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Bulletin No. 268

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1. Recent Corporate Law and Corporate Governance Developments

1.1 Report on financial market infrastructure safety and efficiency

10 December 2019 - The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) have published a report outlining ways in which financial authorities cooperate to promote the safety and efficiency of financial market infrastructures (FMIs). The report, which comes against a backdrop of increasingly globalised markets and growing central clearing of trades, shares the lessons learned from this cooperation.

The report, Responsibility E: A compilation of authorities' experience with cooperation, is based on the Principles for Financial Market Infrastructures (PFMI) and, in particular, on Responsibility E of the PFMI, which specifies that central banks, market regulators, and other relevant

authorities should cooperate with each other, both domestically and internationally, to ensure FMI safety and efficiency.

For the purposes of the report, FMIs include systemically important payment systems, central securities depositories, securities settlement systems, central counterparties, and trade repositories.

The CPMI and IOSCO have observed that cooperation among authorities is evolving and cooperative arrangements for specific FMIs are growing in number and importance. This growth is due, in part, to the increasing globalisation of financial markets, policy decisions resulting in an increased use of and reliance on FMIs, and the systemic importance of specific FMIs domestically and in multiple jurisdictions. The report is based on past experiences and does not deal with new systems, such as "stablecoin" arrangements. It covers the benefits of and triggers for cooperation; the relevant authorities; cooperation regarding a specific FMI; the design of cooperative arrangements; and the tools for cooperation.

1.2 Report on financial stability implications of BigTech in finance and third party dependencies in cloud services

9 December 2019 - The Financial Stability Board (FSB) has published two reports that consider the financial stability implications from an increasing offering of financial services by BigTech firms, and the adoption of cloud computing and data services across a range of functions at financial institutions.

BigTech in finance: Market developments and potential financial stability implications

The entry of BigTech firms into finance has numerous benefits, including the potential for greater innovation, diversification and efficiency in the provision of financial services. They can also contribute to financial inclusion, particularly in emerging markets and developing economies, and may facilitate access to financial markets for small and medium-sized enterprises.

However, BigTech firms may also pose risks to financial stability. Some risks are similar to those from financial firms more broadly, stemming from leverage, maturity transformation and liquidity mismatches, as well as operational risks.

The financial services offerings of BigTech firms could grow quickly given their significant resources and widespread access to customer data, which could be self-reinforcing via network effects. An overarching consideration is that a small number of BigTech firms may in the future come to dominate, rather than diversify, the provision of certain financial services in some jurisdictions.

A range of issues arise for policymakers, including with respect to additional financial regulation and/or oversight. Regulators and supervisors also need to be mindful of the resilience and the viability of the business models of incumbent firms given interlinkages with, and competition from, BigTech firms.

Third-party dependencies in cloud services: Considerations on financial stability implications

Financial institutions have used a range of third-party services for decades, and many jurisdictions have in place supervisory policies around such services. Yet recently, the adoption

of cloud computing and data services across a range of functions at financial institutions raises new financial stability implications.

Cloud services may present a number of benefits over existing technology. By creating geographically dispersed infrastructure and investing heavily in security, cloud service providers may offer significant improvements in resilience for individual institutions and allow them to scale more quickly and to operate more flexibly. Economies of scale may also result in lower costs to clients.

However, there could be issues for financial institutions that use third-party service providers due to operational, governance and oversight considerations, particularly in a cross-border context and linked to the potential concentration of those providers. This may result in a reduction in the ability of financial institutions and authorities to assess whether a service is being delivered in line with legal and regulatory obligations.

The report concludes that there do not appear to be immediate financial stability risks stemming from the use of cloud services by financial institutions. However, there may be merit in further discussion among authorities to assess:

- the adequacy of regulatory standards and supervisory practices for outsourcing arrangements;
- the ability to coordinate and cooperate, and possibly share information among them when considering cloud services used by financial institutions; and
- the current standardisation efforts to ensure interoperability and data portability in cloud environments.

1.3 Australian Law Reform Commission identifies possible future projects including regulation of financial services and legal structures for social enterprises

2 December 2019 - The Australian Law Reform Commission has published a report titled The Future of Law Reform: A Suggested Program of Work 2020-25. It is stated in the report that it: ".seeks to identify the most pressing areas for law reform in Australia that would be suitable for an inquiry by the Australian Law Reform Commission (ALRC). The suggestions in this report are made for the assistance, and consideration, of the Commonwealth Attorney-General, consistent with the Australian Law Reform Commission Act 1996 (Cth). If accepted, the topics set out in this report could form a set program of work for the ALRC over the next five years. This is the first time the ALRC has undertaken this process."

There are five suggested programs of work. Two of these are:

Principle-based regulation of financial services

A future law reform inquiry could consider whether reforms to the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) (the ASIC Act), and any other Commonwealth law should be made in order to simplify and rationalise the regulation of financial services, consistent with recommendations 7.3 and 7.4 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Financial Services Royal Commission). The ALRC suggests a timeframe of 36 months, with potential for interim reports on discrete aspects.

Legal structures for social enterprises

A future law reform inquiry could consider whether reforms should be made to the Corporations Act, the Australian Charities and Not-for-profits Commission Act 2012 No. 168 (Cth), and any other Commonwealth laws to provide for an appropriate corporate structure for social enterprises. The ALRC suggests a 12 month timeframe.

The other suggested programs of work are automated decision making and administrative law, defamation, and press freedom and public sector whistleblowers. The report also refers to eight additional law reform topics that the ALRC considers to be of significance, but which are not included in the suggested program of work for a variety of reasons. These eight topics include drafting statutes to enhance the coherence, readability, and useability of the law, especially in light of the anticipated transition to digital legislation; the rights of creditors of an insolvent trustee, particularly when trust assets may be insufficient to meet creditors' claims; and the regulation of debt management services, "buy now pay later" services, or services targeting people at risk of financial hardship.

1.4 Draft legislation to make the handling and settlement of insurance claims a financial service

29 November 2019 - The Financial Services Royal Commission recommended that the handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definition of "financial service" (see recommendation 4.8).

Consistent with the government's response to recommendation 4.8, the government has released for public consultation exposure draft legislation and regulations to:

- remove the exclusion of insurance claims handling and settlement services from the definition of a "financial service" in the Corporations Act 2001 No. 50 (Cth) (the Corporations Act);
- make handling and settlement of an insurance claim, or potential insurance claim, a "financial service" under the Corporations Act 2001; and
- tailor application of the existing financial services regime to the new financial service of handling and settling an insurance claim.

The consultation is open until 10 January 2020.

View the consultation package.

1.5 Further legislation introduced into Parliament to implement recommendations of the Financial Services Royal Commission

28 November 2019 - The government has introduced into parliament the Financial Sector Reform (Hayne Royal Commission Response - Protecting Consumers (2019 Measures)) Bill 2019, which addresses four recommendations from the Financial Services Royal Commission:

- recommendations 1.2 and 1.3 - requiring mortgage brokers to act in the best interests of consumers when providing consumer credit assistance; reforming mortgage broker remuneration by requiring the value of upfront commissions to be linked to the amount drawn down by borrowers instead of the loan amount; banning campaign and volume-based commissions and payments; and capping soft dollar benefits. These measures will apply from 1 July 2020;
- recommendation 4.2 - ensuring that the consumer protection provisions of the financial services law apply to funeral expenses policies; and
- recommendation 4.7 - banning unfair contract terms in standard insurance contracts. This will apply from 5 April 2021 which is consistent with the commencement of the design and distribution obligations.

The government has also introduced into parliament the Financial Sector Reform (Hayne Royal Commission Response - Stronger Regulators (2019 Measures)) Bill 2019. The Bill implements recommendations from the Australian Securities and Investment Commission (ASIC) Enforcement Review Taskforce Report and will:

- strengthen ASIC's licensing powers;
- bring ASIC's existing search warrant powers into line with those in the Crimes Act 1914 No. 12 (Cth);
- improve ASIC's ability to access certain telecommunications information; and
- extend ASIC's banning powers to ban individuals from managing financial services businesses.

1.6 The British Academy proposes principles for the age of purposeful business

27 November 2019 - The British Academy, the national body for the humanities and social sciences, has published Principles for Purposeful Business: How to deliver the framework for the Future of the Corporation (the Report), outlining the changes needed to put people and planet at the heart of corporate capitalism.

The report is the second major study published by the British Academy's Future of the Corporation programme, an independent initiative combining research, policy and business insights to reformulate the relationship between business and society.

The principles published in the report propose a new formula for corporate purpose: "the purpose of business is to profitably solve problems of people and planet, and not profit from causing problems".

The Report explains how this can be done, presenting eight principles for use in guiding lawmakers and business leaders and including reform of company law.

The principles aim to re-organise the corporate sector around purpose and around corporations' contributions to solving social, political and environmental challenges:

- **corporate law** should place purpose at the heart of the corporation and require directors to state their purposes and demonstrate commitment to them;
- **regulation** should expect particularly high duties of engagement, loyalty and care on the part of directors of companies to public interests where they perform important public functions;

- **ownership** should recognise obligations of shareholders and engage them in supporting corporate purposes as well as in their rights to derive financial benefit;
- **corporate governance** should align managerial interests with companies' purposes and establish accountability to a range of stakeholders through appropriate board structures. They should determine a set of values necessary to deliver purpose, embedded in their company culture;
- **measurement** should recognise impacts and investment by companies in their workers, societies and natural assets both within and outside the firm;
- **performance** should be measured against fulfilment of corporate purposes and profits measured net of the costs of achieving them;
- **corporate financing** should be of a form and duration that allows companies to fund more engaged and long-term investment in their purposes; and
- **corporate investment** should be made in partnership with private, public and not-for-profit organisations that contribute towards the fulfilment of corporate purposes.

As well as presenting the eight principles, the Report highlights the need for leadership from business, investors and government to bring about the necessary changes via a number of pathways. It also reinforces the case for change based on evidence of the widespread external impact of business activities and the global climate crisis presented previously by the British Academy in its 2018 Future of the Corporation report, Reforming business for the 21st century: A framework for the future of the corporation.

1.7 SEC proposes to modernise regulation of the use of derivatives by registered funds and business development companies

25 November 2019 - The United States Securities and Exchange Commission (SEC) has voted to propose a new rule designed to enhance the regulation of the use of derivatives by registered investment companies, including mutual funds, exchange-traded funds (ETFs) and closed-end funds, as well as business development companies. The proposed rule would provide an updated and more comprehensive approach to the regulation of funds' derivatives use.

The *Investment Company Act of 1940 (US)* limits the ability of registered funds and business development companies to obtain leverage, including by engaging in transactions that involve potential future payment obligations. Leverage is commonly thought of in terms of purchasing securities with borrowed funds. However, derivatives, such as forwards, futures, swaps and written options, can also create future payment obligations. The proposed rule would permit these funds to use derivatives that create such obligations, provided that they comply with certain conditions designed to protect investors.

These conditions include adopting a derivatives risk management program and complying with a limit on the amount of leverage-related risk that the fund may obtain, based on value-at-risk. A streamlined set of requirements would apply to funds that use derivatives in a limited way. The proposed rule would also permit a fund to enter into reverse repurchase agreements and similar financing transactions, as well as "unfunded commitments" to make certain loans or investments, subject to conditions tailored to these transactions.

Certain registered investment companies that seek to provide leveraged or inverse exposure to an underlying index - including leveraged ETFs - would not be subject to the proposed limit on fund leverage risk but instead would be subject to alternative requirements under the SEC's proposal. These funds would have to limit the investment results they seek to 300% of the return (or

inverse of the return) of their underlying index (i.e., three times leveraged). Sales of these funds also would be subject to proposed new sales practices rules. Under these new rules, a broker, dealer, or investment adviser that is registered with the SEC would have to exercise due diligence in approving a retail customer or client's account to buy or sell shares of these funds, as well as shares of exchange-listed commodity or currency pools that have similar investment strategies. These proposed new rules are designed to help ensure that retail investors in these products are limited to those who are capable of evaluating their characteristics - including that the funds would not be subject to all of the leverage-related requirements under the proposed rule applicable to registered investment companies generally - and the unique risks they present.

View:

- Fact sheet - SEC Proposes to Modernize Regulation of the Use of Derivatives by Registered Funds and Business Development Companies;
- Proposed Rule; and
- Division of Economic and Risk Analysis Staff Paper - Economics Note: The Distribution of Leveraged ETF Returns.

1.8 APRA proposes changes to prudential standard governing insurance in superannuation

25 November 2019 - The Australian Prudential Regulation Authority (APRA) has released for consultation proposed revisions to *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250).

The proposed changes are aimed at improving superannuation member outcomes by helping trustees select the most appropriate policies for their members, and monitor their ongoing relationships with insurers.

APRA's decision to update SPS 250 follows the release in April of the Post-implementation review of APRA's superannuation prudential framework (the Review). The Review recommended enhancements to APRA's requirements and guidance on the strategy, design and selection of insurers, and how these affect member outcomes.

APRA's proposed changes also respond to two of the recommendations from the Financial Services Royal Commission.

The proposed revisions, outlined in a letter to industry, will require:

- a process that enables beneficiaries to easily opt-out of insurance cover;
- that the level and type of insurance cover not inappropriately erode the retirement income of beneficiaries;
- that any status attributed to a beneficiary in connection with the provision of insurance is fair and reasonable (recommendation 4.15); and
- independent certification that insurance arrangements are in the best interests of beneficiaries (recommendation 4.14).

The consultation closes on 3 February 2020 and APRA will finalise the prudential standard by mid-2020. The revised standard will come into effect on 1 January 2021.

Insights from the consultation will also form the basis of a revised Prudential Practice Guide SPG 250 Insurance in Superannuation, which APRA will consult on early next year.

The letter outlining the proposed revisions and the draft prudential standard is available at: Consultation on Prudential Standard SPS 250 Insurance in Superannuation.

1.9 FSB publishes 2019 globally systemically important banks list

22 November 2019 - The FSB has published the 2019 list of global systemically important banks (G-SIBs) using end-2018 data and an assessment methodology designed by the Basel Committee on Banking Supervision (BCBS).

One bank (Toronto Dominion) has been added to the list of G-SIBs that were identified in 2018, and therefore the overall number of G-SIBs increases from 29 to 30.

FSB member authorities apply the following requirements to G-SIBs:

- higher capital buffer: the G-SIBs are allocated to buckets corresponding to higher capital buffers that national authorities require banks to hold in accordance with international standards. Compared with the 2018 list of G-SIBs, One bank has moved to a lower bucket: Deutsche Bank has moved from bucket 3 to bucket 2;
- Total Loss-Absorbing Capacity (TLAC): G-SIBs are required to meet the TLAC standard, alongside the regulatory capital requirements set out in the Basel III framework. The TLAC standard began being phased in from 1 January 2019 for G-SIBs identified in the 2015 list (provided that they continued to be designated as G-SIBs thereafter);
- resolvability: these include group-wide resolution planning and regular resolvability assessments. The resolvability of each G-SIB is also reviewed in a high-level FSB resolvability assessment process by senior regulators within the firms' Crisis Management Groups; and
- higher supervisory expectations: these include heightened supervisory expectations for risk management functions, risk data aggregation capabilities, risk governance and internal controls.

The BCBS has published updated denominators used to calculate banks' scores and the values of the underlying twelve indicators for each bank in the assessment sample. The BCBS also published the thresholds used to allocate the G-SIBs to buckets, as well as updated links to public disclosures of all banks in the sample.

A new list of G-SIBs will next be published in November 2020.

1.10 Retirement income review consultation

22 November 2019 - The Australian Treasury has published the Consultation Paper Retirement Income Review (the Consultation Paper). The Consultation Paper outlines some of the issues the

Retirement Income Review Panel will be considering and is intended as a guide to those making a submission.

The Retirement Income Review will identify:

- how the retirement income system supports Australians in retirement;
- the role of each pillar in supporting Australians through retirement;
- distributional impacts across the population and over time; and
- the impact of current policy settings on public finances.

The consultation is open until 3 February 2020.

1.11 UK Institute of Directors publishes plan to improve corporate governance

20 November 2019 - The United Kingdom (UK) Institute of Directors (the IoDs) has published a 10 point plan, IoD Manifesto Corporate Governance, to improve corporate governance.

The proposals include calling on government to support the establishment of a Code of Conduct setting out ethical standards for directors, and to encourage minimum requirements of new directors at sizable firms in terms of governance knowledge and skills.

With government outsourcing another major cause of public concern, the IoDs has recommended the creation of a new form of company, the Public Service Corporation (the PSC) to take on public contracts. The PSC would legally require businesses to balance the interests of shareholders with workers, the supply chain, and other stakeholders.

The IoDs has also advocated stronger rules around how companies report on their climate change impact, and for government to explore setting up a Sovereign Wealth Fund to invest in the green economy.

1.12 Report on open banking and application programming interfaces

19 November 2019 - The Basel Committee on Banking Supervision has published its Report on open banking and application programming interfaces (the Report). The Report monitors the evolving trend of open banking observed in Basel Committee member jurisdictions and the use of application programming interfaces.

Open banking is the sharing and leveraging of customer-permissioned data from banks with third-party developers and firms to build applications and services to provide more efficient and transparent options in banking. It comes with benefits to banks but also various challenges, such as risks to their business models and reputation, and issues regarding data privacy, cyber security and third-party risk management.

In response to this trend, banks and bank supervisors should pay greater attention to these challenges that accompany:

- the increased sharing of customer-permissioned data; and
- the growing connectivity of various entities involved in the provision of financial services.

1.13 APRA sets out stronger, more transparent approach to regulating and supervising GCRA risks

19 November 2019 - APRA has published its plans to scale up significantly its efforts to lift standards of governance, culture, remuneration and accountability (GCRA) across the industries it regulates.

In an information paper, APRA has set out a more intensive regulatory approach to transform GCRA practices across the prudentially regulated financial sector, in line with a key commitment made in APRA's Corporate Plan 2019-2023.

APRA's intensified approach to GCRA aims to strengthen the resilience of financial institutions, including addressing, and ideally preventing, issues such as poor risk governance, misaligned incentives and misconduct that have undermined public confidence in the financial sector over recent years.

The key attributes of APRA's new approach to GCRA are:

- strengthening the prudential framework in areas such as remuneration and risk management, and incorporating the wider use of risk governance declarations and self-assessments;
- sharpening APRA's supervisory focus by increasing internal resourcing and capabilities for GCRA supervision, adopting new tools to assess GCRA practices and holding entities more forcefully to account when deficiencies are identified; and
- sharing APRA's insights to better inform industry and the public about APRA's work, promote better GCRA practices, and drive greater accountability among boards and management.

The new approach builds on a program of work that APRA commenced in 2015, including APRA's thematic reviews of risk culture and remuneration, the Prudential Inquiry into the Commonwealth Bank of Australia, and the results of the subsequent self-assessments of a range of large financial institutions. It also responds to recommendations from the Financial Services Royal Commission and the APRA Capability Review.

Although governance, culture, remuneration and accountability are often termed "non-financial risks", a failure to address weaknesses in these areas can cause major financial losses through reputational damage, fines and expensive remediation programs. Remediation costs relating to issues identified in the Financial Services Royal Commission have cost industry in excess of $7 billion to date, and are likely to rise further as both new and historical issues come to light.

View Information Paper - Transforming governance, culture, remuneration and accountability: APRA's approach.

1.14 Gender diversity in UK financial services

18 November 2019 - The UK Financial Conduct Authority has published a Research Note on Gender diversity in UK financial services. The findings include:

- diversity has remained consistently low (approximately 17%), notwithstanding some variation by role seniority, firm size and sector;
- generally, the research found greater gender diversity in firms that are larger and less in customer-dealing roles;
- for a sample of 94 major institutions the typical share of female senior managers has grown relatively rapidly since 2005 (by 9 percentage points), but only from a low base (9%), bringing them as a group in line with the still low industry average. There is wide variation across individual firms in the sample, with gender diversity of senior management ranging from less than 5 to over 40%; and
- large investment management institutions have more gender diverse senior management; by contrast the sample suggests institutional brokerage is the least gender diverse subsector.

1.15 Cryptoassets and smart contracts valid in English law

18 November 2019 - Assets and contracts created with blockchain-type encryption technology have validity under existing English law, a group of legal experts chaired by a senior member of the judiciary has concluded. A 46-page legal statement published by the UK jurisdiction taskforce of the LawTech Delivery Panel concludes that:

- cryptoassets, including but not restricted to, virtual currencies, can be treated in principle as property; and
- smart contracts are capable of satisfying the requirements of contracts in English law and are thus enforceable by the courts. Statutory requirements for a signature can be met by techniques such as private key encryption.

1.16 Women in the boardroom report

30 October 2019 - Deloitte Global's sixth edition of Women in the boardroom: A global perspective reports that women hold just 16.9% of board seats globally, a 1.9% increase from the report's last edition published in 2017.

Women hold just 4.4% of chief executive office (CEO) positions globally. Chief financial officer (CFO) positions are nearly three times more diverse, but women still hold just 12.7% of these positions globally. Given that many board members are recruited from the executive level, this also contributes to a shortage of women in the boardroom.

Key findings from the research include:

- six countries have over 30% women on boards - Norway, France, Sweden, Finland, New Zealand, and Belgium. Three of these six have implemented gender quota legislation, while the other half have addressed diversity efforts without gender quotas;
- Norway, with 41% women on boards, was the first country to enact gender quota legislation (a 40% quota) in 2005;
- France, with 37% women on boards, also has a 40% gender quota which became effective in 2017;
- Belgium, with 30% women on boards, has a gender quota which requires at least a one-third representation of each gender on the board;
- Sweden, Finland and New Zealand have not implemented gender quotas, instead addressing diversity efforts through self-regulation and/or corporate governance code recommendations;
- Australia, Germany, Malaysia, Finland, and South Africa all increased their boardroom gender diversity by 5-7% since the report's last edition. And again, there is a split between countries with gender quota legislation and those without;
- Germany saw a 6.7% increase which is likely linked to recent gender quota legislation passed in 2015;
- Finland saw a 7.2% increase through corporate governance code recommendations and the encouragement of career development programs for women;
- Malaysia saw a 6.9% increase after implementing a series of targets for women in leadership positions, as well as through corporate governance code recommendations;
- South Africa also saw a 6.9% increase after implementing recommendations for listed companies to disclose targets for gender and race representation at the board level;
- similarly, Australia, which saw a 5% increase, has a recommendation that listed companies establish and disclose board diversity policies, as well as voluntary targets for gender representation on boards;
- Europe is home to five of the six countries with the highest boardroom gender diversity in the world, while other European countries have more than 20% women on boards and continue to advance boardroom diversity slowly;
- in the UK, 22.7% of board seats are held by women. While there are no quotas in place, significant efforts have been put in place to advance efforts such as the 2011 Davies Review target which called for FTSE100 companies to have at least 25% women on boards by 2015, which was achieved. The report's successor was launched in 2016 with a target of 33% representation of women on boards by the end of 2020;
- most of the Middle East region has very low representation of women in the boardroom. Some efforts have been put in place to address the challenge such as the United Arab Emirates' 2012 rule requiring all corporations and government agencies to include women on their boards of directors and Saudi Arabia's 2030 vision which aims to increase women's participation in the workforce;
- in the US, 17.6% of board seats are held by women, up from 14.2% two years ago. While there are no national quotas for women on boards, state measures have been passed to help increase women's representation on boards. This includes a measure in California, which became the first state to require specified numbers of female directors on the boards of public companies. The law has drawn criticism and a lawsuit was filed in August 2019 challenging the law as unconstitutional;
- the percentage of board seats held by women in Canada grew to 21.4%, a 3.7% increase since 2017;
- in Latin and South America, only 7.9% of board seats are held be women;
- Australasia has the highest boardroom gender diversity at 26.1%; and
- gender diversity in many of Asia's leading economies remains low at 9.3%. Only a few countries in the region have quotas or other targets to address the issue.

1.17 Report on the owners of the world's listed companies

17 October 2019 - There are approximately 41,000 listed companies in the world with a combined market value of more than USD $80 trillion. This is equivalent to the global gross domestic product. More than half of this amount is held by institutional investors and the public sector, according to a new Organisation for Economic Co-operation and Development report.

The report Owners of the World's Listed Companies (the Report) shows that Asia dominates in terms of the number of listed companies. In fact, 57% of the world's listed companies have selected an Asian stock exchange and together they account for 37% of the global market value. While only 10% of the world's listed companies are listed in the US, it is still the largest single market in terms of value with 36% of the global market value. Despite a marked decline in the number of listed companies during the last two decades, the US still has the largest listed companies in terms of market capitalisation. Almost half of the largest 100 listed companies are listed in the US market.

The Report cites three key features of today's ownership landscape with potential impact on how economies function. First is the effect of an increase in passive indexed investing on shareholder scrutiny and small growth company listings. Today, institutional investors hold 41% of global market capitalisation, much of which is in the form of passive indexing. For these investors, it may be quite rational to give little attention to risks and opportunities in individual companies. And as a consequence, not enough resources may be dedicated to the capital markets' key functions, which are to scrutinise individual corporate performance and provide new promising companies with capital that help them grow.

Second is the political influence on publicly traded companies that may follow from the significant amount of public sector ownership. Today 14% of global stock market capitalisation is held by the public sector - either through direct government ownership or through sovereign wealth funds, public pension funds and state-owned enterprises. And in almost 10% of the world's largest listed companies, the public sector hold more than 50% of the shares.

Third is the widespread concentration of ownership in individual companies. In half of the world's listed companies, the three largest shareholders hold more than 50% of the capital. This may help overcome the so-called agency problem that shareholders in companies with widely dispersed ownership may face. But it may also increase the scope for abusing the rights of other shareholders and, if not properly regulated, jeopardise market confidence.

The Report also notes that most advanced markets have seen a significant increase in ownership by foreign investors in recent decades. And today, cross-border investments account for almost one-quarter of the holdings in public equity markets in the world. Almost 75% of the cross-border investments in public equity markets are held by investors domiciled in the US and Europe. At the same time, these two markets also receive 60% of global cross-border investments in public equity.

2. Recent ASIC Developments

2.1 Superannuation industry urged to focus on improving insurance outcomes for members

13 December 2019 - ASIC has released a report on the superannuation industry's progress in improving consumer outcomes in relation to life insurance provided through superannuation.

Report 646 Insurance in superannuation 2019-20: Industry implementation of the Voluntary Code of Practice (REP 646) comments on industry's implementation of the Insurance in Superannuation Voluntary Code of Practice (the Code). It also provides useful context about why a focus on insurance in superannuation, held by approximately 12 million Australians, is important.

The Code sets standards of practice with the aim of improving industry practices in benefit design, claims handling and communications to members. 70% of superannuation trustees are adopting the Code in whole or part but full implementation is not due for completion until 30 June 2021.

In REP 646, ASIC observes that some improvements in practices are being introduced as a result of adoption of the Code by a significant number of trustees. However, further work needs to be done to achieve the high industry standards consumers expect.

ASIC's REP 646 follows the release in October 2019 of Report 633 Holes in the safety net: a review of TPD insurance claims which focused on total and permanent disability insurance, much of which is held through superannuation.

ASIC also plans further work looking at issues relevant to consumer outcomes in relation to insurance in superannuation. It is anticipated that this work will lead to the release of additional reports containing observations about the extent to which existing market practices concerning insurance in superannuation are delivering good outcomes for consumers.

2.2 Audit inspection findings: 12 months to 30 June 2019

12 December 2019 - ASIC has issued a report on the results from its audit firm inspections for the 12 months to 30 June 2019, and a supplementary report of audit quality measures, indicators and other information.

Report 648 Audit inspection report for 2018-19 found that auditors did not, in its view, obtain reasonable assurance that the financial report was free from material misstatement in 26% of the key audit areas that ASIC reviewed. The 26% figure relates to 207 key audit areas that ASIC reviewed across 58 audit files at 19 Australian audit firms of varying sizes. The largest numbers of adverse findings were in the audit of asset values, particularly impairment of non-financial assets and the audit of revenue. The results compare to 24% of key audit areas in the 18 months to 30 June 2018 and 25% in the 18 months to 31 December 2016.

ASIC has already adopted a broader, more intensive supervisory and enforcement approach as regards to audit. ASIC's new regulatory initiatives include:

- implementing ASIC's "why not litigate" approach to auditor conduct matters;
- an audit firm governance review looking at how conflicts of interest are managed within firms, firm culture and accountability mechanisms on audit quality, and firm talent for quality audits;
- reviewing the analysis of root causes by large firms on selected material changes to financial reports identified from ASIC's financial reporting surveillances;

- increased transparency by publishing the level of adverse findings for large audit firms; and
- publishing a broader group of audit quality measures and indicators.

Audit quality measures, indicators and other information

Report 649 Audit quality measures, indicators and other information: 2018-19 (REP 649) provides a broad group of audit quality measures, indicators and other information to supplement ASIC's audit inspection findings. REP 649 is intended to promote:

- discussion on the measures and indicators that might be used by auditors and audit committees in monitoring initiatives to improve audit quality; and
- good behaviours by auditors and audit committees that support audit quality.

The measures and indicators presented in REP 649 are likely to change in future years as:

- ASIC reassesses the relevance and usefulness of each measure and indicator; and
- more information to support new measures becomes available.

Changes and trends in the measures, indicators and other information over time may also provide useful additional information in the future.

Audit inspection process

ASIC has also updated Information Sheet 224 ASIC audit inspections, which provides further information on its audit inspection process.

2.3 Outcomes of review into internal market making for quoted managed funds

11 December 2019 - ASIC has concluded a review of internal market making practices of non-transparent actively managed funds that are traded on exchange markets.

The review identified market integrity risks under certain internal market-making models- particularly those models where a market maker uses non-public information as part of its pricing methodology. In some models, market-maker quotes are lead indicators of changes to fund portfolio values rather than responding to publicly available information such as indicative net asset values (iNAVs).

ASIC has identified measures firms can implement to manage these risks, set out below. Subject to these controls, ASIC has requested that exchange market operators lift the pause on the admission of new managed funds with internal market making (see 19-195MR ASIC implements pause on admission of managed funds with internal market makers).

ASIC intends to work with market operators and other stakeholders to ensure new funds being admitted for quotation use compliant models, and changes that are required to existing models are made as soon as possible. ASIC also intends to provide stakeholders with more information about its findings and update Information Sheet 230 Exchange traded products: Admission guidelines in early 2020 with guidelines on better practices for managing non-public information.

Some key outcomes of the review are:

- several internal market making practices currently used in Australia raise market integrity concerns because internal market makers have access to non-public information when making decisions about the market quotes they provide.
  Note: In particular, the use of the fund's portfolio composition information by the responsible entity or its market making agent to generate an internal, non-public "fair value" as the reference price for market making may raise market integrity risks whenever this "fair value" deviates from the publicly available iNAV. This includes circumstances where the only difference between the iNAV and the "fair value" methodologies is the frequency of calculation;
- to manage these risks responsible entities and market making agents should review their current arrangements and ensure that:
  - the input for market-making quotes is a reference price or other information that is publicly available;
  - internal compliance and supervision arrangements are adequate;
  - information barriers are established to ensure decisions to buy or sell units are not made by persons or systems with knowledge of the current portfolio holdings; and
  - there are adequate arrangements for identifying and responding to instances of substantial information asymmetry in the market, which may include cessation of market making activities or requesting a trading halt; and
- ASIC has also reviewed alternative frameworks in other jurisdictions for conducting market making in actively managed funds that do not disclose their portfolio holdings daily. ASIC will continue to monitor international developments. ASIC's current position is that, with the aforementioned controls in place, internal market making can be an appropriate framework to facilitate the trading of actively managed funds that do not disclose their full portfolio holdings daily on exchange markets.

2.4 Updated responsible lending guidance

9 December 2019 - ASIC has published updated guidance on the responsible lending obligations that are contained in the National Consumer Credit Protection Act 2009 No. 134 (Cth) (the NCCP Act).

Following an extensive consultation, ASIC has updated Regulatory Guide 209 Credit licensing: Responsible lending conduct (RG 209) to provide greater clarity and support to lenders and brokers in meeting their obligations.

The changes include:

- a stronger focus on the legislative purpose of the obligations - to reduce the incidence of consumers being encouraged to take on unsuitable levels of credit, and ensure licensees obtain sufficient reliable and up-to-date information about the consumer's financial situation, requirements and objectives to enable them to assess whether a particular loan is unsuitable for the particular consumer;
- more guidance to illustrate where a licensee might undertake more, or less, detailed inquiries and verification steps based on different consumer circumstances and the type of credit that is being sought. The updated guidance includes new examples about a range of different credit products including large and longer-term loans, credit cards and personal loans, small amount loans and consumer leases and different kind of consumer

circumstances - such as first home buyers, existing customers, strata corporations, high net worth and financially experienced consumers;
- more detailed guidance about how spending reductions may be considered as part of the licensee's consideration of the consumer's financial situation, requirements and objectives;
- more detailed guidance about the use of benchmarks as a way to check the plausibility of expenses, as well as additional guidance about the Household Expenditure Measure benchmark; and
- clarity about more complex situations for some consumers - for example the different situations of consumers such as income from small business, casual employees, new employees, the gig economy, as well as joint and split liabilities and expenses.

ASIC has also included a section on the scope of responsible lending, explaining the areas that are not subject to responsible lending obligations - such as small business lending irrespective of the nature of the security used for the loan.

The NCCP Act provides consumers with important protections when seeking credit directly from a lender or through a broker. ASIC's revised guidance is intended to assist lenders and brokers to comply with their responsible lending obligations and ensure that they do not recommend or provide credit that is unsuitable.

The guidance has also been updated to reflect technological developments including open banking and digital data capture services. RG 209 notes the cost and ease of access to transaction information will be improved over time, which should improve lenders' overall view of a consumer's financial situation.

ASIC has also published its response to submissions made to Consultation Paper 309 Update to RG 209: Credit licensing: Responsible lending conduct and a tool to assist users of RG 209 to navigate the updated structure of the document.

View:

- RG 209;
- Report 643 Response to submissions on CP 309 Update to RG 209: Credit licensing: Responsible lending conduct; and
- Navigation Guide.

2.5 Report on consumer harm from timeshare schemes

6 December 2019 - An ASIC report provides detailed insights into the risks of harm at each stage of a consumer's journey with time-sharing schemes (timeshare).

Report 642 Timeshare: Consumers' experiences (REP 642) presents key findings from qualitative research commissioned by ASIC to explore consumers' experiences with timeshare from the initial approach and sale through to membership use and the exit process.

The key findings from the research were that, while some research participants were satisfied with their timeshare membership, there was a high level of discontent overall. Many consumers felt that they were not getting the expected value from their membership and that they had

experienced financial stress because of unexpected changes to membership fees, or in some cases, to their personal circumstances.

According to 2018-2019 data sourced from the Australian Timeshare Holiday Owners Council, consumers pay $23,000 on average for their timeshare membership and about $800 in ongoing annual membership costs. The loan interest rate is 13.5% on average, and 48% of consumers who bought or upgraded their membership took a loan to do so.

Timeshare memberships generally range from 20 to 99 years. While most research participants were generally aware of the long-term contract period, they had not considered their options if they could no longer afford their membership or if the financial liability was to be transferred to a family member in the future.

View:

- REP 642; and
- Timeshare Risks & Harms.

2.6 Financial reporting focuses for 31 December 2019

6 December 2019 - Announcing its focus areas for 31 December 2019 financial reports of listed entities and other entities of public interest with many stakeholders, ASIC has called on companies to focus on new requirements that can materially affect reported assets, liabilities and profits.

New accounting standards

Major new accounting standards will have the greatest impact on financial reporting for many companies since the adoption of International Financial Reporting Standards in 2005.

Full year reports at 31 December 2019 must comply with a new accounting standard on lease accounting that requires lessees to recognise lease liabilities and a right-of-use asset for all leases, not just leases formerly classified as finance leases. Some leases and similar arrangements are covered by other accounting standards such as mining leases and leases of biological assets.

This is also the second full year that new accounting standards on revenue recognition and financial instrument values (including hedge accounting and loan loss provisioning) have applied.

The reports must also disclose the future impact of a new standard on accounting by insurers, and new definition and recognition criteria for assets, liabilities, income and expenses.

It is important that directors and management ensure that companies inform investors and other financial report users of the impact on reported results. Required disclosure on the effect of the new standards is more extensive than that made by many companies for the 30 June 2019 half year.

Many Australian Financial Services (AFS) licensees are subject to financial condition requirements that may be affected by the new standards. For example, a net tangible assets

requirement would include lease liabilities but intangible assets such as a lease right-of-use asset would not be counted in meeting that requirement.

Directors and auditors of AFS licensees should report any breaches of financial condition requirements to ASIC as required by the Corporations Act 2001 No. 50 (Cth). Because the financial condition requirements are on an "at all time" basis, compliance needs to be considered from the commencement of the financial year to which the standard first applied. This is the case even if ASIC were to subsequently change a licensee's conditions to allow right-of-use assets to be counted. Similar issues may arise with contract assets recognised in accordance with the revenue standard.

ASIC will be reviewing more than 80 full year financial reports at 31 December 2019 to promote quality financial reporting, and useful and meaningful information for investors.

The role of directors

Directors are primarily responsible for the quality of the financial report. This includes ensuring that management produces quality financial information on a timely basis. Companies must have appropriate processes, records and analysis to support information in the financial report.

Companies should apply appropriate experience and expertise, particularly in more difficult and complex areas such as accounting estimates (including impairment of non-financial assets), accounting policies (such as revenue recognition) and taxation.

Further information can be found in Information Sheet 183 Directors and financial reporting and Information Sheet 203 Impairment of non-financial assets: Materials for directors.

Governance review

ASIC will review the governance processes over financial reporting of several companies, generally where reported net assets and profits were materially changed following its inquiries on financial reports for recent reporting periods. ASIC's work will cover how audit committees and directors fulfilled their role in ensuring the quality of the financial reporting and supporting the audit. ASIC will also review the identification and effectiveness of actions by firms to address root causes from an audit perspective. ASIC will consider whether the results of this review indicate a need to improve governance at the company and/or audit firm. ASIC anticipates completing this work by 30 June 2020.

More detailed information on focus areas for 31 December 2019 is provided in 19-341MR Financial reporting focuses for 31 December 2019.

2.7 Report on mining and exploration initial public offers

5 December 2019 - An ASIC review of mining and exploration initial public offers (IPO) has found that companies, directors and lead managers need to implement better practices that take account of the unique characteristics and vulnerabilities of the micro-cap sector.

Report 641 An inside look at mining and exploration initial public offers (REP 641) considered IPO practices and processes from inception through to on-market trading.

ASIC's review found that:

- some lead managers give preference to a select subset of investors. Retail investors not associated with a lead manager or their networks had limited access to IPO investments. One potential consequence of this can be an environment encouraging a rapid return on the initial investment rather than an investment aimed at the medium to longer term returns;
- this can be exacerbated by the fact lead managers often initiate the IPO origination. In this way, some professional advisers target the sector in order to generate those immediate returns on an investment, gaining a disproportionate benefit through their early, direct involvement in the process;
- the prevalence of conflicts of interest is a significant concern, leading to potential misconduct and unfair outcomes. This is because lead managers may act for both the company and investing clients, hold direct interests in the company, have representatives on the board or provide other ongoing services;
- promotional materials such as investor presentations, explanatory material and email marketing methods are often subject to substandard compliance controls, and yet they can have a significant influence on investors' perceptions and actions; and
- IPO transaction design and structure may lead to a distorted and unsustainable market demand in the securities' short-term trading, at the expense of longer investment horizons more appropriate for the delivery of exploration programs.

ASIC encourages companies, directors and lead managers to have regard to the better practice recommendations outlined in the report and eliminate, or at least recognise and appropriately manage, conflicts of interest.

View REP 641.

2.8 ASIC to ban unfair cold call sales of direct life insurance and CCI

4 December 2019 - ASIC has announced the implementation of a ban on unsolicited "cold call" telephone sales of direct life insurance and consumer credit insurance. The ban will address poor sales practices that have led to unfair consumer outcomes. It will take effect from 13 January 2020.

The ban is consistent with recommendations made by the Financial Services Royal Commission and provides protections to consumers that complement broader legislative reform by the government.

The ban complements enforcement action ASIC has undertaken for past poor sales conduct by insurers. CommInsure was recently fined $700,000 after pleading guilty to unlawful unsolicited telephone sales of life insurance. ASIC has also commenced civil penalty proceedings against Select AFSL Pty Ltd relating to telephone sales of life and accidental injury insurance.

In July 2019, ASIC consulted on the ban and sought feedback in Consultation Paper 317 Unsolicited telephone sales of direct life insurance and consumer credit insurance (CP 317). Of the 15 non-confidential responses ASIC received, no respondents opposed the ban.

ASIC has also updated its guidance in Regulatory Guide 38 The hawking provisions (RG 38) to reflect the ban.

View:

- RG 38;
- Report 640 Response to submissions on CP 317 Unsolicited telephone sales of direct life insurance and consumer credit insurance;
- Submissions on CP 317; and
- ASIC Corporations (Hawking - Life Risk Insurance and Consumer Credit Insurance) Instrument 2019/839.

2.9 Report on financial advice provided by superannuation funds

3 December 2019 - ASIC has released Report 639 Financial advice by superannuation funds (REP 639). REP 639 examines the ways in which superannuation funds help members obtain financial advice and the quality of personal advice obtained through the funds.

In conducting the work, ASIC surveyed 25 superannuation funds about how they help members obtain financial advice (survey) and reviewed a sample of the personal advice provided (advice review). ASIC looked at a cross-section of the Australian superannuation industry and surveyed 11 retail funds, 10 industry funds, two corporate funds and two public sector funds.

Overall, ASIC found that the quality of personal advice provided to members was generally appropriate.

According to responses provided by trustees of the superannuation funds:

- the most popular advice topics sought by members were member investment choice, contributions and retirement planning;
- general advice made up 75% of advice accessed by members from the funds;
- four of the 25 funds surveyed did not offer personal advice to members;
- across all the funds that offer advice services to members, the most common delivery channels for providing advice to members were in-house call centres and advice providers employed by a related party;
- across all funds, the key conflicts of interest identified by trustees were vertical integration, relationships with third-party advice providers, and bonuses paid to advice providers; and
- the majority of superannuation funds intend to increase their use of digital tools in the coming year.

To help superannuation trustees continue to improve the advice services they offer fund members, ASIC has included a number of practical tips in REP 639 for trustee, advice licensees and advice providers.

View REP 639.

2.10 ASIC and APRA issue updated MoU

29 November 2019 - ASIC and APRA have published an updated Memorandum of Understanding (MoU).

The updated MoU follows on from the recommendations of the Financial Services Royal Commission. Recommendation 6.9 of the Financial Services Royal Commission recommended that the law should be amended to oblige ASIC and APRA to cooperate, share information to the maximum extent practicable and notify the other whenever it forms the belief that a breach for which the other agency has enforcement responsibility may have occurred.

Recommendation 6.10 of the Financial Services Royal Commission stated that ASIC and APRA should prepare and maintain a joint memorandum setting out how they intend to comply with their statutory obligation to cooperate.

The updated MoU is available on the ASIC website.

2.11 Updated Regulatory Guide 97 on fees and cost disclosure

29 November 2019 - ASIC has released updated guidance on fees and cost disclosure for issuers of superannuation and managed investment products.

The updated version of Regulatory Guide 97 Disclosing Fees and Costs in PDSs and Periodic Statements (RG 97) explains how product issuers and platform operators should disclose fees and costs.

ASIC's update of RG 97 follows public consultation after an external expert review of the regulatory guide as well as consumer testing of proposed changes to the presentation of fees and costs (see Background).

The main changes to fees and costs disclosure are:

- a re-grouping of values in the re-named fees and costs summary to more clearly show fees and costs that are *on-going* and those that are *member-activity based*;
- a simplification of ongoing fees and costs into three groups - *Administrative, Investment and Transaction*;
- including a single "Cost of Product" figure in a Product Disclosure Statement (PDS); and
- simplifying how fees and costs are presented in periodic statements.

Also, the guidance and associated legislative instrument have been drafted to make the regime more practical for industry and promote compliance by issuers with their legal obligations.

- the guidance has separate sections dealing with superannuation and managed investment products;
- modification of the legislation has been done by way of a legislative instrument that includes a consolidated version of Schedule 10 of the Corporations Regulations 2001 No. 193 (Cth); and

- the costs categories that need to be counted in the disclosed amounts have been clarified, including confirming that some categories that are hard to accurately measure consistently and have limited value for users need not be included (e.g. implicit market costs).

Transition to new requirements

The new disclosure requirements in updated RG 97 will apply to all PDSs issued on or after 30 September 2020.

Periodic and exit statements with reporting periods commencing from 1 July 2021 must comply with the new requirements. However, where a fund is ready, an early opt-in is available for reporting periods commencing from 1 July 2020.

The existing requirements under ASIC Class Order [CO 14/1252] and the transitional version of RG 97 will continue to apply until the end of the transition period. However, industry should note that the updated version of RG 97 provides clearer guidance about those existing fees and costs disclosure requirements that have not changed.

Separately, ASIC will undertake focussed work on fees and costs disclosure on platform arrangements in 2020. ASIC will also work with industry bodies to clarify how financial advisers should use fees and costs information when giving advice.

ASIC will also monitor fees and costs disclosure going forward and consider taking action where it finds misconduct.

To give effect to the new fees and costs disclosure regime, ASIC has released:

- RG 97;
- ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070;
- ASIC Corporations (Amendment) Instrument 2019/1071;
- Report 637 Response to submissions on CP 308 Review of Regulatory Guide 97; and
- Report 638 Consumer testing of the fees and costs tools for superannuation and managed investment schemes.

2.12 Report on compliance with financial advice fee disclosure obligations

28 November 2019 - A new report about fee disclosure obligations released by ASIC has found that consumers receiving financial advice could be at risk of receiving wrong information about advice fees, or in some cases, being charged fees after ongoing fee arrangements have terminated.

Report 636 Compliance with the fee disclosure statement and renewal notice obligations (REP 636) reports on ASIC's compliance assessments of fee disclosure statements (FDSs) and renewal notices (RNs) issued by 30 randomly sampled AFS licensees and their representatives. The review focused on whether the fee disclosure documents provided to clients complied with the law and if not, the nature of the failures.

The provision of FDSs are important legal obligations for consumer protection that were introduced as part of the Future of Financial Advice reforms in 2013. When AFS licensees or

their representatives are recipients of fees from clients under ongoing fee arrangements, they are required by law to provide FDSs and RNs to their clients in a timely manner.

For this review, ASIC required the 30 AFS licensees to produce samples of FDSs and RNs to ASIC for assessment. 1,496 FDSs and 373 RNs were collected and analysed by ASIC along with fee disclosure policies and procedures. ASIC also commissioned a compliance consultant to review 176 FDSs in detail to determine whether the contents complied with legal requirements.

Non-compliance by fee recipients ranged from less material and technical breaches to more significant breaches. The review found that 7% of the FDSs required to be given to clients by law, were not given. In 35% of the instances when an RN was required, an RN was not given.

Of the 176 FDSs reviewed in detail:

- 80% did not include all the required information about services that clients were entitled to receive;
- 73% did not cover all the information about services that clients received; and
- 44% did not include the amount of each fee paid by the clients.

When reviewing policies and procedures, ASIC found that more than half of licensees did not have effective processes to remind them when RNs are due or to turn off ongoing fees.

REP 636 provides practical tips for AFS licensees and their representatives to improve their compliance with the FDS and RN obligations. Fee recipients should consult ASIC's Regulatory Guide 245 Fee disclosure statements (RG 245) for more detailed guidance.

Separately, ASIC is investigating a number of other advice licensees for potential breaches of the FDS and RN obligations. ASIC will determine whether court action is appropriate at the end of these investigations.

View:

- REP 636; and
- RG 245.

2.13 ASIC outlines approach to advice licensee obligations for the financial adviser code of ethics

26 November 2019 - ASIC has taken action to provide certainty to AFS licensees that they will not be in breach of the law because their financial advisers were not able to register with an ASIC approved compliance scheme by 1 January 2020, as originally required.

ASIC's action follows a government announcement that it would accelerate the establishment of a single disciplinary body for financial advisers and the withdrawal of applications for ASIC approval of a compliance scheme.

ASIC will not be monitoring or enforcing individual advisers' compliance with the Financial Planners and Advisers Code of Ethics 2019 (Cth) (the Code). Under the Corporations Act 2001

No. 50 (Cth), ASIC does not have a role as a code monitoring body and is specifically prevented from exercising its power to ban an adviser for breaches of the Code.

The Code was set by the Financial Adviser Standards and Ethics Authority (FASEA) in February 2019. In October 2019, FASEA issued guidance about the interpretation of the Code. FASEA is currently consulting about the guidance. The new single disciplinary body will displace the role of compliance schemes in monitoring and enforcing the Code.

Financial advisers will still be required to comply with the Code from 1 January 2020 and AFS licensees will still be required to take reasonable steps to ensure that their financial advisers comply with the Code. However, after consultation with FASEA, ASIC will take a facilitative approach in its compliance with Standards 3 and 7 of the Code until the new single disciplinary body is operational.

The reasonable steps that ASIC expects AFS licensees to take to ensure that their financial advisers comply with the Code include the following systems and processes:

- making sure that their advisers are aware that they need to comply with the Code from 1 January 2020 onwards;
- providing training and/or guidance to their advisers on the types of conduct that is consistent/inconsistent with the Code;
- facilitating individual advisers' ability to raise concerns with the AFS licensee about how the licensee's systems and controls may be hindering their ability to comply with the Code, and acting on those concerns where appropriate;
- considering whether advisers are complying with the Code as part of their regular, ongoing monitoring of adviser conduct; and
- when it is in place, considering the decisions of the new disciplinary body and making any necessary changes to their systems and processes.

In determining what constitutes reasonable steps ASIC will take into account the context in which AFS licensees are operating. This includes the current dynamic regulatory environment, the timing of guidance provided by FASEA about the meaning of the Code, and the evolving industry understanding about the meaning and implications of the Code.

As noted above, AFS licensees will still be required to take reasonable steps to ensure that their financial advisers comply with the Code from 1 January 2020, and advisers will still be obliged to comply with the Code from that date onwards. ASIC may take enforcement action where it receives breach reports.

ASIC will continue to take action where there are breaches of the law by financial advisers or their AFS licensees.

3. Recent ASX Developments

3.1 Amendments to ASX listing rules and guidance notes

On 1 December 2019, the Australian Securities Exchange (the ASX) released a number of updates to the *ASX Listing Rules* and associated *ASX Guidance Notes*. The purpose of these

amendments was to simplify, clarify, and enhance the integrity and efficiency of the *ASX Listing Rules* as follows:

- the *ASX Listing Rules* saw significant amendments to multiple chapters and Appendices;
- several *ASX Guidance Notes* were amended to reflect the changes made to the Listing Rules; and
- a new *ASX Guidance Note 35 Security Holder Resolutions* was introduced consolidating the materials on meetings of security holders and giving additional guidance to issuers on the requirements for security holder resolutions under the *ASX Listing Rules*.

View the Consultation Response Simplifying, clarifying and enhancing the integrity and efficiency of the ASX listing rules.

3.2 Public consultation - Tranche 1 rule amendments for the CHESS replacement system

On 15 November 2019, the ASX released a consultation paper on the first of three tranches of amendments to the *ASX Settlement Operating Rules*, *ASX Clear Operating Rules* and *ASX Operating Rules* and associated *Procedures* required to facilitate the implementation of the new system that will replace the Clearing House Electronic Subregister System (CHESS) in April 2021.

The proposed changes are being made to:

- implement new business requirements for the CHESS replacement system, which were outlined in the Consultation Paper CHESS Replacement: New Scope and Implementation Plan released by the ASX in April 2018;
- reflect the re-engineering of some existing functionality;
- decommission some existing CHESS functionality; and
- implement other miscellaneous changes - including additional emergency assistance provisions, clarifications and changes to correct errors.

The objective of this consultation is to seek feedback on the operation of the proposed rule amendments and any unintended consequences.

Written submissions are requested in electronic form by 17 January 2020. The Consultation Paper CHESS Replacement Tranche 1 Rule Amendments is available on the ASX website.

4. Recent Takeovers Panel Developments

4.1 Donaco International Limited 03R - Panel declines to conduct proceedings

27 November 2019 - The Takeovers Panel (the Panel) has announced that it has declined to conduct proceedings on an application dated 14 November 2019 from Donaco International Limited (Donaco) in relation to its affairs. The application sought a review of the initial Panel's

decision to decline to conduct proceedings in relation to Donaco's initial application (see TP19/66).

The Panel agreed with the initial Panel's reasons and conclusions in *Donaco International Limited 02* [2019] ATP 23. 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 the Takeovers website.

5. Recent Research Papers

5.1 Worker representation on US corporate boards

This article argues that workers should have representation on corporate boards of directors and explores the policy choices available in the US context to achieve the goal of worker representation. Effectively implementing such a reform requires consideration of key issues, including:

- how many directors should represent employees;
- how they should be chosen and who counts as a worker when the choice is made;
- how they should meaningfully represent workers, and what information the board owes the workforce;
- how these choices are different in a unionised or non-union context; and
- the relationship between a worker's role as director and employee, in terms of pay, time, and protection from repercussions at work.

View Worker Representation on U.S. Corporate Boards.

5.2 Encouraging long-term shareholders: The effects of loyalty shares with double voting rights

The 2014 passage of the *Florange Act* in France changed an opt-in provision for loyalty shares (allocating a second voting right for shares held at least two years) to an opt out provision with shareholder approval. The authors find that before 2014, loyalty shares were popular among small family firms. Following the *Florange Act*, firms with a one share - one vote structure that announced they would opt out of the law incurred a negative market reaction, suggesting that shareholders have a positive perception of loyalty shares. It appears that by encouraging costly monitoring by long-term shareholders, loyalty shares can potentially benefit all shareholders.

View Encouraging Long-Term Shareholders: The Effects of Loyalty Shares with Double Voting Rights.

5.3 Pathways to materiality: How sustainability issues become financially material to corporations and their investors

As sustainability issues, also labelled environmental, social and governance issues, become financially material, companies, investors and regulators are designing strategies and policies to improve sustainability disclosure and performance. In this article, the authors outline a framework of how sustainability issues become financially material arguing that materiality is not a "state of being" but a "process of becoming". The framework could assist companies and investors to make resource allocation decisions based on expectations about future materiality, social entrepreneurs and non-profit organisations to develop their theories of social change, and policy makers to design disclosure regulations. Moreover, the framework generates predictions about the conditions under which sustainability issues become financially material that could be empirically tested in the future.

View Pathways to Materiality: How Sustainability Issues Become Financially Material to Corporations and Their Investors.

5.4 Spinning the CEO pay ratio disclosure

The US SEC recently mandated disclosure of the CEO pay ratio, which is the annual compensation of the CEO scaled by that of the median employee. The authors examine pay ratio disclosures to ascertain how managers use discretion afforded by the SEC to potentially shape the stakeholder reception. Firms with higher pay ratios overall or within an industry tend to use more exemptions that influence the reported employee pay. Their disclosures also contain lengthier pay ratio narratives and have a greater propensity to use corporate spin language in describing its construction. In turn, disclosing higher pay ratios attracts negative media attention, increases shareholder voting dissent on executive compensation, and diminishes labour productivity. The use of spin exacerbates these outcomes. Much of the stakeholder reaction stems from the unexpected portion of the pay ratio and its components. The findings shed light on the real effects of disclosing information about the gap between executive and employee compensation. Managers attempt to assuage negative perceptions of reporting high vertical pay disparity, but these efforts are not successful.

View Spinning the CEO Pay Ratio Disclosure.

5.5 Liability within corporate groups: Parent company's accountability for subsidiary human rights abuses

Multinational enterprises have outsourced production and distribution to layers of subsidiaries and contractors to expand into new markets and increase profitability. This compartmentalisation of the enterprise is facilitated by company laws and has resulted in risk shifting, excessive risk taking and lack of remediation for those injured. Company laws in virtually all jurisdictions allow for corporate personality, which means that the law sees shareholders and the company, or the company and its subsidiaries, as separate entities with their own assets, rights and obligations. The law erects a firewall that makes claims against parent companies extremely difficult. In economic terms, this "separation principle" means the exposure of investors is capped; there is

limited liability as investors can limit their losses by keeping assets separated. Parent companies can pursue outsourcing without commensurate responsibility for losses caused by their expansive operations.

This chapter of a book offers reference points to facilitate analysis, and reviews options for reform. Corporate accountability writings often recognise in the separation principle one of the most significant obstacles on the path to increased access to remedies. In terms of structure, section 2 shows the difficulties posed by legal separation and discusses the corporate group as a legal and economic entity. Section 3 presents the current situation in law (company law, tort law, and other regulatory areas) and policy (international soft law, and national action plans on business and human rights). Section 4 covers proposals for regulatory reform and puts them into perspective by explaining the resilience of the principle and its deep ramifications.

View Liability within Corporate Groups: Parent Company's Accountability for Subsidiary Human Rights Abuses.

6. Recent Corporate Law Decisions

6.1 High Court holds that courts have no power to make common fund orders in class actions

(By Moira Saville, Alexander Morris and Armen Varvachtian, King & Wood Mallesons)

BMW Australia Ltd v Brewster; Westpac Banking Corporation v Lenthall [2019] HCA 45 (4 December 2019) High Court of Australia, Kiefel CJ, Bell, Gageler, Keane, Nettle, Gordon and Edelman JJ

(a) Summary

In a highly anticipated decision, the High Court of Australia (the High Court) has rejected, by a 5:2 majority, the proposition that the Federal Court of Australia and the Supreme Court of New South Wales have power to make common fund orders in class actions. Allowing the appeals of Westpac and BMW against judgments of the Full Court of the Federal Court and the New South Wales Court of Appeal respectively, the High Court's decision requires litigation funders to re-evaluate their business models and the nature of their involvement in representative proceedings. While by no means shutting the door to the viability of funding class actions, the decision underscores the fact that litigation funding is an entrepreneurial endeavour and that, to earn returns, funders must expend effort and carefully evaluate risk.

(b) Background

(i) What is a common fund order?

The so-called "common fund order" is one of the mechanisms which evolved, through judicial decisions in recent years, to address the potential for a disparity of outcomes as between funded and unfunded group members in a funded class action. In circumstances where some, but not all, group members in a class action have signed funding agreements with a third party litigation funder requiring that some of their recoveries in the proceeding be applied to legal costs and a funder's commission, a free rider problem arises to the extent that, if the class action is successful, group members who have not signed such an agreement would receive a greater benefit than

those who have entered into a funding agreement. In other words, there is little economic incentive for a group member to sign a funding agreement if someone else (i.e., the representative applicant) has already done so and the group member could derive a better result without doing so. It has been held to be:

"uncontentious that unfunded class members in a class action should not receive more in the hand from a settlement or judgment than funded class members, who effectively financed the proceeding by pooling their promises to pay a funding commission to the Funder." (*Caason Investments Pty Ltd v Cao (No 2)* [2018] FCA 527 at [161] per Murphy J)

By obliging all group members - whether funded or not - to pay their recoveries into a so-called "common fund", which is to be applied to legal costs and a funder's commission before distribution to group members, a common fund order means that "all class members will pay the same pro rata share of legal costs and funding commission from the common fund of any amounts they receive in settlement or judgment": *Pearson v State of Queensland* [2017] FCA 1096 at [22] per Murphy J. In other words, common fund orders impose on group members, who have chosen not to sign funding agreements, the economic consequences they would have borne (in the form of a diminution of their recovery in the proceeding) had they, instead, signed on the dotted line. This represents a significant commercial benefit for litigation funders, who stand to derive significant commercial returns without having to do the legwork of building a book of interested group members, and undertaking an analysis of the viability of a class action having regard to its risk profile and the balance of costs against potential benefits.

(ii) Can the courts do that?

Noting that they impose obligations on group members without their consent, common fund orders are not universally accepted as being desirable, particularly where other mechanisms for bringing about equality of treatment between funded and unfunded class members may be available: *Asirifi-Otchere v Swann Insurance (Aust) Pty Ltd* [2019] FCA 1500 per Gleeson J. However, the courts have identified that common fund orders have certain benefits and, in a line of authorities in recent years, they have determined that they do have power to make such orders: see, eg, *Money Max Int Pty Ltd v QBE Insurance Group Ltd* [2016] FCAFC 148; *Westpac Banking Corporation v Lenthall* [2019] FCAFC 34; and *Brewster v BMW Australia Ltd* [2019] NSWCA 35. The source of their power to do so has been identified as being s. 33ZF of the Federal Court of Australia Act 1976 No. 156 (Cth) (the FCA Act) and its counterparts in comparable state legislation (in New South Wales (NSW): s. 183 of the Civil Procedure Act 2005 No. 28 (NSW)). Section 33ZF(1) of the FCA Act provides that:

"In any proceeding (including an appeal) conducted under this Part [IVA], the Court may, of its own motion or on application by a party or a group member, make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding."

Until Westpac and BMW asked it to do so, the High Court had not passed judgment upon the correctness of the view that this empowers the making of common fund orders. In this case, the nation's highest court spoke the final judicial word on the question.

(c) Facts

In the Westpac litigation, it is alleged that group members were given advice by Westpac, through its financial advisers, on insurance and the premiums payable for it, and purchased insurance policies from Westpac Life by reason of that advice. It is alleged that, in providing the advice, the relevant financial advisors breached their fiduciary duties, and statutory best interests

and no conflict obligations. It is said that there are over 80,000 group members in the class action, with each claim potentially being worth up to $15,000.

In the BMW case, it is alleged that group members suffered loss as a result of BMW installing faulty airbags in its vehicles. BMW is said to have contravened provisions of the formerly known Trade Practices Act 1974 No. 51 (Cth) and the *Australian Consumer Law* in Schedule 2 (The Australian Consumer Law) of the Competition and Consumer Act (2010) 1974 No. 51 (Cth) by supplying the vehicles to group members, who may number in the order of 200,000 people.

In each case, costs are being funded by a third-party litigation funder. In each case, a relatively small number of group members has entered into a funding agreement with the relevant funder. In these circumstances, the funders sought common fund orders. The Federal Court made a common fund order in the Westpac case, rendering all group members in that proceeding liable for a proportionate share of the legal costs of the proceedings as well as a commission for the funder. Westpac appealed to the Full Court. In the BMW case, the Supreme Court removed the question whether it has the power to make the common fund order to the Court of Appeal.

The two appeals were heard at the same time and in the same courtroom during a historic concurrent sitting of the Full Court of the Federal Court and NSW Court of Appeal. Each court, in separate decisions, held that they had power to make common fund orders.

Westpac and BMW appealed to the High Court.

(d) Decision

(i) High Court finds the courts had no power to make common fund orders

A majority of five judges of the High Court found that, properly construed, s. 33ZF of the FCA Act (and its NSW equivalent) did not empower the courts to make common fund orders. The plurality - Kiefel CJ, Bell and Keane JJ - said that, although the power conferred by those sections is wide, they:

"empower the making of orders as to how an action should proceed in order to do justice. They are not concerned with the radically different question as to whether an action can proceed at all."

That "radically different question" stems from the assertion that common fund orders are necessary to do justice by addressing the free rider problem. But their Honours found that:

"It is not appropriate or necessary to ensure that justice is done in a representative proceeding for a court to promote the prosecution of the proceeding in order to enable it to be heard and determined by that court. The making of an order at the outset of a representative proceeding, in order to assure a potential funder of the litigation of a sufficient level of return upon its investment to secure its support for the proceeding, is beyond the purpose of the legislation."

The words of the statutes authorise orders that would advance the effective determination of the dispute the subject of a class action and "[w]hether or not a potential funder of the claimants may be given sufficient financial inducement to support the proceeding is outside the concern to which the text is addressed." So too is the question of whether a proceeding "is viable at all as a vehicle for the doing of justice between the parties to the proceeding".

As to the question of whether a proceeding should or should not be commenced, or should or should not proceed as a class action, the majority judgments make two key observations. On the former, Gordon J (in a concurring judgment) notes that a class action can be commenced if it

satisfies the threshold criteria provided for in the statute (namely, the existence of at least seven people with claims against the same person, arising in respect of or out of the same, similar or related circumstances, and giving rise to substantial common issues of law or fact). Her Honour observed that a class action "cannot be commenced on the possibility that the Court might be persuaded to make a common fund order to overcome the fact that the class action might otherwise be uneconomic or risky for a litigation funder."

On the latter, the plurality observed that the legislative schemes governing class actions as a whole "make specific provision for the role of the court in determining whether representative proceedings should or should not proceed and for the circumstances in which that intervention by the court may occur". Those circumstances include a recognition that a class action may not withstand scrutiny on a cost/benefit basis, in which case the legislation provides that the court may stay a proceeding or direct that it no longer continue as a class action. Such provisions recognise that the cost of pursuing a class action may be too high, or identifying group members too difficult, in comparison to the value of their claims. In that case, the legislation contemplates that the litigation should cease - not that a common fund order should be made because it would be too hard or expensive for litigation funders to excite sufficient interest among potential group members.

As to issues of access to justice, the plurality observed that legislative means adopted by parliaments to address such concerns are as set out in the words of the statutes. Sections 33ZF and 183 "do not empower the courts to rewrite" the broader legislative scheme. The report of the Australian Law Reform Commission which preceded the enactment of Part IVA of the FCA Act "simply did not include the absence of sufficient incentive for litigation funders to fund litigation" - the plurality thought this significant given that the Commission "was alive to the possibility that a representative proceeding might be funded by third parties." This is echoed by Nettle J, who, in a concurring judgment, said that although litigation funding is no longer invariably considered to be an abuse of process that is contrary to public policy, "[i]t is, however, quite another thing to accept that the commercial interests of those funders formed part of the mischief that the introduction of Part IVA was intended to confront. Plainly, the legislative purpose of the enactment of Part IVA did not extend to addressing uncertainties on the part of litigation funders as to the financial viability of funding such proceedings." The "harnessing" of claims "for the primary purpose of generating profits for entrepreneurial litigation funders", and "the making of orders to facilitate entrepreneurial litigation funders to generate profits by fomenting disputes which, but for the making of such orders, might never flare into controversy", were not within the foresight of the legislature.

(ii) What next for extant common fund orders?

To the extent that common fund orders remain on foot in ongoing class actions, those orders have been shown by the High Court to be beyond power - at least in the Federal Court and the Supreme Court of NSW. Those orders can be of no effect and should, as a formality, be set aside without disputation by representative applicants.

(iii) Does the High Court's decision spell the demise of funded class actions?

Not if litigation funders are prepared to work for their return.

All five of the judges in the majority adverted to the fact that litigation funding is a business - an entrepreneurial undertaking - which seeks to derive a return for funders but which also entails risks. Kiefel CJ, Bell and Keane JJ noted that the practice of making common fund orders at an early stage of proceedings:

"may provide some assurance, even if only provisional, to a litigation funder of a particular level of return on its investment and so relieve the litigation funder of the expense and effort of canvassing the level of public interest in the proposed proceeding and making its assessment of the commercial viability of the proceeding in light of the likely balance of risk and reward.To the extent that a CFO may allow a litigation funder to avoid the burden of the process of book building by enlisting the court's aid, there is no warrant to supplement the legislative scheme by judicial involvement to ease the commercial anxieties of litigation funders or to relieve them of the need to make their decisions as to whether a class action should be supported based on their own analysis of risk and reward."

A similar rationale may be discerned in Gordon J's judgment:

"[T]o ask whether a funder will withdraw funding if a common fund order is not made is to ask the wrong question. A funder assesses whether to fund litigation. Once commenced, it is not appropriate or necessary to improve the economic position of the funder against the possibility that it will carry out a threat to proceed no further. The action as framed and instituted proceeds, or it does not."

The remedy for funders' concerns about not obtaining a large enough return for funding proceedings is for them to test the market for interest among potential group members and to set about entering into funding agreements with those who wish to participate. Suggestions that this process is too hard or too costly found little favour with their Honours. For example, Gordon J observed that one of the reasons for the failure by funders to take active steps to build a book was the relatively high costs of doing so. Her Honour did not think that this appeared "at all convincing", saying:

"the unchallenged evidence of the solicitor acting for the representative applicant based on his past experience of the cost of book building activities in other proceedings was that it 'would likely exceed $1 million' and that '[a]ll or part of such costs may ultimately be deducted from the possible recoveries of Group Members' (emphasis added). A person seeking to build a business usually incurs expenditure in seeking to establish that business. Given the size of the potential return to the litigation funder in these proceedings is not insignificant, it is difficult to accept that the cost to build the book is prohibitively expensive. Whether the litigation funder then seeks to recover that cost from the group members is a separate issue.".

Her Honour also suggested that there appeared no reason why book building could not occur by contacting group members "in a variety of ways without incurring significant costs" as had been proposed for the purpose of giving them notice of an application for a common fund order.

(iv) Are free riders a problem again?

No. The plurality noted that the legislative schemes recognise that a representative party should not necessarily have to bear the entire cost of a class action. However:

"[T]he equitable sharing of the expense of the proceeding may be achieved by the making of a FEO [funding equalisation order] that reduces unfunded group members' awards by an amount equivalent to that paid by funded group members to the litigation funder. The cost of litigation is thus borne equitably between all group members."

Their Honours saw no reason for amounts so taken from unfunded group members to be given to litigation funders - "[t]he funder has no right to that money under contract or under equitable principles" - nor, further, that such an order be made early in a proceeding rather than towards the end. The plurality held that a common fund order is "not the obvious solution" to the free rider problem. This is not least because, under a funding equalisation order, the starting point for the

equitable sharing of costs is the actual cost incurred in funding the litigation. By contrast, a common fund order would impose an additional cost on unfunded group members by way of a funding commission. Gordon J also observed that funding equalisation orders represent an already existing and "accepted solution to the problems which the common fund order supposedly seeks to address".

(v) Conclusion

The High Court has changed the landscape for class actions in Australia's most popular jurisdictions for bringing such proceedings. While a number of immediate effects will be observed in representative proceedings that are currently on foot, longer term changes in funder behaviour may slow the growth of such litigation. That said, a path remains open for litigation funding to continue - albeit requiring funders to revive their previous practice of book building and to undertake their own detailed risk and cost/benefit analyses with a view to earning their returns.

6.2 Considering if an application for leave pursuant to s. 237 of the Corporations Act is in the best interests of the company, or shows a serious question to be tried

(By Belinda Pinnow, MinterEllison)

Dinomyte Pty Ltd v Australian Securities and Investments Commission, in the matter of Hanwood Pastoral Co Pty Ltd [2019] FCA 1989 (26 November 2019) Federal Court of Australia, Gleeson J

(a) Summary

This case relates to an application for leave pursuant to s. 237 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) to bring proceedings on behalf of Hanwood Pastoral Co Pty Ltd (Hanwood). Despite not being completely satisfied that there was a serious question to be tried, the Federal Court (the Court) granted the plaintiffs leave to adduce further evidence in support of the application.

(b) Facts

The first and second plaintiffs, Dinomyte Pty Ltd (Dinomyte) and Frederick William Renton (Renton), sought leave pursuant to s. 237 of the Corporations Act to bring proceedings on behalf of the second defendant Hanwood against six defendants, including Frederick Norman Kelly (Kelly), the sole director of Hanwood since 2015.

Section 237 of the Corporations Act has been described as providing a court with a screening function (see *Carpenter v Pioneer Park Pty Ltd (in Liq)* (2004) 51 ACSR 245 at [16] (*Carpenter*)) and enables members (or former members) and officers (or former officers) to apply to the court for leave to bring proceedings, or intervene in proceedings, on behalf of a company.

"The Court must grant the application where it is satisfied that: (a) it is probable that the company will not itself bring the proceedings, or properly take responsibility for them, or for the steps in them; and (b) the applicant is acting in good faith; and (c) it is in the best interests of the company that the applicant be granted leave; and (d) if the applicant is applying for leave to bring proceedings - there is a serious question to be tried; and (e) either: (i) the applicant gave written notice to the company of the intention to apply for leave and of the reasons for applying at least

14 days before making the application; or (ii) it is appropriate to grant leave even" where the applicant failed to give the company 14 days' written notice of the application.

Details of the proposed proceedings were provided for in a draft statement of claim (SOC) annexed to submissions, being:

- Kelly had removed Renton as a director of Hanwood in 2014 without Renton's consent, enabling Kelly in his capacity as sole director to enter into contracts, or purportedly enter into contracts, for and on behalf of Hanwood;
- in or around December 2014, without consulting with Renton, Kelly engaged a solicitor, Mr Murphy, to act for Hanwood in relation to the sale of land located at North Rothbury, New South Wales (Property);
- in 2015, Kelly caused Hanwood to enter into a contract for the sale of the Property for a sale price of $3.3 million plus GST;
- without Renton's knowledge and pursuant to Kelly's instructions, the sale proceeds were disbursed by Mr Murphy to recipients not entitled to receive the amounts paid to them (Payments);
- Mr Kelly had breached his director duties in ss. 180(1) (to act with care and diligence), 181(1) (to exercise powers and duties in good faith, in the best interests of the company, and for a proper purpose) and 182(1) (to not gain personal advantage from the director's position) (Breaches) of the Corporations Act.

The plaintiffs' alleged Hanwood had suffered loss and damage as a result of the alleged Breaches, comprising the loss of the Payments and interest on the Payments.

Kelly's primary contention was that the SOC was sufficiently defective as to warrant the conclusion that there was no serious question to be tried, and, relying on *Carpenter*, that in the absence of a serious question to be tried, the proceedings were not in the best interests of Hanwood.

(c) Decision

To determine if the application for leave was in the best interests of Hanwood, the Court was required to consider the interests of Hanwood as a whole (considering *In the matter of Gladstone Pacific Nickel Ltd* [2011] NSWSC 1235 at [57]). Additionally, the Court considered *Maher v Honeysett & Maher Electrical Contractors Pty Ltd* [2005] NSWSC 859 where at [44] it was provided that when considering what was in the best interests of the company for the purposes of s. 237 of the Corporations Act, a court should consider: (a) the prospects of success of the action; (b) the likely costs and likely recovery if the action is successful; (c) the likely consequences if the action is not successful; and (d) the nature of any indemnity the applicant has offered the company if the action is brought and the likelihood of recovery under that indemnity. The Court also considered *In the matter of Legal Practice Management Group Pty Ltd, nSynergy Pty Ltd, nSynergy International Pty Ltd* (2018) 125 ACSR 513 where Black J stated at [68], addressing the relevance of an indemnity, that "the case law has recognised the desirability of an indemnity to be given to the company to protect it from adverse costs exposure".

The Court determined that, as a general proposition it was in the best interests of Hanwood to seek compensation for losses sustained by reason of the alleged Breaches and that in the circumstances Dinomyte and Renton's intention to be the plaintiffs in the proposed proceedings made the absence of an indemnity less relevant.

However, further evidence relating to the prospect of recoveries from the proposed proceedings was needed to specifically demonstrate that the proceedings were in the best interests of Hanwood.

On whether a serious question to be tried existed, it was noted that a court must determine whether the plaintiffs "are able to identify the legal or equitable rights to be determined at trial in respect of which the final relief is sought" (citing *Ragless v IPA Holdings Pty Ltd (in Liq)* [2008] SASC 90 at [35]). The plaintiff bears the onus of proving sufficient material to enable the court to make this determination (citing *Ehsman v Nutectime International* [2006] NSWSC 887 at [59]), though it is not necessary to establish that it is more probable than not that the derivative action will succeed (citing *South Johnstone Mill Ltd v Dennis* (2007) 163 FCR 343 at [79]).

It was the Court's opinion that here the facts gave cause for concern that at least some of the sale proceeds had been disbursed improperly, principally because of:

- the contention that Renton was improperly removed from his role as a director of Hanwood;
- the evidence that substantial payments appeared to have been made to an entity related to Kelly; and
- payments made by Hanwood in relation to the sale proceeds remaining unexplained.

While the draft SOC was deficient in several respects, particularly in relation to the alleged Breaches, Gleeson J considered that while she was not presently satisfied that there was a serious question to be tried, it might be possible to redraft the SOC and to adduce further evidence demonstrating that a serious question to be tried existed.

The plaintiffs were granted leave to file further evidence in support of their application, including a further draft SOC.

6.3 Misleading, deceptive or false representations made in the course of providing financial services advice

(By Wrijoy Chowdhury, King & Wood Mallesons)

Australian Securities and Investments Commission v Dover Financial Advisers Pty Ltd [2019] FCA 1932 (22 November 2019) Federal Court of Australia, O'Bryan J

(a) Summary

ASIC sought declaratory relief and civil pecuniary penalties against the:

- first defendant, Dover Financial Advisers Pty Ltd (Dover), for requiring its authorised representatives to provide clients with a Client Protection Policy (Policy) document that contained misleading, deceptive or false representations; and
- second defendant, Terrence Paul McMaster, for participating in Dover's alleged contraventions.

The Policy purported to provide clients with the maximum protection available under the law. However, out of the eleven clauses from the Policy that were considered by the Federal Court of Australia (the Court), nine clauses limited the protections afforded to clients under the

Corporations Act 2001 No. 50 (Cth) (the Corporations Act). Most of these clauses "perversely" shifted the liability of Dover as a financial adviser to its clients. The Court decided that Dover created representations that were misleading, deceptive or false, and that Mr McMaster was knowingly concerned in these contraventions.

(b) Facts

Dover provided financial services advice to clients through authorised representatives. On 25 September 2015, Dover's sole director and company secretary, Mr McMaster, instructed Dover's authorised representatives to provide clients with the Policy document in addition to the ordinary statement of advice.

From 25 September 2015 to 23 November 2017, the Policy was amended several times. Despite these amendments, the Introductory Clause remained the same:

"Dover's Client Protection Policy sets out a number of important consumer protections designed to ensure every Dover client get (sic) the best possible advice and the maximum protection available under the law."

ASIC contended that the Introductory Clause was misleading, deceptive or false because the Policy contained clauses that "purported to limit and exclude Dover's liability to clients in ways that were inconsistent with the requirements of the Corporations Act and which lessened clients' protections under the general law".

(c) Decision

(i) Was the Introductory Clause misleading, deceptive or false?

ASIC relied on the following statutory provisions (extracts):

- a person must not engage in conduct that is misleading or deceptive or is likely to mislead or deceive (s.1041(1) of the Corporations Act and s.12DA(1) of the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) (the ASIC Act)); and
- a person must not make a false or misleading representation concerning the existence, exclusion or effect of any condition, warranty, guarantee, right or remedy (s.12DB(1)(i) of the ASIC Act).

Within the Introductory Clause, ASIC focussed on the words, "every Dover client get (sic). the maximum protection available under the law" to mount its contention that the clause was misleading, deceptive or false. To determine this issue, the Court considered "whether the impugned conduct, viewed as a whole, had a sufficient tendency to lead a person exposed to the conduct into error".

Clauses that did not afford the maximum protection under the law

The Court held that the Introductory Clause was misleading, deceptive or false. To reach this decision, the Court determined that the following clauses limited the protections afforded to Dover's clients under the Corporations Act and general law:

- Authority Liability Exclusion - the purported effect of which was to exclude Dover's liability for most foreseeable breaches of law by its authorised representatives;
- Statement of Advice Liability Exclusion - which sought to prevent clients from bringing claims against Dover if the advice was not clear and comprehensible;

- Insurance Liability Exclusion - which purported to make the client responsible for assessing whether "churning" (i.e. an inappropriate recommendation for a new insurance policy for the purpose of generating a commission or similar fee) had occurred;
- Losses Liability Exclusion and Ceased Engagement Exclusion - which purported to exclude Dover's liability for losses incurred by the client in specified situations;
- Investments Minimum Holding Clause - which purported to exclude liability for claims in respect of investment advice until ten years elapsed from the date of any investment;
- Underinsurance Exclusion - which purported to exclude liability for recommendations made by advisers as to the amount of insurance the client should obtain;
- Insurance Minimum Holding Clause - which imposed on clients an obligation to reimburse their adviser for amounts that had to be repaid by the adviser to an insurer if the client cancelled a risk insurance policy within two years; and
- Delayed Advice Indemnity - which purported to exclude liability for claims arising from any delay in implementing advice even when the adviser was responsible for the delay.

Clauses that afforded the maximum protection under the law

The Court held that two of the eleven clauses raised by ASIC were not misleading, deceptive or false:

- Best Efforts Clause - the wording within this clause, "[w]e will use our best efforts to ensure our advice is in your best interests and appropriate to you" was consistent with the provisions of the Corporations Act (*ASIC v Westpac Securities Administration Limited* [2019] FCAFC 187); and
- Continued Retainer Clause - clients had to engage Dover every six months to review their advice.

(ii) Liability

The Court found that the statement from the Introductory Clause that the Policy provided clients with the "maximum protection available under the law" was misleading, deceptive or false within the definitions of s.1041(1) of the Corporations Act and ss. 12DA(1) and 12DB(1)(i) of the ASIC Act. In effect, every time Dover provided a client with the Policy, they contravened these statutory provisions.

In reaching this decision, the Court dismissed Dover's argument that its clients were not actually misled or deceived by the Introductory Clause. The Court held that it was not necessary or determinative under the Corporations Act and the ASIC Act to prove that any client was subjectively misled or deceived (*Taco Co of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177).

Mr McMaster was "knowingly concerned" pursuant to the Corporations Act and the ASIC Act in Dover's misleading, deceptive or false conduct because he intentionally participated in the contravention. The Court formed this view on the basis that Mr McMaster drafted the Policy and instructed authorised representatives to provide clients with the Policy.

There will be another hearing to determine the form of declaration that should be made by the Court in respect of the above findings.

6.4 The scope of shadow directors' fiduciary duties are commensurate with their instructions

(By Katrina Sleiman and Eleanor Nolan, Corrs Chambers Westgarth)

Standish v Bank of Scotland PLC [2019] EWCH 3116 (Ch) (19 November 2019) High Court of Justice, the Business and Property Court of England and Wales, Chancery Division, Trower J

(a) Summary

The claimant shareholders of Bowlplex Ltd (the company) appealed against a decision of Chief Master Marsh (Marsh CM) in the England and Wales High Court to strike out their claim of an alleged breach of fiduciary duty by the company's shadow director. Marsh CM dismissed the claim on the basis that it was bound to fail.

The claimants submitted that it was arguable that an employee (Mr Sondhi) of a subsidiary of the company's bank, Royal Bank of Scotland plc (Bank), became a shadow director of the company, and was improperly influenced by an unconscionable purpose to restructure the company. They alleged this conduct breached the shadow director's fiduciary duties of good faith and to avoid conflicts, causing the claimants £17.7 million in losses.

Trower J found that there was not a sufficiently pleaded relationship between the acts of direction or instruction which caused Mr Sondhi to be a shadow director and the breaches of which complaint was made.

The decision provides clarification on the scope and range of fiduciary duties which can be imposed on a shadow director. In particular, s. 170 of the *Companies Act 2006 (UK)* (the Companies Act) cannot be read as imposing the full range of fiduciary duties owed by a *de jure* director on somebody merely because they have acquired the status of a shadow director. Rather, fiduciary duties will be imposed on a shadow director because of the relationship he/she has to the company by reason of the acts which put him/her in the position of being a shadow director in the first place.

(b) Facts

The company operated a bowling business in the UK. The Bank administered the company's banking facilities. An indirect wholly owned subsidiary of the Bank, West Register Number 2 Ltd (West Register) was also involved in providing these services. The company's business suffered significant losses as a result of the recession through 2007-2009 and the company was in breach of one of its banking covenants. As a result, the Bank transferred the company's account to its global restructuring group in August 2010.

(i) The restructurings

From August 2010, the Bank sent an employee of West Register, Mr Sondhi, to attend meetings with the company. The claimants alleged that Mr Sondhi indicated that West Register wished to obtain an 80% stake in the company in exchange for continuing banking support. In July 2011, West Register acquired 35% of the equity in the company and the Bank and the company agreed to a restructuring of some parts of the company's debt and West Register's appointment of an observer (being Mr Sondhi) to attend the company's board meetings (First Restructure).

In March 2012, a company voluntary arrangement was approved (Second Restructure) involving the Bank writing off £4.5 million of the company's outstanding debt in return for a reorganisation

of the equity holdings. This meant that West Register ended up with 60%, the claimants ended up with 20% and the final 20% was to be transferred to a management incentive scheme. West Register also exercised its right under the First Restructure to appoint Mr Cooper as the company's non-executive chairman.

(ii) Mr Sondhi's role at meetings and his status as a shadow director

The claimants alleged that the board was accustomed to acting on Mr Sondhi's instruction and that during his tenure as an "observer", he intervened during board meetings to:

- add agenda items or require the explanation of information by the board;
- impose new and onerous employment contracts on board members;
- require the instruction of a consultant regarding the restructuring process; and
- insist on the appointment and dismissal of various directors and consultants.

All parties agreed that Mr Sondhi was indeed a shadow director of the company.

In May 2012, Mr Cooper dismissed Mr Standish as the company's managing director, thereby transferring the latter's shares in the management incentive scheme to Mr Cooper. When the company was eventually sold in March 2015, the proceeds were distributed in accordance with the equity holdings noted above.

(iii) The unconscionable purpose

It was the claimant's case that the Bank, West Register and Mr Sondhi took steps to undermine the company's financial position so as to enable the Bank and/or West Register to acquire 80% of the company's equity at the expense of the claimants (the unconscionable purpose). They claimed that the acquisitions were achieved through the First and Second Restructure. The losses claimed were the amounts which it was said that the claimants' shares would have been worth but for the First and Second Restructures.

The claimants argued that Marsh CM wrongly found that the claimants had no reasonable grounds for alleging that the actions of West Register or Mr Sondhi as a shadow director of the company were capable of amounting to a breach of fiduciary duty. The claimants pleaded that West Register and/or Mr Sondhi as its shadow directors owed their fiduciary duties to the company pursuant to s. 170(5) of Companies Act or alternatively in equity. Section 170(5) of the Companies Act provided that the general duties owed to a company by its directors in ss. 171 to 175 of the Companies Act (such as the duties to promote the company's success, and the no conflict or profit duty) apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply.

(c) Decision

Trower J upheld Marsh CM's decision and dismissed the appeal.

(i) Scope of shadow directors' duties

Marsh CM had noted that while it is settled law that shadow directors may owe fiduciary duties to the relevant company, as distinguished from *de jure* directors, the duties are generally limited to the subject matter of the instructions they give to the board, and by which the person concerned is constituted a shadow director in the first place.

Trower J agreed with Marsh CM on this point, noting at [55] that "It is therefore quite clear that section 170 of the [Companies Act] cannot be read as imposing the full range of fiduciary duties owed by a *de jure* director on somebody merely because they have acquired the status of a shadow director. Put another way, because the status of shadow directorship can be acquired through the giving of instructions that are limited to only some part of a company's activities or affairs, there can be commensurable limitations on the nature and extent of the duties that they will thereby owe".

Trower J noted that this approach was supported by *Vivendi SA v Richards* [2013] BCC 771 (*Vivendi*). In that case, Newey J explained how fiduciary duties will be imposed on a shadow director because of the relationship he/she has to the company by reason of the acts which put him/her in the position of being a shadow director in the first place.

Trower J also noted that the law surrounding the duties of shadow directors may not be entirely settled, referring to *Sukhoruchkin v Van Bekestein* [2014] EWCA Civ 399 at [41] which raised doubt as to whether *Vivendi* is settled law. However, Trower J was provided with no further authority in which it had been established (or even suggested) that a person who has given directions or instructions in accordance with which the directors of a company were accustomed to act owes fiduciary duties in respect of aspects of the company's affairs which are unrelated to those directions or instructions. In Trower J's view, a conclusion to that effect would be inconsistent with the nature and status of shadow directorship as described above and would fail to give proper recognition to the fact that Parliament had not chosen to treat shadow directors as if they were directors for all purposes.

In saying that, Trower J accepted that there is room for some debate around the nature of the relationship required to exist between the direction or instruction on the one hand and the duty or breach on the other. Accordingly, Trower J turned to explain his conclusions on that aspect of the case.

(ii) Mr Sondhi's duties as a shadow director

Trower J agreed with Marsh CM that there was no pleading which asserted that an act or omission said to constitute a breach of duty had either been instructed by, or at least been caused by an instruction given by, Mr Sondhi and/or West Register. In particular, the claimants were unable to point to any pleading which alleged how the instruction to the board to appoint Mr Cooper and the instruction to Mr Cooper to dismiss Mr Standish caused the company to enter into the Second Restructure.

In particular, although it was pleaded that Mr Sondhi promoted the Second Restructure and refused to agree to alternatives to it, it was not pleaded that either of these events was caused by the instruction given to appoint Mr Cooper or the removal of Mr Standish. Indeed, they could not have been, in the light of the fact that there was no plea that Mr Cooper was given any instructions by Mr Sondhi, nor that Mr Cooper gave any instructions to the board (whether in relation to the Second Restructure or otherwise).

Accordingly, Trower J held that March CM was entitled to reach the conclusions that he did.

6.5 Proxy forms not part of "books of the company"

(By Mariana Estifo, Ashurst)

In the matter of Cromwell Corporation Limited [2019] NSWSC 1608 (19 November 2019)
Supreme Court of New South Wales, Rees J,

(a) Summary

This case examined whether authorisation under s. 247A of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) to inspect "books of the company" includes authorisation to inspect proxy forms received by a company in advance of an annual general meeting (AGM).

The action was brought by ARA Real Estate Investors XXI Pte Limited (ARA), a Singaporean company, and the largest security holder of stapled securities, of the entities comprising the Cromwell Property Group (Cromwell). ARA sought to inspect proxy forms held by Cromwell ahead of an AGM where ARA had put forward a candidate for appointment as a director.

Section 247A of the Corporations Act gives company shareholders the right to apply for a court order to inspect the "books of the company" if the application is made in good faith and the inspection is for a proper purpose. ARA's application under s. 247A(1) of the Corporations Act sought a ruling that the phrase "books of the company" included proxy forms that were in Cromwell's possession.

Rees J dismissed ARA's application, finding that the term "books of the company" did not include proxy forms and that ARA had no right under the Corporations Act or general law to be provided copies of the proxy forms. In doing so, her Honour applied the reasoning of a recent decision in the Federal Court of Australia, *Sun Hung Kai Investments Services Ltd v Metals X Limited* [2019] FCA 1673 (*Metals X Ltd*) that ruled proxy forms do not form part of the books of the company.

This conclusion follows the well-settled statutory construction that "'books of the company" does not extend beyond books which belong to the company or in which it has a proprietary interest or which form part of the company's records. Rees J ruled that the character of proxy forms is such that they are not records of the company, but merely documents that the company uses to facilitate an AGM.

The case also serves as a reminder of the limited rights members have to inspect the company documents under general law.

(b) Facts

The material facts in this case were as follows. ARA had put forward a candidate for appointment as a director of Cromwell at an AGM, that was due to be held on 28 November 2019. ARA sought to solicit shareholder support for the resolution to have the candidate appointed as director.

As part of this process, ARA caused a pre-filled proxy form to be sent to members of Cromwell in favour of the candidate. ARA also requested Cromwell to provide them with copies of proxies received by Cromwell. ARA claimed they had a right to the proxies under s. 247A(1) of the Corporations Act or the general law.

Cromwell believed that the pre-filled proxy form was liable to mislead members into thinking that the form had been issued by Cromwell and not ARA, and subsequently published a statement and made an ASX announcement encouraging members to ignore ARA's proxy form.

The two entities both filed Originating Processes in the NSW Supreme Court seeking a determination as to whether ARA was entitled to the proxy forms received by Cromwell ahead of the AGM.

(c) Decision

Rees J ruled that the proxy forms were not "books of the company" within the meaning of s. 247A(1) of the Corporations Act. Her Honour found Colvin J's reasoning in *Metals X Ltd* to be persuasive. That case also involved an interpretative exercise in relation to s. 247A(1) of the Corporations Act.

In reaching this conclusion, Rees J firstly decided that the phrase "books of the company" only extends to documents that form part of the company's records and not documents that are merely in the company's possession.

Subsequently, the question for Rees J to consider became the character of proxy documents and whether those documents were the "books of the company". Her Honour again relied on the reasoning of Colvin J in *Metals X Ltd*, who gave weight to the distinction between a company's separate legal personality to that of its members and shareholders in deciding that proxy forms, while taken into the possession of the company, are not books of the company. Rather, proxies "are received for the purpose of the meeting of members. steps taken by way of preparation to assist that adjudication are not a basis upon which the company.may treat the proxy documents as if they are documents available for their use.nor do they make the documents part of the books of the company". As a result, Rees J ruled that the proxy forms were not "books of the company" for the purposes of s. 247(A) of the Corporations Act. This interpretation of s. 247A(1) of the Corporations Act follows the well-settled statutory construction that "books of the company" does not extend to beyond books which belong to the company or in which it has a proprietary interest or which form part of the company's records.

In relation to a shareholder's entitlement to proxies under the common law, it is important to note that shareholder's rights to the records of a company are limited, and given that no precedent existed before *Metals X Ltd* where shareholders were given access to proxy forms, ARA's argument that a shareholder's rights to the records of a company should be interpreted to include proxy forms was not a persuasive one. Her Honour examined prior cases including *Metals X Ltd*, and *Edman v Ross* (1922) 22 SR (NSW) 351 before concluding that the question that must be answered in relation to a shareholder's common law right to inspect proxy forms is whether that inspection "is necessary with reference to some specific dispute or question in which the shareholder is interested". Rees J pointed to various mechanisms under the Corporations Act that allow a substantial shareholder to communicate to all members of the company, such as providing a statement under s. 249P of the Corporations Act and by accessing the register of members to obtain their contact details to communicate with them directly, to reason that accessing the proxy forms, on top of all these mechanisms, was not necessary.

Rees J concluded that while ARA's application sought to create a "level playing field to solicit votes from shareholders by access to the proxies in the same way that the directors may access proxies", neither the Corporations Act nor the common law right of a shareholder to access the books of the company "provide the levelling effect sought".

6.6 Determining the parameters of an application to extend the period of time for a court to determine a winding up application

(By Daisy Eales, DLA Piper Australia)

Barboutis v The Kart Centre Pty Ltd [2019] WASCA 184 (15 November 2019) Supreme Court of Western Australia, Court of Appeal, Mitchell and Vaughan JJA

(a) Summary

This case concerned factors relevant to an application to extend the period of time for a court to determine a winding up application. The Court of Appeal of the Supreme Court of Western Australia (the Court) held that as the Acting Master had already dismissed the original application, that application had been "determined" and thus satisfied the requirements of s. 459R of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). This did not leave the Court any proper basis to grant the extension application, and thus it was summarily dismissed.

(b) Facts

Mr Barboutis and Mr Freeman formed The Kart Centre Pty Ltd (the respondent) as a business venture involving indoor go kart racing and other entertainment. After a break down in the relationship between himself and Mr Freeman, Mr Barboutis and another shareholder, Bullsbrook Capital Pty Ltd (the appellants), lodged an application to have the respondent wound up on the grounds of insolvency, or alternatively, on just and equitable grounds, pursuant to ss. 459P and 461(1)(k) of the Corporations Act.

In a judgment delivered on 2 October 2019, Acting Master Whitby dismissed the application. The appellants appealed against that order.

Consequently, the appellants also applied for an extension of time for determination of the winding up application, out of a concern that the appellate court would be precluded from making a winding up order after the specified due date had passed. A winding up application must be determined within six months after it is made under s. 459R(1) of the Corporations Act, unless the Court extends this period under s. 459R(2) of the Corporations Act.

(c) Decision

The judgment of the Court largely centred around the proper construction of s. 459R of the Corporations Act, which concerns the period within which a winding up application has to be determined. Due to the six month time limit within that section, the appellants original application would have expired on 5 October 2019. However, Acting Master Whitby had already extended the period of determination to 16 November 2019 pursuant to s. 459R(2) of the Corporations Act. The initial judgment was delivered on 2 October 2019 and the appellant appealed that decision on 16 October 2019. On 7 November 2019, the appellants filed the extension application in order to ensure there was sufficient time for the appeal to be decided.

In response to the extension application, the respondent submitted two reasons why the application should not be granted.

- section 459R of the Corporations Act only applies to applications to wind up a company in insolvency, not on just and equitable grounds. While the original process applied to wind up the respondent on both grounds, the draft grounds of appeal did not include

insolvency. Therefore, there could be no grounds for the Court to wind up the respondents on appeal under s. 459R of the Corporations Act; and

- the winding up application had already been determined when it was dismissed on 2 October 2019. This meant that s. 459R of the Corporations Act had already been complied with, and thus not open to the Court to further extend the period for determining an application that has already been determined.

The appellants responded to the first submission by contending that their draft grounds of appeal did intend to challenge the finding that the respondent's insolvency had not been established. As the appeal grounds had not yet been finalised, their Honours held that it was open to the appellants to strengthen their submissions on this point at a later date. The extension application was accordingly not dismissed on this point.

The second submission triggered a close analysis of s. 459R of the Corporations Act and the intended construction of the provision. Their Honours found that an order dismissing an application to wind up a company, or an order winding up the company in insolvency, made within the specified time period, fulfilled all the relevant requirements of the section. They held this reading to be consistent with other parts of the Corporations Act, such as s. 459A. which allowed the court to order an insolvent company wound up, and s. 467(1), which provides the court with other powers in regard to winding up applications, such as dismissal of the hearing or other interim orders. When all the relevant provisions are read together, it supports the reading that an application under s. 459P of the Corporations Act is disposed of when the company is ordered to be wound up, or the application is dismissed. Therefore, if either of those occurs, the application is "determined" for the purposes of s. 459R of the Corporations Act.

Their Honours disagreed with the appellant's submission that a winding up application is only "determined" if any ensuing appeals are disposed of, as they found it would cause various anomalies in the operation of the relevant sections of the Corporations Act.

First, if the appellant's construction was correct, it would mean that the primary proceedings and any appeals would have to be determined within the prescribed six month period, or an extension application would have to be granted, otherwise s. 459R(3) of the Corporations Act would serve to dismiss the application.

Further, extension applications under s. 459R(2) of the Corporations Act may only be granted where the court is satisfied that special circumstances justify the extension. The existence of an appeal underway does not always qualify as a special circumstance, and therefore there is no guarantee that the court could lengthen the six month time period to allow an appeal.

Second, difficulties would also arise if there was an application for extension of time to appeal or the party had special leave to appeal.

Their Honours distinguished *Merrill Lynch Equities (Australia) Ltd v Triangle Packing Case Pty Ltd* [1999] FCA 810 (*Merrill*), in which Spender J held that if he made an order to wind up the company on the *de novo* review, the court could determine the application outside of the six months prescribed by the Corporations Act. In *Merrill,* the court was conducting a *de novo* review of the decision of a registrar. Mitchell and Vaughan JJA held that as the present case concerned the decision of an Acting Master who relevantly constituted the judicial power of the Supreme Court under s. 6(3)(f) of the Supreme Court Act 1935 No. 36 (WA), it was sufficiently different from the *Merrill* case so as to be distinguishable.

Finally, their Honours outlined the similarities between their construction of s. 459R of the Corporations Act and the accepted construction of s. 459F of the Corporations Act, highlighting

that their reading of s. 459R of the Corporations Act was in line with the current interpretations of the Corporations Act.

Mitchell and Vaughan JJA therefore held that the winding up application had been determined, for the purposes of s. 459R of the Corporations Act, when it was dismissed by Acting Master Whitby on 2 October 2019. There was therefore no proper basis for the Court to further extend the period for determination of that application, and the extension application was dismissed.

6.7 Rejecting an application to terminate the winding up of a company

(By Simeon Flanagan, King & Wood Mallesons)

In the matter of Parkway One Pty Limited (in liquidation) [2019] NSWSC 1495 (1 November 2019**)** Supreme Court of New South Wales, Rees J

(a) Summary

Parkway One Pty Ltd (Parkway One) was in the process of being wound up by its liquidator, Mr Scott of Pricewaterhouse Coopers, who had been appointed by Parkway One's creditors following Parkway One's failure to respond to certain statutory demands. This decision involved an application to terminate the winding up of Parkway One. The application was brought by Fiona Page (Ms Page), the sole shareholder of Parkway One. Rees J dismissed the application on the basis of unsatisfactory evidence that the company was no longer insolvent and could operate in a financially sound and responsible way in the future.

(b) Facts

The liquidator's concerns about Parkway One arose, in part, because of its dealings with a related company, Elefteria Properties Pty Ltd (Elefteria), of which Ms Page was a director. The relevant facts detailing that relationship are outlined below.

- in 2010, Elefteria was incorporated, with Ms Page and her then husband appointed as directors;
- in 2012, Parkway One was incorporated, with several directors, of which Ms Page was not one;
- in 2013, Andrew Pitsis commenced proceedings against Mr Page and Elefteria seeking to recover a loan of $1.84 million. This claim was successful, and Mr Pitsis was awarded damages and an equitable lien was charged over properties owned by Elefteria;
- in May 2015, forms were lodged with ASIC which advised that Mr Page had ceased to be a director of Elefteria in November 2013, and Ms Page had become the sole director of Parkway One in September 2014; and
- during 2016, Parkway One bought three properties from Elefteria and both Elefteria and Parkway One obtained funds from CL Asset Holdings Ltd to pay out creditors to whom Elefteria was indebted.

Additionally, the liquidator also raised concerns about the management of Parkway One, namely:

- its failure to keep company records;
- irregularities in leasing arrangements to which it was a party;
- failures to comply with statutory demands and requests from the liquidator; and

- "troubling" amounts of cash used to pay creditors.

(c) Decision

The courts have developed seven legal principles to determine whether to accept or reject an application to terminate winding up proceedings. Rees J focussed on two of these principles, (i) Parkway One's solvency and (ii) whether the conduct of Parkway One was in any way contrary to "commercial morality" or the "public interest", in her dismissing the application to terminate the winding up of Parkway One.

(i) Parkway One solvency

In determining whether Parkway One was solvent and would continue to be solvent in the near future, the onus rested on Ms Page to provide the "fullest and best" evidence of the company's financial position. Rees J placed considerable weight on the view reached by the liquidator, who remained concerned about the solvency of the company, despite a "protracted interaction" with Ms Page who attempted to prove the company's solvency. Her Honour, agreeing with the view of the liquidator, found that Ms Page had not made out a positive case that the company was, and would continue to be, solvent.

(ii) Commercial morality and public interest

Rees J found commercial morality to be a broad concept, not merely concerned with investigations of corporate misconduct, but encompassing a wide range of considerations that overlap with the protection of the public interest. Her Honour distilled the concept of commercial morality to two key enquiries. First, was the director's behaviour unsatisfactory having regard to their duties as a director under the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) as well as basic concepts of honesty and competence? Second, if breaches have occurred in the past, has a good explanation been provided for such breaches and what steps have been taken to mitigate or fix the breaches? In deciding on whether Ms Page had breached the principle of "commercial morality", her Honour noted the "faint and unsolicited" presence Mr Page retained in the affairs of the company but concluded that "any personal failings of Mr Page should not be visited upon" by Ms Page.

Regarding whether it would be in the public interest to terminate the winding up proceedings, her Honour listed five factors which gave cause for concern.

- Ms Page was not aware of the change of registered office of Parkway One, and the explanations for this were unsatisfactory;
- Ms Page failed to provide information in a timely manner to the liquidator of Elefteria Properties;
- the company has shown a poor attitude in repaying its debts to creditors;
- the company did not keep proper books and records in accordance with s. 286(1) of the Corporations Act; and
- the company used a troubling amount of cash to pay creditors of the company.

Rees J concluded these factors meant that the company could not be "safely released from external administration and returned to the mainstream of commercial life under the control of Ms Page". Her Honour was also not convinced that the company would operate in a "financially sound and responsible way" if the winding up was terminated.

6.8 Curing procedural irregularities in the issue of shares under s. 1322 of the Corporations Act

(By Grace Appleford, Herbert Smith Freehills)

In the matter of Force Commodities Ltd [2019] FCA 1815 (1 November 2019) Federal Court of Australia, McKerracher J

(a) Summary

This case concerned procedural irregularities in 15 different issues of securities. The Federal Court (the Court) made orders under s. 1322 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) validating the securities issues and subsequent trading of those shares. Section 1322 of the Corporations Act gives the court a wide power to validate acts that would otherwise be invalid by reason of a contravention of the Corporations Act. Additionally, the Court made orders to relieve sellers from any civil liability arising from breaches of the Corporations Act from subsequent trading of securities affected by the irregularities.

(b) Facts

Securities issued by Force Commodities Ltd suffered procedural irregularities due to the lack of a valid notice to the ASX under *ASIC Class Order [CO 09/425]* (Securities Issue 1), the lack of a cleansing notice (Securities Issues 2 to 13) and the lack of a valid cleansing notice (Securities Issues 14 and 15). These procedural irregularities were found by McKerracher J to be the honest mistakes of the company secretaries.

Force Commodities Ltd applied to the Court for orders pursuant to s. 1322(4)(a) of the Corporations Act to validate trading in Force Commodities Ltd's shares and options issued. Force Commodities Ltd also applied for an order pursuant to s. 1322(4)(c) of the Corporations Act to relieve any sellers of those securities from civil liability arising out of subsequent trading.

(c) Decision

The Court ordered that:

- any subsequent sale of shares of Securities Issue 1 is not invalidated by the irregularity under s. 1322(4)(a) of the Corporations Act. The irregularity was the failure to give notice to the ASX under [CO 09/425]. Also, those shares issued are validated and confirmed under s. 254E of the Corporations Act;
- any sale of shares is not invalidated by the irregularities under s. 1322(4)(a) of the Corporations Act. The irregularities affecting Securities Issues 2 to 13 were the failure to issue a cleansing notice. The irregularities affecting Securities Issues 14 and 15 were the lack of a valid cleansing notice; and
- any sellers of the affected shares are relieved from civil liability arising out of contravention of ss. 707(3) and 727(1) under s. 1322(4)(c) of the Corporations Act.

(i) Procedural irregularities

Section 1322 of the Corporations Act enables a court, among other things, to:

- declare any act, matter or thing is not invalid by reason of contravention of a provision of the Act; or

- extend the period for doing any act, matter or thing.

The power of the court is confined by the conditions set out in s. 1322(6) of the Corporations Act which were considered to be satisfied.

Force Commodities Ltd could make the application under s. 1322 of the Corporations Act because it was an interested person. Its material legal rights or economic interests may be substantially affected by the failure to issue a cleansing notice (the procedural irregularity). An "act, matter or thing that may be invalid by reason of contravention" was the selling of securities issued with procedural irregularities, because, by engaging in secondary trading, sellers had breached s. 707(3) of the Corporations Act.

The Court made its orders on the basis that:

- no substantial injustice would be likely to result from the making of the orders; and
- if the orders were not made, there may be substantial injustice to sellers of such securities because any sales may be void or voidable.

Key considerations were the remedial nature of s. 1322(4) of the Corporations Act and the honesty of the mistakes which caused the irregularities.

(ii) The remedial nature of s. 1322(4) of the Corporations Act

The Court noted that s. 1322(4) of the Corporations Act is remedial in nature so it is to be given a "generous interpretation". McKerracher J cited *Weinstock v Beck* (2013) 251 CLR 396.

The Court considered that making the orders would prevent, rather than cause, substantial injustice partly because Force Commodities Ltd's application sought to relieve sellers from civil liability arising out of the sale of the shares issued, but did not seek relief from civil liability for itself. This means there is no bar to proceedings being brought against Force Commodities Ltd by sellers who might consider that they have suffered a detriment or by ASIC for breaches of the Corporations Act.

The remedial nature of s. 1322(4) of the Corporations Act is given effect because the irregularities in the share issues were reversed in a manner which protected shareholders' rights to the greatest extent.

(iii) Honest mistakes caused the irregularities

McKerracher J was satisfied the company secretaries made honest mistakes about the need for cleansing notices and the requirements for a valid notice. There was no evidence of "substantial misconduct, serious wrongdoing or flagrant disregard of the corporate law" which might outweigh the reasons for exercising discretion to make the orders sought and warrant refusal of relief.

Where irregularities are the product of honest error or inadvertence, and correcting the irregularities will not prejudice third parties or the public interest in compliance with the law, s. 1322 of the Corporations Act permits the court to avoid the effects of the non-compliance. This follows the legislative policy, drawn upon in *Re Wave Capital Ltd* (2003) 47 ACSR 418, that the law should not inflict unnecessary liability or inconvenience, or invalidate transactions because of non-compliance where such non-compliance can be avoided by an order under s. 1322 of the Corporations Act.

(iv) Section 254E of the Corporations Act

Most orders were made under s. 1322 of the Corporations Act, however, the Court also made an order under s. 254E of the Corporations Act to positively validate and confirm Securities Issue 1. While s. 1322(4)(a) of the Corporations Act enables the court to confirm that shares are not invalidated by a contravention (or irregularity), s. 254E of the Corporations Act allows the court to positively validate and confirm a share issue.

Section 254E of the Corporations Act should be "construed widely". The Court followed the liberal approach in I*n the matter of Laserbond Limited (ACN 057 636 692)* [2007] FCA 2056.

The Court's discretion to make remedial orders under s. 254E of the Corporations Act is substantially the same as the approach to be adopted for making validating orders under s. 1322 of the Corporations Act. The order made under s. 254E of the Corporations Act was made for the same reasons as the s. 1322 remedial order.

6.9 Take care, Quincecare: when banks act without asking

(By Andrew Hay and Samuel Higgs, Clayton Utz)

Singularis Holdings Ltd (In Official Liquidation) (A Company Incorporated in the Cayman Islands) v Daiwa Capital Markets Europe Ltd [2019] UKSC 50 (30 October 2019) Supreme Court of the United Kingdom, Lady Hale (President), Lord Reed (Deputy President), Lord Lloyd-Jones, Lord Sales, Lord Thomas

(a) Summary

The Supreme Court of the United Kingdom (the Supreme Court) has upheld a decision of the Court of Appeal which found that:

- the fraudulent actions of a director who was effectively the "controlling mind" of a company and who directed the company's bank to make payments on the company's behalf could not, in the circumstances, be attributed to that company; and
- the bank which made the payments on the company's behalf acted negligently and in breach of its *Quincecare* duty of care to the company by giving effect to the payment instructions, which the bank should have known were fraudulently given.

In finding in favour of the company in its negligence action against the bank, the Supreme Court held that issues relating to illegality, causation and a countervailing claim in deceit did not operate as defences to defeat the negligence action.

(b) Facts

Mr Al Sanea was the sole shareholder and a dominant director of Singularis Holdings Ltd (Singularis). Although there were six other directors, extensive powers were delegated to Mr Al Sanea, including signing powers over the company's bank accounts.

Singularis obtained a loan from an investment bank, Daiwa Capital Markets Europe Lts (Daiwa), enabling it to purchase shares. The shares were security for the loan and when they were sold and the loan was repaid, Daiwa held a cash surplus of USD $2.04 million in Singularis' account.

With the approval of Mr Al Sanea only, Singularis instructed Daiwa to make numerous payments, which amounted to misappropriation. Singularis was then placed into court ordered liquidation. The liquidators commenced an action against Daiwa claiming the full amount of the payments.

At first instance, the two bases for Singularis' and the liquidators' claim were:

- Daiwa dishonestly assisted Mr Al Sanea's breach of fiduciary duty in misapplying the company's funds; and
- Daiwa breached the *Quincecare* duty of care it owed to Singularis by giving effect to the payment instructions and was negligent in making the payments instructed by Mr Al Sanea.

The *Quincecare* duty is an implied term in a contract between a bank and its customer that the bank will use reasonable care and skill in carrying out the customer's instructions. In doing so, the bank will not give effect to instructions dishonestly given or when there are reasonable grounds to suspect dishonesty.

The Judge dismissed the dishonest assistance claim and upheld the negligence claim. The Court of Appeal then dismissed Daiwa's appeal against the negligence claim.

Daiwa's appeal to the Supreme Court did not challenge the Court of Appeal's findings in relation to the existence and breach of the *Quincecare* duty. Instead, the primary issues before the Supreme Court were:

- whether the actions of Mr Al Sanea as the owner and controller of Singularis could be attributed to the company, even though there were other directors; and
- if Mr Al Sanea's actions were attributed to the company, could the claim be defeated by:
    - illegality;
    - a lack of causation because Daiwa's duty did not extend to protecting Singularis from its own wrongdoing; or
    - an equal or countervailing claim in deceit?

(c) Decision

The Supreme Court dismissed the appeal by Daiwa. It held Mr Al Sanea's fraud could not be attributed to Singularis and Daiwa was liable in negligence. It also held no defences applied. In relation to each issue, the Supreme Court made the following findings.

(i) Attribution

The Supreme Court rejected Daiwa's argument that Mr Al Sanea's fraud could not be attributed to the company. Singularis had its own legal existence separate from the directors. The Supreme Court noted that if the fraud was attributed to a person of the company, a bank's breach of their *Quincecare* duty would not have any consequences. Consequently, the bank's customers would not be protected against the misappropriation of funds.

(ii) Illegality

In relation to the illegality defence, the Supreme Court held that it did not apply. It agreed with the reasons of the judge at first instance who noted that denying the claim would be against the public interest in requiring banks to assist in the process of discovering fraud. Dismissing Singularis' claim would also be an unfair and disproportionate response to its wrongdoing compared to adjusting the claim for contributory negligence.

(iii) Causation

The Supreme Court held that because Daiwa owed a *Quincecare* duty to Singularis, it would be self-contradictory to assert that causation was not established because the loss was caused by the company's own fault. Therefore, causation was established as the money in the company's account would have been available to the liquidators and creditors if Daiwa did not breach their duty.

(iv) Countervailing claim in deceit

The Supreme Court rejected Daiwa's argument that Mr Al Sanea's fraud could defeat the negligence claim, as the existence of fraud was a pre-condition to Daiwa's liability.

Although decided in the UK, this decision is a timely reminder (particularly in the wake of the Financial Services Royal Commission) of the increasing focus on the activities of banks, and the obligation on banks to exercise care and skill in executing a customer's orders.

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