westpac (through the callers) was general advice within the meaning of s. 766B(4) of the Corporations Act.

Their Honours each rejected this characterisation of the advice as "general advice", each instead separately concluding that the advice was "personal advice".

No imperative that the clients' objectives, financial situation and needs be considered in their totality

Their Honours each separately rejected Westpac's contention that s. 766B(3) of the Corporations Act requires consideration of all of the clients "objectives, financial situation and needs", "as a whole".

O'Bryan J held that s. 766B(3) of the Corporations Act requires only that "the provider [of the advice] has considered to some extent one or more of the recipient's objectives, financial situation or needs; the paragraph does not require that the provider has considered any of them 'as a whole' on the basis that doing so would defeat the purpose of s. 961B".

"On Westpac's construction, if the provider did not have complete information about one or more of the client's objectives, financial situation or needs, any advice given would not be personal advice and the obligation under s. 961B would never arise. Such a construction would defeat the very purpose of s. 961B".

Jagot J made a similar observation stating that "if the legislature had intended that personal advice would be given only if the provider of the advice had considered the whole of one or more of the person's objectives, financial situation and needs then there would be no need for the legislation to expressly contemplate that information relating to the client's relevant circumstances may be incomplete for any category. Further, as ASIC submitted, it would lead to a perverse outcome if the client is protected by the personal advice provisions where the provider undertakes a detailed consideration of their personal circumstances but stops short of considering the whole of their circumstances.the legislature could not have intended that the personal advice protections are engaged when only some needs but all objectives are considered or vice versa but are not engaged if nearly all needs and nearly all objectives are considered".

Section 766B(3) of the Corporations Act should be considered in the context of the Corporations Act, and in the context of the communication as a whole

Their Honours each make clear that s. 766B(3) of the Corporations Act should be read in both the broader context of the Corporations Act and in the context of the communication as a whole. Jagot J commented that "the parties were in dispute about the meaning of 'considered', 'in circumstances where' and 'one or more of the person's objectives, financial situation and needs' as they appear in s. 766B(3). I do not consider that the phrases.are capable of being given meaning outside of the full context in which they appear". Jagot J also rejected the approach of the primary judge in looking at the principles of administrative law to give meaning to the word "considered" and stated that "considered" in this context should be given its ordinary meaning, being "to pay attention or regard to; to view or think about with attention or scrutiny".

Likewise, Allsop CJ commented that "care must be taken not to over-complicate these questions, in particular by breaking up the questions of meaning into parts of a section or sub-section to be treated separately".

The question, Allsop CJ stated "is one of the practical application of the statute to the context in question to see whether an express or implied 'recommendation' (that is, commending something by favourable representation or presentation as worthy of confidence or acceptance or as advisable or expedient) or 'statement of opinion' (that is, a judgment or belief or view or estimation) was made. The two concepts are, of course, related. The opinion may be the basis of the recommendation; and the recommendation may carry with it an implied opinion."

More than marketing?

In this case, Allsop CJ held that though the marketing campaign was "carefully calculated" to convince customers to consolidate their superannuation accounts into a Westpac-related superannuation account by giving no more than general advice (i.e. marketing/advertising a service), it was nevertheless personal advice.

".the decision to consolidate superannuation funds into one chosen fund is not a decision suitable for marketing or general advice. It is a decision that requires attention to the personal circumstances of a customer and the features of the multiple funds held by the customer. Westpac attempted, assiduously, to get the customer to make a decision to move funds to BT without giving personal financial product advice as defined in the legislation. It failed. It gave personal advice, because when the telephone exchanges are considered as a whole and in their context, including importantly the 'closing' on the telephone by getting the decision made during the call, there was an implied recommendation in each call that the customer should accept the service to move accounts funds into his or her BT account carrying with it an implied statement of opinion that this step would meet and fulfil the concerns and objectives the customer had enunciated on the call in answer to deliberate questions by the callers about paying too much in fees and enhancing manageability."

Likewise, O'Bryan J found that the way in which the call was framed and the context, meant that the advice to switch accounts involved personal advice. "Notwithstanding the general advice warning that was given at the outset of the call; notwithstanding no fees were charged for the offer of help; and notwithstanding that it was apparent that the callers did not have information about the customer's external superannuation accounts, in my view a reasonable person standing in the shoes of the customers might expect the callers to have considered one or more of the person's objectives, financial situation and needs.By its conduct, Westpac engendered a circumstance in which it conveyed an implicit recommendation to its customers to consolidate their external superannuation accounts into their BT account, and engendered a circumstance in which customers might rely and act on that recommendation because they might expect Westpac to have considered one or more of their personal circumstances in making that recommendation" he stated.

This does not mean that all marketing is "personal advice"

In finding that the advice was "personal advice" Allsop CJ said that "[t]he dichotomy which Westpac seeks to establish in this case between advertising and marketing on the one hand and advice on the other hand is unhelpful. It is true that all advertising and marketing is intended to influence the listener to acquire the provider's products but that advertising and marketing is not necessarily advice. The rub in the present case is that while Westpac may have perceived what it was doing as a marketing campaign in the interests of Westpac, its campaign consisted of making calls to existing Westpac customers on the basis that the purpose of the call was to help the customer in respect of the customer's superannuation. The reasonable customer would not expect that in such a serious context, the customer's superannuation, and given the existing relationship between them, Westpac would present itself as helping the customer if, in reality, it was doing nothing more than helping itself. As the primary judge found at [47], while the customer would assume that Westpac was making the call to the customer self-interestedly, the customer would also assume that Westpac was making the call in the customer's interest."

Both Jagot and O'Bryan JJ reached similar conclusions.

The emphasis on "closing" was a key factor

Allsop CJ observed that "Westpac could have avoided this conclusion and result by the callers ensuring that the customers had the opportunity to consider their own positions and, having done so, later communicate an acceptance, if they wished".

(iv) Consequences of the findings that the conduct constituted personal advice: Other contraventions of the Corporations Act

Having found that the conduct did constitute personal advice, their Honours each held that Westpac also contravened s. 961B(1) of the Corporations Act (the duty to act in the best interests of the client) and in consequence also breached ss. 961K(1), 912A(1)(b) and (c).

In addition, their Honours also agreed with the primary judge that Westpac's conduct contravened s. 912A(1)(a) of the Corporations Act.

Contravention of s. 912A(1)(a) of the Corporations Act: One duty or three?

The case also includes discussion of the interpretation of s. 912A(1)(a) of the Corporations Act: the requirement that financial services licensees must "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly".

Allsop CJ acknowledged that the courts have held s. 912A(1)(a) of the Corporations Act to be "compendious as a single, composite concept, rather than containing three discrete behavioural norms", referencing the decision in *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 (*Story*), but cast doubt over this decision and the various cases that have followed it. Allsop CJ was careful to "reserve for an occasion where the matter was fully argued" whether the phrase is compendious, but in doing so lent weight to the emerging view in the industry that s. 912A(1)(a) of the Corporations Act imposes three concurrent but separate obligations imposed on AFSL holders, including an obligation to act "fairly".

"Fair" to be given its ordinary meaning

Observing that the word "fair" as used in s. 912A(1)(a) of the Corporations Act has not received detailed judicial consideration. O'Bryan J commented that "it seems to me that there is no reason why it cannot carry its ordinary meaning which includes an absence of injustice, even-handedness and reasonableness.It seems to me that the concepts of efficiently, honestly and fairly are not inherently in conflict with each other and that the ordinary meaning of the words used in s. 912A(1)(a) is to impose three concurrent obligations on the financial services licensee: to ensure that the financial services are provided efficiently, and are provided honestly, and are provided fairly". Likewise, Allsop CJ cited the Macquarie Dictionary definition of fairness in his reasons.

Form over substance

In his reasons, Allsop CJ observed that "the provision is part of the statute's legislative policy to require social and commercial norms or standards of behaviour to be adhered to" and as such, emphasis "must be given to substance over form and the essential over the inessential in a process of characterisation by reference to the stated norm".

Conclusions on s. 912A(1)(a) of the Corporations Act

In this case, their Honours each separately agreed with the primary judge that the conduct did constitute a breach of s. 912A of the Corporations Act.

Allsop CJ commented that "it could hardly be seen to be fair, or to be providing financial product advice fairly, or efficiently, honestly and fairly, to set out for one's own interests to seek to influence a customer to make a decision on advice of a general character when such decision can only prudently be made having regard to information personal to the customer.There was a degree of calculated sharpness about the practice adopted in the QM Framework [quality monitoring framework]".

His Honour went on to say that "the QM Framework courted the risk of personal advice being given; and it was. I do not intend to be either flippant, or disrespectful, but the perceived importance of the 'closing' being over the phone might be seen as not wanting to let the customer out of the showroom or shop. This is not ensuring that financial services covered by its licence were provided efficiently, honestly and fairly. There was a contravention of s. 912A(1)(a)."

Jagot J commented along similar lines that "on the primary judge's approach to the facts (that is, that Westpac did not give personal advice) it can nevertheless be said that Westpac was guilty of what would colloquially be described as systemic sharp practice about what must have been one of their clients' major financial concerns, their superannuation. The fact that Westpac provided training to its staff to avoid giving personal advice does not alter this conclusion".

O'Bryan J likewise held that the conduct "was inherently likely to result in financial advice being given to customers in a manner that was unfair to those customers, contrary to the requirement in s. 912A(1)(a)".

Failure to act in the best interests of the client: s. 961B of the Corporations Act

Their Honours also each concluded that flowing from the finding that Westpac acted in a manner that was unfair to customers, the conduct also constituted a failure to act in the best interests of the client (in breach of s. 961B of the Corporations Act).

O'Bryan J said that "The facts found by the primary judge compel a conclusion that the callers contravened s. 961B(1) and Westpac thereby contravened s. 961B(1). Westpac, through its representatives, failed to act in any of the ways referred to in paragraphs (b) to (g) of s. 961B(2). The callers failed to obtain the most basic information that would have been required in order to act in the best interests of the customers".

Allsop CJ held that "the whole approach of Westpac was to obtain an advantage for itself without engaging with the personal circumstances of the customers so as to avoid the consequences of the responsibilities of providing personal advice".

(d) Implications

ASIC has identified "fairness" and "address(ing) poor financial advice outcomes" as a key area of focus. More particularly, ASIC's latest *Corporate Plan* states that the regulator will support measures to improve professional of financial advisers and "target the potential misconduct and harms to consumers that may arise from the industry's shift towards 'general advice' models".

ASIC has also flagged plans to review Regulatory Guide 146 Licensing: Training of Financial Product Advisers over 2019-2020 to assess what training standards apply to individuals providing general advice, or personal advice on basic banking products, general insurance and consumer credit insurance, to retail clients.

(i) Legal implications

- the decision establishes a threshold for what constitutes "personal" as opposed to "general" financial product advice which is lower than what many within the industry had adopted;
- it is clear there is a risk that any financial product advice provided after gathering information about a client's financial situation, objectives or needs may constitute personal advice and that information on one of these factors alone may be sufficient;
- the element of "consideration" of the factors relevant to the client does not require a detailed analysis to be established, nor does consideration necessarily have to occur at the same time as the recommendation is provided;
- it is also clear that the overall impression created through customer interactions and any pre-existing relationship with the provider are relevant considerations in respect whether a reasonable person would expect the advice provider to have taken the client's financial situation, objectives and needs into account;
- the posing of questions to the client which elicit information about their financial situation, objectives and needs will also contribute to the overall impression of the advice provided; and
- the "reasonable person" for the purposes of assessing whether there is an expectation of personal financial situation, objectives and needs being considered is likely to be a reasonable person in the circumstances of the relevant client.

Efficiency, honesty and fairness

- the decision lends significant weight to the emerging view that the general obligation under s. 912A(1)(a) of the Corporations Act to act "efficiently, honestly and fairly" imposes three concurrent but separate obligations, contradicting previous case law on this point (see for example Young J in *Story*); and
- given that the Court effectively held that Westpac acting in its own self-interest was unfair, this raises the question of whether licensees will effectively be held to act in the best interests of their clients irrespective of whether personal advice is provided.

(ii) Practical implications

- the decision significantly impacts on the way licensees interact with clients and potentially signals the end of direct telephone-based product campaigns when considered in combination with the proposals to further reform the anti-hawking regime;
- licensees will need to consider whether general advice and "no advice" distribution models (both directly and via third parties) remain appropriate and sustainable in light of the decision;
- for general advice and "no advice" distribution models that are retained, the overall impression created through the sequence of customer interactions should be scrutinised to determine whether there is a risk personal advice will be provided. Close examination of the customer information gathered will be critical to this step;
- licensees with advice authorisations restricted to general advice will need to reconsider the scope of their activities and the suitability of a limited licence in this regard;

- marketing materials, telephone call scripts, representative training and digital tools should be assessed in isolation and as a complete customer experience;
- compliance with the general obligation of acting efficiently, honestly and fairly must be imbedded in all aspects of the licensee's business given there is likely to be an increase in ASIC relying on breaches of the obligation as the basis for regulatory and enforcement action;
- those implementing the upcoming design and distribution reforms should be mindful of the decision in determining target markets and setting distribution conditions; and
- licensees currently undergoing remediation projects will need to consider the impact of the decision on remediation methodologies, strategies and compensation provisions. For remediation projects dating back prior to the introduction of the Future of Financial Advice best interest duty, licensees will need to consider whether a different methodology should apply depending on when the advice was provided.

6.2 English High Court rejects strike out application by Tesco PLC in relation to shareholder dispute about what is an interest in securities

(By Thomas Hampel, King & Wood Mallesons)

SL Claimants v Tesco PLC [2019] EWHC 2858 (Ch) (28 October 2019) England and Wales High Court, Hildyard J

(a) Summary

The England and Wales High Court (the Court) has ruled against a strike out application made by Tesco PLC (Tesco) in a dispute that was brought by its shareholders. Two claimant groups (the Claimants) brought actions against Tesco under s. 90A of the *Financial Services and Markets Act 2000 (UK)* (the *FSMA*) to recover losses that they claimed to have suffered as a result of certain false and misleading statements that Tesco made in the reporting of its commercial income and trading profits, and which influenced the shareholders' investment decisions.

Most relevantly, all of the Claimants invested in the Tesco shares through a computerised form (known as CREST) and using custodians (and potentially sub-custodians). As a result, Tesco argued that:

- the interest of a claimant in such a custody chain is not within the definition of an "interest in securities" (as referred to in the relevant *FSMA* provisions); and
- regardless, none of the claimants can be said to have "acquired, continued to hold or disposed of" any interest in the securities.

The Court rejected both grounds of Tesco's application based on fundamental issues of statutory construction and by reference to the underpinning purposes of the *FSMA*.

(b) Facts

In 2014, Tesco published information in relation to its commercial income and trading profits. It was common ground that this information contained false and misleading statements. The Claimants reasonably relied on this information to make investment decisions in relation to Tesco's shares, and consequently suffered financial loss.

As a result, the Claimants sought compensation as a remedy under s. 90A and Schedule 10A of the *FSMA*. By s. 90A of the *FSMA*, an issuer of securities is liable to pay compensation to a person who has "suffered loss as a result of . a misleading statement or dishonest omission in certain published information". Under paragraph 3(1) of Schedule 10A of the *FSMA*, this compensation must be paid to a person "who acquires, continues to hold or disposes of securities in reliance on published information to which this schedule applies".

The relevant Tesco shares were held by the Claimants in a "decentralised form" on a computer-based system called CREST, and were acquired, held and disposed of using custodians (and potentially sub-custodians). In addition, most of the shares were also held in a "custody chain", whereby the shares were held for another intermediary. As a result, the relevant CREST members (and none of the Claimants) directly acquired, held and disposed of the legal interest in the shares.

This decision relates to Tesco's application to strike out the Claimant's claims, which was made on the basis that the relevant remedies under the *FSMA* were not available to the Claimants because of *how* they acquired, held and disposed of their interests in the shares.

(c) Decision

The Court rejected both limbs of Tesco's argument and dismissed the strike-out application.

(i) Did the Claimants have an "interest in securities"?

First, the Court determined whether the Claimants held a sufficient "interest in securities". The Court considered the relevant statutory provisions, as well as the rules of interpretation that are provided in paragraph 8 of Schedule 10A (which, most relevantly, included references to "any" interest). The Court noted that it was "unsettling" that such a touchstone provision could be open to this type of challenge.

The Court agreed largely with the legal principles that were advanced as arguments by Tesco. Most relevantly, it considered the decision of *re Lehman Brothers International (Europe)* [2010] EWHC 2914 (Ch), which provides that where there is a chain of intermediaries, the subject matter of each sub-trust in the custody chain is the beneficial interest that the intermediary has and holds on trust, rather than the underlying securities themselves. The Court also noted that there must be something more than a mere contractual right or economic interest in the securities to be considered "any interest".

However, the Court ultimately disagreed with Tesco in relation to the conclusions drawn from these key principles. In doing so, it referred to *In the matter of Lehman Brothers International (Europe)* [2012] EWHC 2997, where it was held that the interest of the "ultimate beneficial owner" (held through a series of trusts and sub-trusts) is an "equitable interest". Accordingly, the Court concluded that there is no doubt that the ultimate investor has an "interest", and that there is legally no doubt this type of an interest is equitable and proprietary (given that these are the hallmarks of beneficial ownership).

The Court also noted that no one but the investor can claim any right of ownership beneficially, and that the property in the relevant share would not be available (to the relevant creditors) in a bankruptcy event of any intermediary.

Accordingly, the Court found that the "right to the right" held through a chain of equitable relationships (and which all relevant Claimants held via a custody chain) was, or could be equated to, an equitable property right. This interest was sufficient to be "any interest" in the securities for the purposes of Schedule 10A of the *FSMA*.

(ii) Even in the contrary, did the Claimants "acquire, continue to hold or dispose of" any interest in securities?

In relation to its second limb of argument, Tesco submitted that the Claimants, being the ultimate investors, only held (at most) a beneficial interest, and that this beneficial interest could only be "created or extinguished" (rather than being "acquired or disposed of").

Whilst Tesco recognised that this narrow construction would ultimately undermine the *FSMA* regime in relation to claims by holders of intermediated securities, it argued that this was because the law had failed to keep pace with the market.

The Court referred to ordinary principles of statutory construction, including the fundamental statutory purpose of protecting the needs of investors, and found that such a narrow construction would potentially undermine that purpose. Put another way, the statutory language was not sufficiently clear to not follow that purpose. As a result, the Court found that any analysis of the provisions should assume that the legislature understood the market in intermediated securities, did not intend to strip away the rights of investors who chose that mode, and adopted language that was appropriate to preserve and enhance those rights.

The Court also referred to key common law principles that established that the word "disposition" could include the "destruction or termination" of an interest. Accordingly, it concluded that it was logical that the words "holding" and "acquisition" should be interpreted similarly broadly.

Overall, the Court held at [120] that:

". any process whereby, in a transaction or transactions on CREST, the ultimate beneficial ownership of securities that are, with the consent of the issuer, admitted to trading on a securities market in accordance with paragraph 1 of Schedule 10A, comes to be vested in or ceases to be vested in a person constitutes (respectively) 'the acquisition or disposal of any interest in securities'."

6.3 When guidance causes confusion, don't look for consensus? The Myer shareholder class action

(By Andrew Lumsden, Justin Fox, Katrina Sleiman, Sean Huber, Corrs Chambers Westgarth)

TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited [2019] FCA 1747 (24 October 2019) Federal Court of Australia, Beach J

(a) Summary

The Federal Court's (the Court's) recent decision in the Myer Holdings Limited (Myer) shareholder class action shows just how easily a board's best laid plans can come unstuck. Although the board of Myer categorically refused to provide earnings forecasts, Beach J found that the CEO's post-briefing discussions with analysts in September 2014 constituted "de facto" profit guidance, and that Myer had an obligation to update the market even if the actual performance was in line with the consensus views of sell-side analysts.

It was, however, not all bad news for Myer. Beach J found that the shareholders had not suffered any loss because of "the hard-edged scepticism" of market analysts and market makers, who doubted Myer would ever achieve its ambitious de facto projections.

This is an important judgment in at least two respects. First, from a continuous disclosure perspective, the Court affirmed the correctness of ASX Guidance Note 8 (the Guidance Note) (which remains unchanged following the ASX's recent updates of the *ASX Listing Rules* and *ASX Guidance Notes* due to take effect from 1 December 2019) and the judgment is also generally consistent with how the market has understood an issuer's continuous disclosure obligations in the context of earnings guidance. Second, Beach J also settled the place of market-based causation in the Australian shareholder class action landscape, but as discussed above the case also demonstrates that faith in the effectiveness of the market can be a double-edged sword.

(b) Facts

The case concerned disclosures made by Myer and its CEO on 11 September 2014.

Myer announced net profit after tax (NPAT) for FY14 of $98.5 million, and in a post release interview the CEO told analysts and the media that in FY15 Myer would likely have NPAT in excess of its FY14 NPAT. On 19 March 2015, Myer announced that its expected FY15 NPAT was not going to be more than $85 million. Following that announcement, Myer's share price fell by around 10%.

It was alleged that the CEO's statement was misleading or deceptive, a breach of the obligation to have a reasonable basis for any forecasts and a breach of Myer's continuous disclosure obligations. The applicant claimed that it and group members suffered loss when they purchased Myer shares at an inflated price.

(c) Decision

The Court found that the CEO's statement on 11 September 2014 was not misleading and the CEO had a reasonable basis for making the statement, but that, from no later than 21 November 2014, Myer should have made a corrective disclosure and in failing to do so had breached its continuous disclosure obligation and engaged in misleading or deceptive conduct; but that failure did not give rise to any meaningful share price inflation and accordingly no loss was suffered by the Myer shareholders.

(i) Informal guidance is still guidance

The Court found that the CEO's comments amounted to de facto profit guidance despite those comments being "informal", despite the board expressly deciding not to provide profit guidance to the market, and despite the fact that the statement was acknowledged not to be formal guidance.

The Guidance Note guides issuers on the subject of "de facto earnings guidance". It says that something falling short of formal guidance is still guidance and once given, the issuer is bound to correct it if it ceases to be materially correct. The Court placed a heavy reliance on the Guidance Note in forming its view about Myer's obligations. This suggests that the Guidance Note is in line with judicial opinion, even though it does not represent a legal determination.

Accordingly, where an entity has published earnings guidance (including de facto guidance) for the current reporting period and it expects its earnings to differ materially from that guidance, it needs to give careful consideration to its potential exposure under s. 1041H of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) for misleading or deceptive conduct, as well as its responsibilities under ASX Listing Rule 3.1 (Rule 3.1) and s. 674 of the Corporations Act.

(ii) Guidance, consensus and continuous disclosure

Having provided the market with guidance, Myer was bound to correct that guidance when it became aware that its own reforecast disclosed a belief by management that the actual performance was likely to be materially short of that guidance.

The Court found that a 5% discrepancy was material in the circumstances. In determining the 5% threshold, context was important - for Myer, a decline in NPAT would be confirmation of a trend of declining profits.

Rather than assessing materiality against the guidance provided by the CEO, Myer determined materiality principally on the basis of whether its reforecast was consistent with or materially different from the Bloomberg consensus. The Court did not agree that this was the correct reference point at which to test materiality. Ultimately, the Court found a series of failures by the board in failing to disclose material variations from the CEO's informal guidance and found that the board was mistaken in measuring its continuous disclosure obligations against consensus rather than the CEO's statement.

The Court did not provide much assistance on the vexed issue of when the issuer has knowledge of a matter for the purpose of determining when a disclosure should be made to the market, where that knowledge is the product of a series of ongoing management inputs. The Court does not point to the generation or receipt of any particular piece of information as the trigger giving rise to the disclosure obligation. Instead, the Court found that Myer had enough information available to it by the annual general meeting (AGM) on 20 November 2015, and that disclosure should have been made at that point. This doesn't sit well with the obligation to disclose information "immediately" as required under Rule 3.1, which the Guidance Note construes to mean "not instantaneously", but "promptly and without delay". Interestingly, the Court rejected any suggestion that sell-side analysts' expectations render predictions of performance as being generally available.

(iii) ASX Listing Rule 3.1A and the reasonable person test

The Court supported the generally accepted view that the exceptions to disclosure arising under ASX Listing Rule 3.1A apply to internal forecasts as they are confidential and generated for internal management purposes and insufficiently definite to warrant disclosure. As such, there was no need to disclose unless a reasonable person would expect the information to be disclosed.

What is a reasonable person's expectation? The Court recognises that the test has a very narrow range of operation and one of those will be the case of informal guidance - an issuer needs to make disclosure if information is required to be released in order to correct or prevent a false market. This is because a reasonable person would expect a listed entity, acting responsibly, to immediately disclose any information necessary to correct or prevent a false market in its securities.

(iv) Reasonable grounds when making a profit forecast

The Court was not persuaded that Myer failed to have reasonable grounds, within the meaning of s. 769C of the Corporations Act, for making a profit forecast. The Court found that the CEO had made a genuine assessment as to the appropriateness of the September 2014 forecast.

Relevantly, the mere *bona fide* holding of an opinion will be insufficient, and where it is alleged that the board held an opinion that the company did not have reasonable grounds for a representation, the opinion does not need to be held by a majority of the board. An opinion held by senior management who were officers may be sufficient to constitute the opinion of the company and hence awareness for the purposes of s. 674 of the Corporations Act.

(v) Market-based theory of causation accepted

The Court accepted the availability of a market-based theory of causation and loss in the context of a shareholder class action. This theory holds that shareholders do not need to show that they personally relied on the impugned disclosure to recover loss, and says that a party who acquires shares on market does so on the assumption that the ASX price represents the workings of a fully informed and efficient market. The failure to keep the market fully informed creates inflation in the share price and therefore "causes" the loss.

(vi) Breach of disclosure obligations, but why no loss?

The Court found that Myer's breaches did not artificially inflate the price of Myer shares because the market price already factored in an NPAT "well south" of the CEO's "rosy picture painted on 11 September 2014". Rather, the 10% drop occurred because the expected NPAT announced on 19 March 2015 was below the market consensus, being new information not already factored into the market price that had been promptly disclosed by Myer.

6.4 Recognition of foreign insolvency proceedings in Australia

(By Anna Byram and Gareth Jenkins, Clayton Utz)

In the matter of Senvion GmbH (No 2) [2019] FCA 1732 (22 October 2019) Federal Court of Australia, Anastassiou J

(a) Summary

Anastassiou J of the Federal Court allowed an application by Senvion GmbH (Senvion) for recognition of a Formal Self-Administration proceeding, which had been commenced by Senvion under the insolvency laws of Germany. The Formal Self-Administration proceeding, which was found to be analogous to the voluntary administration regime under Part 5.3A of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), was recognised pursuant to the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) as a foreign main proceeding. As a result, a stay arose under Article 20(1)(a) of the Model Law, as would apply if the proceeding had been commenced under Part 5.3A of the Corporations Act.

The respondents, three Pacific Hydro entities (the Pacific Hydro Entities) cross-applied, obtaining leave to proceed pursuant to s. 440D of the Corporations Act, in relation to existing proceedings between the Pacific Hydro Entities and Senvion in the Supreme Court of Victoria.

(b) Facts

In April 2019, Senvion, which conducts its business mainly from Germany, commenced self-administration proceedings pursuant to the *German Insolvency Code*.

Senvion subsequently applied for recognition of the Formal Self-Administration proceeding pursuant to the Model Law, with the objective of staying claims made against it, including existing proceedings between Senvion and the Pacific Hydro Entities in the Supreme Court of Victoria.

The Pacific Hydro Entities cross applied for modification of the scope of the stay, or alternatively, leave to proceed with their claim against Senvion.

(c) Decision

(i) Recognition of the insolvency proceeding in Germany

Article 17 of the Model Law provides for a foreign insolvency proceeding taking place in the state where the debtor has its centre of main interests to be recognised in Australia. The Model Law is Schedule 1 to the Cross Border Insolvency Act 2008 No. 24 (Cth) (the CBI Act), and has the force of law in Australia pursuant to that Act.

Anastassiou J found that the relevant criteria under the Model Law were satisfied, and accordingly the Formal Self-Administration should be recognised as a foreign main proceeding within the meaning of Article 17 of the Model Law.

His Honour then gave consideration to the scope of the stay of proceedings that should apply, consequent upon the recognition of the foreign proceeding. In that regard, Article 20 of the Model Law, read with s. 16 of the CBI Act, provides that the scope of the stay imposed on foreign proceedings by Article 1 of the Model Law is to be the same as would apply if the stay arose under Chapter 5 of the Corporations Act.

His Honour accepted Senvion's submission that the Formal Self-Administration proceeding in Germany was analogous to the voluntary administration regime in Australia, such that the stay which should apply to Senvion would be the same as the stay arising under s. 440D of the Corporations Act.

(ii) Relief against the stay

The Pacific Hydro Entities contended that the scope of the stay should be modified to exclude from its operation the Supreme Court proceeding against Senvion. Alternatively, the Pacific Hydro Entities sought leave to continue the proceeding, pursuant to s. 440D(1) of the Corporations Act.

Anastassiou J found that the question was to be determined properly by reference to s. 440D(1) of the Corporations Act, and not any modification of the stay. His Honour observed that the Court's exercise of the discretion conferred under s. 440D(1) of the Corporations Act will turn upon the facts of each case. In the present case, his Honour was persuaded that it was appropriate to grant the Pacific Hydro Entities leave to proceed against Senvion for two primary reasons:

- first, the proceedings were in the nature of a proprietary claim, which would decide whether the subject of the Supreme Court proceedings (being access codes to certain

Pacific Hydro wind farms, through which the wind farms are remotely monitored and controlled) belonged to Senvion (and would be available to its creditors) or not; and

- second, his Honour considered that the Pacific Hydro Entities were particularly dependent upon Senvion so as to make them vulnerable, on the basis that the access codes were necessary in order for the Pacific Hydro Entities to use and enjoy their property, namely, the wind farms. For example, in an emergency, without the codes Pacific Hydro would not be able to shut down or restart the turbines. This was a matter in favour of the Supreme Court proceeding being permitted to proceed.

Leave to proceed against Senvion was granted accordingly.

6.5 Knowledge of insolvency in defence of voidable transactions

(By Amelia Bowring Stone, Corrs Chambers Westgarth)

Queensland Quarry Group Pty Ltd (in liq) & Anor v Cosgrove [2019] QCA 220 (18 October 2019) Supreme Court of Queensland, Court of Appeal, Morrison and Philippides JJA and Flanagan J

(a) Summary

This was an appeal to the Court of Appeal of the Supreme Court of Queensland (the Court) from a decision of the Queensland District Court (the first instance proceeding). In the first instance proceeding, the liquidator of Queensland Quarry Group Pty Ltd (QLD Quarry) sought to recover three debts amounting to $95,000 as voidable transactions from Helen Louise Cosgrove (Cosgrove) pursuant to s. 588FF(1) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). In the first instance proceeding, Cosgrove accepted that the debts were voidable transactions but successfully raised a defence under s. 588FG(2) of the Corporations Act.

The Court was satisfied that the judge in the first instance proceeding made an error in finding that Cosgrove, and a reasonable person in Cosgrove's circumstances, at the time of the transactions, had no reasonable grounds for suspecting that QLD Quarry was insolvent or would become insolvent, as is required to successfully invoke the defence in s. 588FG(2)(b) of the Corporations Act. Accordingly, leave to appeal was granted and Cosgrove was ordered to pay $95,000 (plus pre-judgment interest and costs) to the liquidator.

(b) Facts

QLD Quarry operated a quarry on land owned by Cosgrove. On 4 September 2014, Cosgrove issued a statutory demand to QLD Quarry for payment of a $45,000 debt. Payment of the demand was not met and so Cosgrove filed an application to wind up QLD Quarry on the grounds of insolvency.

An agreement was subsequently reached between Cosgrove and QLD Quarry, and a settlement deed was entered into which provided that QLD Quarry would pay Cosgrove the debt of $45,000 (Debt) and costs in the amount of $16,250 (Costs). The settlement deed also provided for the payment of $50,000 of rental arrears (Rental Arrears). QLD Quarry paid the Debt and Costs on 14 October 2014, and the Rental Arrears on 3 November 2014, to Cosgrove.

Additionally, in June 2014, a contract was entered into between QLD Quarry and Cosgrove relating to the sale of the land. On 29 September 2014, following multiple defaults of QLD Quarry's obligations under this contract, Cosgrove terminated the contract. In October 2014, a new contract for sale of the land was entered into, and following non completion of this contract by QLD Quarry, on 3 February 2015 Cosgrove terminated the contract and took possession of the land. Around the same time, another creditor had issued QLD Quarry a statutory demand and then, following a failure to meet the demand, had instituted proceedings to wind up QLD Quarry. That creditor and QLD Quarry subsequently reached an agreement in relation to the debt, and so Cosgrove was substituted as the applicant in that winding up proceeding and succeeded in winding up QLD Quarry.

In the first instance proceeding, Cosgrove admitted that the Debt, the Costs and the Rental Arrears were unfair preferences and voidable transactions, but successfully relied on the defence in s. 588FG(2) of the Corporations Act.

(c) Decision

The Court (by judgment of Morrison JA, with which Philippides JA and Flanagan J agreed) held that the Debt, the Costs and the Rental Arrears were voidable transactions and that Cosgrove was not able to rely on the defence in s. 588FG(2) of the Corporations Act. Section 588FG(2) states:

"(2) A court is not to make under s. 588FF an order materially prejudicing a right or interest of a person if the transaction is not an unfair loan to the company, or an unreasonable director-related transaction of the company, and it is proved that:

(a) the person became a party to the transaction in good faith; and

(b) at the time when the person became such a party:

(i) the person had no reasonable grounds for suspecting that the company was insolvent at that time or would become insolvent as mentioned in paragraph 588FC(b); and

(ii) a reasonable person in the person's circumstances would have had no such grounds for so suspecting; and

(c) the person has provided valuable consideration under the transaction or has changed his, her or its position in reliance on the transaction."

The Court's judgment predominately concerns the interpretation and application of s. 588FG(2)(b) of the Corporations Act. Importantly, the Court confirmed that "in considering this aspect it must be borne in mind that under s. 588FG(2)(b)(i) of the Corporations Act the grounds for suspecting insolvency must be determined objectively to be "reasonable grounds", and under s. 588FG(2)(b)(ii) of the Corporations Act the test is a negative one, namely whether, objectively determined, a reasonable person in Mrs Cosgrove's circumstances had no grounds for suspecting insolvency". Additionally, the Court highlighted that in relying on this defence, "the onus is on the creditor to exclude other rational hypotheses as to the failure to pay debts as and when they fell due. if insolvency remains as one rational hypothesis, the onus has not been discharged".

The judgment sets out a number of objective facts which were known by Cosgrove, in the 12 month period leading up to the voidable transactions, relating to QLD Quarry's ability to meet its debts as and when they fell due. This includes, among other things, that Cosgrove: (i) issued a statutory demand to QLD Quarry in relation to unpaid debts, (ii) instigated court proceedings to recover debts from QLD Quarry, (iii) applied to be substituted as the applicant in a winding up application, (iv) argued in an interlocutory injunction application brought by QLD Quarry that any undertaking as to damages given by QLD Quarry would be worthless on the basis that it was likely insolvent, and (v) was aware that QLD Quarry owed money to a number of other creditors. Accordingly, the Court found that such factors supported a reasonable suspicion that QLD Quarry was actually insolvent at the time of the voidable transactions.

The Court rejected the finding in the first instance proceeding that there were factors which dispelled Cosgrove's suspicion of insolvency. In this respect, the Court found that there was no pattern involving Cosgrove's (or any other creditors') use of statutory demands or winding up applications that would water down the fact that she ultimately, and successfully, applied to wind up QLD Quarry on the grounds of insolvency.

The Court also rejected the discounting by the judge in the first instance proceeding of QLD Quarry's history of delayed payments in the 12 months leading up the voidable transactions. The Court found there was no pattern to the delay of payments, that the reasons for the delay varied, and that the delays increased as time went on.

In assessing Cosgrove's knowledge of insolvency, the judge in the first instance proceeding had given weight to the fact that from Cosgrove's perspective, the quarry operations appeared to be thriving. The Court identified a number of difficulties with this approach, namely that the volume of trucks coming and going (and the tonnages transported) from the QLD Quarry does not reflect that the operation was profitable. Additionally, it was found that at the same time as Cosgrove estimated the volume of trucks and tonnages, she was urging a finding by the court that an undertaking as to damages by QLD Quarry would be worthless on the basis of insolvency, and that this reflected an inconsistency in Cosgrove's position.

Finally, the Court determined that any belief that QLD Quarry was solvent following Cosgrove's termination of the contract in September 2014 could not be rationally held.

Taking all matters into account, the Court formed the view that in the period leading up to, and at the times of the payments of the Debt, the Costs and the Rental Arrears, there was nothing empirical to indicate that the business was thriving, let alone improving.

Accordingly, the Court found that insolvency remained a rational hypothesis as to QLD Quarry's inability to meet its debts as and when they fell due, and so the defence in s. 588FG of the Corporations Act was not able to be relied on, rendering the Debt, the Costs and the Rental Arrears voidable transactions.

6.6 Accessing proxy documents before a shareholder meeting

(By Lachlan Sievert, Herbert Smith Freehills)

Sun Hung Kai Investment Services Limited v Metals X Limited [2019] FCA 1673 (10 October 2019) Federal Court of Australia, Colvin J

(a) Summary

Sun Hung Kai Investment Services Limited (SHKIS) and Metals X Limited (MXL) sought orders by consent to grant SHKIS (as a shareholder of MXL) and its lawyers, access to inspect and make copies of proxy forms submitted to MXL before a shareholder meeting. The application was made under s. 247A of the [Corporations Act 2001 No. 50 (Cth)] (the Corporations Act) and, failing that, under common law.

Colvin J held that proxy documents were unlikely to constitute documents of the company, and so questioned the jurisdiction under s. 247A of the Corporations Act to make the consent orders. In doing so, his Honour decided not to follow a previous decision, *Jervois Mining Limited, in the matter of Campbell v Jervois Mining Limited* [2009] FCA 316 (*Jervois*), which supported such jurisdiction, concluding that it was plainly wrong.

However, Colvin J held there was a common law power to make the orders, since there was a general interest of shareholders to have proxy documents properly scrutinised by the chair of the shareholder meeting, especially where MXL directors had accessed proxy information to solicit votes.

His Honour therefore granted the consent orders.

(b) Facts

SHKIS requisitioned a shareholder meeting of MXL, at which members were to vote on a resolution to appoint Mr Brett Smith as a director of MXL. MXL's board of directors recommended that shareholders vote against this resolution. Affidavit evidence argued MXL had appointed an external firm to poll or influence shareholders, and that it was collating proxy information for this purpose.

SHKIS then requested MXL to furnish it with certain proxy information for the meeting. This was also for the purpose of lobbying proxy holders and members of MXL to as to how to vote on the resolution.

When this request was rejected, SHKIS sought orders under s. 247A of the Corporations Act requiring MXL to provide it with the proxy information. Section 247A of the Corporations Act provides that a member of a company may apply to the Court to make an order authorising the applicant (or another person on its behalf) to inspect the books of the company, if the Court is satisfied the applicant is acting in good faith and for a proper purpose.

Shortly before the hearing, SHKIS and MXL applied for consent orders under s. 247A of the Corporations Act and, in the alternative, under common law.

(c) Decision

After reviewing the legislative history of s. 247A of the Corporations Act, Colvin J held that the provision evinced a legislative concern with access of company documents by a member, with such access motivated by concerns members may have about the affairs of the company.

The main question to be answered was whether proxy documents form part of the books of the company. Colvin J answered this question by considering the nature of the right to vote by proxy at a shareholder meeting and the character of proxy documents themselves.

(i) The character of proxy documents

Colvin J generally questioned the notion that proxy documents are documents of the company for several reasons:

- proxy documents are notifications to the company for the purposes of a meeting of company members, allowing an important right to be exercised by the member voting via proxy. Although the documents are normally delivered to the company before the meeting, this is for the purpose of the meeting, not for the conduct of the affairs of the company;
- it is the chair of the shareholder meeting, who may or may not be the chair of the board of company directors, that determines the validity of the proxies; and
- if the company dispatches proxy forms for the purposes of a shareholder meeting, it is merely performing a statutory requirement for the purposes of the meeting; this does not cause the forms to be company documents.

(ii) *Armstrong v Landmark Corporation Ltd*

Colvin J held that this analysis of the nature of proxy documents is reflected in the decision of Street J in *Armstrong v Landmark Corporation Ltd* [1967] 1 NSWR 13 (*Armstrong*). *Armstrong* involved an application by a shareholder and director of Landmark Corporation Ltd (Landmark) for an injunction requiring Landmark to provide him with all proxies lodged in respect of a Landmark shareholder meeting.

Street J relevantly held that each shareholder has a right to have the company's constituent documents faithfully observed in relation to the regulation of votes cast at shareholder meetings. As these are rights inherent in individual shareholders, it should be a company director's responsibility to investigate whether those rights are being acknowledged. In doing so, the director should have the power to inspect documents that may reveal whether the company is observing shareholder rights. This includes the right to inspect proxy instruments.

Colvin J considered this interest of the director in inspecting documents to be derivative; the director only has such an interest because of their role in protecting members' voting rights from any encroachment by the company. The company has no separate interest in controlling the provision of proxies.

(iii) *Jervois*

SKHIS relied on *Jervois* as authority to argue that proxy documents are company documents. In this case, although no question of whether proxies formed part of the books of the company was raised, Goldberg J held that it was correct not to argue that these documents *did not* form part of the company's books. Goldberg J also held that lobbying proxy holders was a proper purpose under s. 247A of the Corporations Act.

However, Colvin J chose not to follow this decision, concluding it was plainly wrong for five reasons:

- the Full Court of the Federal Court in *Caratti v Harris & Kirman as Joint Liquidators of GH1 Pty Ltd* [2019] FCAFC 124 subsequently determined that the books of the company do not include documents that are merely in the possession of the company;
- considering first principles, the company and its directors play a role in the proxy process that is significantly different to the role of members. The directors do not determine the validity of proxies, which ensure an important private right of members. A conflict of interest would exist if directors assumed a general role in the proxy process;
- the *Armstrong* decision is incongruent with the notion that proxy documents submitted to the company are company documents that a director may access as a matter of course;
- the view in *Jervois* was determined without detailed analysis and with a concession acknowledged by Goldberg J, and therefore lacks reasoning; and

- the view in *Jervois* had not been subsequently applied by any other court.

(iv) Common law basis for granting access to proxy documents

Despite not finding power to make consent orders under s. 247A of the Corporations Act, Colvin J still considered there to be such power under common law. His Honour held that the orders made in *Armstrong* were on the basis that shareholders have an interest in the proper scrutiny of proxies by the chair of the shareholder meeting, to ensure that proxy voting provisions are followed. Every shareholder also has an interest in other shareholders understanding "the effect of expressing a proxy in a particular form". Therefore, this forms the basis of a common law right.

This is especially the case where there was evidence that directors of MXL had accessed proxy information for the purposes of soliciting proxies. However, this may be different where officers are accessing such information for the purposes of undertaking an independent review of the proxies to assist the chair of the meeting in determining the validity of proxies.

While Colvin J expressed doubts as to whether directors are entitled to unrestricted access to proxy documents, his Honour reserved judgment on this point since no arguments on it were advanced.

6.7 Refusal to requisition a general meeting permitted and no oppression of the shareholders

(By John Saunders, Ashurst)

Pacific Dairies Ltd v Orican Pty Ltd & Ors [2019] VSC 647 (26 September 2019) Supreme Court of Victoria, Sifris J

(a) Summary

Pacific Dairies Limited (the Company) was struggling financially, and elected to issue shares and options to its directors (in payment of their directors' fees) and to issue shares to certain creditors, being certain directors of the Company and their associated entities and related parties (in satisfaction of debts owed), in each case in lieu of cash payments. Following the Company's delisting from the ASX, the Company unsuccessfully attempted to execute several investments to improve its prospects.

In response to the share and options issues and failed investments, a group of the Company's shareholders sought to remove the directors from office. As a result of the Company failing the "two strikes" test, the Company held a spill meeting on 1 February 2019. However, at this meeting the directors were re-elected by an overwhelming majority. Subsequently, the Company's shareholders called for a general meeting to consider a resolution to remove the directors. Instead of holding the general meeting, the Company applied to the Supreme Court (Court) to set aside the request. One of the shareholders also made claims that the directors' conduct amounted to oppressive conduct.

The two proceedings were heard together. The Court found in favour of the Company in both instances - confirming that the Company need not call a general meeting prior to its scheduled AGM, and that the directors' conduct did not amount to oppressive conduct.

(b) Facts

Two proceedings were heard together, both concerning the Company. The first proceeding (Meeting Proceeding) was an application by the Company to set aside a request by its shareholders to hold a general meeting. The second proceeding (Oppression Proceeding) was an application by one of the shareholders (who was also a former chief executive officer of the Company) - William Clarke (Clarke) - alleging oppressive conduct by the directors of the Company.

(i) Background

The Company was suspended from trading on the ASX on 17 May 2016, and was delisted on 20 May 2019 (though harboured an intention to re-list in the future).

During this period, the Company was struggling financially, for example:

- it had attempted to make a number of investments in the dairy industry between 2015 and 2019 and each had failed to eventuate;
- it had recorded losses that were significant as compared to its revenue; and
- the directors estimated that the company was only worth approximately $400,000 (though they maintained that by virtue of the potential investments noted above and related funding proposals, it should properly be valued at $4 million).

Between 2016 and 2019 the Company made a number of security issues, including shares and options to directors (in place of their directors' fees) and shares to discharge loans advanced to the Company by various third party creditors, being certain directors of the Company and their associated entities and related parties. Shares were also issued to parties unrelated to the directors. This approach was driven by the Company's insufficient cash resources, and advice that it was better to give equity than to increase its debts. In each case, the other shareholders at large were not offered an opportunity to participate in the issue of shares.

Motivated primarily by the share issues and the recent financial position of the Company, several attempts were made by groups of shareholders to remove the directors of the Company. After the rejection of the remuneration report on two occasions, a spill meeting was held in February 2019. However, at the spill meeting, the directors were re-elected by "an overwhelming majority", and those directors proposed by the group of shareholders were "overwhelmingly rejected".

(ii) Meeting Proceeding

In March 2019 (little more than one month after the spill meeting), a group of shareholders called for a meeting to be held to consider a resolution to remove the directors of the Company. In response, the Company commenced the Meeting Proceeding seeking to set aside the request.

Clarke submitted to the Court that a company is obliged to call a meeting when the requirements of s. 249D of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) are otherwise met. Clarke submitted that this puts the onus onto the Company to prove that the meeting requested by the Company's shareholders was improper.

The Company submitted to the Court that the meeting was not required in the circumstances, given the looming AGM in November and the recent spill meeting. It also submitted that calling the meeting was an abuse of process and entirely improper.

(iii) Oppression Proceeding

Motivated by the Company's failed financial investments, selective share issues and (what he perceived to be) high directors' fees, Clarke commenced the Oppression Proceeding seeking orders from the Court for, among other things, the removal of the directors of the Company and setting aside the issues of the shares to the directors.

Clarke submitted to the Court that since its suspension from the ASX, the Company had failed to achieve any of its stated goals, and that instead it had paid exorbitant directors' fees and made selective security issues that were unfair and oppressive in the circumstances.

The Company submitted to the Court that the conduct in question did not constitute oppression for the purposes of the Corporations Act.

(c) Decision

(i) Meeting Proceeding

With regard to the Meeting Proceeding, it was noted that courts have historically been reluctant to interfere with a member's right to call a meeting, setting a high bar for a company to meet in making such an application. In particular, the Court noted that it has been held previously that a resolution addressing the composition of a company's board is for a proper purpose.

The Court found in favour of the Company. Given the pending AGM (to be held on 28 November 2019), the Court opined that there was no need to call a meeting under s. 249D of the Corporations Act.

(ii) Oppression Proceeding

With regard to the Oppression Proceeding, the Court acknowledged some concerns as to the management and commercial decisions made by the Company, but did not consider any of the circumstances sufficient to enliven the oppression provision, noting:

"Inadequate and poor stewardship, management and decisions by directors and any consequent dissatisfaction by shareholders does not of itself necessarily give rise to oppressive conduct".

Specifically, in the Court's view, none of the following matters amounted to unfairness or discrimination against the Company's shareholders, nor constituted conduct contrary to the interests of the shareholders as a whole:

- the share and option issues made to particular individuals and entities at various times;
- the failure to call a meeting as requested by certain shareholders (as addressed in the Meeting Proceeding);
- the directors' unsuccessful efforts in the preceding four and a half years to raise funds, without any underlying business or financial resources;
- the failure to keep various potential investments on foot where the Company did not have the funds to settle the transactions; and
- the employment of a director's son in the business.

As a result, on none of the matters advanced did the Court consider that the oppression provisions in the Corporations Act would be enlivened.

6.8 Judicial considerations in the appointment of provisional liquidators

(By Thomas Cleeve, King & Wood Mallesons)

Australian Securities and Investments Commission v Merlin Diamonds Limited [2019] FCA 1546 (20 September 2019) Federal Court of Australia, O'Bryan J

(a) Summary

This decision involved an interlocutory application brought by ASIC to appoint a provisional liquidator to Merlin Diamonds Limited (Merlin), an ASX listed company. The interlocutory application was a preliminary step taken by ASIC in its application to wind up Merlin. O'Bryan J found for ASIC and ordered that provisional liquidators be appointed on the basis that his Honour was satisfied that there was a reasonable prospect that the winding up order would be made and that there was a sufficient reason for the intervention.

(b) Facts

ASIC brought the application to wind up Merlin because it considered that there was a justifiable lack of confidence in the directors' ability to manage Merlin's affairs in the best interests of its shareholders and creditors. The basis of this lack of confidence was the allegation that the directors were knowingly involved in uncommercial related party transactions or failed to exercise their duties to prevent those transactions from occurring, and that Merlin had contravened (and is still contravening) various provisions of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). The relevant transactions involved:

- a series of loans by Merlin to a related entity, Axis Consultants Pty Ltd (Axis), that were made without shareholder approval. In the relevant period, Joseph Gutnick, a director of Merlin, was a director of Axis; and
- a transaction in which Merlin used its own monies to fund the subscription by Chabad Properties Pty Ltd (Chabad), a related party of Merlin, of convertible notes issued by Merlin. Chabad is a trustee of Machon Cham College Fund. Joseph Gutnick and Stera Gutnick each hold one third of shares in Chabad and, until 15 May 2017, Mordechai Gutnick (a director of Merlin) held the remaining one third share (whereupon it was transferred to Zelman Gutnick).

As part of the winding up application, ASIC sought interlocutory orders from the Federal Court (the Court) appointing provisional liquidators. ASIC sought this appointment to ".identify, secure and preserve the assets of Merlin pending the final hearing and determination of ASIC's winding up application and to ensure, in the public interest, that an independent officer of the Court investigates Merlin's affairs and reports back to the Court"(at [6]).

(c) Decision

Section 472(2) of the Corporations Act is the source of the Court's power to appoint provisional liquidators. This section provides the Court with a broad discretion and does not "stipulate criteria governing the appointment of a provisional liquidator.[but] it must be exercised judicially by reference to considerations relevant to its exercise." (at [103]).

There are two relevant considerations (or thresholds) that have been developed by the courts to determine whether to exercise this power. First, the court must be satisfied that there is a reasonable prospect, or it is reasonably likely, that a winding up order will be made on the application. Second, the court must be satisfied that there is urgency and sufficient reason for intervention prior to the final hearing, including whether the appointment is needed in the public interest, or to protect the company's assets or to preserve the status quo in relation to the affairs of the company. O'Bryan J found that, on the facts of the case, both thresholds were met and made an order appointing a provisional liquidator.

(i) Reasonable prospect that a winding up order will be made

O'Bryan J was satisfied that there was a reasonable prospect that a winding up order will be made on the hearing of ASIC's application.

His Honour found that there was a strong *prima facie* case that Merlin contravened, or is still contravening, provisions of the Corporations Act. These contraventions were the failure to have a company secretary under s. 204A(2) of the Corporations Act, the failure to lodge a half yearly report under s. 320 of the Corporations Act, a potential contravention of s. 208 of the Corporations Act by failing to obtain the approval of shareholders in relation to the issue of convertible notes to Chabad (a related party of Merlin) and a potential contravention of s. 208 of the Corporations Act by failing to obtain the approval of shareholders in relation to the loan to Axis (a related party of Merlin).

His Honour considered that these contraventions created a justifiable lack of confidence in the conduct and management of Merlin's affairs and that, therefore, there was a reasonable prospect that a winding up order would be made. In particular, his Honour found that the Chabad and Axis transactions strongly suggest that the current directors of Merlin have applied company money for the benefit of entities related to Joseph Gutnick and Mordechai Gutnick, and that such transactions may constitute a breach of their directors' duties.

(ii) Sufficient reason for intervention

O'Bryan J considered that there were four reasons that supported the intervention of a provisional liquidator:

- the nature and extent of the potential contraventions were such that O'Bryan J considered that the affairs of Merlin had been conducted without due regard to legal obligations and to the interests of shareholders;
- there was a need for an examination of the books and accounts of Merlin by an independent party as, in O'Bryan J's view, there could be no confidence that the current board would undertake such an investigation (particularly given the board's relationship with Axis);
- there was a likelihood of insolvency. Merlin had a negative working capital balance, with ongoing costs and expenses, meaning that a provisional liquidator was required in the public interest; and
- the fact that the appointment of a provisional liquidator would be "an event of default" under a secured note deed (which was the instrument under which Chabad was issued its convertible notes) was not a reason not to appoint a provisional liquidator. This was because, as ASIC submitted, Merlin was already in default of its obligations under the secured note deed.

O'Bryan J further found that certain undertakings provided by Merlin and its directors were not sufficient to address these issues. The principal undertaking provided by Merlin and its directors was: "other than in the ordinary and proper course of business, to preserve the status quo of Merlin". His Honour found that this undertaking was insufficient because it was not clear what decisions and actions could be permitted under this undertaking and, more importantly, the preservation of the status quo (which would include the continued control of the current directors) was inappropriate "in light of the serious concerns that exist as to their disregard of their legal obligations." (at [143])

6.9 Not proven (but not necessarily an endorsement either)? APRA litigation against IOOF entities and officers unsuccessful

(By Kate Hilder, Mark Standen, MinterEllison)

Australian Prudential Regulation Authority v Kelaher [2019] FCA 1521 (20 September 2019) Federal Court of Australia, Jagot J

(a) Summary

The Federal Court (the Court) has dismissed the Australian Prudential Regulation Authority's (APRA's) case against certain APRA-regulated IOOF Holdings Limited (IOOF) entities and five individuals who were responsible persons of those entities for alleged breaches of the Superannuation Industry (Supervision) Act 1993 No. 78 (Cth) (the SIS Act) and prudential standards (including alleged breach of the trustee duty to exercise the requisite degree of care, skill and diligence; to act in the best interests of the beneficiaries of the superannuation funds; and to give priority to the interests of the beneficiaries in the event of a conflict of interest).

Jagot J found that "none of APRA's claims of contraventions of the SIS Act against the respondents are sustainable with the consequence that there is no foundation for the making of any disqualification orders and the further amended originating application should be dismissed".

(b) Facts

Broadly speaking, APRA alleged that two registrable superannuation entities (RSEs) within the IOOF Group of companies - IIML (trustee and licensee of various superannuation funds including IPS Super) and Questor (trustee and licensee of various superannuation funds including TPS Super) - and two of their directors, Mr Kelaher and Mr Venardos contravened their obligations under the SIS Act - ss. 52(2)(b) and 52A(2)(b) (due care, skill and diligence covenant); ss. 52(2)(c) and 52A(2)(c) (best interests covenant); ss. 52(2)(d) and 52A(2)(d) (conflicts covenant) and s. 55 (recovering loss or damage for contravention of covenant as well as prudential standards) - by failing to act in the best interests of superannuation members over the course of various incidents.

For context, both IIML and Questor were dual regulated entities meaning that in addition to being a trustee of one or more superannuation funds, they were also the responsible entity (RE) for one or more managed investment schemes. Both IIML and Questor invested the assets of superannuation funds of which they were trustees in the managed investment schemes of which they were REs. As REs, IIML and Questor also acquired and held interests in those schemes.

APRA alleged that Questor and IIML failed to maintain the structures, policies and procedures required to manage conflicts of interest in their superannuation business. More particularly, APRA argued that Questor and IIML contravened the SIS Act by "differentially" compensating superannuation beneficiaries and other superannuation investors for losses caused by Questor and IIML (or their service providers) "using their own [i.e. the members' own] reserve funds rather than the trustees' own funds or third party compensation".

APRA also alleged that in rejecting a proposed fund transfer - transferring the Optus employee default superannuation arrangements from IPS Super to an AMP fund by way of a successor fund transfer - Mr Kelaher did not take steps to consider whether it was in the best interests of the relevant superannuation beneficiaries.

Finally APRA alleged that Mr Kelaher, Mr Venardos and three responsible officers of the entities Chief Financial Officer David Coulter, General Manager - Legal, Risk and Compliance and Company Secretary Paul Vine, and General Counsel Gary Riordan had refused to properly acknowledge APRA's concerns since 2015 and failed to cause Questor and IIML to take the necessary actions to ensure ongoing compliance with their legal obligations.

APRA sought disqualification orders against the directors and against Mr Coulter, Mr Vine, Mr Riordan and a declaration that IIML and Questor (which at the material times were RSE Licensees owned by IOOF) breached the SIS Act.

(c) Decision

Jagot J found that APRA failed to prove that there had been any breach of any covenant.

She rejected APRA's case on the basis that "none of APRA's claims of contraventions of the SIS Act against the respondents are sustainable with the consequence that there is no foundation for the making of any disqualification orders and the further amended originating application should be dismissed".

(i) Why did APRA's case fail?

Jagot J commented that "it was for APRA to prove the primary facts on which its allegations of contraventions depended. The way in which it sought to do so was fundamentally inadequate". Some of the weaknesses identified by her Honour with respect to APRA's approach for the production and presentation of evidence (overall) include the following.

Over-reliance on IOOF documentation

Jagot J observed that "it was for APRA to prove its case of contraventions by such evidence as it saw fit. The fact that it has chosen to run a purely documentary case means that it must take the documents as it finds them - as documents brought into existence for specific purposes, mostly by authors whose qualifications and experience are unknown, using the benefit of hindsight, often expressed at a high level of generality, and assuming otherwise unproven knowledge of IOOF's systems, policies and procedures".

Insufficient detail about IOOF's actual systems and procedures to support the allegations

Jagot J also considered that a "systemic weakness in APRA's case is that it has asserted contravention of the covenants [under the SIS Act] and, in so doing, has alleged defaults and inadequacies in IOOF's systems, policies and procedures, without descending into the detail of proving the actual systems, policies and procedures in play in respect of the incidents in question".

More particularly, Jagot J found that "APRA has not realistically confronted the need for reliable evidence of the particular factual circumstances said to give rise to the breaches of the statutory covenants.There is an evidentiary vacuum when it comes to the existing systems and procedures making it impossible to perform the kind of analysis that would be required for APRA to make good its claims".

Use of minutes as evidence of breaches of the no conflicts covenant

APRA relied on the minutes of the meetings of the various boards all of which recorded no conflict of interest, to support its case of breaches of the no conflicts covenant. Jagot J rejected this approach on the basis that "the minutes of a meeting are not required to record everything that was said.The Courts have consistently recognised that while minutes of board meetings should record decisions and resolutions made by the board, minutes are not expected to be complete transcripts of words spoken at the meeting and nor do they need to record arguments for or against resolutions".

As such, she concluded that "the absence in the minutes of a detailed record of discussion or consideration about matters before the board does not support the conclusion that such discussion or consideration did not occur."

Reliance on APRA's own opinion

In addition, Jagot J was critical of APRA's reliance on its own expressions of opinion (either by communicating its views directly to the respondents or via policy publications) observing that "the fact that a particular person was aware of APRA's opinion is not relevant to the existence of any of the asserted contraventions".

The group's alleged "profit motive"

Jagot J found that to the extent that APRA's case was that conduct was "driven by the relevant companies saving expenditure on reimbursing beneficiaries for losses, the case theory is tenuous in the extreme".

Reliance on *res ipsa loquitur* is misplaced

Commenting overall on APRA's approach, her Honour said that APRA's "case consisted of identifying an apparent error by the trustee which may or may not have occasioned loss to the beneficiaries, asserting that the error gave rise to reasonably arguable causes of action against the trustee and IOOF Service Co, relying on IOOF documents as constituting admissions (including purported admissions as to legal conclusions), and then treating the mere fact of error and loss as a form of *res ipsa loquitur* sufficient to establish that the relevant respondents breached their statutory covenants".

"Without expressly saying so APRA's approach involved reliance on the doctrine of *res ipsa loquitur* when the one thing that is clear is that the facts of the incidents in question in this case by no means speak for themselves."

(ii) Extension of legal principle?

In addition to taking issue with the way in which APRA approached the task of proving the alleged contraventions, Jagot J also rejected APRA's characterisation of the scope of duties of trustees under the SIS Act.

"APRA has effectively cast the trustees in the role of insurer to the beneficiaries, which is contrary to principle. APRA has also sought to extend legal principle by applying the kind of requirements to which a trustee is subject in deciding whether or not a beneficiary is entitled to a payment out of the trust, a circumstance in which the trustee is bound to give proper consideration to the relevant information and if necessary obtain relevant information to fulfil its trust duty, to the day-to-day decisions which a trustee of a large fund must make in the administration of the trust. APRA has not explained why this extension of legal principle is warranted and.I am unpersuaded that it is warranted" she stated.

(iii) Care, skill and diligence covenant - discussion of the scope of the covenant

Jagot J commented that a "consistent theme of APRA's case is its attempts to draw an analogy between the kind of decision with which *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254 (*Finch v Telstra*) was concerned, and the kinds of decisions which the trustees were making in the present case". APRA argued that *Finch v Telstra* is authority for the principle (among other things) that knowingly excluding relevant information from consideration or failing to seek relevant information in order to resolve a conflict is a breach of a superannuation trustee's obligation to act in the best interests of members.

But, Jagot J observed that in effect APRA was seeking to extend "the principle applying it to decisions about entitlements to any and all matters potentially affecting the capital of the trust". She observed that "there must be a myriad of decisions taken every day by trustees of large superannuation funds which potentially affect the fund both materially and immaterially. The extension of the principle which APRA proposes appears onerous in the extreme and highly impractical".

Jagot J stated, "APRA's case, insofar as it relies on *Finch v Telstra* to suggest that the relevant respondents were making non-discretionary decisions and had to obtain information, such as independent legal advice, before they could make a decision is unpersuasive and not supported by authority. The core trustee duty of determining whether a beneficiary has an entitlement is not analogous to a decision as to whether or not a chose in action, such as the right to make a claim for loss, should or should not be pursued. The latter decision is more akin to an exercise of discretion because it involves a potentially wide range of relevant considerations and an evaluation of all of those considerations including the amount at stake, the prospects of success, the practical and legal issues which will be confronted, and the available alternatives (at the least). Accordingly, I do not accept a fundamental plank in APRA's case that the alleged existence of causes of action or reasonably arguable causes of action imposed on the trustee a duty to 'exhaust' consideration of the potential choses in action and to inquire and obtain further information if any such further information was necessary to enable that exhaustive consideration to be given".

In Jagot J's view "a decision which is taken to ensure and is objectively in the best interests of beneficiaries at the time it is made does not lose that character because, at that time, more information could have been obtained.It will frequently be the case that there is more than one course of action which may be regarded as being in the best interests of the beneficiaries. The test is objective and is to be applied prospectively, that is, from the position of the trustee at the time of the decision, without impermissible hindsight".

Further, she observed that "as far as I am aware, there is no authority that supports this proposition as some form of rigid principle which is to be applied irrespective of the circumstances of the particular case".

(iv) (Alleged) misuse of the reserves?

APRA argued that The Operational Risk Financial Requirement (ORFR) and the general reserve constituted "members' money" and therefore could not properly be used to compensate members for losses caused by other companies in the IOOF group or a third party.

More particularly, APRA argued that in deciding to use the ORFR the trustee and its directors were bound by ss. 52 and 52A of the SIS Act. As such, any decision to use the reserve "must be made in the best interests of beneficiaries and that cannot be the case where there are other sources of compensation available, outside of the trust fund, that are not being considered and pursued".

The ORFR is not "members' money"

In rejecting APRA's argument, Jagot J observed that "it is misconceived and a complete mischaracterisation to describe the ORFR as 'members' money'.it is money in a dedicated fund, held in accordance with the provisions of the SIS Act, for the express purpose of paying compensation to members for losses arising from operational risk, including risks arising from the trustee's conduct. Using that fund to compensate members in such circumstances does not involve compensating members with their own money in any relevant sense; rather, it is to use the fund for the very purpose for which it was created".

Likewise, Jagot J was unpersuaded that the "general reserve" could not be used for the purposes for which they were established and are maintained, including compensation of members.

Her Honour stated "APRA has sought to put a gloss on the use which may be made of the ORFR to the effect that it is available to reimburse members for losses but only when consideration of all other potential avenues for redress have been exhausted. Further, in oral submissions APRA said that any use of the ORFR or the general reserve to reimburse members could not be considered to be 'compensation' of the members for loss because they were being given their own money.The propriety of the use of the ORFR (and any reserve) is to be determined by the statutory scheme and the instruments and policies which regulate the use of the reserve. APRA's construct is not founded on anything in those documents and must be rejected. This undermines a large swathe of APRA's case, founded as it is on the impropriety of the respondents' conduct in proposing the use of or using the ORFR to reimburse members for certain losses".

(v) The duty of a trustee to get in trust property

Elsewhere in the judgment, her Honour expands on the duty of a trustee to "get in trust property". Her view is that "APRA has sought to graft onto the duty of a trustee to get in trust property the notion that this duty extends to pursuing to the point of 'exhaustion' every possible claim, regardless of its legal or practical complexity or its prospects of success. I agree with the first respondent that: The consequences of this error for APRA's closing submissions is profound. In many respects, the entire architecture of APRA's new case regarding the Pursuit, Sweep, CMT and Bendigo matters depends on the correctness of its assertion that pursuing choses in action is an incident of the trustee's duty to get in trust property. The rejection of the proposition leaves those cases without any clear basis in legal principle".

(vi) Reliance on management

APRA submitted that "it is no longer the law that directors can rely upon officers without verification", but Jagot J found that this "goes too far". "As the first respondent submitted there are many circumstances in which a director is entitled to rely on management provided that there are not circumstances from which the director knew or ought reasonably to have known that such reliance was misplaced" Jagot J stated. With respect specifically to directors' oversight of compensation plans, Jagot J rejected what she described as "APRA's attempt to label compensation plans as matters uniquely within the sphere of responsibility of directors".

(vii) No actual conflicts proven

APRA alleged that the conflicts of interest arising from IOOF Group's "conflicted" structure, were not managed in the particular circumstances, and these conflicts led to various breaches of statutory obligations.

More particularly, APRA alleged that the corporate and governance structures of the IOOF Group (as distinct from the structure of IOOF Group itself) gave rise to potential conflicts between: (a) the interests of beneficiaries and the obligations to beneficiaries of each of IIML and Questor in its capacity as trustee and licensee of the relevant superannuation entity; and (b) the interests of other entities in the IOOF Group, or of individuals within it, or the obligations of IIML, Questor and their responsible officers to other persons.

For example, APRA alleged that Mr Kelaher as managing director of IOOF Hold Co, Questor and IOOF service Co had a conflict between his duties to superannuation beneficiaries under s. 52A of the SIS Act and his duties to non-superannuation investors.

Jagot J found that APRA failed to establish that any actual conflict existed. "APRA's contentions about conflicts of interest remained at the level of theory. That is, as will become apparent, APRA has not established the necessary factual foundation to support the conclusion that any actual conflict of interest existed.Its case on the no conflicts covenant exists at a level of generality and theory which is inapt to make the case it apparently wants to make."

(viii) Exclusion of liability: IIML and Questor could not be exempted from liability for contraventions of the section 52 covenants

Though ultimately no breach of any covenant was proven, her Honour did consider the operation of the right of indemnity under the SIS Act.

APRA argued that despite their governing rules IIML and Questor could not be exempted from liability for contraventions of the section 52 covenants and could not indemnify themselves from the assets of the trusts in respect of liability for such contraventions.

In support of this, APRA contended that:

- s. 55 does not provide that it is a defence to liability to rely on an exemption or indemnity in a trust instrument;
- s. 55 cannot be modified or excluded by a trust instrument. If it were otherwise, s. 55 would not apply according to its terms as provided for in s. 7;
- the object in s. 3 reinforces this approach to the construction of s. 55;
- s. 56 preserves a trustee's general right of indemnity out of the trust assets for liabilities incurred in the proper performance of its duties or exercise of its powers;
- ss. 56(2) and 57(2) do not specify the universe of limitations on the provisions of a trust instrument; and
- the terms of the provisions, in the overall context of the SIS Act, mean that no provision of a trust instrument can purport to exclude or modify liability under s. 55(3).

The respondents contended that the governing rules of the trusts, in conformity with the SIS Act, excluded liability for the alleged contraventions of the section 52 covenants and enabled IIML and Questor to indemnify themselves from the assets of the trusts in respect of any such liability.

Jagot J found that though "resolution of this aspect of the dispute" is not straightforward, on balance, APRA's approach better reflects the provisions construed in the context of the SIS Act as a whole.

6.10 Application to set aside statutory demand

(By Olivia Newbold, DLA Piper)

Aromas Cafe Toowoomba Pty Ltd v Aromas Tea & Coffee Merchants Pty Ltd, in the matter of Aromas Cafe Toowoomba Pty Ltd [2019] FCA 1699 (16 October 2019) Federal Court of Australia, Reeves J

(a) Summary

Aromas Cafe Toowoomba Pty Ltd (the plaintiff), sought to have the statutory demand served on it by Aromas Tea & Coffee Merchants Pty Ltd (the defendant), set aside under s. 459G of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).

The statutory demand was served by the defendant following a dispute over the purported sale of a cafe business. The defendant sought recovery for debt allegedly incurred by the plaintiff for products ordered for use in the business. The defendant alleged that the plaintiff had complete control over the business and premises, and was liable to pay all costs associated with the business and premises. Conversely, the plaintiff submitted that it was not liable for the debt as it was not the legal entity in possession of the business and did not incur any of the liabilities of the business. In support of its arguments, the plaintiff submitted that neither of the contracts for the sale of the business (described below) which had previously been in negotiation were completed.

Reeves J held that while the plaintiff failed to establish the grounds in ss. 459H(1)(b) or 459J(1)(a) of the Corporations Act, it successfully established the grounds in ss. 459H(1)(a) and 459J(1)(b) of the Corporations Act and therefore the statutory demand should be set aside on those grounds.

This case is a useful reminder of the process for issuing statutory demands and how they can be set aside, including a good overview of the Graywinter principle.

(b) Facts

This case concerned the application to set aside the statutory demand issued by the defendant on 15 December 2018, whereby the plaintiff was alleged to have owed an amount of $122,956.47 for unpaid invoices relating to stock that was provided to the plaintiff by the defendant between February 2017 and August 2018. The plaintiff sought to have the statutory demand set aside under s. 459G of the Corporations Act which allows a company to apply to the court for an order setting aside a statutory demand served on the company, if the application is made within 21 days after the demand is served and otherwise complies with the Corporations Act including appropriate affidavit requirements.

The statutory demand was served following a protracted dispute about the sale of a cafe business. The dispute concerned whether the plaintiff "operated" the cafe business owned by a related party of the defendant prior to the completion of two contracts for sale of the cafe business (neither of which eventuated), such that it accepted responsibility to pay the operating costs of that business, including the costs of the products supplied by the defendant. The parties attempted to enter into contracts for the sale of the cafe business on two separate occasions, but written contracts were never executed. The parties then engaged in lengthy negotiations to try to resolve various matters in dispute.

(c) Decision

According to the plaintiff, three questions were posed by the application under s. 459G of the Corporations Act to set aside the statutory demand served on it by the defendant:

- is there a genuine dispute about the existence, or the amount, of the debt in terms of s. 459H(1)(a) of the Corporations Act?;
- if not, does the plaintiff have an offsetting debt in the terms of s. 459H(1)(b) of the Corporations Act?; and
- if not, is there a relevant defect in the statutory demand, or some other reason why the statutory demand should be set aside under s. 459J of the Corporations Act?

In considering the first question, Reeves J noted the summary provided in *Citation Resources Ltd (ACN 118 710 508) v IBT Holdings Pty Ltd (ACN 157 759 138)* (2016) 116 ACSR 274 as to what is required to establish a genuine dispute under s. 459H(1)(a) of the Corporations Act. The court in this case resolved that for there to be a genuine dispute, there must be a "plausible contention requiring investigation". In making this determination, the court is not required to determine the merits of, or resolve, the dispute. That case also drew a parallel with the "serious question to be tried" criteria applicable to interlocutory injunctions. The threshold relevant to setting aside a statutory demand is not high or demanding, however the claim must have some merit and be genuine.

Reeves J then went on to summarise the points in *Graywinter Properties Pty Ltd v Gas & Fuel Corporation Superannuation Fund* [1996] FCA 822 (*Graywinter*) and how those have been interpreted and applied over the past two decades.

Reeves J held that the contention of the defendant that there was no genuine dispute was rejected on various grounds including that the debt for the products supplied by the defendant to the cafe business was part of a broader dispute between the plaintiff and the two Aromas entities.

Furthermore, Reeves J observed that instead of both entities commencing the litigation threatened in the initial demand, the defendant alone issued the statutory demand. His Honour determined that in doing so, the defendant was essentially ignoring the broader dispute between the plaintiff and the Aromas entities and attempting to use the process in Part 5.4 of the Corporations Act to recover its alleged debt, as if it was free from the dispute. Reeves J did not view this course as consistent with the legislative purpose of the statutory demand process of Part 5.4 of the Corporations Act, which was described in *Createc Pty Ltd v Design Signs Pty Ltd* (2009) 71 ACSR 602 as "not to provide a means whereby those claiming a genuinely disputed debt can avoid the obligation of establishing their entitlement to that debt in a court of appropriate jurisdiction by placing commercial pressure on the party resisting payment".

His Honour was satisfied that the plaintiff raised a genuine dispute about the existence of the debt to which the statutory demand related in the terms of s. 459H(1)(a) of the Corporations Act. This conclusion, he held, was sufficient in itself to set aside the statutory demand.

While not necessary to do so, given that the plaintiff had established that there was a genuine dispute, Reeves J briefly turned his attention to the other questions (i.e. relating to offsetting debts, defects in the statutory demand and other reasons to set the statutory demand aside). When considering the question about offsetting debts Reeves J agreed with the defendant's contention that the offsetting claims sought by the plaintiff were against the related party of the defendant and not the defendant. His Honour held that the plaintiff had therefore failed to establish a valid offsetting claim against the defendant within the terms of s. 459H(1)(b) of the Corporations Act.

Reeves J rejected the plaintiff's claim in relation to the third question that the statutory demand was defective because it did not identify the "source of the legal obligation" upon which the debt was based and that the "substantial injustice" element was met (i.e. that where there is a defect in a statutory demand, substantive injustice will be caused unless the demand is set aside). His Honour was satisfied that the statutory demand complied with all of the prerequisites set out in s. 459E(2) of the Corporations Act and there was therefore no relevant defect in the statutory demand in this matter.

The plaintiff submitted that defects existing in the affidavit endorsing the statutory demand, constituted "some other reason" to have the statutory demand set aside under s. 459J(1)(b) of the Corporations Act. His Honour held that certain ambiguities and inaccuracies in the affidavit constituted fundamental defects in the affidavit, therefore constituting "some other reason" why the statutory demand should be set aside under s. 459J(1)(b) of the Corporations Act.

Reeves J held that the statutory demand should be set aside under s. 459H of the Corporations Act as there was a genuine dispute between the plaintiff and the defendant about the existence of the debt to which the demand related. Additionally, in further support of this conclusion, his Honour held that the ambiguities and inaccuracies in the affidavit supporting the statutory demand were sufficient to constitute "some other reason" why the demand should be set aside under s. 459J of the Corporations Act.