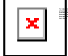

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Bulletin No. 248

Legislation Hotline

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1. Recent Corporate Law and Corporate Governance Developments

1.1 Increase in penalties for corporate and financial misconduct

20 April 2018 - The federal government has announced increased penalties for corporate misconduct and is also increasing the powers of the Australian Securities and Investments Commission (ASIC).

The federal government will increase and harmonise penalties for the most serious criminal offences under the Corporations Act 2001 No. 50 (Cth) to a maximum of:

- for individuals:
  - 10 years' imprisonment; and/or
  - the larger of $945,000 or three times the benefits;
- for corporations:
  - the larger of $9.45 million; or
  - three times benefits or 10% of annual turnover.

The federal government will also expand the range of contraventions subject to civil penalties, and also increase the maximum civil penalty amounts that can be imposed by courts, to the maximum of:

- the greater of $1.05 million (for individuals, from $200,000) and $10.5 million (for corporations, from $1 million); or
- three times the benefit gained or loss avoided; or
- 10% of the annual turnover (for corporations).

In addition, ASIC will be able to seek additional remedies to strip wrongdoers of profits illegally obtained, or losses avoided from contraventions resulting in civil penalty proceedings.

ASIC's powers will be increased through:

- expanding their ability to ban individuals from performing any role in a financial services company where they are found to be unfit, improper, or incompetent;
- strengthening their power to refuse, revoke or cancel financial services and credit licences where the licensee is not fit or proper; and
- boosting ASIC's tools to investigate and prosecute serious offences by harmonising their search warrant powers to provide them with greater flexibility to use seized materials, and granting ASIC access to telecommunications intercept material.

These reforms to ASIC's powers and penalties follow recommendations made by the ASIC Enforcement Review Taskforce (The Taskforce). The Taskforce was established in October 2016 to fulfil the Government's commitment to review the adequacy of ASIC's enforcement regime in response to the Murray Financial System Inquiry, and provided its report to Government in December 2017.

The Government has agreed, or agreed in principle, to all 50 of the Taskforce recommendations and will prioritise the implementation of 30 of the recommendations.

The remaining 20 recommendations relate to self-reporting of breaches, industry codes and ASIC's directions powers, which will be considered alongside the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

The Government's response to the Taskforce Report and the Taskforce Report can be found on the Treasury website.

1.2 Consultation on ipso facto insolvency regulations

16 April 2018 - The federal government has released for public consultation draft regulations and a draft declaration to support the stay on enforcement of ipso facto clauses against relevant entities, which was part of the insolvency law reforms passed in 2017.

The ipso facto stay applies to clauses which allow a party to enforce a right, and terminate or amend a contract, when a company has entered into a formal insolvency regardless of the counterparty's continued performance of its obligations under the contract.

These reforms promote business recovery and restructuring by assisting viable but financially distressed companies to continue to operate and salvage the remaining value of the business, increasing the likelihood of selling the business as a going concern.

The reforms allow for certain contracts or contractual rights to be excluded from being subject to the ipso facto stay, which are the subject of these draft regulations and declaration.

The regulations and declaration will be made prior to the commencement of the primary legislation on 1 July 2018.

The federal government invites stakeholders to provide their feedback on the Treasury website.

1.3 Global ethics board releases revamped code of ethics for professional accountants

9 April 2018 - The International Ethics Standards Board for Accountants (IESBA) has released a completely rewritten Code of Ethics.

While the fundamental principles of ethics have not changed, major revisions have been made to the unifying conceptual framework - the approach used by all professional accountants to identify, evaluate and address threats to compliance with the fundamental principles and, where applicable, independence.

New Code highlights include:

- revised "safeguards" provisions better aligned to threats to compliance with the fundamental principles;
- stronger independence provisions regarding long association of personnel with audit clients;
- new and revised sections dedicated to professional accountants in business (PAIBs) relating to:

- preparing and presenting information; and
  - pressure to breach the fundamental principles;
- clear guidance for accountants in public practice that relevant PAIB provisions are applicable to them;
- new guidance to emphasize the importance of understanding facts and circumstances when exercising professional judgment; and
- new guidance to explain how compliance with the fundamental principles supports the exercise of professional skepticism in an audit or other assurance engagements.

Renamed the *International Code of Ethics for Professional Accountants (including International Independence Standards)*, the new Code becomes effective in June 2019.

1.4 OECD report on digitalisation and finance

9 April 2018 - The OECD has published a report on Financial markets, insurance and pensions: Digitalisation and Finance.

Technology and digitalisation are rapidly transforming the way in which the financial sector is operating. Innovative applications of digital technology for financial services, or Fintech, are being used to alter the interface between financial consumers and service providers and are helping to improve communication with consumers and increase their engagement.

This OECD publication compiles a series of articles that focus on the impact of digitalisation and technology in the areas of financial markets, insurance, and private pensions. It also discusses the tools and policies needed to ensure that the challenges posed by digitalisation result in better outcomes and better management of the risks involved.

The report's contents include:

- framework for digitalisation in finance;
- digitalisation and pensions;
- digitalisation and the insurance sector;
- robo-advice; and
- competition and open application programming interface standards in banking

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1.5 IOSCO issues recommendations to improve regulatory reporting and transparency in corporate bond markets

5 April 2018 - The Board of the International Organization of Securities Commissions (IOSCO) has published its recommendations for improving the information on secondary corporate bond markets available to both regulators and the public.

The recommendations seek to ensure that regulators have better access to information so they can perform their functions more effectively, and to enhance cross-border information sharing and understanding. The transparency recommendations aim to support the price discovery process and facilitate better informed investment choices.

Updating IOSCO's 2004 report on *Transparency of Corporate Bond Markets*, the Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets report makes seven recommendations that emphasize the importance of ensuring the availability of information to regulators, through reporting, and to the public, through transparency requirements.

The report recommends that regulatory authorities should ensure that they have access to sufficient information to perform their regulatory functions effectively. In addition, it recommends regulatory authorities should have clearer regulatory reporting and transparency frameworks to facilitate better crossborder understanding of corporate bond markets. The report also recommends that regulatory authorities should consider steps to enhance pre-trade transparency in corporate bond markets and implement regimes that require post-trade transparency.

1.6 FCA sets out next steps to improve competition in the UK's asset management industry

5 April 2018 - The UK Financial Conduct Authority (FCA) has published the latest step in its response to the concerns identified through its asset management market study.

The publications include:

- final rules following a previous consultation, focused on the duties of fund managers as the agents of investors in their funds; and
- a consultation on proposed rules and guidance, focused on improving the information that investors get about funds.

The final rules and guidance cover:

- a requirement for fund managers to make an annual assessment of value, as part of their duty to act in the best interests of the investors in their funds;
- a requirement for fund managers to appoint a minimum of two independent directors to their boards;
- the introduction of a new prescribed responsibility under the Senior Managers and Certification Regime to bring individual focus and accountability; and
- technical changes to:
    - improve fairness around the way in which fund managers profit from investors buying and selling their funds; and
    - facilitate the movement of investors into cheaper share classes.

To address its concerns that even actively engaged investors do not find it easy to choose which fund is right for them, the FCA is publishing a further consultation on remedies related to funds providing better information about what they are offering.

This includes proposals on:

- how fund objectives can be expressed more clearly and be more useful to investors;
- making it clearer when funds are benchmark-constrained, or limited in how far their holdings can differ from the weightings of a benchmark index; and
- ensuring that where a fund uses one or more benchmarks, this is disclosed consistently and explained to investors.

The FCA has also published an Occasional Paper setting out the results of behavioural research which looked at how different ways of presenting information about charges affected investors' decision-making and their understanding and awareness of charges. This paper can be read here.

Firms have 18 months to implement the rules on assessment of value and appointment of independent directors and 12 months for the rules related to the way in which fund managers profit from investors buying and selling their funds.

1.7 APRA seeks improvement in executive remuneration practices

4 April 2018 - The Australian Prudential Regulation Authority (APRA) has released the results of a Review of remuneration practices at large financial institutions which found considerable room for improvement in the design and implementation of executive remuneration structures.

The review examined whether policies and practices in regulated institutions were meeting the objectives of APRA's prudential framework: that remuneration frameworks operate to encourage behaviour that supports risk management frameworks and institutions' long-term financial soundness.

APRA's review comprised detailed analysis of executive remuneration practices and outcomes from a sample of 12 regulated institutions across the authorised deposit-taking institutions (ADIs), insurance and superannuation sectors. The sample of institutions reviewed collectively accounts for a material proportion of the total assets of the Australian financial system.

The review found that remuneration frameworks and practices did not consistently and effectively promote sound risk management and long-term financial soundness, and fell short of the better practices set out in APRA's existing guidance.

The report identified the need for improvement in:

- ensuring practices were adopted that were appropriate to the institution's size, complexity and risk profile;
- the extent to which risk outcomes were assessed, and weighted, within performance scorecards; and
- enforcement of accountability mechanisms in response to poor risk outcomes; and evidence of the rationale for remuneration decisions.

In response to the findings, APRA will consider ways to strengthen its prudential framework. A future review of the relevant prudential standards and guidance will take account of the forthcoming Banking Executive Accountability Regime (BEAR), as well as international best practice.

Any revisions to the prudential framework will be subject to APRA's usual practices of stakeholder consultation and engagement.

1.8 Senate report on inquiry into foreign bribery

28 March 2018 - The Senate Economics References Committee has published its Report on Foreign Bribery. The report presents the findings of an inquiry into the measures governing the activities of

Australian corporations, entities, organisations, individuals, government and related parties with respect to foreign bribery.

The Committee has made 22 recommendations and these include:

- the Australian Government prioritise the consideration and implementation of the recommendations in the Phase 4 OECD report, and ensure that proposed legislative changes to the foreign bribery offence and related measures to strengthen Australia's foreign bribery regime are implemented or enacted consistent with the Phase 4 OECD report;
- the Australian Federal Police's (AFP) annual report incorporate specific information about the Fraud and Anti-Corruption Centre (FAC), including de-identified data regarding the number of referrals received, the number of matters allocated to the AFP foreign bribery or FAC team, the number of investigations completed, the resources devoted to these activities, and the number of investigations which led to criminal/civil actions and the timeliness of such enforcement action;
- consideration be given to developing a contingency mechanism that explicitly provides for additional one-off funding to appropriate agencies (Australian Federal Police, Australian Securities and Investment Commission, Commonwealth Director of Public Prosecutions) for large and complex investigation of foreign bribery offences to ensure any allegations are thoroughly investigated, and where appropriate, fully prosecuted;
- in considering the report of the review of the enforcement regime of Australian Securities and Investment Commission (ASIC), the government have regard to how any proposed changes will help improve the enforcement of penalties by ASIC for foreign bribery related offences;
- the definition of 'foreign public official' in section 70.1 of the Criminal Code Act 1995 No. 12 (Cth) (the Criminal Code Act) be amended to include candidates for office;
- the foreign bribery offence apply in circumstances where the bribe of a foreign public official was to obtain or retain a personal advantage;
- the Criminal Code Act be amended to include a new corporate offence of failing to prevent foreign bribery, and that principles-based guidance be published as to the steps companies need to take in order to establish and implement adequate procedures in relation to the new failing to prevent foreign bribery offence;
- the foreign bribery offence be amended to clarify that:
    - a person is prohibited from bribing a foreign public official to obtain a business advantage for someone else; and
    - the payer of a bribe does not need to intend to obtain or retain any specific business or business advantage to be guilty of the foreign bribery offence;
- the government introduce a deferred prosecution agreement scheme for corporations, supported by a strong legislative framework which requires strict compliance and allows for adequate responses in the event of a breach;
- the facilitation payment defence currently provided for in s. 70.4 of the Criminal Code Act (and the associated ss. 26-52(4) and 26-52(5) of the Income Tax Assessment Act 1997 No. 38 (Cth)) be abolished over a transition period, to enable companies and individuals to adjust their business practices and procedures to comply with the law as amended;
- ASIC expand the register of beneficial ownership to require companies, trusts and other corporate structures to disclose information regarding their beneficial ownership, and that this information be maintained in a central register;
- the government introduce a debarment framework that would ensure companies are required to disclose if they have been found guilty of foreign bribery offences and give agencies the power to preclude the tenderer from being awarded a contract;
- the government provide practical guidance to companies to draw attention to domestic and international guidance relating to foreign bribery, and to increase awareness of the high-risk sectors and regions in which Australian businesses commonly operate; and
- clear information be provided in the public domain about how and where an individual or a small company should go to make a voluntary report of foreign bribery.

1.9 New Bill - Treasury Laws Amendment (ASIC Governance)

28 March 2018 - The Treasury Laws Amendment (ASIC Governance) Bill 2018 (Cth) proposes to amend the legislation listed below. The Bill was introduced into the House of Representatives and received its second reading speech on 28 March 2018.

According to the explanatory memorandum, the Bill proposes to enable the Governor-General to appoint a second Deputy Chairperson of the Australian Securities and Investments Commission (ASIC).

This would affect the following legislation:

- Australian Securities and Investments Commission Act 2001 No. 51 (Cth); and
- Foreign Evidence Act 1994 No. 59 (Cth).

1.10 New Bill - Treasury Laws Amendment (Enhancing ASIC's Capabilities)

28 March 2018 - The Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018 (Cth) proposes to amend the legislation listed below. The Bill was introduced into the House of Representatives and received its second reading speech on 28 March 2018.

According to the explanatory memorandum, the Bill proposes to:

require ASIC to consider the effects that the performance of its functions and the exercise of its powers will have on competition in the financial systems; and allow ASIC to employ staff outside of the Public Service Act 1999 No. 47 (Cth).

This would affect the following legislation:

- Australian Securities and Investments Commission Act 2001 No. 51 (Cth);
- Business Names Registration Act 2011 No. 126 (Cth);
- Corporations Act 2001 No. 50 (Cth); and
- Mutual Assistance in Business Regulation Act 1992 No. 25 (Cth).

1.11 Penalties for manipulation of financial benchmarks

28 March 2018 - The Government has passed legislation imposing civil and criminal penalties for financial institutions that manipulate financial benchmarks.

The manipulation of any financial benchmark, or product used to determine such a benchmark, is now a specific offence and subject to civil and criminal penalties. This includes maximum penalties of up to $945,000 and/or 10 years imprisonment for individuals and up to $9.45 million for bodies corporate.

These penalties can be used against foreign nationals and bodies corporate, even when the conduct occurs abroad and results in an Australian entity suffering a financial loss or other disadvantage.

Financial benchmarks are used to help value trillions of dollars of financial products and have proven to be a weak spot in the international system of financial regulation. There have been many cases of market misconduct regarding the determination of financial benchmarks, such as the London Interbank Offer Rate (LIBOR), all around the world.

Administrators of significant benchmarks will now be required to hold a "benchmark administrator" license and comply with enforceable rules made by the Australian Securities and Investments Commission (ASIC).

The law will also provide ASIC with a new power to compel submission to a significant financial benchmark - as a last resort - in the case that other calculation mechanisms have failed and the continued generation of the financial benchmark is threatened. Under the law, legitimate business activity that has the effect of moving a benchmark (but not the intent) would not constitute an offence.

1.12 Early 2018 filings show US companies on pace for second highest CEO pay increase in a decade

27 March 2018 - Institutional Shareholder Services Inc. (ISS) has announced the release of an analysis by its data intelligence unit, ISS Analytics, of initial 2018 US CEO pay trends.

Notably, CEO pay increases for fiscal 2017, as reflected in 2018 filings, are shaping up to be the largest since 2010 when companies provided sizeable compensation awards following down years after to the global financial crisis. For the 166 large capitalization, S&P500 companies analyzed by ISS Analytics through 26 March (and excluding changes in pension-based compensation), the median CEO pay increase from fiscal 2016 to 2017 stands at 9.5%, well above the 5% increase evidenced last year and second only over the past decade to the 15.4% jump in 2010.

Key findings from the analysis include:

- stock award increases contributed to an overall 7.4% increase in CEO pay, while increases in paid-out annual incentives added another 2.6%;
- the aggregate value of stock option grants fell behind 2016 levels, acting to reduce overall pay by 2.2%;
- by industry, Transportation, Automobiles & Components, and Materials hold the top three positions for CEO pay gains, while Consumer Staples, Retailing, and Food Beverage & Tobacco hold the bottom three spots, with the latter three all registering a median year-over-year pay reduction; and
- so far this year, 64 S&P 1,500 companies have reported median employee pay above US$100,000.

At a multiple of 208 and 207, Capital Goods and Materials are thus far the industries with the highest disclosed median pay gap between CEOs and rank-and-file employees.

1.13 British and Australian regulators strengthen cooperation on FinTech through enhanced cooperation agreement

22 March 2018 - The Financial Conduct Authority (FCA) and ASIC have signed an Enhanced Cooperation Agreement between their Innovation Hubs to extend their existing agreement of cooperation and coordination on FinTech innovation. This agreement forms part of the broader Fintech Bridge signed by the UK Chancellor of the Exchequer and the Australian Treasurer.

In this enhanced agreement, the FCA and ASIC have agreed to explore ways to quicken the licensing process in terms of the authorisation of innovative businesses that are already authorised in the other jurisdiction. Where a business is a participant in either Authority's regulatory sandbox and would like to enter the other's, the FCA and ASIC will endeavour to facilitate that participation.

The FCA and ASIC will also look to co-host FinTech and regtech events, conduct joint policy work, research and experimentation and explore secondment opportunities. They will work to raise topics or approaches of common interest at an international level to promote greater levels of international cooperation on financial innovation.

Under this new agreement ASIC and the FCA will continue to refer innovative FinTech businesses to each other for advice and support via their respective Innovation Hubs.

Building on cooperation agreements such as the one signed with ASIC, the FCA also recently asked for views on the merits of creating a global sandbox. This could potentially allow firms to conduct tests in different jurisdictions at the same time and allow regulators to work together and identify and solve common cross-border regulatory problems.

1.14 Cyber threats topple over-regulation as top risk for banking and capital markets CEOs

21 March 2018 - PricewaterhouseCoopers (PwC) has published its 21st CEO Survey: The Anxious Optimist in the Corner Office, a global survey of CEO outlooks.

Survey highlights include:

- Banking and Capital Markets (BCM) CEOs are bullish about economic growth - 57% believe it will improve over the next 12 months, compared to 30% in 2017;
- BCM CEOs' optimism about the economy hasn't translated into increasing confidence in the prospects for their own organisations - 38% are very confident about their companies' ability to boost revenue growth over the next 12 months, down from 40% in 2017;
- the pace of technological change (85%) and the closely-related impact of changing consumer behaviour (73%) as threats to growth are on the rise; and
- less than half (44%) of BCM CEOs are clear about how robotics and AI can improve customer experience.

Cyber threats have also replaced over-regulation as the top concern for BCM CEOs, with 89% worried about their cybersecurity, while 93% will be investing more heavily in it in 2018.

1.15 Senate Committee Report - Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill

16 March 2018 - The Senate Economics Standing Committee has made available the report (March 2018) from its inquiry into the Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2017 (Cth).

In its report, the Committee recommends that:

- "an explicit requirement for review be included in the [B]ill";
- "the definition of journalist be reviewed"; and
- "the [B]ill be passed".

The submissions made to the Committee are available on the Committee's website.

1.16 Royal Commission Update - further background papers published

April 2018 - The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission) has made available the following additional background papers:

- Background Paper 6 (Part A) - Some Features of the Australian Financial Planning Industry, which "provides information about the key participants in the Australian financial planning industry, some features of this industry, the main services offered by financial planners and advisers, as well as an outline of a selection of regulatory issues";
- Background Paper 6 (Part B) - Education and Training Requirements for Financial Advisers, which "explains both the current education and training requirements for financial advisers or financial planners and the key aspects of recent reforms in this area";
- Background Paper 6 (Part C) - Financial Products Available to Retail Investors, which "outlines the main categories of financial products available to retail investors, the size of retail investment in the main categories of financial products held by Australian retail investors and the ways in which retail investors are protected, including prohibitions and restrictions on retail investment in particular financial products";
- Background Paper 7 - Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australia Households, which "explain[s] in general terms the legal framework within which financial advice is provided, and financial products are sold, to Australian households"; and
- Background Paper 8 - Key Reforms in the Regulation of Financial Advice, which focuses on the following significant reforms affecting the regulation of financial advice since 2007:
    - Future of Financial Advice (FOFA) reforms;
    - life insurance remuneration reforms;
    - establishment of a Financial Advisers Register; and
    - development of professional standards for financial advisers.

1.17 Basel Committee - frameworks for early supervisory intervention

March 2018 - The Basel Committee on Banking Supervision has published Frameworks for early supervisory intervention, which examines how supervisors around the world have adopted frameworks, processes, and tools to support early supervisory intervention.

Since the global financial crisis, supervisory authorities have increasingly focused their attention on how early supervisory intervention can promote financial stability by reducing the probability and impact of a bank failure. There is also a common recognition that for supervision to operate effectively, identification and intervention at an early stage are critical to prevent problems from escalating or becoming acute.

There have been important developments in supervisory practices in this regard since the crisis. National supervisory authorities have adopted more forward-looking approaches, incorporating both quantitative and qualitative elements into their risk-based supervisory assessments. In addition to institution-specific supervision, supervisors are also adopting benchmarking exercises and thematic reviews as part of their toolkit to better detect emerging risks and potential outlier banks. Many national authorities have also undergone organisational changes to support these approaches, and have introduced dedicated teams and oversight functions to ensure early supervisory actions are taken and followed up.

Based on practices observed, this study finds that early supervisory actions taken by supervisors depend not only on the expert judgment of supervisors but also to a large extent on an organisational infrastructure that sets in place:

- supervisory reinforcement through both vertical and horizontal risk assessments to maximise the early detection of risks;
- a clear framework for when actions should be taken; and
- internal governance processes and programmes to support supervisory development and capacity-building.

2. Recent ASIC Developments

2.1 ASIC reports on Small Business Strategy 2017-2020 4

April 2018 - ASIC has published an overview of its Small Business Strategy 2017-2020 and the progress achieved to date.

Report 571 ASIC and small business (REP 571) explains ASIC's Small Business Strategy and examines the ways in which ASIC assists, engages with and helps protect small business in Australia. It also provides key results for the period 1 July to 31 December 2017 in each of these three areas.

Among the key results for the period 1 July to 31 December 2017:

- ASIC processed over 179,000 new business name registrations;
- ASIC answered over 351,000 inquiries over the phone, by email, via social media and web chat;
- there were over 33,300 views of the ASIC Small Business Hub; and
- ASIC's small business enforcement team had 232 individuals/entites prosecuted for 476 criminal offences and 27 director disqualifications.

Small business is ASIC's largest customer and stakeholder. Of all Australian companies and businesses registered with ASIC, approximately 96% are considered small businesses with fewer than 20 employees.

In March 2017, ASIC established an Office of Small Business to focus ASIC's efforts and initiatives to help small business succeed as a key driver of the Australian economy.

In August 2017, ASIC launched its Small Business Strategy 2017-2020.

2.2 ASIC releases updated guidance on client money

4 April 2018 - ASIC has released updated guidance for Australian financial services (AFS) licensees that hold client money for trading in over-the-counter (OTC) derivatives.

The guidance coincides with the start of ASIC's Client Money Reporting Rules 2017 (the Client Money Reporting Rules) and other client money reforms on 4 April 2018 enacted under the Treasury Laws Amendment (2016 Measures No. 1) Act 2017 No. 25 (Cth) and the Corporations Amendment (Client Money) Regulations 2017 (Cth).

ASIC Regulatory Guide 212 Client money relating to dealing in OTC derivatives (RG 212) has been updated to reflect the changes to the law as a result of these reforms.

The changes mean that the circumstances in which an AFS licensee may use 'derivative retail client money', within the meaning of the Corporations Act 2001 No. 50 (Cth), have been significantly restricted. In particular, AFS licensees can no longer withdraw derivative retail client money from the client money account and use it for a wide range of purposes, including as the licensee's own working capital.

The reforms also impose new record-keeping, reconciliation and reporting requirements on AFS licensees that hold derivative retail client money (unless the client money relates to a derivative that is traded on a fully licensed domestic market, such as ASX 24).

2.3 Industry funding update: ASIC publishes indicative levies for 2017-18

28 March 2018 - Ahead of issuing final industry funding invoices in January 2019, ASIC has published estimates of what regulated sectors will pay.

Industry funding arrangements became law on 1 July 2017.

All organisations that are regulated by ASIC will contribute towards ASIC's regulatory costs incurred in the previous financial year:

- some will pay a flat levy, with the cost of regulating a subsector shared equally among the entities operating in that subsector; and
- others will pay a graduated levy, with the entity's size or level of business activity determining their share of costs.

The indicative levies published are based on ASIC's budgeted regulatory costs outlined in ASIC's draft Cost Recovery Implementation Statement (CRIS).

The indicative levies provided remain an estimate and the amounts are likely to change when ASIC's actual regulatory costs are known in November.

Calculating indicative levies is dependent on ASIC having access to specific business activity metric data relating to each subsector. Some metrics that ASIC requires to make these calculations are new, and have

not yet been collected from industry. As a result, ASIC has calculated indicative levies for 35 of the 48 subsectors.

ASIC will publish its actual regulatory costs in November, along with population and business activity metric data provided by industry, which will enable entities to better estimate their individual levy.

More about indicative levies and industry funding can be found here.

2.4 ASIC releases updated guidance on company reinstatements

26 March 2018 - ASIC has released an updated regulatory guide on company reinstatements to simplify and improve the process, with new information to clarify existing guidance.

Regulatory Guide 83 Reinstatement of companies (RG 83) outlines if and when ASIC may reinstate a company's registration under s. 601AH(1) of the Corporations Act 2001 No. 50 (Cth), and how to apply to a court to reinstate a company's registration under s. 601AH(2) of that Act.

The guide has been updated to reflect minor developments in the law relating to reinstatements and changes to ASIC's policies, management and administration of reinstatement applications. The guide also takes into account the introduction of the ASIC Supervisory Cost Recovery Levy.

RG 83 clarifies the circumstances in which a third party may apply to ASIC for reinstatement of a company. This will assist third parties currently making reinstatement applications to the court in instances where administrative reinstatement is more appropriate.

ASIC will not ordinarily reinstate a company where, upon reinstatement, the company would not have a director to manage the company's business. ASIC is aware of instances of former directors being unaware (and making complaints to ASIC) that a reinstatement application had been made. RG 83 requires an application to include evidence that directors of the company at the time of its deregistration have been notified about the reinstatement application.

The updated RG 83 provides additional information about what supporting documentation should be provided with an application. The amendments aim to reduce the confusion and time spent by applicants in preparing and submitting an application as well as reducing ASIC's processing time.

3. Recent ASX Developments

3.1 Public consultation - Management of the ASX Market

On 21 March 2018, ASX released a Consultation Paper, seeking submissions from stakeholders on the market management of ASX Trade during market issues. This paper is the final of three consultations following the ASX Trade outage in September 2016.

More information about this, and the previous consultations is available on the ASX website.

3.2 Public consultation - Amendments to the ASX Settlement Operating Rules and ASX Clear Operating Rules and Procedures

On 3 April 2018, ASX released a Consultation Paper regarding proposed amendments to the ASX Settlement Operating Rules and ASX Clear Operating Rules and Procedures. ASX intends to replace the Registered Holder Collateral Cover Authorisation form with a rules framework that preserves ASX Clear's interest in, and rights to use and dispose of, CHESS securities lodged as collateral for clients trading options market contracts. Minor amendments are also proposed to the ASX Clear Operating Rules relating to the circumstances in which third parties may take a security interest over collateral and excess cash.

More information about this consultation is available on the ASX website.

3.3 Reports

On 5 April 2018 ASX released the ASX Monthly Activity Report for March 2018.

4. Recent Takeovers Panel Developments

4.1 Auris Minerals Limited - Panel declines to conduct proceedings

6 April 2018 - The Takeovers Panel has declined to conduct proceedings on an application dated 29 March 2018 from Auris Minerals Limited in relation to its affairs.

The application concerned the alleged association of several shareholders, including the Mandevilla Requisitioning Shareholders (see TP18/24), and Mr Rob Martin (a director of Auris) and the disclosure of voting power in substantial holding notices.

The Panel concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances and Auris had not provided a sufficient body of material to justify the Panel making further enquiries as to the alleged association. Accordingly, the Panel declined to conduct proceedings.

The Panel notes that Mr Martin accepted he made an oversight in relation to the disclosure of his voting power in Auris and informed the Panel that he would lodge an ASIC Form 604 and Appendix 3Y in relation to his interests.

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

5. Recent Research Papers

5.1 Public and private enforcement of corporate and securities laws: An empirical comparison of Hong Kong and Singapore

Current scholarship emphasises the correlation between enforcement of corporate and securities laws and strong capital markets. Yet, the issue of how private and public enforcement may achieve the objectives of compensation and optimal deterrence remains controversial. While enforcement strategies have been studied extensively in the US and the UK, comparatively less attention is placed on Asia where concentrated shareholdings are the norm.

This study fills the gap by focusing on Hong Kong and Singapore, two leading international financial centres in Asia. Post-Asian financial crisis of 1997, Hong Kong and Singapore have changed their laws to strengthen the private enforcement framework. Public enforcement activities have also been significant. The question is whether these reforms and enforcement activities succeed in reaching the afore-mentioned objectives. Based on the authors' study of breaches of directorial duties and corporate disclosure violations involving listed companies from 2000 to 2015, the authors find that (1) public enforcement dominates over private enforcement; and (2) there exist important, but limited, substitutes to private enforcement: securities regulators use public enforcement to obtain compensation for investors and shareholders file requisitions to remove the errant directors.

The authors argue that: (a) there is a significant gap in enforcement strategies for directorial wrongdoing in Singapore; (b) for public enforcement of corporate disclosure violations, the beneficiaries of the compensation should be the investors (rather than the company) and the defendants should only be the errant directors (and not the company). The study is relevant to those jurisdictions considering the powers of regulators and improving their enforcement framework.

Public and Private Enforcement of Corporate and Securities Laws: An Empirical Comparison of Hong Kong and Singapore

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5.2 Hacking corporate reputations

The authors exploit unexpected corporate data breaches to study how firms respond to negative reputation events. Data breaches negatively affect firm value by 10-20% following the event, and this effect lasts for years. However, consistent with a decline in corporate reputation reducing the value of a firm's pre-existing corporate social responsibility (CSR) investments, the authors find that firms significantly increase their investment in CSR by an average of 0.4-0.5 standard deviations in the years following an unexpected breach. The paper represents the first empirical study to directly link CSR to corporate reputations and presents the first evidence in the literature that firms actively invest in CSR as the result of a negative reputation shock.

Hacking Corporate Reputations

5.3 Investors as regulators: Green bonds and the governance challenges of the sustainable finance revolution

This article examines the role of the global financial markets in promoting sustainability and the governance challenges arising from green bonds. A growing range of financial instruments and strategies catalyze the desire of investors and corporations to support environmentally and socially sustainable commercial activity. This article focuses on green bonds, a form of debt financing whose proceeds are specifically dedicated to environmentally-friendly "green" projects, assets, and business activities. Having emerged in the past three years, green bonds are expected to play an integral role in responding to the

existential threat and enormous costs posed by climate change. Largely missing from the still-nascent green bond market are government regulators. Instead, its governance is decentralized and primarily shaped by private governance regimes (such as investment standards, certification schemes, ratings, and third-party assessment), which compete or collaborate with each other for market adoption. In comparison to public regulation, private governance is often faster to implement and more responsive to the needs of market participants but may suffer from a lack of legitimacy, accountability, and consistency and be susceptible to greenwashing. To address these deficits, this article identifies and analyzes governance gaps in the green bond market and outlines a public-private hybrid regulatory framework to optimize the interests of investors and stakeholders.

Investors as Regulators: Green Bonds and the Governance Challenges of the Sustainable Finance Revolution

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5.4 Do institutional investors drive corporate social responsibility? International evidence

This paper assesses whether shareholders drive the environmental and social (E&S) performance of firms worldwide. Across 41 countries, institutional ownership is positively associated with E&S performance and additional tests suggest this relation is causal. Institutions are motivated by both financial and social returns. Investors increase firms' E&S performance following shocks that reveal financial benefits to E&S improvements. In cross-section, investors increase firms' E&S performance when they come from countries where there is a strong community belief in the importance of E&S issues, but not otherwise. As such, these institutional investors transplant their social norms regarding E&S issues around the world.

Do Institutional Investors Drive Corporate Social Responsibility? International Evidence

6. Recent Corporate Law Decisions

6.1 The discretion to allow an uncommercial transaction exercised
(Vivek Mahadevan, Herbert Smith Freehills)

Re Cyberduck Software Pty Ltd (In Liq) [2018] VSC 122, Supreme Court of Victoria, Efthim AsJ, 23 March 2018

(a) Summary

The issue in contention was the payment of a GST refund in October 2012 of $271,418.00 owed to Cyberduck Software Pty Ltd (Cyberduck) by the Australian Taxation Office (ATO) to partly settle an outstanding tax liability owed to the ATO by B.A.S. (R&D) Pty Ltd (R&D), which was a related entity of Cyberduck. The crediting of the GST refund against the existing tax liabilities was authorised by the accountant of Cyberduck (who was also the accountant of R&D). Both entities were placed in liquidation by November 2013. After an audit by the ATO in June 2015, the Commissioner of the ATO reversed the input tax credits on which the Cyberduck Credit was founded (i.e. the source of the input tax. The liquidator of both entities sought for the ATO to pay the sum of the GST refund to Cyberduck, claiming the payment of the GST refund was a voidable transaction under the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).

Efthim AsJ found that the payment of the GST refund was voidable as an uncommercial transaction under s. 588FE and an unfair preference under s. 588FA of the Corporations Act. Despite this, His Honour

exercised its discretion under s. 588FF to not make the orders requested by the liquidator, as the GST refund was found to have no basis to be owed to Cyberduck, and therefore could not be refundable.

(b) Facts

R&D and Cyberduck were related entities. In September 2012, Cyberduck was entitled to receive a GST refund from the ATO to the sum of $271,418.00, relating to a claim of input tax credits in respect of goods or services reportedly acquired by Big Ant Studios Melbourne Pty Ltd (Cyberduck Credit). At this time, R&D had existing tax liabilities of $578,829.

On authorisation by Cyberduck's accountant, Mr Traianedes (who was also the accountant of R&D), the ATO refunded the Cyberduck Credit against R&D's existing tax liabilities in October 2012. R&D and Cyberduck were subsequently placed into liquidation by way of creditors wind up in December 2012 and November 2013 (respectively). Mr Traianedes was appointed liquidator of both entities.

After a business activity statement audit by the ATO in June 2015, the Commissioner of the ATO reversed the input tax credits which gave rise to the Cyberduck Credit, as the audit found that the goods or services were not in fact acquired by Big Ant Studios Melbourne Pty Ltd. The Commissioner served Mr Traianedes with a notice of assessment of net amount for the period 1 July 2012 to 30 June 2013.

In response, Mr Traianedes sought orders from the Court under s. 588FF of the Corporations Act for the ATO to pay the sum of the Cyberduck Credit to the liquidated entities, claiming that the Cyberduck Credit:

- for Cyberduck, was an uncommercial transaction by the operation of s. 588FE of the Corporations Act;
- for R&D, was an unfair preference pursuant to s. 588FA of the Corporations Act; and
- in both cases, was an insolvent transaction pursuant to s. 588FC of the Corporations Act, and therefore void against the liquidator under s. 588FE of that Act.

(c) Decision

(i) Insolvent and voidable transaction

An order under s. 588FF of the Corporations Act can be granted by the Court if the Court is satisfied that a transaction of a company is voidable. The threshold question before his Honour was to determine what events constituted the transaction in this case. The ATO argued that the audit conducted in June 2015 (a post liquidation event) should be included in the concept of the transaction, rather than being limited to the payment of the Cyberduck Credit alone. His Honour relied on the policy underlying Part 5.7B of the Act, which was to consider 'transactions' as being limited to circumstances where an insolvent entity disposed of property prior to the actual commencement of formal insolvency. His Honour assessed the transaction in a manner which accorded with commercial reality (*Cussen v Sultan* (2009) 74 ACSR 496) and found that the transaction did not include the post liquidation audit conducted by the ATO.

His Honour then considered whether Cyberduck and R&D were solvent at the time of the payment of the Cyberduck Credit, as defined in s. 95A of the Corporations Act (i.e. whether each entity was able to pay their debts as and when they became due and payable). His Honour found that on the balance of probabilities, the evidence established that Cyberduck and R&D were both insolvent under s. 95A of the Corporations Act, as they had a deficiency of assets in comparison to current liabilities and a lack of cash reserves.

(ii) Uncommercial transaction - Cyberduck

An uncommercial transaction is a transaction of a company that a reasonable person in the company's circumstances would not have entered into, having regard to the benefits/detriment to the company of entering into the transaction; the respective benefits to other parties to the transaction and any other

relevant matters (s. 588FB(1) of the Corporations Act). His Honour identified that for a transaction to be uncommercial, the consideration received must be so large that it could not be explained by normal commercial practice (*Capital Finance Australia Ltd v Tolcher* (2007) 164 FCR 83). In considering the above principles in light of the evidence before him, his Honour relied on *Gibbons v Deputy Commissioner of Taxation* [2003] NSWSC 936 (amongst other similar cases) to establish that the payment of a tax liability was "uncommercial" in the context of s. 588FB(1) of the Corporations Act as it represented a benefit to the ATO with the result that Cyberduck's assets were depleted to the detriment of its creditors.

(iii) Unfair preference - R&D

A transaction constitutes an unfair preference when an unsecured creditor gains more than they otherwise would, if they had to prove for their debt in a winding up of the company (s. 588FA(1)) of the Corporations Act. The ATO contended that as the Cyberduck Credit was paid by Cyberduck and there was no diminution of R&D's assets, there was no preferential effect. His Honour preferred authority that suggested that an unfair preference could still exist in these circumstances, as there was nothing in s. 588FA(1) of the Corporations Act that expressly incorporated a debtor asset diminution concept (*Burness v Supaproducts Pty Ltd* (2009) 259 ALR 339). The relevant test was whether the ATO, in receiving the Cyberduck Credit, received more than they otherwise would have in an ordinary winding up - on the evidence, His Honour found this was the case, as if the money paid to the ATO was ordered to be refunded, then there would be a dividend to creditors.

The ATO further claimed protection under the good faith defence in s. 588FG(2)(b) of the Corporations Act, which prevents the Court from making an order under s. 588F if the benefactor of the transaction had no reasonable grounds for suspecting the company was insolvent when it made the transaction and a reasonable person in the benefactor's circumstances would have had no such grounds (s. 588FG(2)(b)). His Honour accepted the liquidator's evidence that the ATO (or a reasonable person in the ATO's position) had reasonable grounds for suspecting that Cyberduck or R&D was insolvent, as the ATO knew that R&D had a substantial outstanding balance that they could not pay out of their own funds and had failed to file any tax related statements since it commenced trading. As such, the ATO was unable to gain the benefit of s. 588FG(2)(b) of the Corporations Act.

(iv) Discretion of the Court

His Honour confirmed that the Court has a discretion as to whether to make any order under s. 588FF of the Corporations Act even when a liquidator satisfies the Court that the transaction is voidable (*Great Investments Ltd v Warner* (2016) 243 FCR 516). The ATO contended that there were no legal or policy grounds for the Court to give effect to the liquidator's payment order, as the ATO's post liquidation audit revealed that Cyberduck was never entitled to claim the Cyberduck Credit. His Honour agreed with the ATO's contention, as to make the order would give Cyberduck and R&D an effective windfall, as they were never entitled to claim the Cyberduck Credit in the first place.

6.2 Winding up not an unreasonable order where alternative remedies are uncertain

(Emily Smith, Ashurst Australia)

Asia Pacific Joint Mining Pty Ltd v Allways Resources Holdings Pty Ltd [2018] QCA 48, Supreme Court of Queensland, Court of Appeal, Gotterson and McMurdo JJA and Jackson J, 23 March 2018

(a) Summary

At first instance, Asia Pacific Joint Mining Pty Ltd (APJM) was found to have engaged in conduct contrary to the interests of the members as a whole as well as conduct oppressive, prejudicial or discriminatory to members, in relation to its majority shareholding in Samgris Resources Pty Ltd (Samgris). Asia Pacific Joint Mining unsuccessfully appealed against the Supreme Court's order to have Samgris Resources Pty Ltd wound up.

(b) Facts

APJM was the majority shareholder in Samgris. Two of the minority shareholders commenced proceedings seeking orders that APJM had engaged in conduct that was "contrary to the interests of the members as a whole" (s. 232(d) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act)) and "oppressive to, unfairly prejudicial, or unfairly discriminatory against, members" (s. 232(e) of the Corporations Act).

At first instance, Bond J in the Queensland Supreme Court found that APJM had so acted, and that the relationship between APJM and the minority shareholders had been one of "quasi-partnership" until the relationship between the parties irretrievably broke down due to APJM's conduct. This finding empowered the court to order that Samgris be wound up.

The trial judge also had grounds to order that the appellant company be wound up under s. 461(1)(k) of the Corporations Act where it was just and equitable that the company be wound up.

The trial judge found Samgris to be:

"... the type of company for which winding up is regarded as the characteristic remedy where the working relationship [between the shareholders] predicated on mutual cooperation, trust and confidence has irretrievably broken down."

The trial judge held that s. 467(4) of the Corporations Act compelled the winding up order, unless his Honour formed the opinion that the minority shareholders were acting unreasonably in seeking to have the company wound up, instead of pursuing another remedy, despite the concurrent availability of winding up as a remedy under s. 231 of the Corporations Act. His Honour concluded that the minority shareholders were not acting unreasonably in preferring a winding up order over the alternative of a purchase of their shares. On this basis, his Honour ordered that Samgris be wound up. APJM appealed this order to the Court of Appeal.

(c) Decision

Gotterson and McMurdo AJ and Jackson J dismissed the appeal with costs. McMurdo AJ delivered the substantive reasons.

The trial judge was correct to regard himself as bound to apply the reasonableness limitation in s. 467(4) of the Corporations Act to the discretion to order winding up, notwithstanding that the remedy was available under both ss. 233 and 461(1)(f), (g) or (k) of that Act.

Applying s. 467(4) of the Corporations Act, the reasonableness of the minority shareholder's preference for winding up is to be assessed by reference to the consequences of the events and circumstances to be redressed.

The Court considered that the minority shareholders' preference for winding up was not unreasonable as:

- there was uncertainty as to whether the appellant would be able to comply with any share buy-out ordered by the court, therefore a buy-out order may still result in the winding up of Samgris; and

- APJM had offered no evidence of its preparedness to comply with a buy-out order.

On this basis, whilst the buy-out order was an available remedy, the minority shareholders were not unreasonable in seeking to have the company wound up in the circumstances.

The appeal was dismissed with costs.

6.3 Penalties imposed on Storm Financial directors in long-running dispute

(Sam Dimopoulos, King & Wood Mallesons)

Australian Securities and Investments Commission v Cassimatis (No 9) [2018] FCA 385, Federal Court of Australia, Dowsett J, 22 March 2018

(a) Summary

The Court issued orders against Mr and Mrs Cassimatis, both directors of Storm Financial Pty Ltd ("Storm Financial"), following an earlier decision that held they had breached s. 180(1) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). The orders imposed were a declaration of contravention, a pecuniary penalty of $70,000 each and disqualification orders preventing both Mr and Mrs Cassimatis from managing a corporation for 7 years.

In determining these orders, Dowsett J held, among other things, that:

- the length of time between a Court making a disqualification order and when the conduct in question occurred and the initiation of proceedings by the Australian Securities and Investments Commission (ASIC) were factors mitigating the length of the disqualification period; and
- the Court's power to grant injunctive relief under s. 1324 of the Corporations Act does not extend to restraining a person from applying for an Australian Financial Services Licence (AFSL).

(b) Facts

This case dealt with the orders to be imposed upon Mr and Mrs Cassimatis, both directors of Storm Financial, following the findings by *Edelman J in ASIC v Cassimatis (No 8)* [2016] FCA 2012 that Mr and Mrs Cassimatis had each committed one contravention of s. 180(1) of the Corporations Act by failing to exercise an appropriate degree of care and diligence. Edelman J held that a reasonable director in Mr and Mrs Cassimatis' position would have taken precautions to prevent Storm Financial giving certain advice to a vulnerable group of investors. That advice was for clients to borrow against the value of their homes and invest in funds based on the ASX300. Providing this advice exposed Storm Financial to risk of regulatory action which could have resulted in the loss of its AFSL, thereby putting Storm Financial's existence into jeopardy.

ASIC sought the following orders under the Corporations Act against both Mr and Mrs Cassimatis:

- declarations of contraventions under s. 1317E;
- the imposition of pecuniary penalties under s. 1317G;
- disqualification orders under ss. 206C and 206E; and
- injunctive relief under s. 1324 restraining them from holding AFSLs or providing financial services.

(c) Decision

Dowsett J made the following orders:

- declarations that both Mr and Mrs Cassimatis contravened s. 180(1) of the Corporations Act;
- a pecuniary penalty of $70,000 on Mr and Mrs Cassimatis, respectively; and
- orders disqualifying both Mr and Mrs Cassimatis from managing corporations for a period of 7 years, commencing on 22 March 2018.

In making these orders, Dowsett J gave the following reasons.

(i) Pecuniary penalties

In determining the size of the pecuniary penalty, Dowsett J compared the conduct of Mr and Mrs Cassimatis to the conduct of Mr Lindberg in *ASIC v Lindberg* (2012) 91 ACSR 640 and Mr Shafron in *Gilfillan v ASIC* (2012) 92 ACSR 460.

In ASIC v Lindberg, Robson J held that Mr Lindberg did not bring about AWB's unlawful conduct, and imposed a pecuniary penalty of $100,000. In *Gilfillan v ASIC*, the Court held that Mr Shafron contravened the Corporations Act on 3 occasions, with each contravention involving the failure to advise the James Hardie Board on relevant matters, and imposed a pecuniary penalty of $75,000. Dowsett J stated that while he considered the conduct of Mr and Mrs Cassimatis more serious than that of Mr Lindberg or Mr Shafron, and that the $70,000 penalty sought by ASIC was 'on the low side', his Honour adopted the figure of $70,000 suggested by ASIC.

Dowsett J also refrained from engaging with Mr and Mrs Cassimatis' argument that the seriousness of their conduct was mitigated because ASIC would not have taken any serious action against Storm Financial, as that argument invited the Court to review ASIC's conduct where there was no basis for doing so.

Finally, Dowsett J held that providing or offering investment advice to vulnerable investors without having regard to their vulnerability was, of itself, serious misconduct. Further, his Honour held that having adequate insurance arrangements in place did not mitigate Mr and Mrs Cassimatis' breach of duty, since a claim under the policy could have prejudiced Storm Financial's interests and resulted in higher premiums and/or reputational damage.

(ii) Disqualification orders

In determining that a disqualification period of 7 years was appropriate, Dowsett J explained that Mr and Mrs Cassimatis were entitled to consider it unfair that the disqualification period would commence from the date of judgment (22 March 2018), being 7 to 8 years after proceedings were initiated and 12 years after the relevant conduct. In fact, these observations led his Honour to fix the disqualification period at 7 years, even though this was the same period imposed upon Mr Shafron in *Gilfillan v ASIC*, and as mentioned above, his Honour considered the conduct of Mr and Mrs Cassimatis to be more serious than that of Mr Shafron.

(iii) Injunctive relief

ASIC, in its submissions, sought an injunction under s. 1324 of the Corporations Act restraining both Mr and Mrs Cassimatis from each holding an AFSL, or providing financial services under an AFSL, for a period of 10 years. Dowsett J refused to order the relief on the basis that s. 1324(1) of the Corporations Act did not empower the Court to grant such an injunction.

Section 1324(1) only empowers the Court to grant an injunction restraining conduct which constituted, constitutes or would constitute misconduct, as set out in paragraphs (a)-(f) of s. 1324(1), which all relate to contraventions of the Corporations Act. The injunction sought by ASIC would not restrain misconduct, but rather lawful conduct, since the sections dealing with the application and issuing of AFSLs, namely ss.

911A(1), 911B, 913A, 913B and 914A of the Corporations Act, allow any person to apply for an AFSL, with ASIC left to determine whether a licence should be granted and if conditions should be imposed.

Therefore, in Dowsett J's view, the Court's power under s. 1324 of the Corporations Act does not extend to restraining lawful action, or compelling conduct where there is no lawful obligation to perform such conduct.

6.4 Guidance for liquidators as to the distribution of "trust assets", but do liquidators have the power to sell "trust assets"?

(Rebecca Hanrahan, Clayton Utz)

Jones (Liquidator) v Matrix Partners Pty Ltd, in the matter of Killarnee Civil & Concrete Contractors Pty Ltd (in liq) [2018] FCAFC 40 , Federal Court of Australia, Full Court, Allsop CJ, Siopis and Farrell JJ, 21 March 2018

(a) Summary

An unresolved issue in insolvency law in Australia has been how a liquidator of an insolvent former trustee company should distribute trust assets in liquidation, in accordance with the priority regime under the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) or by some other equitable means.

Prior to this case, and the recent decision of *Commonwealth v Byrnes and Hewitt in their capacity as joint and several receivers and managers of Amerind Pty Ltd (Receivers and Managers appointed) (in liquidation)* [2018] VSCA 41, it appeared that the preferred answer was to distribute on a *pari passu* basis.

In this case, the Full Court of the Federal Court found that the priority regime in the Corporations Act does apply to a trustee company in liquidation. Allsop CJ found that the trustee's right of exoneration supported by an equitable lien constitutes property of the corporate trustee and is therefore subject to the priority regime in s. 556 of the Corporations Act. Farrell J found that even if the distribution of the trust assets is to be in accordance with equitable principles, equity would follow the Act to provide for employees to retain their priority. Siopis J dissented on this issue and found that the right of indemnity was not property of the company, and therefore not subject to s. 556 of the Corporations Act.

In addition, this decision clarified that where a trust deed automatically disqualifies an insolvent corporate trustee from acting as trustee, the liquidator ought to apply to court to be appointed as a receiver to sell the trust assets and for directions to distribute the proceeds of sale.

(b) Facts

In this case, the Company carried on business as trustee of a single trust (the Trust). It did not conduct business on its own account. All assets were held on the terms of the Trust and all claims and liabilities were entered into or incurred in accordance with it.

Administrators were appointed to the Company, and arranged for the Company to realise certain assets held as the trustee of the Trust, including the collection of debts, and the sale of its business, plant and equipment. Some proceeds were applied to meet the administrators' remuneration and expenses.

The creditors then resolved to wind the Company up and the administrators became the liquidators. The liquidators received the balance of the money realised by the administrators, and caused the Company to

realise the remaining assets of the Trust (the Sale Proceeds). The liquidator also recovered an amount of $4.5 million as an unfair preference (the Unfair Preference Proceeds).

On and from the date of the appointment of the liquidators, the Company was disqualified from holding the office of trustee of the Trust by reason of the terms in the trust deed. The liquidator applied to the Court for directions and declarations to the effect that he was entitled to sell the Trust assets, and apply the proceeds in accordance with s. 556 of the Corporations Act.

(c) Decision

Four separate questions were answered by the Full Federal Court as follows:

Question 1: Whether the assets of the Trust as at the time of the resolution to wind up the Company (the Trust Assets) were assets in the winding up of the Company so that the liquidator had the power under s. 477 of the Corporations Act to sell the Trust Assets?

Answer: No.

Question 2: Whether either or both the proceeds of realisation of the Trust Assets and the Unfair Preference Proceeds were to be applied by the liquidator in accordance with the priority regime established by ss. 555, 556, 560 and 561 of the Act?

Answer:

- Unfair Preference Proceeds: Yes.
- Sale Proceeds: Majority (Allsop CJ and Farrell J) answered Yes.

Question 3: Should the liquidator be directed under s. 511 of the Corporations Act to deal with either or both the proceeds of realisation of the Trust Assets and the Unfair Preference Proceeds as assets in the winding up of the Company?

Answer: Majority (Allsop CJ and Farrell J) answered Yes to both.

Question 4: Should the liquidator be directed under s. 511 of the Corporations Act to deal with either or both the proceeds of realisation of the Trust Assets and the Unfair Preference Proceeds on a *pari passu* basis to unsecured creditors of the Trust after providing for the costs of administration?

Answer: Majority answered No.

In dealing with these issues, Allsop CJ found:

A trustee's right of exoneration (being the right to be paid from the trust assets for liabilities incurred) is property of the trustee, which is beneficially held by the trustee. The right of exoneration is property within the meaning of s. 9 of the Corporations Act.

The nature and character of the right of exoneration is exercisable only to pay trust creditors. Allsop CJ considered that *Re Enhill Pty Ltd* [1983] 1 VR 561 was wrong in relation to the proceeds of the exoneration being available generally to all creditors and should not be followed. Allsop CJ agreed with the comments of King CJ in *In re Suco Gold Pty Ltd (In Liq)* (1983) 33 SASR 99 that a trustee has no legal right to apply the trust property other than for the authorised purposes of the trust. In his view, Suco Gold should be followed as to the question of the application of Act and, in particular, the order of priorities amongst the creditors entitled to participate in the proceeds of any right of exoneration.

The trust assets cannot be sold without an order of the Court. The trustee's right to trust property arises from the trust relationship, which the Court of Equity will always supervise. For this reason, the liquidator was not empowered to sell the trust property in the absence of a Court order.

The approach of King CJ in Suco Gold in relation to the application of s. 556 of the Corporations Act to trust property was correct, and underlying this approach is the conclusion that the Act applies to funds produced from the exercise of the rights of exoneration and recognises the limitation on such funds (i.e. to pay the debts or liabilities of the relevant trust creditors).

Where a company has only ever acted as corporate trustee for a single trust, the property of the company includes the right of exoneration, and funds obtained from the exercise of this right are to be distributed in accordance with the statutory command in s. 501 and s. 556 of the Corporations Act.

Siopis J (in dissent in relation to questions 2 to 4) found:

The only basis upon which the Court could authorise the sale of trust assets was in reliance upon the trustee's equitable lien, and that required intervention of a Court exercising equitable jurisdiction to effect a judicial sale or to appoint a receiver to carry out the sale and the distribution of proceeds.

The moneys held by the liquidator from the sale of Trust Assets were the product of an unauthorised sale by the liquidators and s. 556 of the Corporations Act had no application to trust monies which the liquidator holds from those sales.

Alternatively, the statutory priority regime in s. 556 of the Corporations Act did not apply to the assets which the insolvent company held in its capacity as trustee. The phrase "property of the company" in the Act is addressed to the property of the company capable of producing money to contribute to the fund contemplated in ss. 501, 555 and 556 of the Corporations Act. The exoneration process does not yield any funds to the company in liquidation capable of contributing to the fund and therefore the right of exoneration is not property of the company. For this reason, s 556 of the Corporations Act did not apply to the trust property. Instead, any distribution to unsecured trust creditors should be made on a *pari passu* basis.

In a separate judgment, Farrell J agreed with Siopis J in relation to question 1, and agreed with Allsop CJ in relation to question 2 (which Farrell J noted was consistent with Byrnes, a decision which she considered was binding on the Full Federal Court not exercising appellate jurisdiction). However, in relation to question 2, Farrell J noted that she would not have taken the same path to that result as Allsop CJ, and found that a Court of Equity should follow the Act in giving directions as to how trust creditors should be paid out of trust assets.

In relation to question 2, each judge acknowledged that the parties were agreed that the Unfair Preference Proceeds should be treated in accordance with the priority regime in the Corporations Act, and adopted the parties' position.

6.5 Director's decision to appoint administrator invalid for lack of authority and lack of reasonable belief as to company's solvency

(Daniel Byrne and Milaan Latten, Corrs Chambers Westgarth)

In the matter of Bean and Sprout Pty Ltd (administrators appointed) [2018] NSWSC 351, Supreme Court of New South Wales, Black J, 20 March 2018.

(a) Summary

The administrator of a company, Bean and Sprout Pty Ltd, sought a declaration from the New South Wales Supreme Court as to whether his appointment was valid. Disputes had arisen between the directors of the company, leading them to take steps to remove each other from the board. One of the directors, believing himself to be the sole director of the company, then purported to appoint the administrator pursuant to s. 436A of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). It was held that he had no authority to do so. The court then considered whether, had the director had the requisite authority, the appointment would have been valid under s. 436A. The court concluded that as the director did not have access to key financial documents, he could not reasonably have formed an opinion as to the solvency of the company. The court also concluded that the appointment was for an improper purpose. The appointment of the administrator was therefore held to be invalid.

(b) Facts

On 7 January 2018, Mr Kong Yao Chin was purportedly appointed as the voluntary administrator of Bean and Sprout Pty Ltd (Company) by a resolution of the Company. Mr Chin sought an order pursuant to s. 447C(2) of the Corporations Act that the Supreme Court of New South Wales declare whether his appointment as administrator of the Company was valid. That section provides that if there is any doubt as to the validity of an administrator's appointment, the court may make such an order. A complicating factor in this case concerned the identity of the directors of the Company.

Three parties claimed to be directors of the Company:

- the Second Defendant, Ms Jiayi Hui (referred to in the decision by her Anglicised name, Joyce) who was the procurement manager of the Company;
- the Third Defendant, Mr Jianshu Li Hui (referred to in the decision by his Anglicised name, Charles) who was the "supervisor" of the sole shareholder of the Company, Guangzhou Aomai Information & Technology Ltd (GA); and
- the Fourth Defendant, Mr Weiguang Huang Hui (referred to in the decision by his Anglicised name, Allan) who was a director and minority shareholder of GA.

Disputes had arisen in 2017 between many of these parties. It was Allan who purported to appoint Mr Chin as administrator.

The validity of the resolution appointing Mr Chin was contingent on a number of acts of the corporate shareholders of the Company and GA. This was complicated by the fact that GA was a corporation governed by the law of the People's Republic of China (PRC).

There were initially four directors of GA. The chair of GA was Therese.

On 17 December 2017, GA resolved to remove Therese as the chair of GA and replace her with someone else.

On 28 December 2017, Therese purported to convene a meeting of GA with Allan (one of the directors of GA) to remove all of the directors of the Company other than Allan. Black J held that this resolution was invalid as Therese had no authority to convene the meeting under PRC Law. Only the chair could convene such a meeting.

By a resolution on 7 January 2018, Allan, believing himself to be the sole director of the Company, purported to appoint Mr Chin as the voluntary administrator of the Company pursuant to s. 436A of the Corporations Act. Allan claimed that the reason for this appointment was that he believed the Company was insolvent or likely to become insolvent. In March 2016, GA had "advanced" $1.1 million to the

Company and then provided a further $600,000 as an "equity contribution". Allan claimed that the Company owed a debt of $1.5 million that it could not repay to GA due to insufficient assets.

An earlier resolution had in fact been passed on 5 January 2018 by the other directors of GA removing Allan as a director of the Company.

(c) Decision

The issue before Black J was whether Mr Chin had been validly appointed by the resolution passed by Allan on 7 January 2018. Black J ultimately did not have to decide whether Allan had been removed as a director when the resolution appointing Mr Chin as administrator was passed. The facts demonstrated that Allan was not the sole director of the Company at the time and therefore Allan himself could not pass a resolution under s. 436A of the Corporations Act to appoint Mr Chin.

Black J then went on to consider whether the appointment could have been valid had Allan had the requisite authority. This was dependent on whether the requirements of s. 436A had been complied with.

That section provides:

Company may appoint administrator if board thinks it is or will become insolvent

(1) A company may, by writing, appoint an administrator of the company if the board has resolved to the effect that:
(a) in the opinion of the directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time; and
(b) an administrator of the company should be appointed.

(2) Subsection (1) does not apply to a company if a person holds an appointment as liquidator, or provisional liquidator, of the company.

Section 436A of the Corporations Act requires that the directors resolve that, in their opinion, the company is insolvent or likely to become insolvent in the near future. The resolution will not be valid if the directors are not of that opinion or do not hold the opinion in good faith: *Kazar Duus* (1998) 88 FCR 218. A director must take adequate steps to satisfy themselves of the insolvency: *Re Lime Gourmet Pizza Bar (Charlestown) Pty Ltd (formerly under administration)* [2015] NSWSC 244.

One of the issues in this case was that Allan was unable to inspect the Company's financial documents. Joyce and Charles had locked Allan out from the Company's computer systems, meaning Allan could not access financial records relevant to the question of the Company's solvency. Allan's primary basis for his opinion of insolvency was the money advanced by GA, but there was no evidence that this would be called in or that it would lead to the likely insolvency of the Company. There was also no evidence that the Company's other liabilities, including lease payments or taxation obligations, were not being or able to be met. Black J concluded that, as Allan did not have the relevant information as to the Company's solvency, he could not reasonably have formed an opinion that the Company was insolvent or likely to become so.

Black J held that Allan's appointment of Chin as administrator was an attempt to bring the Company under independent control due to his concerns as to the conduct of the Company's affairs. It was not to address issues of the Company's solvency. This was an improper use of the power under s. 436A of the Corporations Act. Black J stated that the court would not exercise its discretion to cure the defects in the appointment where the Company was apparently solvent and the appointment had been made for an improper purpose.

6.6 Guidance for parties seeking leave pursuant to s. 444E(3) of the Corporations Act

(Sarah Dressler, DLA Piper)

Adelaide Brighton Cement Limited, in the matter of Concrete Supply Pty Ltd v Concrete Supply Pty Ltd (Subject to Deed of Company Arrangement) [2018] FCA 315, Federal Court of Australia, Besanko J, 14 March 2018

(a) Summary

This case relates to Adelaide Brighton Cement Limited (ABCL) applying for leave under s. 444E(3) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) to begin and proceed with a proceeding against Concrete Supply Pty Ltd (subject to Deed of Company Arrangement) (Concrete Supply). The proceeding for which leave is sought is part of a broader proceeding involving Concrete Supply, the administrators and the directors of Concrete Supply. The defendants to the proceeding are Concrete Supply, Domenic Charles Cantone and Nicholas David Cooper in their respective capacities as administrators and deed administrators of Concrete Supply (the administrators), Pelegrino Obbiettivo, Genesio Obbiettivo and Tina Obbiettivo. The fourth, fifth and sixth defendants are directors of Concrete Supply (directors).

In this case Besanko J addressed whether leave ought to be granted pursuant to s. 444E(3) of the Corporations Act to allow ABCL to proceed against Concrete Supply and the relevant factors to be taken into account on such an application for leave. Besanko J explored whether leave under s. 444E(3) of the Corporations Act ought to be refused because to grant leave may be futile and whether the existence of a Deed of Company Arrangement constitutes a bar to proceedings in respect of which leave has been granted where there is substantial overlap between a claim to set aside a Deed of Company Arrangement and a claim in debt.

The court ordered that leave is to be granted *nunc pro tunc* pursuant to s. 444E(3) of the Corporations Act to ABCL to begin and proceed with the proceeding against Concrete Supply in relation to the claims made in paragraphs 9, 10, 11, 13 and 14(a) of the Originating Process.

(b) Facts

ABCL carries on business in South Australia supplying cement and lime. Concrete Supply is a private company incorporated in Australia which carries on business in South Australia supplying cement. ABCL supplied cement to Concrete Supply between July 2008 and November 2017.

ABCL issued an Originating Process on 12 January 2018 seeking claims against Concrete Supply that all relate in one way or another to the supply of cement by ABCL to Concrete Supply for which the latter (it is alleged) has not paid ABCL. ABCL's case is that between August 2009 and November 2017, it supplied cement to Concrete Supply under an agreement known as the Bulk Supply Agreement. The administrators were appointed in November 2017 following talks between ABCL and Concrete Supply in regards to an outstanding debt of $12,477,842.58, owed under the terms of the Bulk Supply Agreement. The administrators are deed administrators under a Deed of Company Arrangement executed on 21 December 2017 by Concrete Supply, the administrators and the directors (the DOCA). The Bulk Supply Agreement was terminated the same month the administrators were appointed. Just prior to that, ABCL and its customer had discovered that they had very different views about the $12,477,842.58. While ABCL saw it as a debt, Concrete Supply's directors informed ABCL that it constituted a rebate authorised by ABCL.

Furthermore, ABCL claimed relief in relation to the DOCA. It claimed that the resolution put to the second meeting of creditors that Concrete Supply execute the DOCA should be set aside, or that Mr Cantone's

decision to exercise his casting vote in favour of the resolution that Concrete Supply execute the DOCA should be set aside, or that the DOCA executed by Concrete Supply be terminated. Although ABCL's claims against the directors did not require leave, Besanko J drew a relationship between ABCL's claim in debt and its claim that the DOCA should be set aside or terminated. ABCL contended that it is inevitable or, at least highly likely, that the existence of the debt will be central to the challenge to the DOCA and this is a powerful reason to grant leave. However, the Company and the administrators contended that the challenge to the DOCA can be determined without determining the existence of the debt.

(c) Decision

The provisions of the DOCA raised a point about whether leave should be refused because to grant leave would be futile. The argument was that, absent a variation of the DOCA, legal proceedings are barred and the only way ABCL can proceed to enforce its claim in debt is under the provisions of the DOCA. Besanko J concluded that the case is a clear one for leave and there is at least a possibility that the DOCA will be seen as a bar which does not apply to proceedings in respect of which s. 444E(3) of the Corporations Act leave has been granted.

Besanko J stated that the decisive factor in this case is that there is a substantial overlap between ABCL's claim to set aside or terminate the DOCA and ABCL's claim in debt. ABCL alleges that the administrators failed to carry out sufficient investigations into the debt and their report was misleading in relation to it. Besanko J explained that it may be possible to determine ABCL's case concerning the setting aside or termination of the DOCA without deciding whether the debt exists, but that cannot be predicted with confidence at this stage and, in any event, the evidence common to both issues is likely to be substantial. In reaching his conclusions Besanko J did not overlook the fact that proof of the existence of the debt does not mean that the DOCA will be set aside or terminated.

Besanko J concluded that the matter which brings the scale down in favour of a grant of leave is the overlap between the claims. Besanko J outlined that the existence of the debt and the circumstances in which it was incurred (if it was incurred) is a common and underlying theme in respect of the claim and the Court should take steps to ensure, so far as it is possible to achieve at this stage, that that issue should be examined by a court only once.

The court ordered that leave is to be granted *nunc pro tunc* pursuant to s. 444E(3) of the Corporations Act to ABCL to begin and proceed with the proceeding against Concrete Supply in relation to the following claims made in the Originating Process issued on 12 January 2018:

- a declaration that the Company owes the plaintiff $12,457,472.22;
- a declaration that the Company failed to maintain adequate books and records in contravention of s. 286 of the Corporations Act;
- a declaration that the Company engaged in misleading or deceptive conduct or unconscionable conduct in contravention of s. 18 and s. 20 of the *Australian Consumer Law* or unconscionable conduct under the general law;
- a declaration that the Company held cement which was received but not paid for, and any income generated using that cement, on trust for the plaintiff; and
- a declaration that the Company breached its fiduciary duty to the plaintiff by disposing of property held on trust for the plaintiff.

This case provides instructive guidance on the circumstances by which parties can obtain leave from the courts to commence proceedings against a company which would normally be protected from creditor-initiated litigation by virtue of a Deed of Company Arrangement.

6.7 Court confirms ability for liquidators to disclaim EPO liabilities in certain circumstances

(David Tai, King & Wood Mallesons)

Longley v Chief Executive, Department of Environment and Heritage Protection [2018] QCA 32, Supreme Court of Queensland, Court of Appeal, Gotterson and McMurdo JJA and Bond J, 9 March 2018

(a) Summary

The liquidators of a company sought a judicial direction that they were justified in not causing the company to comply with a governmental order in respect of land which they had disclaimed under s. 568 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). The Court (on appeal) held that there was a valid disclaimer of property under s. 568 of the Corporations Act, that the liabilities imposed by the governmental order were terminated by the disclaimer, and that s. 5G of that Act did not prevent the disclaimer from operating to terminate the company's liabilities under the order.

(b) Facts

The appellants were the liquidators of Linc Energy Limited ("Linc"), a company that operated a pilot underground coal gasification project near Chinchilla, Queensland. The project operated under a mineral development licence (the MDL), a petroleum facility licence (the PFL), and two environmental authorities issued under the Environmental Protection Act 1994 No. 62 (Qld) (the EPA Act) which were required as conditions of the two licences.

On 13 May 2016, before Linc went into liquidation, the Chief Executive of the Department of Environment and Heritage Protection (the Chief Executive) issued an Environmental Protection Order (the EPO) to Linc by authority of s. 358 of the EPA Act. The EPO required Linc to undertake certain work on the Chinchilla site (the Site), and to refrain from doing certain environmentally damaging things on the Site. The EPO also required Linc to retain and maintain any infrastructure on the site which was necessary to ensure compliance with the requirements of the EPO.

On 30 June 2016, after Linc went into liquidation, Linc's liquidators disclaimed property constituting the Site and the MDL pursuant to s. 568(1) of the Corporations Act (the PFL and the environmental authority relating to it had already expired at the relevant time).

Section 568 of the Corporations Act provides a mechanism by which a liquidator may cause a company to disclaim property to which burdensome obligations or liabilities apply. Section 568D provides that "[a] disclaimer is taken to have terminated . the company's rights, interests, liabilities and property in or in respect of the disclaimer property, but does not affect any other person's rights or liabilities except so far as necessary in order to release the company and its property from liability".

The appellants claimed that as a result of the disclaimer and the operation of s. 568D, Linc's liabilities under the EPO had been terminated. Conversely, the respondents contended that Linc remained bound to comply with the EPO notwithstanding the disclaimer.

In the context of that dispute, the appellants applied under s. 511 of the Corporations Act (now repealed) seeking a judicial direction from the Supreme Court of Queensland that they would be justified in not causing Linc to comply with the EPO.

The primary judge held that Linc remained obligated to meet the requirements of the EPO. The primary judge considered that there was a direct inconsistency between the operation of ss. 568 and 568D of the Corporations Act and the operation of ss. 319 and 358 of the EPA Act. He further reasoned that, although s. 109 of the Constitution would ordinarily resolve inconsistency between State and Commonwealth legislation in favour of the Commonwealth legislation, s. 5G of the Corporations Act applied to roll back

the operation of s. 568 of that Act to avoid inconsistency with the State legislation. His Honour thus held that the disclaimer did not terminate Linc's liabilities owed under the EPO.

On appeal, the key issues before the Queensland Court of Appeal were:

- whether there was a disclaimer of property under s. 568 of the Corporations Act;
- whether the EPO imposed "liability . in respect of the disclaimer property" for the purposes of s. 568D of the Corporations Act; and
- whether s. 5G of the Corporations Act prevented the disclaimer from operating to terminate Linc's liability to comply with the EPO.

(c) Decision

(i) Whether there was a disclaimer of property

In delivering the leading judgment, McMurdo JA (with whom Gotterson JA and Bond J agreed) held that the respondents had made "unambiguous admissions" at trial that the Site and the MDL had been disclaimed under s. 568 of the Corporations Act. Further, at trial, it was not submitted by the respondents that the inconsistency between the CA and the EPA required the disapplication of ss. 568 and 568D of the Corporations Act. The respondents' admissions were also consistent with the respondents' conduct outside of the litigation.

On this basis McMurdo JA held that "[t]he Chief Executive ought not to be permitted to depart from that position" in the appeal proceedings, and held that the property was therefore validly disclaimed.

(ii) Whether the EPO was a 'liability . in respect of the disclaimer property'

McMurdo JA held that the requirements of an EPO will not have the requisite connection with property, such that its requirements would be liabilities in respect of property under s. 568D of the Corporations Act, in every case. This EPO, however, was expressly issued with respect to the activities of Linc on the Site under its MDL.

His Honour considered that by the disclaimer of the land and the MDL, Linc's authority and capacity to engage in those activities was terminated. Once the land and MDL had been disclaimed, there was no activity which could be carried out by Linc to which the general environmental duty could attach, and for which the EPO could have operated in the pursuit of its stated purpose. The connection between the disclaimed property and the liabilities under the EPO was thereby clear and immediate: the liabilities under the EPO were premised upon Linc's carrying out activity which it could not and would not carry out, once the land and the MDL had been disclaimed.

(iii) Whether s. 5G prevented the disclaimer from operating to terminate Linc's liability to comply with the EPO

Section 5G of the Corporations Act provides that, in certain circumstances where the CA and a State law are inconsistent, that inconsistency will be resolved in favour of the State law by rolling back the operation of the inconsistent Corporations Act provision to the extent of the inconsistency. The respondents contended that s. 5G(11), or alternatively s. 5G(8), applied to roll back the operation of ss. 568 and 568D of the Corporations Act in this case.

McMurdo JA held that s. 568D of the Corporations Act was not a section that Parliament could have intended could be disapplied only in part, as it would produce the absurd result that by disclaimer a liquidator could lose all rights and interests in property but remain burdened by a liability in respect of it. Consequently, s. 5G of the Corporations Act could be applied in this case only by impugning the

disclaimer itself which, given the respondents' prior admissions of a valid disclaimer, is not a submission the Court should accept.

Nevertheless, in case it was incorrect to hold the respondents to their admissions, McMurdo JA proceeded to consider (and reject) the application of ss. 5G(11) and 5G(8) of the Corporations Act. Section 5G(11) operates to roll back the operation of a Corporations Act provision "in a State or Territory". His Honour held that ss. 568 and 568D of the Corporations Act are incapable of being disapplied only in one State because there would remain at least potential for the inconsistent operation of laws, and s. 5G(11) can only apply if it ensures that no such inconsistency would arise.

His Honour also held that s. 5G(8) of the Corporations Act is not engaged because s. 5G(8) requires the State provision to be a law whose subject matter is the external administration of corporations. The relevant provisions of the EPA pursuant to which the EPO was issued cannot be characterised as such.

For these reasons, McMurdo JA (with the other judges agreeing) ordered that the appeal be allowed and the orders of the primary judge be set aside.

6.8 Jurisdictional requirements for the disqualification of directors revisited

(Hugh Pegler, MinterEllison)

O'Sullivan v Australian Securities and Investments Commission [2018] FCA 228, Federal Court of Australia, Perram J, 7 March 2018

(a) Summary

The Federal Court has allowed an appeal from the Administrative Appeals Tribunal (the Tribunal) in the matter of *O'Sullivan v Australian Securities and Investments Commission* [2018] FCA 228. The Tribunal had affirmed a decision of ASIC (the Respondent) to prohibit Mr O'Sullivan (the Applicant) from providing financial services for 7 years and disqualify him from managing a corporation for 5 years. The Court found that the Applicant had been denied procedural fairness. The Tribunal's orders were set aside and the matter remitted to the Tribunal for redetermination.

The Court rejected a jurisdictional argument that the Tribunal had erred in upholding a disqualification made by ASIC under s. 206F of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) in circumstances where a liquidator's report made under s. 533 of that Act was known by ASIC to be incorrect. It was alleged that in these circumstances, the jurisdictional prerequisite in s. 206F(1)(a)(ii) of the Corporations Act that reports be lodged was not satisfied. The Court held that regardless of correctness, the mere existence and lodgement of the requisite reports will satisfy the jurisdictional requirement.

(b) Facts

The Applicant had been a director of Cashflow Financial Solutions Pty Ltd (Cashflow) and Provident Capital Ltd (Provident). Cashflow provided short term inventory financing loans to small to medium enterprises. Provident provided property finance secured by registered first mortgages. This was funded by issuing debentures to retail investors, borrowing under wholesale lending facilities and the operation of two managed investment schemes. Interests associated with the Applicant owned a majority of Cashflow and all of Provident.

Provident was wound up with liquidators appointed on 24 October 2012 and Cashflow was wound up with liquidators appointed on 28 May 2013. Reports were filed under s. 533 of the Corporations Act by the liquidators of both companies.

On 20 February 2015 ASIC banned the Applicant from providing financial services for 7 years under s. 920A(1)(e) of the Corporations Act and disqualified him from managing a corporation for 5 years under s. 206F of the Act. The Applicant lodged an appeal with the Tribunal.

The Tribunal hearing concluded in November 2015. After this time, a large quantity of additional documentation became available, which resulted in the production of an agreed statement of facts. This was provided to the Tribunal in November 2016. Written submissions as to why the fresh evidence, including the agreed statement of facts, should be considered were also provided to the Tribunal in November 2016. The Tribunal delivered its reasons and upheld ASIC's decision on 2 May 2017.

(c) Decision

(i) Procedural fairness

Perram J found that the Tribunal failed to consider either the agreed statement of facts or the written submissions. Counsel for the Respondent accepted this material was important and that the Tribunal had failed to respond to the arguments raised by it. It followed that the applicant had been denied procedural fairness. The appeal succeeded on this basis.

(ii) Jurisdictional argument

The appeal also dealt with the contention raised in the notice of appeal that neither the Tribunal nor ASIC had jurisdiction to prohibit the Applicant from managing corporations under s. 206 of the Corporations Act given that the Cashflow Liquidator's Report made under s. 533 of that Act (the Liquidator's Report) was known by ASIC to be incorrect. It was uncontested evidence that the Liquidator's Report was incorrect. However, the Tribunal found this would not necessarily impact the disqualification, and that ASIC was authorised to make a decision on disqualification regardless of the correctness of the reports lodged under s. 533 of the Corporations Act.

There were two inherent problems with the contention. First, this jurisdictional argument had no effect on the decision to prohibit the Applicant from providing financial services, which was made under s. 920A(1)(e) of the Corporations Act. It was directed only at the order prohibiting the Applicant from managing a corporation made under s. 206F of the Act. Second, if the contention was accepted, the Tribunal would lose its ability to hear the review application, so the Court would set aside the Tribunal decision and the ASIC order would be left standing (leaving the Applicant disqualified from managing corporations).

It was concluded that this argument would be better made as an application for a writ of prohibition which joined ASIC and the Tribunal as respondents. Here the Tribunal could be joined if the argument otherwise succeeded. It did not.

The Applicant argued that the jurisdictional trigger mechanism in s. 206F(1)(a) of the Corporations Act had not been met.

Section 206F(1) of the Corporations Act dictates that:

"ASIC may disqualify a person from managing corporations for up to 5 years if:
(a) within 7 years immediately before ASIC gives a notice under paragraph (b)(i):
(i) the person has been an officer of 2 or more corporations; and
(ii) while the person was an officer, or within 12 months after the person ceased to be an officer of those corporations, each of the corporations was wound up and a liquidator

lodged a report under subsection 533(1) (including that subsection as applied by section 526-35 of the Corporations (Aboriginal and Torres Strait Islander) Act 2006) about the corporation's inability to pay its debts; and ."

The first element of the trigger condition was clearly made out. The Applicant had been an officer of 2 or more corporations. It was the second element of the trigger mechanism, whether a liquidator had lodged a s. 533 report about each of those corporation's inability to pay their debts which was in issue.

On the face it appeared satisfied, but the Applicant argued that because the report was wrong, and known to be so by ASIC, it did not satisfy the second element. This argument was rejected. The Court did not accept that ASIC knew unsecured debts alleged to be owing were not in fact owing, and did not accept that ASIC knew the Liquidator's Report was wrong in suggesting the contrary.

The Court held that even if ASIC knew these matters, it would come to the same conclusion. The mere lodgement of the required two reports satisfies the second element of the trigger mechanism in s. 206F(1)(a)(ii) of the Corporations Act. The jurisdictional requirement does not require that the reports be "right, reasonable or even sensible".

Perram J was bound to follow the reasoning in *Murdaca v Australian Securities and Investments Commission* [2009] FCAFC 92 at [117]: "it is the fact of lodgement of such a report that matters for the purposes of s 206F(1)(a)(ii). The correctness of information, assertions and opinions contained in the report is (at best) only relevant to the third stage of the process ie the decisions stage (s 206F(1)(c)".

The jurisdictional arguments were thus rejected in full, but the appeal was allowed, given the breach of procedural fairness. The matter was remitted to the Tribunal for redetermination.

7. Contributions

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

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