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Bulletin No. 253

Legislation Hotline

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1. Recent Corporate Law and Corporate Governance Developments

1.1 Passage of legislative amendments to enhance ASIC's capabilities

18 September 2018 - The Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018 (Cth) has successfully passed through Parliament. These amendments enhance the Australian Securities and Investments Commission's (ASIC's) capabilities, by providing it with greater operational flexibility and by making express provision for ASIC to consider competition in its decision-making processes.

According to the explanatory memorandum, the Bill amends the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) (the ASIC Act) to:

- require ASIC to consider the effects that the performance of its functions and the exercise of its powers will have on competition in the financial system; and
- allow ASIC to employ staff outside of the Public Service Act 1999 No. 147 (Cth) (the PSA Act).

The ASIC Act already requires ASIC to strive to improve the performance of the financial system in the interests of the efficiency and development of the economy and therefore implicitly requires ASIC to consider competition. However, an explicit reference to take competition issues into account would oblige ASIC to consciously consider how its actions may impact on competition in the financial system and will enable ASIC to favour one option over another due to its effects on competition.

The amendment of the ASIC Act to cease the requirement for ASIC staff to be engaged under the PSA Act will allow ASIC to more effectively recruit and retain staff in positions requiring specialist skills. It will bring ASIC into line with other financial regulators, the Australian Prudential Regulation Authority (APRA) and the Reserve Bank of Australia (the RBA), that are able to recruit outside of that Act.

1.2 Gender diversity momentum continues on ASX 200 boards

7 September 2018 - The boards of Australia's largest companies are drawing closer to achieving 30% female representation by the end of 2018.

The Australian Institute of Company Directors (the AICD) 30% by 2018: Gender diversity progress report found that women accounted for 28.5% of ASX 200 board positions. This is up from just 20.6% at the same time in 2015, when the AICD released its first quarterly gender diversity report.

Over the same period, the number of ASX 200 boards with no women dropped from 30 to just three.

Other key findings include:

- 83 of ASX200 companies have achieved the 30% female board members target;
- 90 of ASX200 companies only need one more female board member to achieve the 30% target;
- 15 of ASX200 companies have achieved the 30% female board members target; and
- the appointment rate of women to ASX 200 boards this year was 50%, up from 36% in 2017.

1.3 OECD report: Financial system risk is elevated and global standards are essential in managing cross-border infrastructure investment

3 September 2018 - A new Organisation for Economic Development (OECD) report, the OECD Business and Finance Outlook 2018, highlights a number of major risks having the potential to disrupt global economic growth. It notes that the gradual normalisation of monetary policy in an environment of growing debt will be a major test of whether the Basel III regulatory reforms have achieved their goal of ensuring safety and soundness in the financial system.

According to the report, although capital rules have been strengthened, the business models of systemically important banks have changed little since before the crisis of 2008. One gauge of interdependence, the notional value of over-the-counter derivatives, was USD 532 trillion in the second half of 2017, only slightly below its pre-crisis peak of USD 586 trillion in late 2007.

The report states the financial outlook will also be shaped by China's ability to manage risks relating to high indebtedness and leverage in its banking, shadow banking and wealth management industries. The extent of non-performing loans in China is obscured by the lack of information about which assets are sitting in off-balance sheet vehicles. These could disrupt growth beyond China if further changes to the structure of financial markets and institutions are not considered in major advanced and emerging economies, according to the report.

The risks to financial stability in China arising from elevated corporate indebtedness make it all the more important to ensure that China's Belt and Road Initiative (the BRI) results in economically viable projects. The Outlook recognises the important contribution that the BRI can make to filling the global infrastructure gap, but emphasises that all international infrastructure efforts should be mutually reinforcing and respect global standards. The report highlights that cross-border investment projects must be viable, cost effective and appropriately selected, regardless of the source of funding.

The report argues that the BRI will need to engage with other investing economies and institutions given its largely debt-funded nature and coverage of many countries with challenging business environments. It states that significant contributions from OECD countries will be critical in the BRI's success. This will require an increasing role for markets in resource allocation decisions. Property rights, competition, level playing fields and sound governance will need to be strengthened to make this possible.

Five areas that could benefit cross-border infrastructure investments from greater alignment with international standards stand out:

- the growing role of state-owned enterprises in the global economy calls for ways to ensure a level playing field that discourages subsidies and non-transparent processes and allows recipient countries to benefit from investments based on widely accepted practices of corporate governance;
- open and transparent arrangements for procurement, especially for large infrastructure investments, are needed;
- the heavy costs that bribery and corruption can impose must be avoided, both in the case of large infrastructure projects and elsewhere and, social and environmental costs need to be taken

into account by ensuring responsible business conduct that minimises disruption to local communities;
- governments need to conduct environmental impact assessments prior to implementing proposed projects for facilities and infrastructure; and
- open and transparent regimes for cross-border investment are needed to reduce costs and increase options regarding technology.

In all five areas, the OECD provides essential guidance for both the economies where the new infrastructure projects would be located, as well as for those countries where the financing, equipment and expertise may originate.

1.4 FTSE100 pay and director re-election spark renewed shareholder opposition at UK 2018 AGM season

29 August 2018 - New analysis of voting trends during the United Kingdom (UK) 2018 annual general meeting season shows that shareholder opposition rose by over a quarter in 2018, landing 120 companies on the Investment Association's Public Register (the Public Register) of shareholder votes.

The new data compiled by the Investment Association, the trade body that represents the UK's asset management industry, shows that 120 FTSE All-Share companies were added to the Public Register, which tracks significant shareholder dissent (over 20%), up to the end of July 2018, compared to 110 companies over the same period in 2017. In total, 237 individual resolutions were added to the Public Register in 2018, a jump of 25% from 2017. Significantly, in 2018, 29 repeat offenders appeared on the Public Register for the exact same resolution as last year (35 resolutions in total).

Opposition to individual director re-election was also a key theme this year, with the number of total resolutions more than doubling from 38 in 2017 to 80 in 2018. The rise was particularly stark in the FTSE 250, where oppositions more than doubled (106%) with 37 resolutions in 2018 compared to just 18 in 2017.

While executive pay declined overall as an issue in the FTSE All-Share, with the total number of remuneration resolutions dropping from 68 in 2017 to 61 in 2018, there was a sharp rise in objections to FTSE 100 pay this year. This year, 18 pay resolutions attracted over 20% shareholder dissent among FTSE 100 companies - double the number (9) in 2017. This resulted in the near doubling of FTSE 100 companies on the Public Register because of pay, up from eight in 2017 to 15 in 2018 (88%).

Among the 46 companies added to the Public Register in 2018 for director re-election, nearly half (43%) saw their chairperson face opposition of greater than 20%, pointing to a growing disquiet over individual accountability for the decisions made.

1.5 Four out of five executives surveyed by PwC report blockchain initiatives underway

27 August 2018 - The new research from PwC - Blockchain is here. What's your next move? - surveyed 600 executives in 15 countries and territories, on their development of blockchain and views on its potential.

As blockchain rewires business and commerce, the research provides one of the clearest signals yet of organisations' fear of being left behind as blockchain developments accelerate globally opening up opportunities including reduced cost, greater speed and more transparency and traceability.

A quarter of executives report a blockchain implementation pilot in progress (10%) or fully live (15%). Almost a third (32%) have projects in development and a fifth (20%) are in research mode.

The United States (29%), China (18%) and Australia (7%) are perceived as the most advanced countries currently in developing blockchain projects. However, within three to five years, respondents believe China will have overtaken the United States (30%), shifting the early centre of influence and activity from the United States and Europe.

The survey reflects the early dominance of financial services developments in blockchain with 46% identifying it as the leading sector currently and 41% in near term (3-5 years). Sectors identified by respondents with emerging potential within three to five years include energy and utilities (14%), healthcare (14%) and industrial manufacturing (12%).

Blockchain's biggest benefits will be developed and delivered through shared industry wide platforms. But the study notes that this will not happen without industry specific companies - including competitors - agreeing common standards and operating together.

Despite the technology's potential, respondents identified trust as one of the biggest blockers to blockchain's adoption:

- 45% identified it as blocker to blockchain adoption; and
- 48% believe that regulatory uncertainty is the biggest blocker.

Concern about trust amongst users is highest in Singapore (37%), United Arab Emirates (34%) and Hong Kong (35%), reflecting in part the dominance of financial services in blockchain development. Concern about regulatory uncertainty was highest in Germany (38%), Australia (37%) and the United Kingdom (32%).

One in three of those respondents who reported little or no involvement with blockchain cited the reason for a lack of progress as cost (31%), uncertainty over where to start (24%) and governance issues (14%).

The study identifies four key areas for focus in the development of internal or industry wide blockchain platforms:

- make the business case: organisations can start small, but need to set out clearly the purpose of the initiative so other participants can identify and align around it;
- build an ecosystem: Participants should come together from different companies in an industry to work on a common set of rules to govern blockchains. Of the 15% of survey respondents who already have live applications, 88% were either leaders or active members of a blockchain consortium;
- design deliberately around what users can see and do: Partners need rules and standards for access permissions. Involving risk professionals from the start - including legal, compliance, cybersecurity - will ensure blockchain frameworks that regulators and users can trust; and
- navigate regulatory uncertainty: The study warns that blockchain developers should watch but not wait as regulatory requirements will evolve over the coming years. It is vital to engage with regulators to help shape how the environment evolves.

1.6 Australian Charities and Not-for-profits Commission Legislative Review 2018

22 August 2018 - In December 2017, the government commissioned the Review of Australian Charities and Not-for-profits Commission (ACNC) legislation, chaired by Mr Patrick McClure AO, who was asked to inquire into, and make recommendations on appropriate reforms to ensure that the regulatory environment established by the Australian Charities and Not-for-profits Commission Act 2012 No. 168 (Cth) (the ACNC Act) and the Australian Charities and Not-for-profits Commission (Consequential and Transitional) Act 2012 No. 169 (Cth) (the ACNC(C&T) Act) continues to remain contemporary, that the legislation delivers on its policy objectives and that the legislation does not impair the work of the ACNC Commissioner (the Commissioner) to deliver against the objects of the ACNC Act.

The final report Strengthening for Purpose: Australian Charities and Not-for-profits Commission Legislative Review 2018 has four parts:

- objects, functions and powers;
- regulatory Framework;
- red tape reduction; and
- additional amendments.

Recommendations

1. The objects in the ACNC Act not be changed.
2. The ACNC Act be amended to include functions and duties that align with the objects.
3. The ACNC should continue to prioritise its education and research functions, including the use of behavioural insights and incentives.
4. The ACNC Act be amended to replace the term "responsible entity" with "responsible person".
5. The powers of the Commissioner to replace a responsible person be removed.
6. An Executive Committee comprising the Commissioner and the Assistant Commissioners be established to be responsible for the strategic direction and performance of the ACNC.
7. The ACNC Act be amended to give the Commissioner broader powers to delegate functions or powers to staff.
8. The Advisory Board be empowered to provide advice to the relevant Minister or the Commissioner on its own initiative and engage directly with the sector.
9. ACNC governance standard 3 be repealed and governance standard 5 amended, to remove the word "perceived" with a view to consistency with the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).
10. A registered entity be presumed to comply with the ACNC governance standards if it already complies with other comparable governance requirements.
11. The Corporations Act be amended to "turn on" the duties and other provisions previously "turned off'.
12. Registered entities be required to report based on size, determined on rolling three-year revenue, with thresholds of less than $1 million for a small entity, from $1 million to less than $5 million for a medium entity, and $5 million or more for a large entity.
13. Minimum reporting requirements for small registered entities be amended to allow in an annual information statement an option to provide a simplified balance sheet or a statement of resources.
14. Registered entities be required to disclose related party transactions.
15. Large registered entities be required to disclose the remuneration paid to responsible persons and senior executives on an aggregated basis.
16. If recommendations 12 and 13 are adopted, the necessity for the exemption from financial reporting for basic religious charities be reviewed, and if recommendations 5 and 10 are also adopted, all exemptions for basic religious charities be reviewed.
17. The Commissioner be given a discretion to disclose information about regulatory activities (including investigations) when it is necessary to protect public trust and confidence in the sector.
18. The Commissioner be authorised to collect the personal details of responsible persons involved in unlawful activity.

19. The ACNC be resourced to enable the Commissioner to enforce and develop the law where registered entities engage in disqualifying purposes (within the meaning of the Charities Act 2013 No. 100 (Cth)).
20. Test case funding be made available to develop the law in matters of public interest, including disqualifying purposes.
21. ACNC's regulatory approach to high-risk registered entities be further developed in partnership with the Australian Criminal Intelligence Commission (the ACIC), the Australian Transactions Reports and Analysis Centre (AUSTRAC) and other Commonwealth departments and agencies.
22. The ACNC be resourced to enhance its access to criminal intelligence databases, use of secondments and information sharing with the ACIC and other agencies.
23. The Australian Charities and Not-for-profit Commission Regulation 2013 No. 22 (Cth) be changed to disqualify a person from being a responsible person if they have a conviction for terrorism, terrorism financing, money laundering, fraud, importation or distribution of illicit drugs or a child sexual offence under Commonwealth, State or Territory law.
24. The ACNC Act be amended to provide that certain not-for-profits with annual revenue of $5 million or more must be registered under the ACNC Act to be exempt from income tax and access Commonwealth tax concessions.
25. The Australian Consumer Law be amended to clarify its application to charitable and not-for-profit fundraising and a mandatory code of conduct be developed.
26. The use of the Charity Passport by Commonwealth departments and agencies be mandated.
27. Responsibility for the incorporation and all aspects of the regulation of companies which are registered entities be transferred from ASIC to the ACNC, except for criminal offences.
28. A single national scheme for charities and not-for-profits be developed.
29. Review the interface between the ACNC Act and the Corporations Act and consider the additional amendments set out in Appendix B.
30. The ACNC Act and the ACNC(C&T) Act be consolidated and there be ongoing five year reviews.

1.7 APRA proposes changes to make the Australian ADI capital framework more transparent, comparable and flexible

14 August 2018 - APRA has sought industry feedback on potential approaches to adjust the capital framework for authorised deposit-taking institutions (ADIs) to make capital ratios more transparent, comparable and flexible.

The prospective approaches are outlined in Discussion Paper: Improving the transparency, comparability and flexibility of the ADI capital framework which has released for industry consultation.

The approaches would not change the amount of capital ADIs are required to hold beyond the unquestionably strong capital benchmarks announced in July 2017. Rather, APRA is considering whether to alter the way ADIs' capital requirements are calculated and disclosed to facilitate greater domestic and international comparability and transparency of ADI capital strength.

Though Australia's capital framework is largely based on internationally agreed minimum standards set by the Basel Committee on Banking Supervision, APRA takes a more conservative approach to the definition of "capital" and the calculation of risk-weighted assets in some areas. Consequently, Australian ADIs typically have lower reported capital ratios than overseas peers with comparable capital strength.

The discussion paper outlines two general approaches designed to aid ADIs in representing and communicating their capital strength:

- under one approach, ADIs would continue using existing definitions of capital and risk-weighted assets, but APRA would develop a methodology allowing them to improve the credibility and robustness of internationally comparable capital ratio disclosures; or
- under a second approach, APRA would change the way ADIs calculate capital ratios to instead use more internationally harmonised definitions of capital and risk-weighted assets.

To maintain the strength and risk-sensitivity of the capital framework, there would need to be corresponding increases in minimum ratio and/or capital buffer requirements.

APRA is open to considering these approaches independently or in combination, or indeed retaining its current methodology, and is seeking industry feedback on whether the benefits of the suggested approaches outweigh the regulatory burden and associated increase in complexity.

Separately, the discussion paper proposes measures to make the capital framework more flexible in times of stress, including by increasing the size of regulatory capital buffers relative to minimum regulatory capital requirements.

1.8 Report shines spotlight on diversity outside ASX200

16 August 2018 - A new report reveals women account for 15.8% of board roles in ASX 201-500 companies. There are signs that boards of newer companies and those chaired by individuals who also chair larger listed boards are leading the way towards greater gender diversity.

The Beyond 200: A Study of Gender Diversity in ASX 201-500 companies, released by the AICD and Heidrick & Struggles, is the first report of its kind examining the state of gender diversity on ASX 201-500 companies.

Key findings from the report include:

- female representation on boards greatly declines beyond the ASX 200, falling from 27.9% across the ASX 200 to 15.8% across ASX 201-500 companies;
- newer companies are more likely to have greater gender diversity - of the 83 companies that listed on the ASX in the past 5 years, 25.3% have 30% or more women on their boards;
- female representation rises to 22.9% on ASX 201-500 boards chaired by an ASX200 Chair;
- 16% of ASX 201-500 boards have achieved or surpassed the 30% target;
- 38% of ASX 201-500 boards have no women at all; and
- women account for 10.3% of board roles for ASX 201-500 companies in male-dominated industries, compared to 24.1% across the ASX 200.

In 2015, the AICD set a target for all boards to achieve gender diversity based on a strong body of evidence showing that diverse boards lead to better outcomes for shareholders and stakeholders alike. Research also shows 30% is where "critical mass" is reached in a group setting and the full benefits of diversity are realised.

1.9 Report: AI Creating Big Winners in Finance but Others Stand to Lose as Risks Emerge

15 August 2018 - Artificial intelligence (AI) is changing the finance industry, with some early big movers monetising their investments in back-office AI applications. But as this trend widens, new systemic and security risks may be introduced in the financial system. These are some of the findings of a new World

Economic Forum report, The New Physics of Financial Services: Understanding how artificial intelligence is transforming the financial ecosystem, prepared in collaboration with Deloitte.

The report points to Ping An's OneConnect and BlackRock's Aladdin platform as prime examples of the trend. In China, OneConnect sells AI-powered services ranging from credit adjudication to instantaneous insurance claims settlement to hundreds of small and mid-sized Chinese banks and is expected to fetch up to $3 billion at public sale. In the US, Aladdin provides sophisticated risk analytics and comprehensive portfolio management tools that leverage machine learning to a range of asset managers and insurers and is expected by BlackRock's Chief Executive Officer Larry Fink to provide 30% of the firm's revenue by 2022.

The report, which draws on interviews and workshops with hundreds of financial and technology experts, observes that the "size of the prize" driven through these as-a-service offerings and other applications of AI is much larger than that of the more narrow applications that drive efficiency through the automation of human effort.

The report predicts that AI will also accelerate the "race to the bottom" for many products, as price becomes highly comparable via aggregation services and third-party services commoditise back office excellence.

As such, financial institutions are seeking to build new sources of differentiation on the back of AI, such as on-the-fly product customisation and free advisory services built into products.

For example:

- Canadian lender RBC is providing its automotive dealership clients with sophisticated demand-forecasting tools that complement the existing credit products it provides to these firms; and
- IEX, a young New York-based stock exchange, is exploring the use of machine learning in creating new order types that protect trades from execution during unstable, potentially adverse conditions.

The net result for customers will be "self-driving finance", a customer experience where an individual's or firm's finances are effectively running themselves, engaging the client only to act as a trusted adviser on decisions of importance.

But the expanding presence of AI in finance does not come without tensions and risks. First, financial institutions will be drawn closer to big tech since cloud computing is central to most AI strategies. But there is a chance that most of the benefits will escape them. Second, the report warns that AI will raise new challenges for the financial ecosystem, particularly around regulation. The divergent path being taken by regulators around the world towards customer data could create a new form a regulatory arbitrage. Finally, the report points to systemic and security risks from creating a more networked finance system, where a few AI databases contain most clients' information.

1.10 Banking Royal Commission publishes background papers on insurance

August 2018 - The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry has published four new background papers on insurance:

- Background Paper 26: Some features of the general and life insurance industries;
- Background Paper 27: Reforms to general and life insurance;
- Background Paper 28: Group life insurance; and

- Background Paper 29: Life insurance.

2. Recent ASIC Developments

2.1 ASIC reports on review of ASX Group's technology governance and operational risk management standards

12 September 2018 - ASIC has released a report on the recent review of the Australian Securities Exchange Limited (ASX) Group's technology governance and operational risk management arrangements.

ASX Group's arrangements for managing operational and technological risk have historically served the Australian market well. Report 592: Review of ASX Group's technology governance and operational risk management standards acknowledges this and sets out identified areas for improvement and recommendations for ASX Group to address these.

The review was conducted with the help of KPMG, and the RBA also worked closely with ASIC. The review benchmarked ASX Group's technology governance and operational risk management arrangements against internationally recognised standards. It found ASX Group's practices were more comparable to those of other global exchanges but lagged behind the better practices in the broader financial services sector.

ASX Group recognises the areas for improvement identified in the review. It is undertaking an extensive work program to implement all of the recommendations and already had improvements in progress in almost half of the identified areas before the review started or before the recommendations were finalised.

ASX Group anticipates a significant component of the action items in this work program will be completed by the end of 2018 and expects all of the recommendations from the review to be fully implemented and embedded within three years.

The program of work that ASX Group is undertaking is being closely supervised by ASIC and the RBA.

Many of the findings and recommendations from this review will be relevant to other financial services sector organisations regulated by ASIC. ASIC encourages the boards and senior management of these other organisations to critically review their own technology governance and operational risk controls and to evaluate this report's findings and recommendations in the context of their own business.

2.2 ASIC approves Australian Financial Complaints Authority rules

12 September 2018 - ASIC has approved the Australian Financial Complaints Authority (the AFCA) Complaint Resolution Scheme Rules and the Terms of Reference of the AFCA Independent Assessor (IA).

ASIC is required to approve material changes to the AFCA scheme under the Corporations Act 2001 No. 50 (Cth). This is a key part of ASIC's role in overseeing the operation of the new scheme.

It is a statutory requirement that financial firms, including most credit representatives, that deal with retail clients must join the AFCA scheme by 21 September 2018.

Almost all Financial Ombudsman Scheme members have effectively transferred their membership to AFCA. About 80% of members of the Credit and Investments Ombudsman Scheme and about 64% of superannuation trustees and retirement savings accounts providers have also joined.

Applying for membership can be done online.

AFCA is providing regular membership updates to ASIC so that ASIC can monitor financial firm compliance with the statutory membership deadline.

2.3 ASIC's Corporate Plan 2018-2022

7 September 2018 - In ASIC's Corporate Plan 2018-22 ASIC publishes its updated vision, mission and strategic plan.

ASIC's mission is to use all regulatory tools to:

- change behaviour to drive good consumer and investor outcomes;
- act against misconduct to maintain trust and integrity in the financial system;
- promote strong and innovative development of the financial system; and
- help Australians to be in control of their financial lives.

The Corporate Plan outlines the following:

- ASIC's strategic planning framework, including the new "threat, harm and behaviour" framework to better identify and prioritise action against actual and potential harms to consumers and investors - some of the biggest threats come out of poor culture and professionalism, poor governance and incentives and practices that target financially vulnerable consumers;
- the environmental trends and the challenges ASIC faces;
- core focus areas, likely to cause the most significant harms to consumers and investors;
- specific regulatory actions ASIC will take this financial year and over the medium term;
- how ASIC will strengthen its capabilities as an organisation committed to upholding values of accountability, professionalism and teamwork; and
- how ASIC will measure and evaluate its performance.

2.4 ASIC updates guidance for trustees of wholesale equity schemes

4 September 2018 - ASIC has released RG 192 Licensing: Wholesale equity schemes following public consultation.

The updates to the guidance reflect:

- the changes made to the relief provided in the ASIC Corporations (Wholesale Equity Scheme Trustees) Instrument 2017/849 to trustees of wholesale equity schemes that are operated by a manager holding an Australian financial services (AFS) licence; and
- the amendments made to the financial requirements that may apply to these managers in the ASIC Corporations (Amendment and Repeal) Instrument 2017/848.

Background:

To remove impediments in the venture capital and private equity industry, ASIC has, since 2007, given trustees of wholesale equity schemes relief from the requirement to hold an AFS licence to provide certain financial services in connection with the wholesale equity scheme.

A "wholesale equity scheme" is essentially an unregistered managed investment scheme operated by a manager that holds an AFS licence. Wholesale equity schemes primarily invest in securities of unlisted companies and all members must be wholesale clients. Wholesale equity schemes are usually structured by the manager using a multiple unit trust structure with separate corporate trustees that are related bodies corporate of the manager.

In September 2017, following public consultation on proposals set out in Consultation Paper 280: ASIC class order on wholesale equity schemes: Licensing relief for trustees-[CO 07/74], ASIC issued ASIC Corporations (Wholesale Equity Scheme Trustees) Instrument 2017/849, which updated the relief to take into account a strengthening of financial and custody requirements in 2013, outlined in ASIC Class Orders CO 13/760, CO 13/761 and CO 13/1410.

ASIC also issued ASIC Corporations (Amendment and Repeal) Instrument 2017/848 to amend ASIC Class Orders CO 13/760 and CO 13/761 as they apply to managers of wholesale equity schemes to make these consistent with the requirements in the new instrument.

2.5 ASIC reports on corporate finance regulation - January to June 2018

31 August 2018 - ASIC has published its ninth report on the regulation of corporate finance issues over January to June 2018 and provided an update on specific focus areas for the next six months.

Report 589: ASIC regulation of corporate finance: January to June 2018 provides statistical data and includes relevant guidance about ASIC's regulation of:

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

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

The report also provides some practical guidance on electronic lodgement of corporate finance documents and the new fee for service regime.

2.6 ASIC's review of direct life insurance finds high cancellation rates and poor claims outcomes

30 August 2018 - ASIC's review of direct life insurance sales has found that sales practices and product design are leading to poor consumer outcomes. ASIC's Report 587: The sale of direct life insurance reveals that consumers are cancelling their policies in very high numbers, specifically:

- one in five of all policies taken out were cancelled in the cooling off period;
- one in four of all policies that remained in force beyond the cooling off period were cancelled within 12 months;

- three in five of all policies sold were cancelled within three years; and
- life insurance sold direct compares poorly with other channels when it comes to claims: 15% of claims are declined, with 27% of claims withdrawn.

ASIC has also released Report 588: Consumers' experiences with the sale of direct life insurance, consumer research conducted as part of this review, which found consumers struggle with the direct life insurance sales experience and the complexity of the products, and consumer understanding of key features is often poor.

ASIC listened to more than 540 recorded sales calls and identified a failure by all firms to provide adequate information about important aspects of the cover, including key exclusions and future premium increases.

Four firms were also found to engage in pressure selling techniques, including refusing to send out paperwork unless a consumer committed to buy.

More than half the firms had incentive schemes which encourage sales staff to prioritise closing a sale ahead of the needs of the customer, including bonus payments heavily focused on value or volume of sales.

Sales of accidental death insurance were particularly problematic, including where consumers were "downgraded" to accidental death insurance after being rejected for comprehensive life insurance. Accidental death insurance only covers death due to some types accidents, and offers little value to consumers, with a claims ratio of only 16.1% over the 2015-2017 financial years.

Unless firms can demonstrate that accidental death insurance can meet consumer needs, ASIC expects firms to stop selling this product.

ASIC is calling on industry to respond to these findings by committing to higher enforceable standards that improve customer outcomes.

ASIC also identified certain business practices, including scripts, training, quality assurance and incentives, which contribute to poor consumer outcomes.

See: Improving the sale of direct life insurance.

2.7 ASIC publishes a review of reverse mortgage lending

28 August 2018 - A review by ASIC has found that reverse mortgages are allowing older Australians to achieve their immediate financial goals - improving their lifestyles in retirement - but longer-term challenges exist.

For older Australians who own their home with few other assets, a reverse mortgage can allow them to draw on the wealth locked up in their homes, while they continue to live in their property.

ASIC reviewed data on 17,000 reverse mortgages, 111 consumer loan files, lender policies, procedures, and complaints. ASIC also commissioned in-depth interviews with 30 borrowers and consulted over 30 industry and consumer stakeholders.

The review found borrowers had a poor understanding of the risks and future costs of their loan, and generally failed to consider how their loan could impact their ability to afford their possible future needs.

Lenders have a clear role to play here and need to do more. For nearly all of the loan files reviewed, the borrower's long term needs or financial objectives were not adequately documented.

Importantly, under legal protections in place since 2012, borrowers can never owe the bank more than the value of their property, and can remain in their home until they pass away or decide to move out. However, depending on when a borrower obtains their loan, how much they borrow, and economic conditions (property prices and interest rates), they may not have enough equity remaining in the home for longer term needs (e.g. aged care).

ASIC's report also finds that there is an opportunity for lenders to reduce the risk of elder abuse. Under the new Code of Banking Practice, recently approved by ASIC, banks will be required to take extra care with customers who may be vulnerable, including those who are experiencing elder abuse.

Consumers also had limited choices for finding a reverse mortgage. Several providers withdrew from the market after the global financial crisis. From 2013 to 2017, two credit licensees provided 80% of the dollar value of new loans from 2013 to 2017.

See: Report 586: Review of reverse mortgage lending in Australia and ASIC found that reverse mortgages helped people stay in their home, but there can be long term risks.

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3. Recent ASX Developments

3.1 Response to consultation - removal of registered holder collateral cover authorisation form

On 7 September, ASX released its response to consultation on proposed amendments to the ASX Clear Operating Rules and the ASX Settlement Operating Rules to:

- support the removal of the Registered Holder Collateral Cover Authorisation form for client accounts; and
- enable a third party to take a security interest over collateral and excess cash where prescribed conditions are met.

This response to the consultation summarises feedback received from stakeholders on ASX's April consultation and ASX's response to that feedback. The rule amendments have received regulatory clearance and will be effective 1 March 2019.

See: ASX Clear: Removal of Registered Holder Collateral Cover Authorisation Form.

3.2 Response to consultation - CHESS replacement

On 4 September 2018, ASX released its response to consultation on the replacement of CHESS. The response to the consultation provides a summary of the feedback received and the specific changes ASX will be making as a result. This includes feedback on:

- the new and enhanced business functionality of the replacement system;
- redundant services that would be decommissioned;
- the draft implementation plan; and

- the associated testing and transition arrangements.

See: CHESS Replacement: New Scope and Implementation Plan.

3.3 Monthly activity report

On 5 September 2018, ASX released the ASX Monthly Activity Report - August 2018.

4. Recent Takeovers Panel Developments

4.1 Tribune Resources Limited - Declaration of unacceptable circumstances

17 September 2018 - The Takeovers Panel (the Panel) has made a declaration of unacceptable circumstances in relation to an application dated 20 August 2018 by R Hedley Pty Ltd in relation to affairs of Tribune Resources Limited (Tribune) (see TP18/61).

Sierra Gold Ltd (Sierra), Trans Global Capital Limited (Trans Global) and Rand Mining Limited (Rand) are the three largest shareholders of Tribune, holding 16.04%, 16.91% and 26.32% of Tribune shares respectively.

The Panel considered that:

- the market has not been informed, and continues not to be informed, of persons who have a relevant interest in Tribune shares held by Sierra, Trans Global and Rand;
- tracing notice responses by Sierra, Sierra Gold Pty Ltd (SGPL), Trans Global and Rand contain material that, in the submissions made by those parties to the Panel, was and is false; and
- if material provided to the Panel in the submissions by Tribune, Sierra, SGPL, Trans Global and Rand is accurate, there have been numerous contraventions of the substantial holding provisions in relation to Tribune shares.

The Panel was concerned that there may be contravention of the takeovers prohibition in s. 606 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), but did not reach any conclusions noting that:

- R Hedley Pty Ltd had reserved the right to make a further application in relation to any breach of s. 606 of the Corporations Act; and
- further historical material would be required to allow the Panel to reach conclusions on that issue.

The Panel is considering what final orders it will make and will publish details in due course.

On 28 August 2018, the Panel made interim orders (see TP18/62) prohibiting Sierra, Trans Global, Rand, Nimby WA Pty Ltd, Mr Anthony Billis, Lake Grace Exploration Pty Ltd, Northwest Capital Pty Ltd and Ms Phanatchakorn Wichaikul from disposing, transferring, charging or otherwise dealing with their shares in Tribune (in the absence of the consent of a member of the Panel). The interim orders were made to preserve the status quo while the Panel considered the matter. The interim orders remain in effect.

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

4.2 Tikforce Limited - Panel declines to conduct proceedings

29 August 2018 - The Panel has declined to conduct proceedings on an application dated 14 August 2018 from EZR Systems Pty Ltd, Valplan Pty Ltd as trustee for the Troy R Valentine Fam S/F Account, Alignment Capital Pty Ltd, Cityside Investments Pty Ltd and Union Square Capital Pty Ltd on behalf of the Endeavour A/C in relation to the affairs of Tikforce Limited (Tikforce).

The application concerned the issue of shares and options of Tikforce in connection with the conversion of convertible notes including the disclosure in relation to the resolution to approve the issue of shares and options for the purposes of ASX Listing Rule 7.1 and for all other purposes at a general meeting of Tikforce (see TP18/59).

On 17 August 2018, ASX issued a letter to Tikforce that included directions in relation to the general meeting. In response, Tikforce withdrew all the listing rule resolutions from the general meeting held on 20 August 2018 and announced that, in consultation with the ASX, it intends to issue a new notice of meeting which will include additional disclosure as requested by the ASX.

The Panel considered, as a result of the actions of the ASX and response by Tikforce, that the circumstances which the applicants submitted were unacceptable had been addressed. The applicants also submitted that there was no need for the application to proceed further.

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 Takeovers Panel website.

5. Recent Research Papers

5.1 Expert directors

Corporate boards of directors mediate the agency costs between the corporation's managers and shareholders. For boards to do this well, they must include the right people. At present, most believe that the best kind of director is an independent director. Indeed, it is important that boards have independent directors to deal with clear conflicts between managers' self-interest and corporate interests, a prime example is having independent directors set the CEO's salary. Independence, though, is not the only quality of a good director and boards often face significant problems that independence alone does not solve. The heavy focus on board independence has obscured another important director attribute: expertise.

This article approaches the questions of when and why corporations might appoint expert directors. It argues expert directors can improve business performance, and perhaps avoid legal or regulatory liability, for problems consisting of at least two criteria. First, the corporation faces risks that are difficult to quantify or measure, but may also result in catastrophic losses. Second, the board's general business skills and experience are insufficient to discern whether the managers' course of action is reasonable in light of that risk. It illustrates these criteria in the past case of Sarbanes-Oxley's "audit committee financial expert," a rare circumstance where the law has affirmatively approved the appointment of expert directors. It then analyses the possibility that corporations might soon add cybersecurity experts to their boards.

Expert Directors

5.2 The new hedge fund activism: Activist directors and the market for corporate quasi-control

Activist hedge funds increasingly seek and secure board representation in public companies. Representation on target boards may signal a longer-term commitment to target companies that can mitigate some of the typical criticisms of traditional hedge fund activism, such as short-termism. Hedge funds may hold shares for longer periods when they obtain board seats and often become heavily involved in corporate strategy and operations. This article argues that the phenomenon of activist board representation has created an active market for corporate quasi-control, defined as power that is greater than influence but that falls short of actual corporate control. It also discusses recent innovations in activist tactics which can promote the market for corporate quasi-control such as "wolf pack activism", where more than one hedge fund descends upon a company, and "golden leash" compensation structures, which incentivise activist appointed directors to increase the share price of target companies.

The New Hedge Fund Activism: Activist Directors and the Market for Corporate Quasi-Control

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5.3 Making sustainability disclosure sustainable

Sustainability is receiving increasing attention from issuers, investors and regulators. The desire to understand issuer sustainability practices and their relationship to economic performance has resulted in a proliferation of sustainability disclosure regimes and standards. The range of approaches to disclosure, however, limit the comparability and reliability of the information disclosed. The Securities & Exchange Commission (the SEC) has solicited comment on whether to require expanded sustainability disclosures in an issuer's periodic financial reporting, and investors have communicated broad-based support for such expanded disclosures, but, to date, the SEC has not required general sustainability disclosure.

This article argues that claims about the relationship between issuer sustainability practices and risk management, business plan and economic vulnerability, as well as the need for investors and regulators to evaluate those claims, warrant incorporating sustainability information into SEC-mandated financial reporting. Drawing upon the existing narrative disclosure frameworks in SEC-mandated reporting requirements, the article offers an innovative proposal for sustainability disclosure - a sustainability discussion and analysis section of the annual report. The article identifies critical components necessary to make mandated sustainability disclosure both practical and effective and offers a workable first step for integrating sustainability disclosure into issuer financial reporting.

Making Sustainability Disclosure Sustainable

5.4 Illegal phoenix activity: Practical ways to improve the recovery of tax

Illegal phoenix activity generally involves closing one debt-laden company and continuing its business through another company minus those debts. Its propensity to cause losses of federal revenue has recently been highlighted by the Australian Government Treasury announcement of a suite of measures to combat it. However, there is already an extensive array of legislative and administrative tools that are available against illegal phoenixing. This article considers both the existing and proposed measures and makes some practical suggestions to improve the recovery of tax. However, solutions are not found exclusively in tax law and its administration. Since illegal phoenix activity is facilitated by the creation and demise of companies and their controllers are regulated by the Corporations Act 2001 No. 50 (Cth), suggestions are made regarding corporate law and its administration by ASIC.

Illegal Phoenix Activity: Practical Ways to Improve the Recovery of Tax

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5.5 Corporate governance reform in post-crisis financial firms: Two fundamental tensions

The manner in which financial firms are governed directly impacts the stability and sustainability of both the financial sector and the "real" economy, as the financial crisis and associated regulatory reform efforts have tragically demonstrated. However, two fundamental tensions continue to complicate efforts to reform corporate governance in post-crisis financial firms. The first relates to reliance on increased equity capital as a buffer against shocks and a means of limiting leverage. The tension here arises from the fact that no corporate constituency desires risk more than equity does, and that risk preference only tends to be stronger in banks, and in financial distress, which places a premium on evaluating who these capital providers are, and what their risk incentives look like.

The second tension relates to reliance on increased board independence as a buffer between the risk management function and senior corporate management. The tension here arises from the fact that a growing empirical literature increasingly associates board independence with increased risk-taking and worse performance in the wake of the crisis, in addition to the more general concern that independent directors may lack industry-relevant expertise. This once again places a premium on evaluating who these outside voices in the boardroom are, and what capacities they bring to the table in the financial context. This essay explores these tensions in the context of financial firm governance and assesses the intellectual groundwork that remains to be done as a preliminary to identifying a coherent way forward.

Corporate Governance Reform in Post-Crisis Financial Firms: Two Fundamental Tensions

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5.6 Prosecuting corporate crime when firms are too big to jail: Investigation, deterrence, and judicial review

Some corporations have become so large or so systemically important that when they violate the law, the government cannot credibly threaten them with "efficient" criminal sanctions. By extending a standard microeconomic model of corporate liability, this paper shows how this "Too Big To Jail problem" reduces prosecutors' ability to deter corporate crime just by fining a defendant corporation without any accompanying prosecution of culpable individuals. Further, the paper shows how corporate criminal liability alone cannot incentivise a Too Big To Jail firm to invest in internal controls or cooperate with government investigations. In the presence of Too Big To Jail firms, prosecutors must adopt a strategy that credibly threatens culpable managers with non-monetary penalties and that eschews excessive reliance on corporate defendants' cooperation.

The paper also advances a structural explanation for the relative dearth of individual prosecutions relative to negotiated criminal settlements with Too Big To Jail companies. Prosecutors rely on an institutional apparatus for investigation that can produce the information necessary for corporate settlements but will not reliably produce the kind of information necessary to bring charges against culpable individuals. In response, the paper proposes to enlist the courts as a bulwark against the tacit collusion in which prosecutors can agree to a large corporate settlement without insisting on an investigation that can produce a coherent theory of the underlying individual responsibility. Thus, a legislative reform is presented which would authorise judicial review of federal Deferred Prosecution Agreements to ensure that prosecutors have collected sufficient evidence prior to entering corporate settlements.

Prosecuting Corporate Crime When Firms Are Too Big to Jail: Investigation, Deterrence, and Judicial Review

6. Recent Corporate Law Decisions

6.1 Liquidators denied access to documents sought to assess whether prospective defendant could pay judgment debt

(By Bonnie Johnston, MinterEllison)

Pleash (Liquidator) v Tucker [2018] FCAFC 144 (29 August 2018) Federal Court of Australia, McKerracher, Farrell and Banks-Smith JJ

(a) Summary

This case involved an appeal from a decision to refuse to order production of certain documents in response to summonses issued under s. 597(9) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). As part of an examination about the examinable affairs of Equititrust Limited (Equititrust), the liquidators sought access to financial documents of the respondents, on the basis they were relevant to whether a judgment obtained against the first respondent might ultimately be recoverable from him. The Full Court of the Federal Court of Australia (the Court) dismissed the appeal on the basis that financial documents of a trust do not need to be produced where an examinee has no proprietary interest in the trust assets, even where a party contends those assets might be available to satisfy a prospective judgment debt.

(b) Facts

The appellants were the liquidators of Equititrust (Liquidators). The first respondent, Mr David Tucker, was previously a director of Equititrust, as well as its solicitor. The remaining nine respondents were related entities that Mr Tucker was either a director, or the sole director. Six of the respondents were corporate trustees of trusts.

Equititrust was a money lender operating on the Gold Coast. In February 2012, the directors of Equititrust resolved to appoint administrators on the basis the company was, or was likely to become, insolvent (pursuant to s. 436A of the Corporations Act). However, Equititrust was indebted to its secured creditor, BOS International (Australia) Ltd (BOSI), for approximately $11.5 million. BOSI subsequently appointed receivers and managers of the property of Equititrust and, in April 2012, the Liquidators were brought in when the company was wound up.

In July 2012, MS Asia Debt Acquisition Ltd (MS Asia) acquired the debt owed by Equititrust for $2 million. The Liquidators contended that Mr Tucker was involved in this debt acquisition and had an interest in the proceeds received by MS Asia. The Liquidators therefore applied, pursuant to s. 596A of the Corporations Act, for the issue of a summons to certain individuals (including Mr Tucker) for examination about the examinable affairs of Equititrust. In January 2017, the Federal Court ordered that Mr Tucker, among others, be summonsed for examination, and Mr Tucker was also later ordered by a Deputy Registrar to produce documents at his examination. Whilst Mr Tucker's application to set aside the order for examination was dismissed, the primary judge separately reviewed the orders to produce documents. The Liquidators sought access to the documents on the basis they were relevant to whether any judgment obtained against Mr Tucker in an action with respect to the MS Asia transaction might ultimately be recoverable from him. The primary judge ordered the production of some documents but excluded others. The excluded documents were various financial documents which did not relate to assets held directly by Mr Tucker but to assets and liabilities of discretionary trusts and a superannuation fund, of which Mr Tucker was the primary (but not sole) beneficiary. In this case, the Liquidators sought leave to appeal the orders excluding the production of these documents.

(c) Decision

The Liquidators appealed on two grounds, first the primary judge erred in holding the excluded documents were not relevant to the examinable affairs of Equititrust and second, the primary judge made a number of errors in making this finding. The appeal therefore concerned the scope of documents to be produced in response to summonses issued under s. 597(9) of the Corporations Act. Specifically, the Court considered whether financial documents of a trust ought to be produced where an examinee had no proprietary interest in trust assets but those assets might be available to satisfy a prospective judgment debt.

Section 597(9) of the Corporations Act provides that the Court may direct a person to produce, at an examination of that or any other person about a corporation's examinable affairs, books that are in the first mentioned person's possession and are relevant to matters to which the examination relates or will relate.

(i) Access to property where there is no proprietary interest

The first issue was whether, in the context of examinable affairs, property must be owned by a prospective defendant to be relevant to the potential recovery of a judgment debt. Although acknowledging that Mr Tucker, as the beneficiary of the discretionary trusts concerned, had no proprietary interest in the income and capital of those trusts, the Liquidators contended the documents should be produced because:

- documents relating to an interest in a discretionary trust are within the scope of an examination; and
- documents relating to a judgment debtor's potential access to a source of funds to satisfy a judgment, even if not directly available to a judgment creditor, are within the scope of an examination.

The Court said that the question was whether the documents sought would assist in assessing the capacity of a prospective defendant to satisfy a judgment. Following a review of various cases, the Court confirmed the applicability of the general law position that a beneficiary's control over a trustee does not operate so that the income and capital of a discretionary trust may be treated as if it were the property of the beneficiary.

The Court did not accept either of the two bases advanced by the Liquidators to contend that Mr Tucker's interests in the various trusts were sufficient to require production of the relevant documents. It was found that the scope of examinable affairs could not be extended to include a consideration of which assets outside of those that comprise a prospective defendant's property might voluntarily be directed to payment of such debt. Without some kind of agreement or obligation by a trustee or third party to make funds available, the Court considered it would be difficult to imagine how documents that evidence assets not owned by the defendant could properly assist the liquidator in assessing the ability of the prospective defendant to satisfy a judgment or assist in advising creditors.

(ii) The tracing investigation and the application to adduce fresh evidence

The second issue was whether the Liquidators could rely upon a prospective tracing investigation to justify production of the excluded documents, as it was a matter that was raised only briefly before the primary judge and then was brought up late in the appeal. The Liquidators contended the excluded documents were relevant because they may have shown whether profits from the MS Asia transaction were received by any of the trusts, which might allow such profits to be traced.

The Court dismissed the appeal insofar as it asserted that the primary judge erred in failing to address tracing as a basis for ordering production of documents and held that the Liquidators had not met the requisite onus to enable them to determine the tracing-based application on appeal. The Court considered that the Liquidators had not sufficiently explained why the requested documents would shed light on the whereabouts of the funds relating to the debt acquisition and enforcement of securities by MS Asia. Further, the Liquidators failed to properly explain the basis on which tracing may be available and result in some benefit to the creditors.

However, the Court considered that the potential to trace money into third party entities may be a sufficient basis for the production of documents under s. 597(9) of the Corporations Act and stated there was no impediment to the Liquidators bringing a further application under s. 597(9) if they considered it appropriate to do so.

(iii) Bankruptcy Act

The final issue considered by the Court was whether the Bankruptcy Act 1966 No. 33 (Cth) (the Bankruptcy Act) provided a reason to justify production of the documents. This claim was based on a statement by Mr Tucker that, if a judgment was entered against him, he would not rely on the assets of the trusts but would file for bankruptcy. The Liquidators therefore relied on the potential for orders to be made under the Bankruptcy Act with respect to property not owned by the bankrupt person.

The primary judge identified issues confronting the Liquidators in seeking to rely on these provisions to justify production of the relevant documents and concluded the possibility of orders being made against one of the trusts was too remote and dependent on unrelated contingencies to support the Liquidators' request to access the documents. The Court found that the primary judge took into account matters that were open to him and agreed that, at this stage of proceedings, the prospect of the relevant provisions of the Bankruptcy Act being relied upon by any trustee in bankruptcy was uncertain. Having regard both to this uncertainty and to the interests of those from whom documents were sought, the Court held that there was no error in the manner in which the primary judge exercised his discretion.

6.2 Court grants two year extension of time for registration of security interests

(By Matthew Harper, Ashurst)

In the matter of Highlake Resources Pty Ltd [2018] FCA 1292 (24 August 2018) Federal Court of Australia, McKerracher J

(a) Summary

The plaintiff in this proceeding was the holder of security interests granted in June 2016. In June 2018, it discovered that these interests had not been registered on the Personal Property Securities Register (PPSR). Relying on s. 588FM of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), it applied to the Federal Court for an extension of time to register its security interests.

McKerracher J granted the extension of time. His Honour held that the failure to register had been accidental or inadvertent. His Honour also held that the Court should exercise its discretion to extend time because no third parties were prejudiced by the delay in registration and the grantors of the security interests did not oppose the application.

(b) Facts

In May 2015, the plaintiff, Squadron Resources Pty Ltd (Squadron), entered into a convertible note agreement with Centennial Mining Ltd (referred to as "HeadCo" in the judgment) and three of its subsidiaries: Highlake Resources Pty Ltd, Matrix Gold Pty Ltd and Maldon Resources Pty Ltd (the defendants).

The monies payable under the convertible note agreement were secured through two agreements. First, HeadCo provided a general security deed in favour of Squadron as security trustee. Second, the defendants each granted a security interest over all their present and after-acquired property in favour of Squadron, under an agreement referred to as the Subsidiary GSD. The parties exchanged copies of the Subsidiary GSD on 22 June 2016.

On 22 June 2018, Squadron discovered that the security interests under the Subsidiary GSD were not registered on the PPSR. Squadron determined that this was due to miscommunication between its former employees and former solicitors. Squadron finally registered the security interests on 26 June 2018.

Ordinarily, a person should register security interests in their favour within 20 business days of the date that the security agreements came into force. Squadron's failure to do so meant that, if one or more of the defendants were wound up or entered administration within six months after 26 June 2018, Squadron would lose the benefit of the security interests granted by those defendants (see s. 588FL of the Corporations Act).

To avoid this risk, Squadron applied to the Federal Court under s. 588FM of the Corporations Act for an extension of time for registration of its security interests.

(c) Decision

Section 588FM(1) of the Corporations Act allows a person to apply for a court to set a later time for a person to register its security interests, to avoid six months of exposure to insolvency related events.

In accordance with s. 588FM(2)(a) of the Corporations Act a Court may set a later time if it is satisfied that the failure to register the security interest:

- was accidental or due to inadvertence or some other sufficient cause; or
- is not of such a nature as to prejudice the position of creditors or shareholders.

A Court may also set a later time if it is satisfied, on other grounds, that it is just and equitable to grant relief (s. 588FM(2)(b)).

McKerracher J summarised the following principles from case law on s. 588FM(2):

- it confers a "broad judicial discretion";
- inadvertence includes failing to be "properly attentive" and innocent misunderstandings of the consequences of failing to register a security interest;
- once inadvertence is established, a court still has a discretion whether to extend time for registration;
- the length of delay in registration is relevant to the exercise of this discretion;
- a highly relevant factor in exercising this discretion is whether there are any other security interests registered against the grantor (this helps to determine whether late registration would disturb any accrued rights);

- other relevant factors are whether the secured party would not have advanced the funds without the security interest, and also whether the grantor provided the security interest on the understanding that it would be registered; and
- finally, if the applicant does not lead evidence of the solvency of the grantor and the likelihood of its future solvency, a Court should not grant an extension without ensuring that the interests of unsecured creditors are protected.

McKerracher J held that Squadron's failure to register its security interests within the required 20 business days was accidental or due to the inadvertence of its former employees and/or solicitors. His Honour made clear that this finding did not mean that Squadron's former solicitors were neglectful.

McKerracher J then considered whether the Court should exercise its discretion to grant the extension. His Honour noted that the delay in registration was "not insignificant" but emphasised that delay alone is not problematic. Instead, what is crucial is whether third parties have transacted with the grantor of the security interest during the period of delay, on the basis that the grantor's assets were unencumbered.

McKerracher J held that Squadron's delay in registration, in the circumstances, did not prejudice other creditors. His Honour noted that, while one of the defendants had granted other security interests since 22 June 2016, the holders of these interests did not object to Squadron's application for an extension. In any case, these other interests had priority over Squadron's security interest because they were purchase money security interests (s. 62 of the Personal Property Securities Act 2009 No. 130 (Cth) (the PPSA)) or were held by an authorised deposit-taking institution (s. 75 of the PPSA).

Finally, McKerracher J also held that the Court should exercise its discretion for two reasons:

- the defendants did not object to Squadron's application; and
- an extension would protect noteholders that had acted on the assumption that the security interests were registered.

McKerracher J therefore granted the extension on the basis that the failure to register was accidental or inadvertent. His Honour also concluded, without discussing the point, that it was just and equitable to grant the extension.

6.3 Court refuses to grant injunctive relief to prevent winding up applications in respect of "solvent" companies that failed to comply with statutory demands

(By Nick Walker, King & Wood Mallesons)

A G Coombs Pty Ltd v M & V Consultants Pty Ltd (in liq) [2018] VSC 468 (22 August 2018) Supreme Court of Victoria, Sloss J

(a) Summary

A G Coombs Pty Ltd and A G Coombs (NSW) Pty Ltd (jointly referred to as AG Coombs Companies), two companies that were "unquestionably solvent", failed to respond to statutory demands issued by M & V Consultants Pty Ltd (M&V). This failure meant the statutory presumption of insolvency applied to both AG Coombs Companies. To prevent an application to be wound up, the AG Coombs Companies sought an injunction, arguing that such an application would be an abuse of process. The Court refused to grant the injunction, determining that it will rarely be an abuse of process for a creditor which has the presumption of insolvency in its favour to proceed with a winding up application.

(b) Facts

M&V and the AG Coombs Companies had worked together on a range of major construction projects since around December 2012. In April 2018, M&V went into voluntary administration, then in May 2018 it went into liquidation. Mr Stone and Mr Franklin were appointed as administrators and subsequently liquidators of M&V.

While acting as administrator, Mr Stone sought to recover outstanding amounts payable to M&V from the AG Coombs Companies by issuing statutory demands to the AG Coombs Companies in May 2018. The AG Coombs Companies failed to respond to the statutory demands within the 21 days required by s. 459G(2) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) due to an oversight by their solicitors.

As a result, the statutory presumption of insolvency applied to the AG Coombs Companies accordance with s. 459C(2)(a) of the Corporations Act and M&V was entitled to apply to the Court under s. 459P of the Corporations Act for the AG Coombs Companies to be wound up.

The AG Coombs Companies' solicitors wrote to M&V's solicitors to enquire as to its intentions regarding the statutory demands. M&V's solicitors responded that it anticipated receiving instructions to immediately commence winding up proceedings against each of the AG Coombs Companies.

To prevent the application being made to wind them up, the AG Coombs Companies sought an injunction on the grounds that the applications would be an abuse of process, claiming that:

- M&V was abusing the processes of the court in the sense discussed in *Williams v Spautz* (1992) 174 CLR 509, by maintaining the demands and threatening to apply to wind up the plaintiffs to gain some sort of advantage not intended by Part 5.4 of the Corporations Act;
- the application to wind up the companies would plainly fail because the companies were "unquestionably solvent"; and
- under the "second branch" of *Fortuna Holdings Pty Ltd v Deputy Commissioner of Taxation (Cth)* [1978] VR 83 (Fortuna Holdings), a winding up application should not proceed in circumstances where there is a more suitable alternative means of resolving the disputed claim.

(c) Decision

The arguments put forward by the AG Coombs Companies were unsuccessful and injunctive relief was denied.

(i) Applying to wind up to gain an advantage?

Sloss J held that despite the rigour of the statutory demand procedures in Part 5.4 of the Corporations Act, those procedures do not entirely preclude an application for an injunction to prevent an abuse of process arising as a result of an application to wind up a company for failing to comply with a statutory demand. Sloss J determined that the regime in Part 5.4 of the Corporations Act "does not preclude allegations of an abuse of process where the abuse is alleged to be the institution of proceedings for an improper purpose". However, Sloss J determined that in this case, the evidence presented fell well short of demonstrating that M&V made the applications for winding up for an improper or ulterior purpose.

(ii) Unquestionably solvent?

Notwithstanding the argument that the AG Coombs Companies were "unquestionably solvent" (including evidence that A G Coombs Pty Ltd had an equity position of just short of $15,000,000), Sloss J stated that the issue of solvency is one that "falls to be determined on the application for winding up brought under s. 459P" of the Corporations Act.

Sloss J stated that unless the abuse is manifest, an interlocutory determination as to whether to restrain an application under s. 459P of the Corporations Act is an unsatisfactory venue to determine whether a company is solvent. Once the statutory presumption of insolvency applies, the issues as to solvency fall to be determined at the application to wind up the company, and are to be determined upon consideration of the "fullest and best" evidence available.

(iii) Second branch of Fortuna Holdings

Sloss J queried the extent to which the abuse of process principles decided under the previous winding up regime apply today, particularly in the context of a winding up for failing to comply with a statutory demand. Sloss J determined that it "seems unlikely that any scope remains" for the application of the type of abuse of process under the "second branch" of Fortuna Holdings.

6.4 Derivative action applications and their requirements

(By Matthew Edwards, Clayton Utz)

Wu v Li [2018] ACTSC 224 (17 August 2018) Supreme Court of the Australian Capital Territory, McWilliam AsJ

(a) Summary

Mr Wu (the Plaintiff) sought leave to commence a derivative action against Mr Yuxin Li and Ms Hong Chen (the Defendants) on behalf of Golden Constructions Pty Ltd (the Company). The proposed action alleged a breach of a building contract, and the breach of a loan agreement by Mr Li. In the event that the claim for breach of contract failed, the Plaintiff asserted an alternate claim on a quantum meruit basis. The court granted the leave request and joined the Company to the claim. This decision was reached as the Plaintiff had:

- reasonable prospects of success;
- potential for tangible benefits;
- the support of the liquidator;
- provided sufficient security; and
- made the application in good faith.

To maintain sufficient protection, the Defendants were permitted to apply to the Court for orders revoking the grant of leave if the Plaintiff failed to provide additional security within 28 days of any request by the liquidator of the Company.

The Defendants also retained the right to raise issues regarding limitation periods in the trial of the proceeding.

(b) Facts

The Plaintiff was a former director of the Company, in which he additionally held a 35% share. The Defendants together held a 65% share of the Company.

In or around August 2008, the Company and the Defendants entered into a building contract requiring the Company to build a residential dwelling on a property in O'Malley. This property was alleged to have been owned by the Defendants.

On 14 November 2017, the Plaintiff sought leave to bring multiple derivative actions against the Defendants on behalf of the Company. These actions were for:

- a breach of the building contract by the Defendants, resulting in a claim for approximately $1,200,000;
- if the claim for breach of the building contract fails, an alternative claim bought on a quantum meruit basis for approximately $2,800,000; and
- a claim for recovery of loan funds from Mr Li for approximately $580,000.

The Plaintiff additionally sought to join the Company to the proceedings as a second Plaintiff to guard against the possibility that the Company was found to be the proper Plaintiff.

(c) Decision

As a shareholder, there was no issue as to the Plaintiff's entitlement to make a derivative action application.

Whether the application was allowed turned on three matters. They were:

- whether the proceedings proposed to be pursued had some solid foundation, in that they exhibited such a degree of merit as to be neither vexatious nor oppressive and to present reasonable prospects of success;
- the liquidator's attitude to the question whether the proceeding should be pursued; and
- whether practical considerations supported the initiation of the proceedings, with particular reference to financial protection of the liquidator and the estate of the company by means of indemnity and if required, security.

(i) Whether there is a solid foundation for the proposed proceedings

This prerequisite required the Plaintiff to have reasonable prospects of success and a genuine prospect of a tangible benefit.

The Plaintiff's claims in the proceedings concerned construction work, for which the Company was largely unpaid, and a loan made to Mr Li, which had not been repaid. From the evidence produced, her Honour held that these claims were arguable and had reasonable merit.

The Defendants argued that there was no genuine prospect of a tangible benefit to the Company resulting from the proceeding. However, her Honour referred to evidence of the liquidator which indicated that the Company stood to benefit more than $200,000 from the proceeding. Her Honour held that this prospect of recovery, whilst a small percentage of the overall sum, was a sum properly characterised as a tangible benefit, particularly in light of the fact that the Company and liquidators had an indemnity for their costs.

The Defendants argued that the three claims are statute barred and therefore offer no serious question to be tried. Her Honour dismissed this argument and noted that the limitation periods were not clear so as to permit a summary determination. As a result, the arguable merit of the claims remained. In coming to this conclusion, her Honour noted the questions regarding concealment in relation to the breach of contract, the threshold requirements for unjust enrichment in relation to the quantum meriut claim, the existence of a loan and the assumptions that have to be made in relation to the claim for the recovery of loan funds.

The Defendants further argued that the application did not have a solid foundation as they were brought for a collateral purpose and therefore not made in good faith. The Defendants submitted this position due to the small percentage of money recoverable to the Company and the potential for the Plaintiff to use the current proceedings as a basis for defending a separate action between the parties in the Federal

Court of Australia. Her Honour dismissed this argument. It was held that the monetary return and potential set-off in subsequent litigation between the parties were entitlements the law permitted and were not abuses of process. Furthermore, any return to creditors, where the Company and liquidator are indemnified on costs, was found to be better than no return at all and in the best interests of the Company. This indemnity also supported a finding that the application was made in good faith.

(ii) Attitude of the liquidator

The liquidator supported the proposed action. The liquidator deposed to the fact that, had he had the funds to do so, he would have advanced the claims himself. As a requirement of his consent, the liquidator requested that a Deed of Indemnity be entered into protecting both the Company and the liquidator from adverse costs. Such a Deed was entered into.

The liquidator's supportive attitude operated in favour of the Plaintiff's application for leave.

(iii) Whether practical considerations support the initiation of the proceedings

The Plaintiff's indemnity of the Company supported the leave application and the initiation of these proceedings.

The Plaintiff provided $70,000 into a solicitor's trust account in order to support the indemnity. Her Honour expected that this amount would be sufficient given the limited scope of the proceedings, the proceedings' lack of complexity and the fact that costs orders could be made against the Plaintiff, rather than the Company, if the proceedings failed.

However, to provide additional protection, her Honour imposed a condition on the grant of leave allowing the Defendants to apply to revoke the grant of leave in circumstances where the Plaintiff fails to provide additional security to the Company upon request by the liquidator.

In the circumstances, her Honour was satisfied that leave should be granted to the Plaintiff to commence the derivative proceedings.

6.5 Proceeding against company rejected for its detrimental effects on winding up

(By Beau Deane Paterson, DLA Piper)

Chen v Diversipak Pty Ltd (in liq) [2018] FCA 1314 (10 August 2018) Federal Court of Australia, Bromwich J

(a) Summary

Ms Chen, a former director and employee of Diversipak Pty Ltd, brought a claim against the company alleging infringement of a trade mark registered in her name. The company was in liquidation and her proceeding was prima facie prohibited under s. 471B of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).

Ms Chen sought leave to commence the proceeding against the company under s. 471B of the Corporations Act but her application was rejected. Bromwich J found that he was unable to accurately assess the value and seriousness of Ms Chen's claim, nor could he justify the detrimental effect of the proceeding on the company and the liquidation process given the likely cost of the proceeding and its early stage.

(b) Facts

Ms Chen was a director of Diversipak until May 2017 when her position was terminated by the provisional liquidator. She continued as an employee of the company in liquidation until she resigned in June 2018.

In her resignation letter, Ms Chen purported to terminate a licence she alleged she had given to the company permitting use of a trade mark registered in her name. The trade mark bore the words "Diversipak Packaging Solutions" with a logo above.

Ms Chen commenced the proceeding after becoming concerned that the liquidator had sold, and would continue to sell, stock that bore the trade mark after she had terminated the licence.

Ms Chen sought a number of forms of relief including interlocutory relief to prevent the company from trading using the trade mark, and to require the company to maintain registration until the final determination of the case. But the primary issue concerned whether Ms Chen had leave to commence proceedings against the company in liquidation due to the operation of s. 471B of the Corporations Act. Section 471B prohibits a person from, among other things, commencing a proceeding against a company while the company is being wound up or after a provisional liquidator has been appointed unless the Court gives leave.

(c) Decision

The Corporations Act sets a high bar to commencing proceedings against a company in liquidation. Bromwich J held that leave will only be granted if there is a serious question in dispute, which his Honour took to mean that the claim needs to have a strong foundation. Ms Chen was unable to meet this threshold.

In undertaking his analysis, Bromwich J relied on 16 factors identified by McKerracher J in *Commissioner for Consumer Protection v Unleash Solar Pty Ltd (in liq)* [2015] FCA 348 at [22]-[23]. In particular, his Honour focused on the value and seriousness of Ms Chen's claim, the stage of the proceedings and the effect the proceeding would have on the orderly winding up of the company.

Ms Chen's claim was complicated at the outset by the fact that, although the trade mark was registered in her name, it was used by exclusively by the company. Bromwich J found that he was unable to accurately ascertain on the submissions made by the parties the value of the trade mark to the company and therefore the value and seriousness of Ms Chen's claim. Counsel for Ms Chen argued that there had been infringement of her rights through current trade-marked stock in the possession of the company and by past sales of trade-marked stock. But he also admitted that he was unable to place a particular dollar value on either of these elements. Further, the evidence available did not allow Bromwich J to assess the value of the trade mark independently of the business name, which the company was entitled to retain and to use.

Bromwich J noted that at the time of the hearings, the proceedings were at a very early stage and that there would be considerable delay before trial and an eventual judgment could be progressed. His Honour was of the opinion that this was a claim in which the "cost of litigation [was] not just unlikely to meet the value of the fruits of the litigation, but carrie[d] a very distinct risk of exceeding it by a very substantial degree.".

In any event, allowing the proceeding would, in his Honour's opinion, undermine the orderly winding up of the company, which was close to completion. The proceeding would prejudice creditors and weigh unreasonably on company resources.

In the circumstances, the arguments in favour of granting Ms Chen leave to commence the proceedings were significantly outweighed by the disadvantages of doing so. The originating application was dismissed with costs to be paid by Ms Chen.

6.6 Mismanagement, misconduct and misrepresentations showcase a just and equitable cause

(By Aaron Jones, Herbert Smith Freehills)

Gognos Holdings Ltd v Australian Securities and Investments Commission [2018] QCA 181 (3 August 2018) Supreme Court of Queensland, Court of Appeal, Sofronoff P and Gotterson and McMurdo JJA

(a) Summary

The Queensland Supreme Court of Appeal (the Court) has dismissed the appeal brought by Gognos Holdings Ltd (Gognos) and Dynamic Agri Tech Ltd (DAT) (collectively, the appellant companies) against the decision of Bowskill J at first instance where her Honour ordered that it was just and equitable for the appellant companies to be wound up. The Court was of the view that there was no error at first instance that the nature and extent of the risks to the public interest from the appellant companies being allowed to continue, given their "lamentable history of mismanagement and misconduct" and ongoing contraventions of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), were sufficient for Bowskill J to find that it was just and equitable for the appellant companies to be wound up.

(b) Facts

At first instance, ASIC instituted proceedings against the appellant companies seeking orders that the appellant companies be wound up under s. 461(1)(k) of the Corporations Act. Section 461(1)(k) of the Corporations Act provides that a Court may order the winding up of a company if the Court is of the opinion that it is just and equitable that the company be wound up.

ASIC's claim that the appellant companies be wound up was supported by evidence of prolonged and extensive misconduct in relation to the appellant companies' affairs and numerous contraventions of the Corporations Act committed by the companies, including failures to lodge financial reports, report to members, hold annual general meetings and maintain accurate account records. Further, ASIC claimed that the appellant companies had made misrepresentations to the ASX and its investors (in particular by the companies' director Mr Manasseh) and that the intended business of the appellant companies (that is, the manufacture and distribution of animal fodder production units) had not been successful and on this basis the appellant companies were not "clearly solvent" even though $7.7 million raised from investors would likely be lost to them.

(i) History of the appellant companies

Prior to 2008, DAT had been an investor in Almighty Fodder Ltd (Almighty), which was said to have developed valuable technology for the product of animal fodder before Almighty proved unsuccessful and was wound up. Following its winding up, DAT took over the business of Almighty while the business of Gognos was to be the public raising of funds for the development of DAT and to fund the ASX listing of DAT. Investors subscribed for shares in Gognos upon representations that DAT would become listed and that Gognos shares would be "converted" to DAT shares. The funds were to be recorded by Gognos as loans to either DAT or its subsidiary Dynamic Agri Tech Finance Pty Ltd (DAT Finance) and then loaned by that company to Dynamic Fodder Pty Ltd (Dynamic Fodder) which acted as the group's treasury entity and which held the only bank account within the group.

Bowskill J held that the $7.7 million raised by Gognos from investors went to Dynamic Fodder to fund the operations of DAT and that there were conflicting explanations on the evidence for how Gognos came to own its current shares in DAT given the money was recorded as loans to DAT or DAT Finance with the intention that the "loans" would be repaid by the issue of shares in DAT once floated. Her Honour said that the perilous financial position of Gognos was apparent from the company's lack of reliable financial accounts and that the consolidated accounts of the Dynamic group demonstrated that neither DAT nor Dynamic Fodder had the capacity to repay its liabilities. On this basis, Bowskill J concluded that both appellant companies were not "clearly solvent".

(ii) Change in directors

Until July 2017, Mr Manasseh was a director and company secretary of Gognos and a director of DAT. The appellants argued that Mr Manasseh, together with Mr De Andrade, ceased to be directors of both companies and that they were replaced by Mr Zwar and Mr Davis on the board of DAT and by Mr Zwar, Mr Davis and Mr Lissa on the board of Gognos although these directors had not been properly appointed in accordance with each appellant company's constitution. Her Honour held that this demonstrated a "lack of rigour . in the conduct of people charged with the responsibility to conduct the affairs of two public companies" and that Gognos at certain times did not have three directors as required under s. 201A(2) of the Corporations Act.

Although her Honour held that the appellant companies had intended to distance themselves from Mr Manasseh given, among other things, his "blatantly dishonest" misrepresentations to investors, her Honour accepted ASIC's submission that the "whole idea" of the departure of Mr Manasseh as a director, the appointment of the new directors and the proposed $400,000 facility to be provided by Mr Manasseh to the appellant companies to assist with its operations was a plan devised by Mr Manasseh and others to ensure the companies could continue to operate beyond the first instance proceedings.

(iii) Grounds of appeal

The appellant companies appealed the decision of Bowskill J on the grounds that, among other things, her Honour had made erroneous findings in determining that it was just and equitable for the appellant companies to be wound up because by allowing the companies a further opportunity to carry on business, there was some prospect that not all money contributed by investors would be lost.

(c) Decision

McMurdo JA (with whom Sofronoff P and Gotterson JA agreed) agreed with the decision of Bowskill J at first instance that it was just and equitable for both the appellant companies to be wound up. McMurdo JA held that although the appellant companies were correct in arguing that Dynamic Fodder did not control the appellant companies (even though Bowskill J found that it was the trading and operating company of the Dynamic group), Dynamic Fodder was the only company within the corporate group which held a bank account and all money raised from investors found its way to Dynamic Fodder. Further, McMurdo JA held that Mr Manasseh's role as the director of Dynamic Fodder and his continued involvement with the current directors of the appellant companies on the evidence meant that Mr Manasseh would likely participate in and be involved in the future affairs of the companies.

(i) Impact of winding up

Although Bowskill J had acknowledged that it would be an "extremely unfortunate" outcome that the investors would lose all their money if the appellant companies were wound up, McMurdo JA held that her Honour had correctly found that it was in the public interest, and not merely those of the shareholders, which was to be considered in determining whether s. 461(1)(k) of the Corporations Act was enlivened.

McMurdo JA held that the legal principles in relation to s. 461(1)(k) of the Corporations Act were not in question and that the issue was the application of these principles to the factual circumstances of this case. McMurdo JA drew on the decision of Lord Shaw of Dulfermline in *Loch v John Blackwood Ltd* [1924] AC 738 at 788 that "at the foundation of applications for winding up, on the 'just and equitable' rule, there must lie a justifiable lack of confidence in the conduct and management of the company's affairs" and the decision of Gordon J in *Australian Securities and Investments Commission v ActiveSuper Pty Ltd* (No 2) [2013] FCA 234 at [23] that a risk to the public interest may take several forms. For example, a winding up order may be necessary to ensure investor protection, or where a company has not carried on its business candidly, or it might be justified to prevent and condemn repeated breaches of the law. On this basis McMurdo JA held that Bowskill J correctly identified the relevant enquiry, namely whether there was a real risk to the public interest that warranted the protection of a winding up order, and that her Honour was correct to order the winding up of the appellant companies given their ongoing contraventions of the Act and the lack of evidence which suggested that compliance would occur in the future if the companies were not wound up.

McMurdo JA concluded that it was the task of Bowskill J to assess the nature and extent of the risks to the public interest from the appellant companies being allowed to continue operations, given their lamentable history of mismanagement and misconduct and that her Honour had to consider whether the risk to the public interest has been either eliminated or reduced to an acceptable level. McMurdo JA was satisfied that there was no error in the exercise of her Honour's discretion under s. 461(1)(k) of the Corporations Act and that her Honour was correct to conclude the companies should be wound up.

6.7 NSWSC orders the removal and replacement of Atlas Construction liquidators

(By Annabel Gibson, King & Wood Mallesons)

In the matter of Atlas Construction Group Pty Ltd (in liq) [2018] NSWSC 1189 (2 August 2018) New South Wales Supreme Court, Ward CJ in Eq

(a) Summary

The New South Wales Supreme Court (the Court) has ordered the removal and replacement of the current liquidators of Atlas Construction Group Pty Ltd (Atlas) on application by Fitz Jersey Pty Limited (Fitz Jersey). The Court held it was appropriate to do so where:

- there were insufficient funds even to meet outstanding costs and expenses of the administration and the liquidation to date;
- Fitz Jersey was only prepared to provide additional funding to its proposed replacement liquidator;
- the incumbent liquidators considered it to be in the best interests of the creditors that they be replaced in light of the lack of funding; and
- the liquidator nominated by Fitz Jersey was appropriate and impartial.

(b) Facts

On 17 December 2010, Fitz Jersey as owner and Atlas as builder entered into a construction agreement for a home unit development (the Construction Agreement). The amount payable under the Construction Agreement was $180 million.

On 15 November 2016, Atlas issued a payment claim to Fitz Jersey pursuant to s. 13 of the Building and Construction Industry Security of Payment Act 1999 No. 46 (NSW) (the SOP Act), claiming the sum of $10,748,466.31. The amount paid by Fitz Jersey as at that date was stated to be $232,998,469.48. Fitz

Jersey denied the claim but acknowledged the final adjusted Construction Agreement price was $232,998,469.48.

Atlas' payment claim was formally adjudicated in accordance with the SOP Act, resulting in an adjudication determination in Atlas' favour for the amount of $10,748,466.31 plus interest and adjudication fees. When Fitz Jersey failed to pay the amount, Atlas obtained judgment against Fitz Jersey in Court in the sum of $11,023,799.76. Meanwhile, Fitz Jersey had commenced proceedings to overturn the adjudication determination (the Adjudication Proceedings). When Fitz Jersey again failed to pay the amount, Atlas sought a garnishee order for debts in the sum of $11,023,799.76 which amount was paid to Atlas by Fitz Jersey's bank (the Garnisheed Funds). Soon after receipt of the Garnisheed Funds, Atlas' directors resolved to pay a fully franked interim dividend of $6,781,559.

(i) Voluntary administration and liquidation

On 4 April 2018, Atlas appointed voluntary administrators pursuant to s. 436A of the [Corporations Act 2001 No. 50 (Cth)](). Fitz Jersey lodged a formal proof of debt for $39,894,968.86 claiming overpaid fees under the Construction Agreement and damages. On advice from solicitors who had also represented Atlas in the ongoing Adjudication Proceedings, Fitz Jersey's claim was admitted by the administrators for voting purposes in the sum of $1.

The Administrators' Report to Creditors noted that, in the administrators' view, there were no potential recoveries from unfair preferences or uncommercial transactions. In respect of the interim dividend payment, it was also their view that any potential recoveries would be strongly contested and challenging to pursue.

Both the directors and Fitz Jersey submitted deed of company arrangement (DOCA) proposals. The administrators recommended Fitz Jersey's DOCA, under which creditors (other than contingent creditors) would receive 100 cents in the dollar. The creditors rejected Fitz Jersey's DOCA and resolved to wind up Atlas. Fitz Jersey suggested that this was an attempt to avoid investigation into whether the interim dividend paid for using the Garnisheed Funds could be recovered.

(ii) Current proceeding

On 21 June 2018, Fitz Jersey commenced the current proceedings, seeking removal of the current liquidators and their replacement by a nominated liquidator, on grounds that Atlas' affairs require independent investigation in light of the interim dividend payment that was paid using the Garnisheed Funds and Fitz Jersey's proof of debt claim for $39,894,968.86, among other things. The liquidators did not oppose their replacement in light of the lack of funding and the fact that Fitz Jersey would only fund its proposed replacement liquidator. The directors of Atlas argued that Fitz Jersey's application to remove the liquidators was an attempt to hijack the liquidation, and they nominated other liquidators in the event that the Court were to determine that the incumbent liquidators should be replaced.

(c) Decision

Ward CJ made orders that the incumbent liquidators be removed and that Fitz Jersey's nominated replacement liquidator be appointed in their stead.

In reaching this decision, her Honour accepted the incumbent liquidators' position that it was in the interests of creditors that they be replaced in circumstances where:

- they are presently unfunded; and
- the funding proffered by Fitz Jersey would not be provided so long as the liquidators remain in office.

Accordingly, her Honour held the real question for determination was whether it would be in the best interests of creditors to accede to the application at hand (citing *Advance Housing Pty Ltd (In Liq) v Newcastle Classic Developments Pty Ltd* (1994) 14 ACSR 230 at 234 and *In the matter of ACN 159 605 188 Pty Ltd (in liq) (Formerly Securimax Pty Ltd)* [2018] NSWSC 356 at [21] per Black J)).

Ward CJ found that it was not irrational for Fitz Jersey to harbour concerns that the incumbent liquidators had, in assessing its proof of debt, relied on advice from solicitors who were acting for Atlas on matters in respect of which there was an adversarial position between Fitz Jersey and Atlas. Her Honour further held this was a relevant matter in deciding whether to accede to the application.

In responding to claims that the replacement liquidator would not be independent, her Honour did not consider that the draft funding agreement between the replacement liquidator and Fitz Jersey required the replacement liquidator to "in any way to relinquish his statutory responsibilities, or to kowtow to Fitz Jersey's request to conduct public examinations into certain matters".

Her Honour further concluded that there was nothing to deny the conclusion that the replacement liquidator would be an impartial, independent and appropriate liquidator, and that accepting such an appointment would not involve any abdication of the Court's responsibility to select an appropriate and impartial liquidator (citing *In the matter of Evcorp Grains Pty Ltd (No 2)* [2014] NSWSC 155 at [21] per Brereton J).

Ward CJ accordingly found it appropriate make the orders sought by Fitz Jersey. In reaching this conclusion, her Honour emphasised that she did not make any finding of impropriety on the part of the incumbent liquidators, and nor would the evidence support any such finding.

6.8 Application for orders for convening of scheme meeting

(By Katrina Sleiman, Corrs Chambers Westgarth)

In the matter of Sirtex Medical Limited [2018] FCA 1315 (1 August 2018) Federal Court of Australia, Markovic J

(a) Summary

The Court approved an application by Sirtex Medical Limited (Sirtex) for orders convening a meeting of its shareholders to consider a proposed scheme of arrangement under s. 411 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).

(b) Facts

On 14 June 2018, CDH Genetech Limited (CDH), China Grand Pharmaceutical and Healthcare Holdings Limited (CGP) (collectively, Bidders) and Sirtex entered into a scheme implementation deed (SID) in respect of a proposed scheme of arrangement (Scheme).

The proposed Scheme involves Sirtex shareholders transferring their shares to Grand Pharma Sphere (Australian Bidco) Pty Limited (Bidco). The consideration for each share transferred is a total cash payment of $33.60 per Sirtex share less any dividends paid by Sirtex up to a maximum of $0.30 per Sirtex share. The Scheme will effect the acquisition of Sirtex by Bidco and will result in Sirtex becoming a subsidiary of Bidco and being delisted from the ASX.

The three stages to an application under s. 411 of the Corporations Act are:

- the Court approves the convening of a scheme meeting and approves the draft explanatory statement to be sent to the scheme members;
- the members vote on the proposed scheme at the scheme meeting; and
- the Court approves the proposed scheme.

(c) Decision

With respect to the standard of review, the approach of the Court at the first court hearing is that it will not ordinarily summon a meeting unless the scheme is of such a nature and cast in such terms that, if it receives the statutory majority at the meeting the Court will be likely to approve it on the hearing of a petition which is unopposed: *FT Eastment & Sons Pty Ltd v Metal Roof Decking Supplies Pty Ltd* (1977) 3 ACLR 69 at 71.

Based on the evidence, the Court was satisfied of the following matters:

- the proposed Scheme is an arrangement in respect of which the Court may order a meeting of members pursuant to s. 411(1) of the Act;
- ASIC has had a reasonable opportunity to consider the Scheme;
- the explanatory statement provides adequate disclosure to Sirtex shareholders;
- the procedural requirements of the Federal Court (Corporations) Rules (2000) 1999 No. 359 (Cth) have been met; and
- there is no apparent reason why the Scheme should not receive Court approval if the necessary number of votes are achieved.

Sirtex drew the Court's attention to a number of specific matters.

First, Sirtex proposed one class of members for voting purposes, including:

- Sirtex shareholders who also hold Sirtex rights which would vest after the Scheme becomes effective but before the Scheme record date (thereby enabling them to participate in the Scheme); and
- Sirtex shareholders who are group members of a representative proceeding brought absent Sirtex.

Second, Sirtex and Bidco agreed to deal protection devices in the form of exclusivity arrangements and break fees. The Court held that the exclusivity arrangements complied with the following requirements identified by Santow J in *Re Arthur Yates & Co Ltd* (2001) 36 ACSR 758 at [9]:

- they should be for no more than a reasonable period capable of precise ascertainment (in this case, 12 months);
- they should be framed so that they are subject to the overriding obligation not to breach directors' fiduciary duties or be otherwise unlawful; and
- they should be of adequate prominence in the explanatory memorandum sent to shareholders.

Sirtex and Bidco agreed to:

- a break fee of 1% of the Scheme consideration payable by Sirtex depending on the circumstances of termination of the Scheme but not payable if the Scheme does not proceed as a result of Sirtex shareholders not voting in its favour; and
- a break fee of $200 million payable by CGP to Sirtex in certain circumstances.

Sirtex and the Bidders acknowledged in the SID that they believe the Scheme will provide significant benefits, and that each party required the relevant break fee in its favour as a condition to entry into the SID, the boards of all parties believe the break fees are appropriate and the parties believe that the break fees represent a genuine pre-estimate of their costs. The Court accepted that the break fees were not excessive and would not operate coercively on the members when participating in the Scheme.

Third, the SID provided that if it is terminated in circumstances where Sirtex is entitled to payment of the break fee, and Sirtex has received payment of that fee, then Sirtex and the Bidders will use their best endeavours to negotiate, having regard to their own best interests, and enter into an agreement for the grant by Sirtex to the Bidders of exclusive commercialisation rights for the China market. As the rights will not apply where the Scheme does not become effective because shareholders do not approve the Scheme by the requisite majorities, the Court was satisfied that those rights would not coerce the members of Sirtex to vote in favour of the scheme: cf *Re Unity Mining Ltd (No 2)* [2016] VSC 830.

Fourth, the Scheme requires clearance from the Committee on Foreign Investment in the United States (CFIUS). CFIUS approval is not a condition precedent to implementation of the Scheme, however an order issued by CFIUS pursuant to an ongoing investigation may result in a legal restraint being imposed that could delay or prevent the Scheme from completing. The scheme booklet contains disclosure of the requirement.

Fifth, the Bidders and Bidco provided a deed poll in favour of Scheme shareholders pursuant to which they have undertaken to pay or procure the payment of the Scheme consideration. As CDH is incorporated in the Cayman Islands and CGP is incorporated in Bermuda, evidence was led from a solicitor admitted to practice in the Cayman Islands and a solicitor admitted to practice in Bermuda regarding the due execution of the deed poll and its enforceability in the applicable jurisdiction.

The Court was satisfied that orders should be made requiring Sirtex to convene the Scheme meeting.

7. Contributions

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

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