## Ian Ramsay


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**Bulletin No. 286**

Editor: Professor Ian Ramsay, Director, Centre for Corporate Law

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## 1. Message from the Editor

This is the final issue of the Corporate Law Bulletin. I would like to thank all those who have played an important role with the Bulletin over the 24 years of publication and 286 issues - the publisher SAI Global, the law firms that have contributed case notes for the Bulletin (Ashurst, Clayton Utz, Corrs Chambers Westgarth, DLA Piper, Herbert Smith Freehills, King & Wood Mallesons, and Minter Ellison), and the Australian Securities Exchange (ASX), the Australian Securities and Investments Commission (ASIC) and the Takeovers Panel. I would also like to take this opportunity to thank the readers of the Bulletin, some of whom have been readers since the first issue.

The first issue of the Bulletin was published in September 1997 by the Centre for Corporate Law at the University of Melbourne. Commencing with issue 54 in February 2002, SAI Global became the publisher of the Bulletin. I have been pleased to be the editor of the Bulletin since the first issue. I have also been pleased to receive feedback over many years that the Bulletin has been a useful and important contribution to the understanding of corporate law and corporate governance developments in Australia and internationally.

Professor Ian Ramsay, Director, Centre for Corporate Law, University of Melbourne (i.ramsay@unimelb.edu.au).

## 2. Recent Corporate Law and Corporate Governance Developments

### 2.1 Coalition of institutional investors issues public statement on climate policy

10 June 2021 - A coalition of 457 institutional investors, including Australian institutional investors, managing more than US$41 trillion in assets (representing an estimated 37% of all global assets under management), has published a joint statement on climate policy. In the statement, the investors call on all governments to undertake five priority actions in 2021:

- strengthen Nationally Determined Contributions (NDCs) for 2030 before the 26th United Nations Climate Conference of the Parties (COP26) in November 2021, to align with limiting warming to 1.5-degrees Celsius and ensuring a planned transition to net-zero emissions by 2050 or sooner;
- commit to a domestic mid-century, net-zero emissions target and outline a pathway with ambitious interim targets including clear decarbonization roadmaps for each carbon-intensive sector;
- implement domestic policies to deliver these targets, incentivise private investments in zero-emissions solutions and ensure ambitious pre-2030 action through: robust carbon pricing, the removal of fossil fuel subsidies by set deadlines, the phase out of thermal coal-based electricity generation by set deadlines in line with credible 1.5-degrees Celsius temperature pathways, the avoidance of new carbon-intensive infrastructure (e.g. no new coal power plants) and the development of just transition plans for affected workers and communities;
- ensure COVID-19 economic recovery plans support the transition to net-zero emissions and enhance resilience (this includes facilitating investment in zero-emissions energy and transport infrastructure, avoiding public investment in new carbon-intensive infrastructure and requiring carbon-intensive companies that receive government support to enact climate change transition plans consistent with the Paris Agreement); and
- commit to implementing mandatory climate risk disclosure requirements aligned with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, ensuring comprehensive disclosures that are consistent, comparable, and decision-useful.

The full statement is available on the Investor Agenda website.

**2.2 UK Law Commission publishes discussion paper on corporate criminal liability**

10 June 2021 - The United Kingdom (UK) Law Commission has published a discussion paper titled "Corporate Criminal Liability". The discussion paper outlines the basis of criminal liability applying to corporations, discusses the criticisms which are made of the current law, examines some overseas analogues and proposals for reform, and asks a series of questions as to whether, and how, the law should be reformed.

The background to the inquiry by the Law Commission is stated in the discussion paper as follows:

> "The general rule for attributing criminal liability to companies in England and Wales is the 'identification principle' or 'identification doctrine'. This states that where a particular mental state is a required element of the offence, only the mental state of a senior person representing the company's 'directing mind and will' can be attributed to the company. In practice, this is limited to a small number of directors and senior managers, which restricts the scope of criminal liability, because the individuals who might commit the wrongdoing are not always senior enough within the company to represent its 'directing mind and will'.
>
> Concern has been expressed that the identification principle does not adequately deal with misconduct carried out by and on behalf of companies, and does not strike an appropriate balance. In particular, some have suggested that it has proved disproportionately difficult to prosecute large companies such as banks for economic crimes committed in their names, by relatively senior managers, for the company's benefit. Commentators and policymakers have also noted that it can be much easier in practice to hold a small company to account for wrongdoing than a large business where responsibility for decision-making is more diffuse. Yet it is precisely these larger corporations whose actions will often have the most serious social and economic consequences.
>
> In recent years, there have been some specific offences created by Parliament which seek to avoid the problems associated with the identification principle by criminalising 'failure to prevent' other offences, such as bribery or tax evasion.There are competing concerns, however, that alternative models for assessing the criminal liability of corporations may place a disproportionate and costly compliance burden on law-abiding businesses".

The discussion paper is available on the Law Commission website.

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**2.3 Woolworths publishes report of the review of the independent panel into the proposed Dan Murphy's development in Darwin and the Woolworths' response**

9 June 2021 - Woolworths Group Ltd has published the report of the Independent Panel Review into the proposed Dan Murphy's development in Darwin along with the Group's response to the report.

The background to the report is that since 2013, Woolworths has investigated establishing a Dan Murphy's liquor supermarket store in Darwin. However, the site chosen for the store, which was to be the sixth largest Dan Murphy's store in Australia, was controversial because of its close proximity to three "dry" (i.e. alcohol free) Aboriginal and Torres Strait Islander communities. Following extensive public debate regarding the proposed development, in December 2020, Woolworths commissioned the review by the independent panel. The panel concludes that Woolworths:

- failed to adequately consider and understand the interests of the Aboriginal and Torres Strait Islander communities; and
- failed to consider the development proposal against Woolworths's own aspirations as a leading corporate citizen.

The panel recommends that Woolworths should not proceed with the Dan Murphy's Darwin development - and Woolworths has announced that it has adopted this recommendation. In its response to the report, Woolworths states that "we acknowledge and fully accept that, in proposing the Darwin Dan Murphy's in the way that Woolworths did, Woolworths has not met all of the aspirations and standards in its purpose and values".

Other recommendations of the panel include "that Woolworths Group continues to invest in and consider ways to implement its social value and purpose through principles and practices underpinned by proactive engagement, elevated responsibility and enhanced accountability".

Given the international debate about corporate purpose, the first chapter of the panel's report is titled "the Shifting Sands of Corporate Purpose: Citizenship, Reputation, Legitimacy and Trust". The panel writes in this chapter:

"In creating value for society, corporate purpose has transcended its historical use as a 'tick-the-box' citizenship tool. Corporate purpose is fast transitioning to the clearly articulated reason for a corporation to exist. But to demonstrate a strong sense of corporate purpose, corporations must first establish legitimacy and trust by demonstrating their capabilities and character to their stakeholders. The range of stakeholders has grown substantially over time to now include consumer groups, peak bodies, suppliers, and importantly, in this context, vulnerable communities. To meet the needs of these diverse groups, corporations must take a balanced approach that goes beyond legal and regulatory compliance. Today, corporations must integrate social value and corporate purpose into principles and practices".

Available on the Woolworths Group website are:

- The report of the Independent Panel Review; and
- The Woolworths Group Reflections on the Independent Panel Review.

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**2.4 Proposed reform of Australia's financial market infrastructure**

8 June 2021 - The Australian Treasurer Josh Frydenberg has released the report of the Council of Financial Regulators' (CFR) review into Financial Market Infrastructure (FMI) Regulatory Reforms and announced a series of reforms to ensure financial regulators have sufficient powers to intervene to manage a crisis and pre-emptively identify and manage risks.

FMIs include financial markets, clearing and settlement facilities, benchmark administrators and derivative trade repositories. They play a critical role in the operation of financial markets and the financial system more broadly, supporting $18 trillion in securities transactions and $185 trillion in notional value of derivatives transactions every year. The Treasurer has announced that, consistent with the CFR recommendations, the Government will:

- introduce a crisis management regime that will allow the Reserve Bank of Australia (RBA) to manage a failure at a domestic clearing and settlement facility. These powers will be supported by a $5 billion standing appropriation, with Ministerial agreement, to provide temporary funding to a clearing and settlement facility if that were necessary to ensure continuity of services;
- enhance the supervisory and licensing powers of ASIC and the RBA in respect of FMIs; and
- streamline and clarify certain regulatory powers.

The report and CFR's response to consultation are available on the CFR website.

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**2.5 Bank for International Settlements research on corporate debt following the GFC and through the pandemic**

7 June 2021 - The Bank for International Settlements (BIS) has published the latest issue of its quarterly review. The main focus of this issue is on corporate debt following the global financial crisis (GFC) and through the COVID-19 pandemic.

The BIS research finds that debt securities markets have grown globally. Offshore affiliates of non-financial corporates (NFCs) have played an important role in this growth since the GFC. For NFCs from emerging market economies (EMEs) in particular, debt issuance through such affiliates - mainly in the United States Dollars (USD) - has been closely linked with global financial conditions. Against the backdrop of a temporary spike in credit risk premia after the pandemic's outbreak, issuance has been robust throughout the past year. Combining data on both international and domestic debt securities reveals that borrowing by advanced economy corporations and by hard-hit EME industries has surged.

The latest quarterly review is available on the BIS website.

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**2.6 Regulators state that they expect Australian institutions to cease the use of LIBOR in new contracts before the end of 2021**

4 June 2021 - The Australian Prudential Regulation Authority (APRA), ASIC and the RBA have published a joint statement in which they reiterate the importance of ensuring a timely transition away from the London Interbank Offered Rate (LIBOR). This requires ceasing the use of LIBOR in new contracts before the end of 2021.

On 2 June 2021, the Financial Stability Board (FSB) announced that all new use of LIBOR benchmarks should cease as soon as practicable and no later than the timelines set out by home authorities and/or national working groups in the relevant currencies. In particular, even though some USD LIBORs will continue until mid-2023, the US Banking Supervisors have stated that firms should cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by no later than 31 December 2021.

The FSB also released:

- an updated Global Transition Roadmap for LIBOR incorporating the confirmed LIBOR cessation dates and transition milestones set across the different LIBOR jurisdictions;
- a statement encouraging the adoption of overnight risk-free rates (RFR) where appropriate, while recognising the role for use of forward-looking RFR term rates in some limited cases; and
- a statement supporting the use of the International Swaps and Derivatives Association (ISDA) spread adjustments in cash products.

APRA, ASIC and the RBA support the guidance and expectations set by the FSB and the US Banking Supervisors. They state that continued reliance on LIBOR poses significant risks and disruptions to the stability and integrity of the financial system. Firms themselves may also face financial, conduct, litigation, and operational risks associated with inadequate preparation.

ASIC, APRA, and the RBA expect all market participants to adhere to the deadline at the end of 2021 for the issuance of new LIBOR contracts. They should also accelerate the active conversion of legacy LIBOR contracts.

On 2 June 2021, the Board of the International Organization of Securities Commissions (IOSCO), in a public statement, reiterated the importance of ensuring a smooth and timely transition away from LIBOR.

The full statement is on the IOSCO website.

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**2.7 UK government publishes report on executive pay and investment in the UK**

4 June 2021 - The UK Department for Business, Energy & Industrial Strategy (DBEIS) has published a report titled "Executive Pay and Investment in the UK". The report explores the relationships between Chief Executive Officer (CEO) performance targets, the pay incentives associated with those targets, and company investment for companies listed on the Financial Times Stock Exchange (FTSE) All-Share index (as of April 2020) from 2013 to 2019. The study has 3 aims:

- to explore the prevalence of different performance targets in UK executive pay contracts, with a view to better understanding the use of different target types and whether they are calibrated effectively to incentivise target achievement;
- to examine the evidence for whether CEOs influence company investment decisions to improve performance against specific targets in their pay contracts; and
- to examine the evidence for whether there is a systematic relationship between the presence and size of specific performance targets and company investment.

It is stated in the conclusion to the report:

"This study has conducted detailed investigation into how CEOs typically perform against their annual bonus and LTIP [long-term incentive plan] targets, and it has also considered a broad range of relationships between executive pay targets and investment decisions. Whilst there is good evidence to suggest that CEO performance targets do influence firm performance in a manner consistent with increasing CEO payout, it is much less clear that CEOs are influencing firm performance (and therefore their pay) by changing investment. There is some evidence of such investment decisions amongst certain firms, but less clear evidence of this behaviour across the wider FTSE All-Share group. We note that the latter finding does not necessarily mean that

CEO pay is correctly set in most large firms. Indeed, one reason why there is little need for CEOs to reduce investment to hit the threshold payout could be that threshold targets are too easy to hit. Still, the evidence does not suggest a systematic problem with executive pay causing underinvestment".

The report is available on the DBEIS website.

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**2.8 Appearance of ASIC Chair, Deputy Chair and Commissioners before the Senate Economics Legislation Committee**

2 June 2021 - The new Chair (Joseph Longo) and new Deputy Chair (Sarah Court) of ASIC, and other ASIC Commissioners and staff, have appeared before the Senate Economics Committee as part of the Committee's 2021-2022 Budget Estimates hearings. The matters discussed at the hearing included:

- proxy adviser practices;
- ASIC's new product intervention power and motor vehicle add-on insurance and extended warranty products;
- ASIC's regulatory role in relation to cryptocurrency;
- ASIC's recently published Information Sheet 255 on activist short selling campaigns in Australia;
- responsible lending obligations; and
- the regulation of financial advice.

The transcript of the hearings is available on the Senate Economics Legislation Committee website.

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**2.9 US SEC awards US$23 million to whistleblowers**

2 June 2021 - The US Securities and Exchange Commission (SEC) has announced awards of approximately USD13 million and USD10 million to two whistleblowers whose information and assistance led to successful SEC and related actions. The whistleblowers' substantial assistance, provided to the SEC and another federal agency, included submitting information and documents, participating in interviews, and identifying key individuals who engaged in the misconduct at issue.

The SEC has awarded more than USD928 million to 166 individuals since issuing its first award in 2012. All payments are made out of an investor protection fund established by Congress that is financed entirely through monetary sanctions paid to the SEC by securities law violators. Whistleblowers may be eligible for an award when they voluntarily provide the SEC with original, timely, and credible information that leads to a successful enforcement action. Whistleblower awards can range from 10% to 30% of the money collected when the monetary sanctions exceed USD1 million.

More information about the whistleblower program is available on the SEC website.

### 2.10 World Economic Forum paper on the role and responsibilities of gatekeepers in preventing illicit financial flows

2 June 2021 - The World Economic Forum has published a paper titled "the Role and Responsibilities of Gatekeepers in the Fight against Illicit Financial Flows: A Unifying Framework". According to the paper, efforts to combat corruption and illicit financial flows need to hold a prominent place within the private sector. Private sector gatekeepers, such as art advisors, bankers, accountants, lawyers and real estate agents, are essential for preventing and disrupting illicit financial flows. They must implement responsible practices in every aspect of their operations and collaborate across their industry and supply chains.

The paper proposes, for gatekeepers, three principles (integrity; transparency; and accountability) and five practices (establish clear, concrete and up-to-date policies; promote effective due diligence; centre a culture of integrity through training and incentives; foster a "speak-up" culture; and collaborate across industries and sectors). The paper also contains commentary on the principles and practices.

The paper is available on the World Economic Forum website.

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### 2.11 Treasury and Attorney-General consultation on guaranteeing a minimum return of class action proceeds to class members

1 June 2021 - The Treasury and the Attorney-General's Department have published a consultation paper titled "Guaranteeing a minimum return of class action proceeds to class members". The background to the consultation is that on 21 December 2020, the Parliamentary Joint Committee on Corporations and Financial Services handed down its report, "Litigation funding and the regulation of the class action industry". Recommendation 20 of the report was that the Federal Government consult on:

- the best way to guarantee a statutory minimum return of the gross proceeds of a class action (including settlements);
- whether a minimum gross return of 70% to class members, as endorsed by some class action law firms and litigation funders, is the most appropriate floor; and
- whether a graduated approach taking into consideration the risk, complexity, length and likely proceeds of the case is appropriate to ensure even higher returns are guaranteed for class members in more straightforward cases.

This joint consultation by the Treasury and the Attorney-General's Department responds to Recommendation 20 of the Committee's report.

The consultation paper states that there are a range of options to legislate a statutory minimum return. These include amending Corporations Act 2001 No. 50 (Cth) to ensure, as a condition of the Australian Financial Services (AFS) Licence or Managed Investment Scheme (MIS) regimes, that litigation funders do not impose costs where doing so would result in plaintiffs receiving less than the guaranteed minimum, or setting a statutory cap on returns with court oversight.

The consultation paper is available on the Treasury website.

## 2.12 OECD publishes voluntary transparency and disclosure standard for state-owned enterprises and their owners

31 May 2021 - The Organisation for Economic Co-operation and Development (OECD) has published a document titled "Maintaining competitive neutrality: Voluntary transparency and disclosure standard for internationally active state-owned enterprises and their owners". It is stated in the document that state-owned enterprises (SOEs) represent a significant and, by some measures, growing share of the economy. One quarter of the world's largest multinationals are effectively under state control. SOEs are important elements of most national economies and operate in sectors that provide essential public services vital to competitiveness, such as transportation, public utilities and finance. The concentration of SOEs in these sectors can have direct implications for the global competitive landscape.

The OECD states in the document that information disclosure and high standards of accountability in SOEs can contribute to improved efficiency and performance of SOEs. In addition, transparency and disclosure are key to ensuring competitive neutrality between SOEs and other market participants.

The OECD voluntary standard is intended to outline a set of best practices for transparency and disclosure by internationally-active SOEs and their owners. The aim of the standard is to support the preservation of competitive neutrality and ensure that internationally-active SOEs operate efficiently, transparently and on equal footing with private companies in the global marketplace. The standard is organised in three parts:

- principles for transparency and disclosure by SOEs;
- principles for transparency and disclosure by the state-owner; and
- ensuring access to information and facilitating international cooperation.

The voluntary standard is available on the OECD website.

## 2.13 Report on the challenges facing charities when raising funds

27 May 2021 - A report co-published by Justice Connect reveals that over 600 charities and community organisations surveyed face major challenges because of outdated fundraising laws.

The Fundraising Survey 2021 report finds that 55% of charities and community organisations surveyed use online fundraising methods with many more hesitant, identifying the fundraising registration process as either "very complex with excessive information required" or "somewhat complex". In the era of COVID-19 pandemic restrictions and compounding crises, charities have pivoted to online with limited resources to fundraise for the support they give to increasingly more communities. Complex fundraising regulations are still a barrier to charities pursuing their purpose to serve community.

Other findings include:

- 53% of Australian charities and not-for-profits consider the impact of current fundraising rules and registration processes as "significant"; and
- the majority of charities use online fundraising, however 39% of Australia's charities and not-for-profits are not aware of the need to comply with different state and territory licenses and regulations when raising funds online.

According to Justice Connect, the findings of the report will be used to help it continue to advocate for a single national scheme for the regulation of charitable fundraising, as recommended by the Royal Commission into National Natural Disaster Arrangements.

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**2.14 Global framework for ESG and securities lending**

27 May 2021 - The Pan Asia Securities Lending Association (PASLA) and the Risk Management Association (RMA) have published the Global Framework for ESG and Securities Lending (GFESL). The GFESL aims to help institutional investors apply Environmental, Social and Governance (ESG) principles to their securities lending programmes in alignment with their organisational ESG policies.

The GFESL provides standardised options, essential background and key considerations across the six main touchpoints between securities finance and ESG - including voting rights, transparency in the lending chain and lending over dividend record dates - and offers suggestions on best practice in each case.

**Key best practice recommendations**

Among the best practice recommendations, the GFESL suggests that institutional investors that lend securities should consider:

- **Voting rights:** Assessing or developing a policy for recalling loaned securities based on ESG considerations in their proxy voting framework; identifying the types of shareholder resolutions on which they want to vote by company and by issue;
- **Transparency in the lending chain:** Implementing effective minimum standards that reflect their corporate-level sustainability framework; for example, applying an ESG lens to selecting direct counterparties;
- **Collateral and cash reinvestment:** Applying the same ESG standards to the non-cash collateral they are prepared to accept when they lend securities as those that they apply to their investment portfolio;
- **Lending over record date:** Establishing a clear policy on lending securities over dividend record dates and communicating this with agent lenders; monitoring counterparty exposure in order to identify unusual activity; and
- **The short side of the market:** Identifying the areas in which they see potential for a conflict between facilitating participation in the short side of the market and their corporate ESG commitments; developing a policy to govern the facilitation of participation in short-selling that includes specific guidance on the circumstances under which they would limit lending or decline to lend.

The International Securities Lending Association (ISLA) has endorsed the GFESL. The GFESL is available on the ILSA website.

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### 2.15 European Securities and Markets Authority publishes guidance on funds' marketing communications

27 May 2021 - The European Securities and Markets Authority (ESMA), the EU's securities regulator, has published the final report on its Guidelines under the Regulation on cross-border distribution of funds. The Guidelines specify the requirements that funds' marketing communications must meet, which is to:

- be identifiable as marketing communications;
- describe the risks and rewards of purchasing units or shares of an Alternative Investment Fund (AIF) or units of an Undertaking for Collective Investment in Transferable Securities (UCITS) in an equally prominent manner; and
- contain clear, fair and not misleading information, taking into account the on-line aspects of marketing communications.

ESMA conducted a public consultation on the Guidelines to gather the views of relevant stakeholders. The report contains a feedback statement summarising the responses received and highlighting the amendments and clarifications introduced in the final Guidelines to consider the feedback received during the consultation.

The report is available on the ESMA website.

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### 2.16 UK Financial Reporting Council report on corporate governance and workforce engagement

24 May 2021 - The UK Financial Reporting Council (FRC) has published a report on corporate governance and workforce engagement. This report aims to provide a deeper understanding of the current intersection of corporate governance with employee voice, in the light of requirements in the *2018 UK Corporate Governance Code* for boards to ensure effective workforce engagement. Through analysis of company reports, a survey of FTSE 350 companies, and a series of interviews with directors, executives and workforce representatives, the report explores the approaches companies have taken to providing a workforce voice in the boardroom, why different approaches have been chosen, what these changes have meant in practice and how effective they have been from both a management and workforce perspective.

Of the three core options for workforce engagement in the revised *Corporate Governance Code* - a worker director, designated non-executive director (NED) and advisory panel - 68% of companies in the sample have adopted one or more of these as a direct consequence of the Code (40% have appointed a designated NED, 12% have established an advisory panel and 16% have combined an advisory panel with a designated NED). Only one company was found to have appointed a worker director following the issuance of the revised Code, adding to the four FTSE 350 companies with worker directors that pre-date the Code. The remaining 32% of FTSE 350 companies examined in the report have not adopted any of the three suggested options, instead either choosing to adopt "alternative arrangements" - which are permitted by the Code - or stating that their existing engagement mechanisms are adequate to satisfy the Code's requirements.

The report is available on the FRC website.

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### 2.17 US Presidential Executive Order on climate-related financial risk

20 May 2021 - The US President Joseph Biden has issued an Executive Order titled "Climate-Related Financial Risk". The Executive Order:

- requires the National Climate Advisor and the Director of the National Economic Council to develop, within 120 days, a comprehensive government-wide climate-risk strategy to identify and disclose climate-related financial risk to government programs, assets, and liabilities;
- requires the Treasury Secretary, in her role as the chair of the Financial Stability Oversight Council, to work with Council members to assess climate-related financial risk to the stability of the federal government and the stability of the US financial system;
- directs the Labor Secretary to consider suspending, revising, or rescinding any rules from the prior administration that would have barred investment firms from considering environmental, social and governance factors, including climate-related risks, in their investment decisions related to workers' pensions;
- directs the development of recommendations for improving how federal financial management and reporting can incorporate climate-related financial risk, especially as that risk relates to federal lending programs and requires consideration of new requirements for major federal suppliers to disclose greenhouse gas emissions and climate-related financial risks and to ensure that major federal agency procurements minimise those risks; and
- directs that the federal government develop and publish annually an assessment of its climate-related fiscal risk exposure and also directs the Office of Management and Budget to reduce the federal government's exposure through the formulation of the President's Budget and oversight of budget execution.

The full text of the Executive Order is available on the White House website.

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### 2.18 Analysis of the charity sector by the Australian Charities and Not-for-profits Commission

May 2021 - The Australian Charities and Not-for-profits Commission (ACNC) has published the latest edition of its Australian Charities Report. The report examines the 2019 Annual Information Statements of more than 48,000 charities.

The data from the 2019 Annual Information Statement shows that charity sector revenue grew by 6.8% in 2019 - a growth rate greater than that of the Australian economy in the same period. The data shows that charities employed 1.38 million people (11% of the Australian workforce) and received $166 billion, with $11.8 billion coming from donations. This is an increase of $1.3 billion in donations from the previous year. Charities distributed $7.2 billion in grants and donations within Australia (an increase of 27% on the previous year) and just under $2 billion in grants and donations outside of Australia (up 20% on the previous year). More than half of all charities (51%) operated without any paid staff, relying entirely on volunteers. Small charities (annual revenue less than $250,000) made up 65% of the sector, large charities (annual revenue of $1 million or more) made up 19%, and medium charities (annual revenue of $250,000 to $999,999) made up 16%.

The report is available on the ACNC website.

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**2.19 Views of institutional investors on company engagement, ESG, remuneration, and shareholder activism: survey results**

May 2021 - Morrow Sodali, a firm that provides shareholder services to corporate clients, has published a report that presents the results of a survey it undertook seeking the views of institutional investors. Forty-two global institutional investors, managing approximately USD 29 trillion in assets, were surveyed.

The survey asked questions addressing four issues:

- company engagement;
- ESG and sustainability;
- remuneration and voting; and
- shareholder activism.

The key findings of the survey are:

**Company engagement**

- Investors are giving ESG more focus when engaging and investing, and a significant majority are taking ESG into greater consideration when voting;
- Key drivers for increased ESG focus are the links to financial performance, followed by legislative changes and client interest;
- Investors cite the discussion of ESG in the context of a company's business plan as the key basis for effective company engagement; and
- Climate risk remains the number one engagement priority closely followed by human capital management, remuneration and board composition. COVID-19 was also a top engagement priority as were cybersecurity and supply chain management.

**ESG and sustainability**

- Climate change is very important to the investment decision-making process;
- Every surveyed investor reviews a company's climate-related disclosures;
- The top three improvements investors are seeking from climate-related disclosures are clear links to financial performance, the time horizon to impact on strategy and the disclosure of metrics, targets and achievements;
- Companies are expected to disclose their "Corporate Purpose", and engagement with the board was given as the top action in the absence of disclosure;
- The TCFD was overwhelmingly the most popular ESG reporting framework, followed by the Sustainability Accounting Standards Board (SASB) and then in-house proprietary frameworks focused on material topics; and

- Many investors support an annual "Say on Sustainability". However, there are also many who consider the option to vote against the reelection of directors as sufficient to make their voices heard on this topic.

**Remuneration and voting**

- ESG factors should be considered when designing executive remuneration plans;
- For both short and long-term incentive plans, a weighting for ESG metrics and targets between 5% and up to 25% was most supported;
- To avoid misalignment between pay and performance, companies should be wary of paying executive bonuses when severely impacted by COVID-19;
- Large incentive payouts lacking performance hurdles and the payment of bonuses where COVID-19 impacts were severe, were the top two indicators of pay and performance misalignment that would result in negative votes on "Say on Pay";
- With COVID-19, the appropriateness of dividend payments when faced with liquidity problems, big lay-offs, taking government subsidies, and dilution of share capital were ranked as concerns relatively equally; and
- A majority of survey respondents support the adoption of loyalty shares.

**Shareholder activism**

- Investors prefer to influence boards by engaging with directors, followed by direct engagement with management. Although ranking lower, collaboration with other investors and voting against directors are also viable influencers;
- After financial performance, poor strategy, weak governance and misallocation of capital were the highest-ranking reasons for supporting an activist;
- Lack of responsiveness to investor support for ESG resolutions and material ESG controversies could also result in support for an activist; and
- A clear majority are prepared to file or co-file an ESG-related resolution.

The report is available on the Morrow Sodali website.

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## 2.20 Vanguard publishes two guides on how it evaluates resolutions dealing with climate change and diversity, equity and inclusion

May 2021 - Vanguard has published two guides (which it refers to as "Stewardship Insights") on how it evaluates resolutions that deal with climate change and resolutions that deal with diversity, equity and inclusion.

**Resolutions dealing with climate change**

Vanguard states that climate change "represents a profound, fundamental risk to investors' long-term success and has the potential to materially affect companies across many sectors". It states that:

> "Vanguard expects boards to effectively oversee material climate-related risks, and to disclose those risks using widely recognized investor-oriented reporting frameworks. We support the framework created by TCFD for disclosing strategy, risk management, governance, metrics, and targets. Where climate change is a material risk for companies, we expect boards to disclose those risks along with the company's climate strategy and

progress on goals. And we look for companies to make progress in response to shareholder feedback. We evaluate Say on Climate proposals through a lens of materiality and consider a wide range of criteria in our analysis, including the reasonableness of the request, whether the proposal addresses a gap in disclosure, and its alignment with industry standards. In addition, we consider regional differences, such as the binding nature of shareholder votes in the UK or amendments to a company's constitution related to shareholder proposals in Australia".

**Resolutions that deal with diversity, equity and inclusion**

Vanguard states that "risks to shareholder value associated with diversity, equity, and inclusion (DEI) remain a top engagement priority for Vanguard" and that it views "each proposal through the lens of financial materiality to the company" and assesses "the reasonableness of the proposal and whether the requested action addresses a gap in a company's current practices or stated intentions".

The two guides are available on the Vanguard website:

- Vanguard Investment Stewardship Insights How we evaluate Say on Climate proposals; and
- Vanguard Investment Stewardship Insights Shareholder proposals: Diversity, equity, and inclusion.

## 3. Recent ASIC Developments

### 3.1 Extension of licensing relief to all trustees of registrable superannuation entities for consistent treatment under the law

18 June 2021 - ASIC has extended existing licensing relief for public offer trustees to include all registrable superannuation entities to ensure that non-public offer trustees are regulated consistently with public offer trustees under the Corporations Act 2001 No. 50 (Cth).

ASIC Corporations (Superannuation and Schemes: Underlying Investments) Instrument 2016/378 (primary instrument) confirms that a dealing authorisation under an AFS Licence is not required by public offer trustees in order to deal in a financial product (other than an interest in the fund) in the ordinary course of operating the superannuation fund. ASIC Corporations (Amendment) Instrument 2021/550 (amending instrument) has extended the exemption to non-public offer trustees, having regard to law reform that requires these trustees to hold an AFS licence.

From 1 July 2021, all registrable superannuation trustees will be required to hold an AFS licence with authorisations to deal in superannuation interests and to provide a superannuation trustee service.

The change is consistent with ASIC's previously communicated position that the relief would be extended to non-public offer trustees following the implementation of the Financial Sector Reform (Hayne Royal Commission Response) Act 2020 No. 135 (Cth) and associated regulations.

The relief applies to all superannuation trustees for a period of 18 months, ending 31 December 2022. No immediate action is required by trustees who currently rely on the relief or wish to do so in the future. Prior to its expiry, ASIC will consult on the operation of the instrument with industry and reconsider the appropriateness of the relief following the introduction of the new financial service - "provide a superannuation trustee service".

**Background**

On 4 December 2015, ASIC released Consultation Paper 244 - Remaking ASIC class orders on dealing in underlying investments to publicly consult on the relevant class orders that were due to sunset in April 2017 (refer: 15-367MR).

On 17 May 2016, ASIC released the primary instrument. This instrument continues, with minor and technical changes, the relief given under ASIC Class Orders [CO 02/1161], [CO 02/1073] and [CO 02/1074], which relate to various Chapter 7 requirements that apply to underlying investments in a superannuation fund (refer 16-169MR).

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### 3.2 ASIC review of 31 December 2020 financial reports

16 June 2021 - ASIC has announced the results from its review of the financial reports of 85 listed entities for the year ended 31 December 2020. The review was conducted as part of ASIC's ongoing risk-based reviews of financial reports.

ASIC has made inquiries of 15 entities on 22 matters. The largest numbers of matters relate to impairment of non-financial assets, asset values and disclosure in the operating and financial review.

According to ASIC, many companies have continued to make useful and meaningful disclosures on the impact of COVID-19 conditions. However, ASIC states that it still identifies some entities with businesses adversely affected by the pandemic that did not appear to give sufficient attention to the reporting of asset values and financial position.

Other matters discussed in the ASIC review of financial reports are:

- impairment;
- expected credit losses on trade receivables;
- operating and financial review;
- consolidation accounting;
- lease accounting;
- off-balance sheet arrangements;
- revenue recognition; and
- provisions.

The full review is available on the ASIC website.

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### 3.3 New market integrity rules for capital

16 June 2021 - ASIC has made new market integrity rules for capital. The *ASIC Market Integrity Rules (Capital) 2021* (Capital Rules) replace the existing separate rule books for securities market participants and futures market participants to create a common set of rules for capital.

Consistent with ASIC's proposals in Consultation Paper 302 *Proposed changes to ASIC's capital requirements for market participants*, the Capital Rules will:

- move futures market participants from the existing net tangible asset regime to a risk-based regime, subject to a minimum core capital requirement of $1,000,000;
- increase the minimum core capital requirement for securities market participants to $500,000;
- include a requirement to calculate an underwriting and sub-underwriting risk amount; and
- simplify the capital requirements by removing redundant rules and forms.

As a result of feedback received from industry, ASIC has:

- introduced an extension of the proposed transition period from six to 12 months;
- modified the proposed liquidity requirements by replacing the proposed 12-month cash flow requirement with a three-month cash flow requirement, together with a requirement to maintain a 12-month liquidity plan;
- included the ability to offset a right-of-use asset against a corresponding lease liability, with the net amount (if positive) to be treated as an excluded asset; and
- adjusted various components of the commodity position risk requirements and FX position risk as they apply to principal positions.

Following a 12-month transition period, market participants will be required to comply with the Capital Rules from 17 June 2022. Market participants may wish to opt into the Capital Rules before 17 June 2022, by providing written notice to ASIC. Upon opting in, market participants will be required to lodge monthly risk-based returns through ASIC's regulatory portal.

Exemptions to requirements contained within the Capital Rules apply to clearing participants of an approved clearing facility, authorised deposit taking institutions and principal traders only.

Download

- REP 692; and
- ASIC Market Integrity Rules (Capital) 2021.

**Background**

ASIC supervises the capital and reporting requirements for non-clearing market participants and is empowered to make and enforce market integrity rules. ASIC assumed responsibility for supervision of market participant capital from the ASX on 1 August 2011. No substantive changes had been made to the capital requirements for non-clearing participants since 2000. ASIC's review highlighted that the capital requirements were not able to adequately address the risks of operating a market participant business today.

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**3.4 Guidance on ongoing fee arrangements**

15 June 2021 - ASIC has released an information sheet (INFO 256) on ongoing fee arrangements to provide greater clarity to financial advisers and advice licensees on their obligations when providing personal advice to retail clients. This follows recent changes to the law that will take effect on 1 July 2021 (see Background below).

INFO 256 answers frequently asked questions about the obligations that apply to fee recipients in relation to ongoing fee arrangements, fee disclosure statements (FDSs), and ongoing fee consents.

In developing this guidance, ASIC has taken into account the financial advice industry's response to recent ASIC consultations, including Consultation Paper 332 *Promoting access to affordable advice for consumers* (CP 332). Industry has asked for shorter, simpler, and more user-friendly regulatory guidance from ASIC. As a result, INFO 256 will replace Regulatory Guide 245 *Fee disclosure statements*, which will be withdrawn.

ASIC has also released consequential amendments to RG 175 *Licensing: Financial Product Advisers-Conduct and Disclosure* (RG 175). The updated RG 175 reflects new advice obligations introduced into the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), following the Financial Services Royal Commission. It includes an example of the lack of independence disclosure statement to help advisers understand the requirements in ASIC Corporations (Disclosure of Lack of Independence) Instrument 2021/125 (see details below).

**Background**

The Financial Services Royal Commission Final Report made a number of recommendations to address consumer harm resulting from fees for no service and poor advice from financial advisers, whose duty to their client conflicts with their own interests. To address these issues, the Royal Commission made recommendations to:

- introduce annual renewal of ongoing fee arrangements and a requirement that AFS licensees cannot deduct ongoing fees without the client's consent (Recommendation 2.1);
- introduce a requirement for AFS licensees to disclose their lack of independence where they would contravene s. 923A of the Corporations Act if they used the restricted terms "independent", "unbiased" and "impartial" (Recommendation 2.2); and
- limit advice fee deductions from superannuation choice accounts (Recommendation 3.3).

The Government implemented Royal Commission Recommendations 2.1, 2.2 and 3.3 in the Financial Sector Reform (Hayne Royal Commission Response No. 2) Act 2021 No. 19 (Cth). The legislation received Royal Assent on 2 March 2021. On 25 March 2021, ASIC made three legislative instruments to implement aspects of these Royal Commission recommendations (refer 21-058MR).

On 13 May 2021, the Government made the Financial Sector Reform (Hayne Royal Commission Response-Advice Fees) Regulations 2021. On 11 June 2021, the Government also announced that a new regulation will be made to assist advisers with meeting their existing obligation to provide an FDS during the transition year.

ASIC will update INFO 256 to reflect the new regulation after it is made. ASIC will also make consequential amendments to other regulatory guidance to reflect the new obligations, including Regulatory Guide 182 *Dollar Disclosure* (RG 182) and Information sheet 228 *Limited AFS Licensees - Advice conduct and disclosure obligations* (INFO 228).

### 3.5 Extension of transitional relief for foreign financial services providers following Federal Budget

11 June 2021 - ASIC is extending for 12 months - to 31 March 2023 - its transitional relief for foreign financial services providers (FFSPs) from the requirement to hold an AFS Licence, pending the outcome of the Australian Government's consultation about the regulation of FFSPs.

As part of the Federal Budget released on 11 May 2021, the Government announced that it will consult on options to:

- restore regulatory relief for FFSPs who are licensed and regulated in jurisdictions with comparable financial service rules and obligations, or have limited connection to Australia, from holding an AFS licence; and
- create a fast-track licensing process for FFSPs who wish to establish more permanent operations in Australia.

ASIC Corporations (Amendment) Instrument 2021/510 extends the relief contained in the following instruments:

- ASIC Corporations (Repeal and Transitional) Instrument 2016/396;
- ASIC Corporations (CSSF-Regulated Financial Services Providers) Instrument 2016/1109; and
- ASIC Corporations (Foreign Financial Services Providers-Limited Connection) Instrument 2017/182.

The three instruments currently apply to a range of FFSPs until 31 March 2022.

The instrument also delays the commencement of the ASIC Corporations (Foreign Financial Services Providers-Funds Management Financial Services) Instrument 2020/199 until 1 April 2023. Under that instrument ASIC gives licensing relief to some providers of funds management financial services to certain categories of Australian professional investors.

As Treasury will consult on proposals that affect licensing of FFSPs, ASIC has paused its assessment of licence applications lodged by FFSPs pending the outcome of the Government's announced reforms, unless the applicant requests that ASIC continue with the assessment of their application.

During this extended transitional period, ASIC will consider new applications for individual temporary licensing relief or new standard or foreign AFS licence applications from entities that cannot rely on the transitional relief. FFSPs that have been or are granted a foreign AFS licence will be able to continue to operate their financial services business in Australia under the licence issued by ASIC pending any legislative changes arising from the Government's consultation.

### 3.6 ASIC highlights focus areas for 30 June 2021 financial reports under COVID-19 conditions

10 June 2021 - ASIC has highlighted key focus areas for financial reporting by companies for reporting periods ending 30 June 2021 under COVID-19 conditions. ASIC states that it expects directors, preparers of financial reports and auditors to pay attention to:

- asset values;
- provisions;
- solvency and going concern assessments;
- events occurring after year end and before completing the financial report; and
- disclosures in the financial report and Operating and Financial Review (OFR).

ASIC also states:

- Entities may continue to face some uncertainties about future economic and market conditions, and the future impact on their businesses. Assumptions underlying estimates and assessments for financial reporting purposes should be reasonable and supportable. Assumptions should be realistic, and not overly optimistic or pessimistic;
- Useful and meaningful disclosures about business impacts and potential uncertainties will continue to be vital. Uncertainties may lead to a wider range of valid judgments on asset values and other estimates. These uncertainties may change from period to period. Disclosures in the financial report about uncertainties, key assumptions and sensitivity analysis will be important to investors;
- The OFR should complement the financial report and tell the story of how the entity's businesses are impacted by the COVID-19 pandemic. The underlying drivers of the results and financial position should be explained, as well as risks, management strategies and future prospects;
- Appropriate experience and expertise should be applied in the reporting and audit processes, particularly in more difficult and complex areas, such as asset values and other estimates;
- Directors and auditors should be given sufficient time to consider reporting issues and to challenge assumptions, estimates and assessments; and
- Directors should make appropriate enquiries of management to ensure that key processes and internal controls have operated effectively during periods of remote work. Where possible, auditors should be given access to perform procedures on-site rather than remotely, including stock counts and system walk-throughs.

**Relief on reporting deadlines**

ASIC has extended the deadline for both listed and unlisted entities to lodge financial reports under Chapters 2M (Financial reports and audit) and 7 (Financial services and markets) of the Corporations Act 2001 No. 50 (Cth) by one month for balance dates from 23 June 2021 to 7 July 2021 inclusive. The extended deadlines will assist with any pressures on resources for the audits of smaller entities and provide adequate time for the completion of the audit process given challenges presented by COVID-19 conditions.

When deciding whether to depart from the normal statutory deadlines, ASIC states that directors should consider the information needs of shareholders, creditors and other users of their financial reports, as well as meeting borrowing covenants or other obligations.

**Further information about focus areas in financial reports**

In an attachment to its 10 June 2021 announcement regarding focus areas for 30 June 2021 financial reports, ASIC provides further information regarding:

- factors affecting asset values, provisions and assessments of solvency and going concern;

- asset values;
- provisions;
- subsequent events;
- disclosures;
- reporting processes; and
- cloud computing and other matters.

The full announcement is available on the ASIC website.

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### 3.7 ASIC issues information sheet on activist short selling in Australia

1 June 2021 - ASIC has published Information Sheet 255 *Activist short selling campaigns in Australia* (INFO 255), considering the practice of "activist short selling" in Australia and outlining ASIC's expectations to promote market integrity during these campaigns.

Activist short selling involves a person taking a short position in a financial product and then publicly disseminating information directly or through an agent that might negatively impact the price of the product (short report). A short report may, for example, call into question or directly criticise an entity's finances, management, public disclosures or future prospects.

INFO 255:

- describes the impact of activist short selling on markets;
- provides an overview of the Australian regulatory framework relevant to these campaigns;
- recommends better practices for activist short sellers and authors of short reports, market operators, target entities and market participants; and
- lists some of the actions that ASIC may take in response to these campaigns.

ASIC states that to protect the integrity of Australia's securities markets, activist short sellers, target entities, market operators and market participants should apply the better practices.

These include, for activist short sellers, releasing short reports outside normal trading hours; drawing on reliable information and avoiding overly emotive language. Target entities should seek a temporary trading halt to provide time to digest and comprehensively respond to the claims of activist short sellers.

ASIC also reminds market participants of their obligations to report suspicious short selling activity under the market integrity rules, and for market operators to maintain a fair, orderly and transparent market.

## 4. Recent ASX Developments

### 4.1 Recent ASX Listing Rules amendments

5 June 2021 - ASX has amended its Listing Rules to incorporate changes relating to (among other things) its online forms, notification of security issues and corporate action timetables.

The Compliance Update with further details of these changes can be found here.

The ASX also published updated versions of the following Guidance Notes reflecting the rule changes:

Guidance Note 8 - Continuous Disclosure: Listing Rules 3.1-3.1B

- Guidance Note 8 includes a new s. 7.9 *Cancelling, deferring or reducing a dividend, distribution or interest payment* providing guidance on the post-consultation amendments to Listing Rules 3.21 and 3.22;
- Additional guidance in s. 4.15 (*Guidelines on the contents of announcements under Listing Rule 3.1*) on naming counterparties to market sensitive contracts;
- A new footnote in s. 4.15 explaining ASX's approach to situations where a listed entity fails to disclose the fact that a previously announced material customer contract has not proceeded or has been terminated;
- Further explanatory material in s.4.15 and s. 5.9 (*Listing Rule 3.1A.3 - the reasonable person test*) emphasizing the fact that a listed entity cannot satisfy its obligation to disclose market sensitive information under Listing Rule 3.1 by disclosing information that is materially inaccurate, incomplete or misleading; and
- A new s. 7.10 (*Ramping announcements*).

Guidance Note 14 - ASX Market Announcements Platform

Guidance Note 20 - ASX Online

- Guidance Notes 14 and 20 incorporate changes to reflect the new and amended online forms and address issues raised by respondents in their submissions on the consultation paper.

Guidance Note 30 - Notifying Changes in Issues Securities and Applying for Quotation of New or Additional Securities

- Guidance Note 30 has substantial new guidance in s. 2 (*Notification obligations relating to changes in issued securities*) explaining the new and amended obligations under the Listing Rules to notify the ASX of the issue, conversion, payment up or cessation of securities. It also has a new table in Annexure A summarizing how those notification obligations apply to common corporate actions and events.

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### 4.2 Activity Report

4 June 2021 - ASX has released the ASX Monthly Activity Report for May 2021.

## 5. Recent Takeovers Panel Developments

**5.1 Unlocking a stalemate - Cardinal Resources Limited**
*(By Tania Mattei, Counsel of the Takeovers Panel. The views in this article are those of the author and are not necessarily held by the Panel or individual Panel members. The author thanks Allan Bulman and Katrina Fong for their helpful input.)*

**Introduction**

Throughout its 20-year history, the Takeovers Panel has been presented with a number of applications relating to the "truth in takeovers" policy. The recent applications in relation to Cardinal Resources Limited (Cardinal) highlight the tensions that inherently exist in the policy and serve as an interesting backdrop for a renewed discussion on the topic.

**Background**

As was reported in the November and December 2020 issues of the Corporate Law Bulletin, the applications involved a bidding war for Cardinal, a gold exploration and development company with tenements in Ghana. The multinational saga began in March 2020 with Nord Gold S.E., a privately-owned gold producer with operations in West Africa, Kazakstan and Russia (Nordgold), obtaining a 19.9% foothold in Cardinal and making an indicative non-binding proposal to acquire all remaining Cardinal shares for A$0.45775 per share in cash. While Nordgold was allowed to undertake due diligence, by mid-June 2020 a strategic process run by Cardinal led to a recommended deal for a cash off-market takeover bid at A$0.60 per share from a subsidiary of Shandong Gold Mining Co, Ltd, a gold and metals company listed on the Shanghai and Hong Kong Stock Exchanges (Shandong).

Nordgold followed a month later with a hostile unconditional on-market takeover bid at A$0.66 per share. The two bidders traded bids until Shandong stated on 19 October 2020 that its offer price of A$1.00 per Cardinal share was its "best and final in the absence of a higher competing offer".

On 21 October 2020, Nordgold matched Shandong's offer at A$1.00 per Cardinal share, noting that its increased offer price "is not a higher competing offer".

After making an earlier statement to the contrary, and following a statement from Shandong, Cardinal conceded that ". Shandong Gold will not increase its offer price.unless [Nordgold] (or anyone else) increases its offer above $1.00 or announces an intention to do so". See TP20/65 in relation to *Cardinal Resources Limited 01*.

On 23 October 2020, presumably to force Nordgold's hand, Cardinal made an announcement that it had received shareholder intention statements from shareholders representing 19.38% of its shares (later increased to 22.81% of its shares) to the effect that the shareholders intended to accept the Shandong offer on the last day of the Shandong offer provided that Nordgold had not increased its offer above A$1.00 per share or there was no superior proposal in excess of A$1.00, in each case prior to 5.30pm (AEDT) on 29 October 2020.

The response from Nordgold was probably not what Cardinal expected. On 26 October 2020, Nordgold lodged an application with the Panel raising concerns in relation to the shareholder intention statements (see *Cardinal Resources Limited 02*) and made an announcement stating that the offer price of A$1.00 per Cardinal share under the Nordgold offer was best and final in the absence of a higher competing offer.

Carefully navigated statements followed from the bidders. First, Shandong stated that "should a higher competing offer be made or announced, [Shandong] intends to increase the Cash

Consideration under its Offer to A$1.05 per Cardinal share". Nordgold quickly countered announcing that it would make a simultaneous off-market takeover bid for Cardinal and that "if a higher competing offer is made, Nordgold may increase its offer price under its off-market offer, including to A$1.05 per share or another price that may defeat the higher competing offer and any competing offer from Shandong".

Cardinal and another substantial shareholder, Samson Rock Capital LLP, lobbed in separate applications to the Panel (see *Cardinal Resources Limited 03 & 04*). Samson Rock advanced that "the auction for control of Cardinal has hit an impasse, and there has ceased to be an efficient, competitive and informed market for control". Cardinal decried that there was "a contrived stalemate for control with the [truth in takeovers] Policy being used as a sword against a technical deficiency in a Best and Final Statement and the introduction of the Nordgold Simultaneous Off-Market Offer.". Both applicants submitted that the bidders should not be held strictly to their statements and instead be permitted to increase the offer price of their respective bids.

**Last and final statements**

ASIC Regulatory Guide 25 - *Takeovers: false and misleading statements* provides that "[a] 'last and final statement' is a statement made by a market participant that it will or will not do something in the course of the bid" and that "market participants that make a last and final statement should be held to it, as with a promise" (see Regulatory Guide (RG) 25.2 and 25.9). The policy requires a clear and express qualification if the maker of a statement wants the ability to depart from it (see RG 25.6).

The sitting Panel in *Cardinal* noted at [34] that (excluding footnotes):

> The "truth in takeovers" policy has been endorsed by the Panel, on a number of occasions, as a "fundamental tenet" of Australia's takeover regime and that requiring "persons to act in accordance with statements that they have made to the market concerning their intentions in the context of a takeover bid under Chapter 6 promotes the principle set out in s. 602(a)."

The sitting Panel declined to conduct proceedings on the basis that it did not consider that there was any reasonable prospect that it would find the circumstances surrounding the Shandong and Nordgold bids unacceptable.

The sitting Panel did not accept submissions that Nordgold had "misused" the truth in takeovers policy to stymie the auction for control. It considered that Shandong's and Nordgold's last and final statements had been made on definitive terms and given voluntarily. Accordingly, the Panel stated that it was incumbent upon the statement makers to consider carefully the implications of making their respective statements and to assume the risk for doing so. It noted, among other things, that it was open to Shandong to have reserved its rights to also increase its offer price if another bid equal to A$1.00 per Cardinal share emerged.

The sitting Panel did not comment on the "pseudo auction" or "virtual bidding war" being conducted by the bidders of their intentions to increase the offer price to A$1.05 per share or beyond.

The sitting Panel expressly acknowledged at [50] that holding the bidders to their last and final statements "may not result in the most commercial outcome for all parties" but considered that it was "important from a market integrity and certainty perspective that bidders should not be able to depart from their clear and definitive statements".

Interestingly, the UK Takeover Panel decided a matter on similar facts, noting that the principle of certainty should not be risked to accommodate the apparent disadvantage which may result from the application of the rule in a particular case (see *In Cala plc - Dotterel Limited - Miller 1999 plc* (Panel Statement No. 1999/8, 28 May 1999).

It can be observed that in *Cardinal* it was relatively straight forward for market integrity to be preserved in circumstances where there was no departure from a last and final statement and the rights or interests of third parties had not been affected by a departure.

As noted above, the Panel has consistently supported the general principle underlying the policy. However, as the Panel stated in *BreakFree Limited 04R* at [65] (referring to PS 25 now RG 25):

> .PS 25, is one of the Policy Statements concerning ASIC' s enforcement discretions... Accordingly, whether ASIC has a discretion in any particular case depends on whether or not there would be a contravention of the Act (in this case, particularly, s. 1041H) which would be enforced by a court or unacceptable circumstances which would be declared and remedied by the Panel. While ASIC needs to make its own assessment whether a statement may be "relied on" against a person, whether a market statement would be misleading or deceptive for the purposes of s. 1041H is a question of law, not administrative discretion. Similarly whether circumstances are unacceptable is a matter for the decision by the Panel, not ASIC.

Both the initial Panel in *Finders Resources Limited 02* and the review Panel in *Finders Resources Limited 03R* supported the proposition that while the Panel will have regard to RG 25, the question of whether circumstances are unacceptable is "a matter for the decision by the Panel, not ASIC" (quoting *BreakFree Limited 04R*).

Unlike its counterparts in the UK and Hong Kong, the Panel is not a market monitor that can quickly seek clarification regarding market announcements. It can only respond to an application. Considering the Panel's duty to exercise its powers in accordance with the Corporations Act 2001 No. 50 (Cth), in particular s. 657A in making a declaration and s. 657D in making orders, it is not surprising that, while the starting premise is the same, outcomes vary once the unique and often unpredictable circumstances of each matter are examined. For example, in *Rinker Group Limited 02R* the Panel reluctantly ordered compensation to remedy the unacceptable circumstances because the application was made too late and the opportunity had passed for the statement in breach of a "no increase" statement to be withdrawn and withdrawal rights offered to any shareholders who had accepted the offer.

**Shareholder intention statements**

In Nordgold's application, it submitted, among other things, that Cardinal's announcement implied that each shareholder that provided an intention statement was compelled to accept the Shandong bid (in the absence of a superior proposal) and that by encouraging additional statements it was attempting to establish a truth in takeovers acceptance facility.

The sitting Panel declined to conduct proceedings. It did not consider that the wording of the shareholder intention statements indicated that the shareholders were compelled to accept the Shandong bid, Cardinal's invitation to other shareholders to provide additional statements operated as a quasi-acceptance facility or Cardinal's decision to solicit the intention statements at a time when the two bids were fundamentally on equivalent terms was prima facie unreasonable.

While RG 25 is focused primarily on statements by bidders and targets, it also portends possible regulatory action where a substantial holder departs from an unqualified acceptance statement.

The Panel has previously stated that statements from shareholders who are not substantial shareholders should not be bound by their statements (see *Finders Resources Limited 02* at [28] and *BreakFree Limited 03 & 04* at [126]).

Here, the sitting Panel noted that the question of whether some or all of the shareholders were bound by their statements was theoretical in the absence of the shareholders resiling from those statements.

**A grey knight saves the day**

The sitting Panel in *Cardinal* was never required to consider a departure from the last and final statements of Shandong and Nordgold. The stalemate was broken when a grey knight emerged. On 24 November 2020, Engineers & Planners Company Ltd, a Ghanaian owned mining company (E&P), announced an off-market cash takeover bid for A$1.05 per share, subject to conditions including financing.

Notwithstanding immediate protestations from Nordgold regarding the legitimacy of the E&P bid generally and more particularly its status as a "higher competing offer", later that day, Shandong relied on the E&P bid to increase its offer price to A$1.05 per share. On the basis of Shandong's increase, Nordgold considered itself free of its last and final statement and later matched Shandong's offer price, but ultimately let its offers lapse. No-one sought to test the validity of the E&P bid before the Panel.

Notwithstanding a last minute announcement from an Emirati-Russian joint venture (and anagrammatically named) Dongshan Investments Limited, for a bid at A$1.20 per share, Shandong took control of Cardinal at A$1.075 per share following the deployment of a conditional price increase closing strategy.

**Where to from here?**

Whether the Panel can, or should, shift the balance towards strict adherence in relation to intention statements by bidders and targets is an open question. As demonstrated by *Cardinal*, the truth in takeovers policy is antithetical to auction behaviour and the tension between a competitive market and an informed market is among a number of relevant matters that each sitting Panel must consider in relation to last and final statements taking into account RG 25.

There is less clarity in RG 25 regarding statements by market participants other than bidders and targets. In an environment where shareholder intention statements are increasingly being used to influence bid outcomes, there may be opportunity for a broader discussion on the application of the policy to those market participants. A number of questions arise out of *Cardinal*. Does the market expect all shareholders (substantial and non-substantial) to be bound by intention statements? Is it appropriate to imply an absolute quality to intention statements of shareholders? If so, is it practical to inquire whether shareholders who provide intention statements understand their effect? Should target directors provide intention statements in relation to their target shares when they remain subject to making recommendations in relation to a bid?

## 6. Recent Research Papers

### 6.1 An analysis of ESG shareholder resolutions in Australia

This article describes and analyses the recent significant increase in Australia of resolutions proposed by shareholders focused on ESG issues. The research is placed in the context of the legal framework in which shareholder resolutions are advanced. Two sources of data are used for the analysis. First, information about shareholder ESG resolutions proposed in listed Australian companies between 2002 and 2019 was obtained. Second, interviews were conducted with representatives of the proponents of ESG resolutions, institutional shareholders, company directors, governance professionals, and the ASIC. The analysis finds that ESG shareholder resolutions have increased in number, prominence and impact. There has been a significant increase in shareholder ESG resolutions in the last three years, particularly resolutions focused on climate change, albeit that this increase has been concentrated in a small number of companies and industries, with the source of this activism - the filers of the resolutions - being even more concentrated. Against a background of modest average levels of support for shareholder ESG resolutions, the atypical cases of those companies which have recorded high levels of support is notable. The research finds that shareholder ESG resolutions are generally recognised as a valuable corporate stakeholder engagement mechanism and one that has resulted in positive change in some of the companies which have been the subject of those resolutions.

An analysis of ESG shareholder resolutions in Australia

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### 6.2 Regulating financial advisers in the UK: Lessons for Australia

Prompted by the 2008 GFC, the Australian government introduced the Future of Financial Advice reforms in 2013. The reforms aimed to improve the quality of financial advice by virtue of a best interests duty and a ban on conflicted remuneration, inter alia. Despite the reforms, public trust in financial advisers remains unacceptably low. Adviser misconduct, driven by conflicted self-interest, remains prevalent. By contrast, there is relatively greater trust in financial advisers in the UK. This article focuses on how the UK regulates financial advisers, where the best interests duty and suitability rule also apply. The UK regulatory regime offers directions and possibilities for further Australian reforms.

Regulating financial advisers in the UK: Lessons for Australia

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### 6.3 One-stop shop: Consumer credit issued at the point of sale

In Australia, most providers of consumer credit must possess an Australian Credit Licence (ACL). Licensees are subject to obligations, including "responsible lending" requirements. At present, providers of goods or services who offer credit to consumers at the "point of sale" are exempt from this licensing requirement. In 2019, the Australian government pledged to abolish this exemption. More recently, however, it has moved to repeal much of the responsible lending regime. This article outlines the unique features of point-of-sale credit. Drawing on focus groups conducted by the authors, it evaluates claims that point-of-sale credit can cause harm, particularly to vulnerable consumers. It concludes that even if the responsible lending regime is no longer to have general application, all providers of point-of-sale credit should be required to obtain an ACL. They should also be subject to specific rules, like other "high-cost", "high-risk" products such as payday loans and consumer leases.

One-stop shop: Consumer credit issued at the point of sale

### 6.4 Financial intermediation in the age of Fintech: P2P lending and the reinvention of banking

This article focuses on the rise of FinTech over the past ten years, particularly with respect to the role of technology-based platforms in the provision of credit. In this specific context, Peer-to-Peer (P2P) lending has acquired an increasing importance, with a larger share of loans having been originated through P2P platforms instead of traditional banking channels. This trend has been welcomed by policy-makers as a move towards alternative market-based finance, which should contribute to better risk diversification by moving risks away from systemic financial institutions. At the same time, this shift presents a number of regulatory questions that have remained largely unexplored. This is so because the nature and role of P2P platforms has remained loosely defined, which means that it has been difficult to identify relevant regulatory challenges emerging from these channels of finance. This research tackles two inter-related questions. First, it addresses the conceptual redefinition of financial intermediation. This allows understanding the function of P2P platforms, and whether they have supplemented the intermediation role traditionally conducted by banks. Second, it explores the risks that arise in connection with P2P lending channels. This second enquiry highlights outstanding policy and regulatory issues that have remained unexplored or downplayed in current debates.

Financial intermediation in the age of Fintech: P2P lending and the reinvention of banking

### 6.5 Two stories about shareholders

Corporate law contains two contradictory stories about the role of shareholders. In one, the shareholders are a useful countervailing force against the self-interested behaviour of corporate agents. In the other, shareholders lack the motivation, information, and proper incentives to contribute to the good governance of business corporations. Both stories are true on occasion, but is one more true than the other? Currently, developments in corporate and securities law are predicated on the idea that shareholders are, generally, a positive force in corporate governance. This seems to be a corollary of agency cost theory, the dominant paradigm for understanding the relationships between corporate actors.

This article reviews the body of empirical research on the outcomes of the various forms of shareholder activism. Proposals, proxy campaigns, and takeovers represent the most impactful and costly forms of shareholder engagement with corporations. As it happens, the empirical evidence does tend to strongly support one of the two stories about the role of shareholders, but it is not the one currently dominating law reform efforts. If the character of shareholder interventions generally supports the story that shareholders lack the proper incentives and information to contribute to positive business outcomes, then much about the current regulatory scene needs to be re-evaluated.

Two stories about shareholders

### 6.6 Decentralised finance: Regulating cryptocurrency exchanges

Global financial markets are in the midst of a transformative movement. The creation of Bitcoin and Facebook's proposed distribution of Diem mark a watershed moment in the evolution of the financial markets ecosystem. Purportedly, P2P distributed digital ledger technology eliminates legacy financial market intermediaries such as investment banks, depository banks, exchanges, clearinghouses, and broker-dealers.

Yet careful examination reveals that cryptocurrency issuers and the firms that offer secondary market cryptocurrency trading services have not quite lived up to their promise. Notwithstanding cryptoenthusiasts' calls for disintermediation, evidence reveals that platforms that facilitate cryptocurrency trading frequently employ the long-adopted intermediation practices of their traditional counterparts. In fact, when emerging technologies fail, cryptocoin and token trading platforms partner with and rely on traditional financial services firms. As a result, these platforms face many of the risk-management threats that have plagued conventional financial institutions as well as a host of underexplored threats. Automated or algorithmic trading strategies, accelerated high frequency trading tactics, and sophisticated Ocean's Eleven-style cyberheists leave crypto investors vulnerable to predatory practices.

Early responses to fraud, misconduct, and manipulation emphasise intervention when originators first distribute cryptocurrencies- the initial coin offerings. This article rejects the dominant regulatory narrative that prioritises oversight of primary market transactions. Instead, this article proposes that regulators introduce formal registration obligations for cryptocurrency intermediaries -the exchange platforms that provide a marketplace for secondary market trading. This approach recognises the dynamic nature of cryptocurrency secondary market actors seeking to achieve disintermediation yet balances the potential benefits of trading intermediaries with normative regulatory goals-protecting investors from fraud, theft, misconduct, and manipulation; enforcing accountability; preserving market integrity; and addressing enterprise and systemic risk management concerns.

Decentralised finance: Regulating cryptocurrency exchanges

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### 6.7 Short memories? The impact of SEC enforcement on insider leakage

The authors study the impact of SEC enforcement on information leakage by corporate insiders. They find that SEC enforcement has a significant and immediate deterrent effect on insider leakage. Furthermore, enforcement actions undertaken after a long period of SEC enforcement inactivity display a more significant effect on leakage, consistent with predictions that insiders adapt their behaviour depending on how active they perceive the regulator to be. The authors also study SEC escalations in sanctioning and find that they have a particularly notable deterrent effect, changing insider leakage behaviour for approximately 24 months. The results suggest that capital markets regulators need to intervene on a regular basis in order to maintain deterrence of undesirable behaviour.

Short memories? The impact of SEC enforcement on insider leakage

## 7. Recent Corporate Law Decisions

### 7.1 Successful application to terminate the winding up of a company

*(By Professor Ian Ramsay, Editor)*

*Hughes, in the matter of Substar Holdings Pty Ltd (in liq) (No 2)* [2021] FCA 658 (16 June 2021), Federal Court of Australia, McKerracher J

**(a) Summary**

This case is a useful example of the principles that a court applies when considering an application to terminate the winding up of a company. The application to terminate the winding up was successful.

**(b) Facts**

In August 2020, liquidators were appointed to Substar Holdings Pty Ltd (Substar). The liquidators were later appointed as receivers and managers of the property of the Taurus Investments Trust (the Trust), of which Substar is the trustee. This appointment was necessary to enable the liquidators to realise the property of the Trust to satisfy the liabilities incurred by Substar in its capacity as trustee, in circumstances where Substar conducted no business, and only held assets in its capacity as trustee.

The liquidators applied to the court for orders for the termination of the liquidation of Substar on the basis that its sole director, Mr Andrew Scala (the Director) had put forward a proposal to the liquidators which they considered allowed each of Substar's creditors to be repaid in full as well as the costs and remuneration of the liquidators to be met.

The evidence before the Court was that Substar carried on no business of its own and held all of its assets in its capacity as trustee of the Trust. The value of Substar's assets was estimated by the liquidators to be approximately $1,400,000. The liquidators issued a notice to creditors calling for the submission of formal proofs of debt. On the basis of the proofs received, the liquidators estimated the liabilities of Substar to be approximately $237,000.

The background to the winding up of Substar was that:

- the registered office of Substar had been care of the former accountants of Substar;
- the former accountants failed to notify the Director of correspondence served on them for Substar, including:
  - a statutory demand for payment of debt pursuant to a default judgment of which the Director was not aware; and
  - a subsequent application to wind up Substar in the Supreme Court of Western Australia.
- the former accountants failed to notify the Director of the hearing of the winding up application in the Supreme Court as a result of which the Court made an order for the winding up of Substar.

**(c) Decision**

The Court referred to its power to terminate the winding up of a company in s. 482(1) of the Corporations Act 2001 No. 50 (Cth), which provides as follows:

> "At any time during the winding up of a company, the Court may, on application, make an order staying the winding up either indefinitely or for a limited time or terminating the winding up on a day specified in the order".

In exercising the power in s. 482(1) of the Corporations Act, the Court referred to the eight factors set out by Master Lee QC of the Supreme Court of Queensland in *Re Warbler Pty Ltd* (1982) 6 ACLR 526 at 533 and Black J of the Supreme Court of New South Wales in *Re MWM Sydney Pty Ltd (in liq)* [2016] NSWSC 688 at [16]-[17] (citations omitted):

- The granting of a stay is a discretionary matter, and there is a clear onus on the applicant to make out a positive case for a stay;
- There must be service of notice of the application for a stay on all creditors and contributories, and proof of this;
- The nature and extent of the creditors must be shown, and whether or not all debts have been discharged;
- The attitude of creditors, contributories and the liquidator is a relevant consideration;
- The current trading position and general solvency of the company should be demonstrated. Solvency is of significance when a stay of proceedings in the winding up is sought;
- If there has been non-compliance by directors with their statutory duties as to the giving of information or furnishing a statement of affairs, a full explanation of the reasons and circumstances should be given;
- The general background and circumstances which led to the winding-up order should be explained; and
- The nature of the business carried on by the company should be demonstrated, and whether or not the conduct of the company was in any way contrary to "commercial morality" or the "public interest".

The Court emphasised that when winding up orders have been made against a company on insolvency grounds, it is necessary for the company to demonstrate that it is now solvent and that the circumstances that necessitated the initial winding up order are no longer present. The Court also referred to the judgment of Brereton J in *Re Glass Recycling Pty Ltd (in liq)* [2014] NSWSC 439 at [19] where his Honour stated that a relevant consideration is whether it would be reasonable to entrust the affairs of the company, once again, to the directors, under whose management it previously failed.

The Court applied the above principles and found that:

- the liquidators had given notice of the application to all creditors and the ASIC;
- the liquidators had ascertained the nature and extent of all the company's creditors and their debts and all debts would be discharged;
- the liquidators supported the application and no creditor had raised an objection given that it was proposed that all creditors be paid in full;
- the liquidators were of the view that Substar would be solvent following the receipt of the funds from the Director;
- the circumstances leading up to the winding up had been explained;
- in relation to whether there had been non-compliance by the Directors with his statutory duties as to the giving of information or furnishing a statement of affairs, the Court observed that the liquidators encountered significant difficulties over an extended period of time in making contact with the Director and having then made contact with him, he informed the liquidators that Substar had no books or records because he did not believe it

was required to keep any. The Court further observed that no evidence had been led to dispel the concern that this unsatisfactory state of affairs could continue following termination of the winding up. However, the Court stated that the weight to be given to this consideration was somewhat lessened in the present case where the liquidators themselves have applied for termination of the winding up (as opposed to a creditor of the company) and Substar did not carry on any business and its sole purpose is to hold property as a corporate trustee; and
- the liquidators submitted that it would not be contrary to commercial morality or the public interest for the winding up to be terminated because (i) Substar carried on no business of its own; and (ii) upon the funds being received by the liquidators, the debts of Substar (save for a loan which the Director intended to repay through the sale of various properties) would be discharged in full and Substar would be solvent.

The Court made orders including that upon receipt by the liquidators of the amount of $530,000 (to cover all creditors' claims, the liquidators' remuneration, disbursements and legal fees and some other matters) paid by or on behalf of Substar and provided such funds are received within 60 days of the date of the orders:

- the winding up of Substar be terminated; and
- the receivership of the property of the Trust be terminated.

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**7.2 Appointment of provisional liquidators and receivers and managers**
*(By Professor Ian Ramsay, Editor)*

*Re DIP Gailey Road Pty Ltd* [2021] VSC 345 (15 June 2021), Supreme Court of Victoria, Connock J

**(a) Summary**

This case is a useful example of the principles that a court applies when considering an application to appoint provisional liquidators and receivers and managers. The application to appoint the provisional liquidators and receivers and managers was successful.

**(b) Facts**

The plaintiff sought orders from the court that:

- provisional liquidators be appointed to DIP Gailey Road Pty Ltd (the Company), pursuant to s. 472 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act); and
- receivers and managers be appointed of the property and assets of the GR Funding Trust (the Trust) pursuant to s. 37 of the Supreme Court Act 1986 No. 110 (Vic) (the SC Act) and r. 39.02 of the Supreme Court (General Civil Procedure) Rules 2015 No. 103 (Vic).

The Company and the Trust are the vehicles through which a failed student accommodation development project (the Project) was to be undertaken on land purchased by the Company in Queensland. The plaintiff invested $5,900,000 in the Project by purchasing shares in the Company and units in the Trust. The Project involved the construction of a six-storey 90-bed student accommodation complex that was to be held for about five years after its construction and then sold. The Project stalled and failed after the planning phase and there has been no development or construction. The Court was informed that the defendants supported the appointment of the provisional liquidators and the receivers and managers. About two weeks before the current application, the plaintiff had made an application to the Court that the Company be wound up on the just and equitable ground pursuant to s. 461(1)(k) of the Corporations Act.

**(c) Decision**

**(i) Legal principles regarding the appointment of provisional liquidators and winding up on the just and equitable ground**

Section 472(2) of the Corporations Act provides that:

> "The Court may appoint a registered liquidator provisionally at any time after the filing of a winding up application and before the making of a winding up order or, if there is an appeal against a winding up order, before a decision in the appeal is made".

The Court stated that generally, an applicant for the appointment of provisional liquidators must satisfy the Court as to two matters:

- there is a reasonable prospect that a winding up order will be made; and
- there exist factors sufficient to require the exercise of the Court's discretion to appoint provisional liquidators prior to the hearing of the winding up application.

The Court referred to the judgment of Tamberlin J in *ASIC v Solomon* (1996) 19 ACSR 73 at [80] where his Honour identified six matters that have been addressed in many later cases. They are (citations omitted):

- The court should only appoint a provisional liquidator where it is satisfied that there is a valid and duly authorised winding up application and a reasonable prospect that the winding up order will be made;
- The fact that the assets of the company may be at risk is a relevant consideration;
- The provisional liquidator's primary duty is to preserve the status quo to ensure the least possible harm to all concerned and to enable the Court to decide, after further examination, whether the company should be wound up;
- The Court should consider the degree of urgency, the need established by the applicant creditor, and the balance of convenience. The power is a broad one and circumstances will vary greatly;
- It may be appropriate to appoint a provisional liquidator in the public interest where there is a need for an independent examination of the state of accounts of the company by someone other than the directors; and
- Where the affairs of the company have been carried on casually and without due regard to legal requirements, so as to leave the Court with no confidence that the company's affairs would be properly conducted with due regard for the interests of shareholders, it may be appropriate to appoint a provisional liquidator.

The Court stated that the principles relevant to an application to wind up a company on the just and equitable ground include (citations omitted):

- where there is "a justifiable lack of confidence in the conduct and management of the company's affairs" and thus a risk to the public interest that warrants protection; and
- a lack of confidence may arise where, "after examining the entire conduct of the affairs of the company", the Court cannot have confidence in "the propensity of the controllers to

comply with obligations, including the keeping of books, records and documents, and looking after the affairs of the company".

The Court observed that there is a significant overlap between matters relevant to the just and equitable ground, and the matters which weigh in favour of the appointment of a provisional liquidator.

**(ii) Legal principles regarding the appointment of receivers and managers**

Section 37 of the SC Act provides that a Court may appoint, whether on an interlocutory or final basis, a receiver if it is "just and convenient" to do so. The Court referred to a number of authorities for the proposition that the general ground on which the Court appoints a receiver is the protection or preservation of property for the benefit of persons who have an interest in it and that receivership is a measure of last resort.

**(iii) Application of the principles**

**Appointment of provisional liquidators**. The Court made an order for the appointment of provisional liquidators to the Company because it was satisfied that there was at least a reasonable prospect that a winding up order would be made and that there existed factors sufficient to require the exercise of the Court's discretion to appoint provisional liquidators prior to the final hearing of the application to wind up the Company on the just and equitable ground.

The Court was of the opinion that there was at least a reasonable prospect that the Company would be wound up on the just and equitable ground because:

- the sole venture for which the Company was established had stalled and failed;
- having regard to the plaintiff's inability to establish what had been occurring with the Project and the Plaintiff's investment in the Project, the Company's ongoing failure to address requests made by the plaintiff requiring the provision of information, and concerns regarding the adequacy of the books and records of the Company, there was at least a reasonable prospect that it would be established that there is a justifiable lack of confidence in the conduct and management of the Company's affairs, and a risk to the public interest warranting protection;
- it appeared that the Company had no ongoing business that could or might be jeopardised by the appointment and no goodwill that might be adversely affected or lost; and
- there were material concerns regarding the Company's solvency.

These factors also supported the exercise of the Court's discretion to appoint provisional liquidators. Provisional liquidators were needed to protect the Company's assets, conduct an independent examination of the Company's affairs, and the appointment of provisional liquidators was in the public interest.

**Appointment of receivers and managers of the property and assets of the Trust**. The Court made an order for the appointment of receivers and managers of the property and assets of the Trust. The factors that the Court considered relevant included:

- the plaintiff had been unable to find out what became of his investment in the Trust despite repeated requests for information;
- the evidence before the Court was that it appeared that Trust property may have been improperly managed, or that it had been or was in danger of being lost;
- there was a need for someone impartial and independent to step in, in the interests of the Trust and its unit holders; and

- there was no ongoing project, business or goodwill that could be jeopardised by the appointment.

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### 7.3 Court decisions herald dramatic evolution of climate change litigation

*(By Louise Camenzuli and Julia Green, Corrs, Chambers Westgarth)*

*Sharma by her litigation representative Sister Marie Brigid Arthur v Minister for the Environment* [2021] FCA 560 (27 May 2021), Federal Court of Australia, Bromberg J

*Vereniging Milieudefensie v Royal Dutch Shell plc* C/09/571932 / HA ZA 19-379 (26 May 2021), Hague District Court, Netherlands, L Alwin, IAM Kroft and ML Harmsen

#### (a) Summary

Climate change litigation has evolved dramatically with the emergence of significant court judgments from the Federal Court of Australia and Hague District Court, Netherlands. These developments occur in an international context of renewed focus on the Paris Agreement, and preparations for the 26th United Nations Climate Change Conference of the Parties (COP26) in Glasgow in November 2021.

The key takeaways from the decisions are:

- The Federal Court in *Sharma v Minister for the Environment* (*Whitehaven*) agreed with the applicants that, based on the common law of negligence, the Commonwealth Minister for the Environment owes a duty of care to protect young people from the human health impacts of climate change. While the applicants were ultimately unsuccessful in obtaining an injunction against Whitehaven, the Minister needs to make her decision about the project extension taking into account the Court's findings on climate change, and the duty of care. The stage is also set for further challenges to determinations by decision makers on this basis. This has implications for proponents seeking approvals for high emissions projects and in particular, those linked to fossil fuels;
- The decision of the Netherlands Court in *Vereniging Milieudefensie v Royal Dutch Shell plc (Shell)* points to the willingness of courts to impose positive obligations on major emitters to develop corporate policies that align with adopted international climate change agreements, such as the Paris Agreement. Shell has announced in its public statement of 26 May 2021 that it intends to appeal the Court's decision; and
- A successful appeal against a decision of a regulator in Australia, such as the Commonwealth Minister for the Environment, on the grounds of a breach of a duty of care, could well pave the way for Australian litigation akin to the decision in *Shell.* Any such litigation could compel Australian corporations to take active steps to develop corporate policy to reduce emissions (including Scope 1, 2 and 3 emissions).

#### (b) The *Shell* Decision

In *Shell*, the applicants argued that the aggregate greenhouse gas emissions generated by the company via its business operations and products amount to a breach of the standard of care of persons and corporations to protect the human rights of others, specifically the right to life, as set out in the Dutch Civil Code.

The applicants relied upon the Netherlands' commitment to the Paris Agreement targets and the existing body of evidence surrounding the impacts of climate change, to argue that Shell has a human rights obligation to reduce its greenhouse gas emissions in alignment with the goals of the Agreement.

In coming to its decision, the Court posed the following question: is Shell obliged to reduce all scopes of greenhouse gas emissions via its corporate policy? The Court made the following key findings:

- the duty of care in the Dutch Civil Code is to be interpreted in the context of the relevant facts and circumstances. In this scenario, the "best available science on dangerous climate change and how to manage it, and the widespread international consensus that human rights offer protection against the impacts of dangerous climate change and that companies must respect human rights";
- the existential threat posed by climate change is serious;
- enforcing action in alignment with the goals of the Paris Agreement sits within the function of the Court; and
- corporate entities have an obligation to limit and address the human rights impacts incurred via their activities, business relationships and supply chain, from the manufacturing to end-user stages.

In applying the above, the Court held that it could compel Shell to bring its corporate policy into alignment with the Paris Agreement. More specifically, the Court determined that Shell must reduce its net greenhouse gas emissions by 45% by the end of 2030, compared to 2019 levels.

This line of reasoning in *Shell* flows on from the 2019 *Urgenda* Decision. Here, the Supreme Court and Hague Court of Appeal held that the Dutch State has a duty of care to protect the human rights of its citizens, by taking appropriate action to mitigate the existential threat of climate change. This argument was framed in light of the human rights legislation operative in the Netherlands (the Dutch Civil Code), and the projected housing and safety crises that could arise by flooding as a result of sea level rise.

The Court held that the existential threat posed to the current and future citizens of the Netherlands was reasonably foreseeable on the available scientific evidence. Further, the Court could compel the State to implement an action plan to reduce its greenhouse gas emissions by at least 25% by the end of 2020 compared to 1990 levels.

### (c) The *Whitehaven* Decision

Similar arguments were advanced in *Whitehaven* regarding the Vickery/Whitehaven Extension Project. *Whitehaven* concerned an application for approval by the Commonwealth Minister for the Environment (Minister) for the extension and expansion of a coal mine near Gunnedah pursuant to the Environmental Protection and Biodiversity Conservation Act 1999 (Cth) ss. 130(1) and 133 (EPBC Act).

The applicants in the class action, a group of eight Australian children, claimed that in considering the development, the Minister had breached her duty of care to protect Australian children from the reasonably foreseeable harm resulting from climate change incurred by increased greenhouse gas emissions.

*Whitehave* indicates the emergence of an Australian line of precedent akin to that of *Urgenda* and *Shell.* However, the case was pursued under the common law of negligence rather than reliance upon international human rights principles. The Court held that:

- the Minister's prospective approval of the development would have a direct impact in increasing greenhouse gas emissions, creating a nexus between the Minister's conduct and the human health risks experienced by children;
- a reasonable person in the Minister's position would foresee that, in granting the approval, Australian children would be exposed to a real risk of harm due to carbon emission induced climate change, being "mental or physical injury, including ill health or death, as well as damage to property and economic loss"; and
- there is a duty owed by the Minister to Australian children, to protect them from the human health impacts of climate change which may be incurred by the grant of approvals under the EPBC Act.

The reasoning suggests the Minister may need to have more explicit regard to the future wellbeing of Australians, and the prospective climate impacts of proposals, when determining approvals under the EPBC Act. This will more likely apply to "big emitter" developments such as fossil fuel developments. This is particularly poignant in light of the recent review of the EPBC Act, for which the Final Report was released in October 2020. The key message of that report being that:

"Australia's natural environment and iconic places are in an overall state of decline and are under increasing threat. The environment is not sufficiently resilient to withstand current, emerging or future threats, including climate change. The environmental trajectory is currently unsustainable".

**(d) Implications of *Whitehaven***

The finding that a duty of care exists suggests Australian jurisprudence may begin to develop along a similar trajectory to that observed in the Netherlands. On the facts of the *Whitehaven* matter, the Court ultimately rejected the proposition that an injunction to restrain the Minister from granting an EPBC Act approval for the Whitehaven project was necessary. The Court noted that it was not satisfied "that it is probable that the Minister will breach the duty of care in making her decision as to whether or not to approve the Extension Project".

Instead, it was held to be preferable that the grant of any injunctive relief occur only after the Minister had made her decision pursuant to the EPBC Act. However, the Minister has now been left by the Court to make a decision about the project, having been told clearly by the Court that she must take into account the avoidance of personal injury to people, and will know she owes a duty of care to Australian children to protect them from foreseeable harm by her decision.

Likewise, the finding in *Shell* is not set in stone. While Shell is now subject to a positive and immediately binding obligation to reduce its greenhouse gas emissions, the full implications of this remain unclear as the Court found Shell had not yet violated this obligation, in light of its ongoing efforts to develop its emissions policy. Further, Shell announced in its public statement of 26 May 2021 that it intends to appeal the Court's decision.

While decisions such as *Urgenda* and *Shell* may have opened a window for duty of care arguments to be made in Australia, the extent to which this will result in enforceable sanctions against corporate entities remains unclear.

The distinction between *Shell* and *Whitehaven*, the latter being an Australian judgment, is that *Whitehaven,* akin to *Urgenda*, was an appeal against a prospective approval of a regulator (in this case, the Minister for the Environment) and not the entity behind the proposed action. However, a successful appeal against a decision of a regulator in Australia, such as the Minister for the Environment, on the grounds of a breach of a duty of care, could well pave the way for Australian litigation akin to the decision in *Shell*.

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**7.4 Challenges of taking derivative action under ss. 236 and 237 of the Corporations Act 2001**
*(By Isabella Impiazzi, MinterEllison)*

*Pesec v Consolidated Builders Ltd (No 3)* [2021] ACTSC 105, Supreme Court of the Australian Capital Territory, McWilliam AsJ, 28 May 2021.

**(a) Summary**

The plaintiff, Mr Pesec, sought leave from the Court pursuant to ss. 236 and 237 of the Corporations Act 2001 No. 50 (Cth) (Corporations Act) to bring derivative proceedings on behalf of the defendant, Consolidated Builders Ltd (CBL) concerning the issue of shares by CBL to its managing director. Mr Pesec alleged that the share issue was in breach of the statutory requirements and CBL's constitution, the shares were issued at below market value and the directors breached their duties. Section. 237 of the Corporations Act contains five elements which must be satisfied before leave is granted. Three of the elements were in dispute. McWilliam AsJ held the grant of leave would not be in CBL's best interest as the costs of court proceedings would outweigh any benefit gained. Accordingly, the grant of leave was refused.

**(b) Facts**

These proceedings concerned an application by the plaintiff, Mr Pesec, as a member of the defendant, CBL, seeking leave from the Court to bring a derivative action on behalf of CBL. CBL entered an option deed with the managing director, Mr Zivko, which allowed Mr Zivko or his nominee to purchase shares in CBL at a fixed price of $21 per share. CBL issued 150,000 shares to XO 1 Pty Ltd (XO 1) as Mr Zivko's nominee in exchange for $3,150,000 in subscribed capital. Mr Pesec alleged that:

- the shares were issued at below market value;
- member approval was not obtained for the share issue which constituted a breach of s. 208 of the Corporations Act and clause 5 of CBL's constitution;
- each director was "involved" in the breach per s. 209 of the Corporations Act;
- so far as the share issue was to form part of Mr Zivko's remuneration, it was not "reasonable" in accordance with s. 211 of the Corporations Act (which provides an exemption to the requirement for member approval if shares are issued as part of a remuneration package) with respect to CBL's assets and revenue; and
- the directors' conduct breached various statutory and fiduciary duties.

Mr Pesec claimed that CBL suffered loss at the hands of the directors and sought that CBL commence proceedings for relief including declaratory and compensatory relief for contraventions of the Corporations Act and loss of value for the shares, and rescission of the share issue to XO 1.

**(c) Decision**

**(i) Legal principles and elements to be satisfied**

Section 236 of the Corporations Act empowers a member to bring an action on behalf of the company provided that leave is granted by the Court pursuant to s. 237. Section 237 of the Corporations Act contains five elements which must be satisfied before leave is granted:

- it is probable the company will not bring the proceedings itself;
- the applicant is acting in good faith;
- the grant of leave is in the best interests of the company;
- there is a serious question to be tried; and
- the company has been given the requisite notice of the application for leave.

A Court will not lightly grant leave as doing so requires a company to commence proceedings it would otherwise be unwilling to initiate itself. As such, the Court's discretion is limited whereby if all five elements are established, leave must be granted. Conversely, if any element is not established, leave must be refused (*Huang v Wang* [2016] NSWCA 164).

In this instance, the first and fifth criteria were not in dispute. McWilliam AsJ considered the remaining elements in turn.

**(ii) Did Mr Pesec establish there was a serious question to be tried?**

McWilliam AsJ turned first to whether there was a serious question to be tried which was the major element in dispute between the parties. CBL contended that this element should be assessed in light of the practical consequences of granting leave to bring the proposed action. As such, the Court must justify imposing the burden of bringing highly disruptive court proceedings against the entire board of CBL. McWilliam AsJ rejected this submission and held that the wording of s. 237 does not import a requirement for the Court to undertake a balancing exercise or consider the practical consequences to CBL in order to determine whether Mr Pesec's claim was sufficient enough to "justify" the potential detriment to CBL. Rather, the test was whether Mr Pesec could identify the legal or equitable right to be determined at trial based on sufficient material put before the Court (*Ragless v IPA Holdings Pty Ltd (in liq)* [2008] SASC 90; *Vinciguerra v MG Corrosion Consultants Pty Ltd* [2010] FCA 763).

Upon consideration of the evidence setting out the events leading up to the option deed, the terms of the option deed and the assessment of the market value of the shares and financial position of CBL, McWilliam AsJ identified four key areas of dispute:

- whether the option deed was reasonable remuneration pursuant to s. 211;
- the market value of the shares issued to XO 1;
- ratification of the option deed by the members; and
- the "involvement" of the directors.

CBL contended that the share issue was part of Mr Zivko's "reasonable" remuneration and therefore qualified for the exemption from member approval pursuant to s. 211. Mr Pesec submitted that the remuneration was a benefit paid for the performance of a service, but CBL argued that the remuneration included compensation or a bonus. McWilliam AsJ did not consider this issue at length and instead concluded that there were valid, competing arguments about the reasonableness of the share issue which constituted a serious question to be tried.

On the evidence, McWilliam AsJ concluded there were also arguable concerns about the quality and effectiveness of the valuation method used to price the shares issued under the option deed. Additionally, there were uncertainties around the legitimacy of the ratification of the option deed by the other members. External accountants prepared a report that was issued to the members to help them assess whether to approve or ratify the share issue. This report was said to be so flawed it was unreliable. Mr Pesec submitted that the purported ratification was ineffective because the members were ill-informed. Based on the evidence relied upon by Mr Pesec, McWilliam AsJ concluded that there was substance to Mr Pesec's concerns which in turn meant there was a reasonably arguable fact in dispute with regard to the quality of the report.

Mr Pesec also pleaded the directors were "involved" in the contravention of s. 208 of the Corporations Act and had breached their statutory and fiduciary duties. McWilliam AsJ considered there to be sufficient evidence before the Court to establish that Mr Pesec had a case of substance on this point as well.

**(iii) Was Mr Pesec acting in good faith?**

McWilliam AsJ held Mr Pesec had satisfied this element as he was an active shareholder concerned about the apparent favouring of Mr Zivko and the argued inadequate disclosure of the share issue to shareholders. CBL suggested that Mr Pesec had a collateral purpose because proceedings would cause the members of the board to bring cross-claims against each other meaning they would be unable to continue, ultimately resulting in the entire board being replaced. This submission came in light of Mr Pesec's history of criticising and espousing concern for the way the board was running CBL. However, McWilliam AsJ rejected CBL's submission because, even if this was the case, it would not necessarily indicate a lack of good faith (*Maker v Honeysett & Maher Electrical Contractors Pty Ltd* [2005] NSWSC 859).

**(iv) Would the grant of leave be in CBL's best interests?**

Despite success in these two elements, Mr Pesec's case fell down on the final criteria.

Evidence was put forward that other members of CBL were reluctant to support Mr Pesec's complaints. McWilliam AsJ acknowledged this could be due to gaps in the members' knowledge which could be attributable to the flawed report, but considered the absence of support from other shareholders to be relevant to determining whether the derivative action was in the best interests of CBL. On this point, McWilliam AsJ suggested it could be inferred that the shareholders understood the failures of the report and simply did not agree with Mr Pesec, or that, for whatever reason, they did not want CBL to conduct expensive litigation over a benefit paid to its managing director. Weighing these issues, McWilliam AsJ considered that the benefit to CBL by instigating the proposed proceedings was uncertain.

Regarding the alleged contravention of s. 208 of the Corporations Act, McWilliam AsJ stated that, while it was important for companies to comply with the Corporations Act, a finding that CBL contravened s. 208 would only be capable of being made out after outlaying significant legal costs to determine what constitutes "reasonable" remuneration in the circumstances. On this point, it was far from certain that it would be in CBL's interest to litigate its own potential contravention. Further, s. 209 of the Corporations Act provides that the contravention does not affect the validity of transactions connected with it. Therefore, if the option deed is valid despite the contravention, rescission of the resolution approving the option deed would be unlikely since the deed was a contract between CBL and Mr Zivko, and assessing the quantum of compensation for purchasing shares at an undervalue (provided this was established) would be costly.

Finally, McWilliam AsJ held that the costs of the proceedings was a significant factor weighing against the grant of leave. Essentially, the proceedings would be brought to bring the board to account if the directors were found to have breached their duties and to recover compensation from them for the contested share value. The cost of legal fees to revisit what may turn out to be reasonable remuneration for Mr Zivko in the circumstances meant that instigating proceedings may be in CBL's interest generally, but not properly and fully in CBL's best interest on balance.

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**7.5 Voidable transactions and breaches of directors' duties**
*(By Freeman Chen, Herbert Smith Freehills)*

*Baskerville v Crowson* [2021] QSC 118 (27 May 2021), Supreme Court of Queensland, Rafter AJ

**(a) Summary**

In this judgment, the Supreme Court of Queensland outlined the relevant factors and circumstances in determining:

- whether a transaction is voidable in the context of insolvency under s. 588FF of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act); and
- whether the defendant director had breached his duties.

**(b) Facts**

**(i) Relevant entities and the purchase of the Hydco**

Mac Drilling Pty Ltd (Mac Drilling) is a company owned and controlled by Mark Anthony Crowson (Mr Crowson). Its directors are Mr Crowson and Ms Crowson. In 2014, Damien Lagos (Mr Lagos) and Mr Crowson purchased a Hydco 500 drilling rig (the Hydco) for the reduced price of $22,000. The Hydco needed repairs and refurbishment. The company Down to Earth Drilling Pty Ltd (DTED), of which Mr Crowson and Mr Lagos were appointed as directors, was incorporated for the purpose of owning the Hydco. Ownership of the Hydco was transferred to DTED.

**(ii) Damage to the Hydco**

In 2015, the Hydco sustained fire damage where it was stored. Mac Drilling made an insurance claim, which was rejected and contested. Mac Drilling spent a total of $128,254.98 on repairs to the Hydco, and Ms Crowson contributed $32,500.

**(iii) Purchase of the Warman Scout**

In 2017, Mr Lagos acquired another drilling rig, the Warman Scout, in his own name for $25,000. There were different accounts as to what was agreed between Mr Lagos and Mr Crowson on how the rig was to be used. On one hand, Mr Lagos claimed that they agreed that DTED could use the Warman Scout to create revenue and retain enough money in its bank account, with the remainder to be split between Mr Crowson and Mr Lagos. On the other hand, Mr Crowson said that they agreed that he could use the Warman Scout for his own purposes until the money from the insurance claim had come through or the Hydco was sold.

The Warman Scout was used for eight water bore jobs. Five of them were invoiced to Mac Drilling instead of DTED. Additionally, Mr Crowson transferred $4158, proceeds earned by DTED for a job, from DTED to Mac Drilling.

**(iv) The disputed transaction**

On 10 August 2018, Mr Lagos was removed as a director of DTED. On 2 December 2018, Mr Crowson caused DTED to enter into an asset sale agreement and transferred the Hydco to Mac Drilling for $60,000. With the exception of $6,666.25, the remainder was purportedly paid by way of forgiveness of debts DTED owed to Mr Crowson, Ms Crowson and Mac Drilling.

**(v) The proceedings**

On 6 August 2019, the Court ordered that DTED be wound up. In these proceedings, the plaintiffs are DTED and its liquidator. The defendants are Mr Crowson and Mac Drilling. The plaintiffs claimed for:

- the return of the Hydco or damages to the value of it under s. 588FF of the Corporations Act; and
- damages under s. 1317H of the Corporations Act as a result of a breach of directors' duties owed by Mr Crowson to DTED.

**(c) Decision**

**(i) Unreasonable director-related transaction**

The plaintiffs claimed that the asset sale agreement was an unreasonable director-related transaction under s. 588FDA of the Corporations Act, meaning it would be a voidable transaction.

It was accepted that the sale of the Hydco constituted a transfer, and that it was made on behalf of or for the benefit of a director of DTED. The issue turned on whether a reasonable person in DTED's circumstances would have entered into the transaction.

His Honour held that entering into the transaction was detrimental to DTED, and was an unreasonable director-related transaction. A reasonable person in Mr Crowson's position as director would not have entered into the transaction for the following reasons:

- the Hydco was DTED's only realisable asset, and sold at an amount considerably less than fair market value;
- the purported consideration for the sale by way of forgiveness of debt did not constitute valuable consideration - the amounts paid by Mac Drilling and Ms Crowson to repair the Hydco were not loans to DTED; and
- the purpose of the transaction was to defeat DTED creditors.

**(ii) Insolvent transaction**

The plaintiffs also claimed that the sale was an insolvent transaction under s. 588FC of the Corporations Act, meaning it would be a voidable transaction. To establish this, the sale must:

- be an uncommercial transaction under s. 588FB of the Corporations Act - this was established for the same reason the sale was found to be an unreasonable director-related transaction; and
- have been entered into at a time when DTED was insolvent, or caused DTED to become insolvent.

His Honour cited Rangiah J in *Pearce v Gulmohar Pty Ltd* [2017] FCA 661, who outlined the following factors relevant to an assessment of company solvency:

- the likelihood that directors or related companies will lend money or defer debt; and
- "cogent evidence of a degree of commitment and capacity on [the] part of a financier" to provide sufficient financial support.

Because DTED only had one asset which had not generated any income, it was clearly reliant on related party support to remain solvent. The issue turned on whether Mac Drilling interests intended to provide ongoing financial support to DTED.

On the evidence, his Honour concluded that DTED did not have ongoing related party financial support, and was insolvent as at the time of the transaction. Mr Crowson argued that continued financial support was evidenced through the payment of DTED's expenses. However, the payment of expenses totalling $412.00 was deemed insufficient to support such a finding.

**(iii) Breach of directors' duties**

Finally, the plaintiffs claimed that Mr Crowson had breached his duties as a director of DTED by issuing invoices for work done using the Warman Scout from Mac Drilling instead of DTED.

On the facts, there were competing accounts given by Mr Crowson and Mr Lagos as to how they agreed to use the drilling rig. His Honour found Mr Crowson to be an unreliable witness with an implausible case, and accepted Mr Lagos' evidence that the Warman Scout was purchased for DTED to generate income.

His Honour concluded that, by using the Warman Scout for his own purposes, issuing invoices to Mac Drilling, and retaining revenue generated, Mr Crowson had:

- failed to discharge his duties with the appropriate care and diligence;
- failed to act in good faith and in the bests interests of DTED and for a proper purpose; and
- gained an advantage for himself or Mac Drilling at the detriment of DTED.

Mr Crowson was ordered to pay compensation to DTED under s. 1317H of the Corporations Act.

**(iv) Orders**

His Honour ordered that:

- Mac Drilling transfer title of the Hydco to the plaintiffs; and
- Mr Crowson pay the sum of $30,308.67 to the plaintiffs.

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### 7.6 Federal Court finds it appropriate to appoint liquidators of former corporate trustee as receiver and manager over the property of a trust to secure the company's right of indemnification

*(By Brett Cook and Bianca Fernandez, Clayton Utz)*

*Rohrt, in the matter of Rose Guerin and Partners Pty Ltd (in liq) v Princes Square W24NY Pty Ltd (No 2)* [2021] FCA 547 (24 May 2021), Federal Court of Australia, Anderson J

**(a) Summary**

The plaintiffs (the Liquidators) are the joint and several liquidators of Rose Guerin and Partners Pty Ltd (in liquidation) (the Company), having been appointed by a secured creditor as administrators on 19 December 2019, and later as liquidators on 5 February 2020.

The Company was, at 19 December 2019, the trustee of The Rose Guerin and Partners Trust (the Trust). The Company as trustee of the Trust conducted an accountancy practice in New South Wales under the name "RBG" (the Business). The Defendant, Ms Guerin, replaced the Company as trustee of the Trust on 19 December 2019.

The Liquidators sought orders for their appointment as receiver and manager over the property, assets and undertakings of the Trust. The application was made pursuant to s. 57(1) of the Federal Court of Australia Act 1976 No. 156 (Cth) (FCA Act), which provides:

- "The Court may, at any stage of a proceeding on such terms and conditions as the Court thinks fit, appoint a receiver by interlocutory order in any case in which it appears to the Court to be just or convenient so to do"; and
- "The Court ordered that the Liquidators be appointed as receiver and manager. However, the Court also ordered that the Liquidators are not permitted to charge any fees in relation to the liquidation or administration of the Company or in relation to their appointment as receiver or manager, without approval by court order".

**(b) Factual background**

On 19 December 2019, following their appointment as administrators of the Company, one of the liquidators, Mr Rohrt, attended the Company's premises to inform Ms Guerin, the sole director and company secretary, of his appointment and to take control over the assets of the Company. Ms Guerin was not present at that time.

By a deed of variation dated 19 December 2019, the Company was purportedly removed as trustee of the Trust and was replaced by Ms Guerin. The Liquidators disputed the validly of that appointment. However, the Court considered it unnecessary for the purposes of the application that the validity of Ms Guerin's appointment be decided.

On 22 December 2019, the Liquidators gave notice to Ms Guerin, pursuant to s. 509A of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), for the production of the books and records of the Company. On 21 May 2020, the Liquidators obtained orders for a warrant to be issued pursuant to s. 530C of the Corporations Act and that warrant was executed on 27 May 2020. By that warrant, the Liquidators seized various books and records related to the Company and the Business.

**(c) The parties' submissions**

The Liquidators submitted that it was appropriate and/or necessary to appoint the Liquidators as receiver and manager for the following three reasons:

- The Trust was solely a trading trust and the Liquidators needed access to the books and records of the Trust to properly perform their functions in winding up the Company;
- Their appointment as receiver and manager of the Trust was necessary so that the Liquidators could pursue the Company's entitlement to indemnification from the Trust assets; and

- According to the Liquidators, there were "irregularities" associated with the removal of the Company as trustee.

As to the "irregularities" associated with the removal of the Company as trustee, the Liquidators submitted that a receiver and manager can be appointed over trust assets where there has been misconduct, waste or improper disposition of assets or if the trust is in a state of disarray, if it appears that the trust property has been improperly managed, or is in danger of being lost, or if the "circumstances render it just and convenient".

The Liquidators submitted that those criteria had been satisfied for the following reasons:

- There had been misconduct in relation to the management of the Trust, and the Trust was in disarray as a result of the purported removal of the Company as trustee, and the Company's failure to provide books and records to the Liquidators;
- The Trust property had been improperly managed by reason of the purported removal of the Company as trustee, and the failure to provide to the Company proper indemnification as the former trustee of the Trust; and
- There were unresolved issues relating to the winding up of the Company, including a number of claims from creditors of the Business operated by the Trust.

Ms Guerin submitted that the general common ground upon which the Court appoints a receiver and manager is the protection or preservation of property for the benefit of persons who have an interest in it (*Hosking, in the matter of Business Aptitude Pty Ltd (in liquidation)* [2016] FCA 1438 at [17]). Ms Guerin, nonetheless opposed the appointment of a receiver and manager to the Trust assets, for the following reasons:

- Ms Guerin submitted that she had reached "arms-length" agreement with the creditors of the Company as to payment of their claims. Therefore, Ms Guerin submitted that the appointment of a receiver and manager to the corporate trustee was not required for the protection or preservation of property for the benefit of those arms-length creditors;
- Aside from the arms-length creditors, Ms Guerin submitted that the only other creditor was herself, and she did not need the appointment of a receiver and manager for the protection or preservation of property for her benefit;
- Ms Guerin also submitted that one creditor, Adchris Pty Ltd, had no realistic claim and as a result, the appointment of a receiver and manager was not required for the protection or preservation of property for the benefit of that creditor because it had no interest in any property;
- As to the Australian Taxation Office's claim, Ms Guerin submitted that the appointment of a receiver and manager was not required for its benefit, because it could recover from Ms Guerin personally, as she was a director of the Company; and
- Ms Guerin also submitted that the affidavit material evidenced an usual degree of "disharmony, antipathy and distrust" between Mr Rohrt and herself, and that suggested ongoing conflict. On that basis, Ms Guerin submitted that if the Court was minded to appoint a receiver and manager to the Company and the Trust, it should not be the Liquidators.

**(d) Decision**

His Honour outlined the relevant principles as to the appointment of a receiver and manager. His Honour accepted the parties' submission that the general ground upon which the Court appoints a receiver is the protection or preservation of property for the benefit of persons who have an interest in it (citing *Hosking*).

His Honour also noted, "where the trustee is removed and replaced, the outgoing trustee retains a right of indemnity from the trust assets, secured by an equitable charge over them, for its liabilities incurred by reason of acting as trustee" (*In the matter of Stansfield DIY Wealth Pty Ltd (in liq)* [2014] NSWSC 1484) and that it is well-established that a "receiver and manager can be appointed over trust property to secure the trustee's right of indemnity out of the assets of the trust" (*SMP Consolidated Pty Ltd (in liquidation) v Posmot Pty limited* [2014] FCA 1382).

His Honour acknowledged that a liquidator's essential functions are to identify, take possession of and realise the company's assets, to investigate and determine claims against the company and apply the assets to the satisfaction of those claims (citing *Commissioner of Taxation v Iannuzzi (No 2)* [2019] FCA 1818).

His Honour concluded the Liquidators should be appointed as receiver and manager to secure the Company's right to be indemnified out of the Trust assets for the following reasons.

First, it was apparent that one of the main assets of the Trust was income generated by the Business. Second, it was apparent that the Liquidators did not know the current state of the Business and while they had been provided with a great deal of data relating to the Company, some accounting records concerning the Trust or the Business had not been provided. His Honour accepted Mr Rohrt's evidence that the Liquidators were not presently in a position to accurately assess the extent of the assets of the Trust or Business, or to secure the Company's right of indemnification out of the Trust assets.

Third, it was apparent that the defendant had continued to act as trustee of the Trust and, in that capacity, carry on the Business. In those circumstances, his Honour said it was possible for Ms Guerin to dissipate the assets of the Business and, in doing so, imperil the Company's right to be indemnified out of the Trust assets. Lastly, his Honour was not satisfied that any disqualifying conflict of interest on the part of the Liquidators had been established.

Notwithstanding his Honour's finding that it was appropriate to appoint the Liquidators as receiver and manager, his Honour made an order that, without approval by court order, the Liquidators were not to charge any fees in relation to the liquidation or administration of the Company or in relation to their appointment as receiver and manager.

Having reviewed the evidence, his Honour had concerns about the scale of the Liquidators' fees to date. His Honour noted that the secured creditor of the Company submitted a proof in the order of $300,000 and the Liquidators' fees and disbursements were in excess of $550,000. His Honour expressed concern that the fees charged were "totally disproportionate to the complexity of this proceeding and the scope of work that has been completed".

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### 7.7 Does a contract of sale fall within the definition of "financial records" under s. 9 of the Corporations Act 2001?

*(By Jessie Li, DLA Piper)*

*Re ICRA Rolleston Pty Ltd* [2021] QSC 98 (18 May 2021), Supreme Court of Queensland, Flanagan J

**(a) Summary**

This case concerns an application for an order made under s. 1303 of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) compelling the Respondents to make available a contract of sale for inspection and copying. The Applicant's argument was that the Respondents had contravened s. 421(2) of the Corporations Act because the Applicant was entitled to inspect "financial records". The question before the Court was whether a contract for sale fell within the meaning of "financial records" for the purposes of the Corporations Act.

**(b) Facts**

ICRA Rolleston Pty Ltd (the Company), Rolleston Coal Holdings Pty Ltd and Sumisho Coal Australia Pty Ltd are parties to a joint venture in respect of a coal mine located near Rolleston, Queensland.

On 8 December 2020, Rolleston Coal Holdings Pty Ltd, as a secured creditor of the Company, appointed the Respondents as receivers and managers of the Company pursuant to its right under a charge. On 10 December 2020, the Applicant, who is the sole director, employee and creditor of the Company, appointed an administrator in accordance with s. 436A of the Corporations Act on the basis that the Company was insolvent or likely to become insolvent at a future time.

In February 2021, the Respondents entered into a contract to sell the Company's 12.5% interest in the joint venture. The Applicant, through his solicitors, sought to request the contract of sale from the Respondents on the basis of two provisions in the Corporations Act - s. 421(2) which provides that any director, creditor or member of a corporation may "inspect records kept by a managing controller of property of the corporation for the purposes of paragraph (1)(d)" and s. 421(1)(d) which requires receivers and managers, such as the Respondents, to "keep such financial records as correctly record and explain all transactions that the managing controller enters into as the managing controller."

The Respondents refused to make available for inspection the contract for sale as they argued it was not a "financial record".

**(c) Decision**

The Applicant would be entitled to inspect the contract of sale if it fell within the definition of "financial record". His Honour considered the definition of "financial records" as set out in s. 9 of the Corporations Act and separated the question into three sub-issues:

- Was the contract of sale a document of prime entry?;
- Was the contract of sale a "working paper or other document needed to explain (i) the methods by which financial statements are made up; and (ii) adjustments to be made in preparing financial statements"?; and
- As the definition of "financial records" in s. 9 is an inclusive definition, was the contract of sale a financial record within the ordinary meaning of that term?.

**(i) Was the contract of sale a "document of prime entry"?**

The first issue for consideration was whether the contract was a "document of prime entry" given that the s. 9 definition in the Corporations Act defines "financial records" as including "documents of prime entry". His Honour determined that a "document of prime entry" is to be ordinarily understood as those documents that form an accounting record of when a transaction is first entered into a company's books of account. Flanagan J further noted that documents of prime entry form the original source material for accounting entries made into the cash book, purchase ledger, and fixed asset register. In this regard, the contract of sale was a record of the financial effect of the transaction and could not be construed as a document of prime entry.

**(ii) Was the contract of sale a working paper or other document needed to explain the methods by which financial statements are made up and adjustments to be made in preparing financial statements?**

The second issue was whether the contract of sale was a document that falls within paragraph (c) of the definition of "financial records" because it constituted a working paper or other document needed to explain the methods by which financial statements are made up and adjustments are to be made in preparing financial statements. The Applicant relied on the judgment in *Boulos v Carter* [2005] NSWSC 891 to argue that because the contract of sale evidenced a transaction undertaken by the respondents as receivers, it also comprised a financial record of the kind captured under s. 421(1)(d). Flanagan J rejected the Applicant's reliance for two reasons. First, the orders sought in that case were useless as the documents had been voluntarily provided. Second, his Honour stated that there was a clear distinction between source documents, which evidence a transaction, and financial records.

**(iii) Was the contract of sale a "financial record" within the ordinary meaning of that term?**

Finally, Flanagan J rejected the Applicant's submission that the contract of sale should fall within the ordinary meaning of "financial records". The Applicant submitted that similarly to how an invoice or receipt of the Company constitutes a "financial record", a contract by which a company's principal asset has been sold should likewise be construed as a financial record. His Honour stated that, for the purposes of the Corporations Act, financial records should comprise documents used to compile financial statements and represent source materials in their preparation. His Honour considered that this construction was supported by s. 286 of the Corporations Act, which states that financial records kept by a company in conformity with that section must "correctly record and explain its transactions and financial position and performance" and "enable true and fair financial statements to be prepared and audited". In this respect, a contract of sale was a document that evidenced the transaction itself and not a financial record within the ordinary meaning of that term.

**(d) Conclusion**

On these three bases, his Honour rejected the application and determined that the contract for sale was not a "financial record" for the purposes of the Corporations Act.

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**7.8 Unconscionable conduct case results in $50 million penalty under Australian Consumer Law**
*(By Jack Heithersay, Jessica Apel and Alana Perna, Ashurst)*

*Australian Competition and Consumer Commission v Telstra Corporation Limited* [2021] FCA 502 (13 May 2021), Federal Court of Australia, Mortimer J

**(a) Summary**

In this case, the Federal Court of Australia ordered Telstra to pay a $50 million penalty for engaging in unconscionable conduct in breach of the Australian Consumer Law. On the basis of

Telstra's admissions in the parties' agreed statement of facts and joint submissions, the Federal Court found that Telstra:

- engaged in unconscionable conduct in breach of the Australian Consumer Law when staff at licensed Telstra-branded stores sold post-paid mobile contracts to Indigenous consumers on its behalf; and
- failed to take steps to implement processes to protect against, or remediate the effects of, the conduct.

The Court found that while Telstra did not authorise this conduct, the staff's conduct was nonetheless properly attributable to Telstra.

Before these proceedings began, Telstra had already committed to remediate consumers, improve its existing compliance program, review and expand its Indigenous Hotline, and enhance its digital literacy program in remote areas.

**(b) Facts**

From January 2016 to August 2018, staff at Telstra licensed stores located in Arndale in South Australia, Broome in Western Australia, and Casuarina, Palmerston and Alice Springs in the Northern Territory (the Relevant Stores) sold Telstra post-paid mobile contracts to 108 Indigenous consumers who did not speak English as a first language, had difficulties with literacy and financial concepts, and/or were unemployed and relied on government benefits as a primary source of income. Telstra was the only service provider in many of the remote communities in which the Relevant Stores were located, leaving the customers with little or no choice but to use the Telstra stores.

The Court found that staff at the Relevant Stores engaged in a range of exploitative practices on Telstra's behalf, including:

- misrepresenting or failing to adequately explain the nature and potential costs of products and services, including by falsely representing that consumers were receiving mobile devices for "free";
- manipulating credit assessments, so as to be able to enter into post-paid contracts with consumers who would otherwise have failed Telstra's credit assessment process; and
- exploiting the consumers' lack of understanding of the terms of the transaction, or taking advantage of the cultural propensity for Indigenous Australians to express agreement as a means of avoiding conflict.

While Telstra did not direct, approve or authorise the conduct of the staff at the Relevant Stores, the conduct was taken to have been engaged in on behalf of Telstra pursuant to s. 139B(2) of the Competition and Consumer Act 2010 1974 No. 51 (Cth).

Furthermore, the Court found that from at least December 2016 Telstra became increasingly aware of certain aspects of the conduct and failed to implement the necessary controls to guard against the risk of this conduct or remediate its effects.

The Court found that as a result of Telstra's conduct, the Indigenous consumers were exposed to serious financial hardship and distress, including by incurring significant debts to Telstra (ranging from $1,600 to almost $20,000). Some of the consumers were also referred to debt collectors.

The Australian Competition and Consumer Commission (ACCC) commenced proceedings against Telstra in November 2020, alleging that the conduct of the staff at the Relevant Stores contravened s. 21 of the Australian Consumer Law.

**(c) Decision**

**(i) Penalties for conduct**

On the basis of Telstra's admissions in the parties' agreed statement of facts and joint submissions, the Court ordered Telstra to pay a pecuniary penalty of $50 million. This penalty was the amount that the ACCC and Telstra had submitted was appropriate for the conduct, having regard to the relevant penalty factors and the applicable statutory maximum penalty of $130.9 million. This is the second highest penalty ever ordered for a breach of the *Australian Consumer Law*.

Telstra received consideration for the fulsomeness and timeliness of its co-operation. However, the Court considered that Telstra's:

- approach to complaints about the sales practices;
- delay in accepting responsibility for the conduct; and
- debt recovery practices,

were aggravating factors. Therefore, the Court's penalty emphasised the need to send a strong and clear message to those who might be tempted to take advantage of vulnerable consumers, and who are slow to remediate their conduct out of self-interest.

**(ii) Non-pecuniary requirements**

In addition to the pecuniary penalty of $50 million ordered by the Court, the ACCC also accepted a court enforceable undertaking from Telstra requiring it to:

- provide remediation to affected consumers;
- improve its existing compliance program for competition and consumer law breaches; and
- undertake other commitments in relation to consumers in remote areas, including reviewing and expanding its Indigenous hotline and enhancing its digital literacy program.

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**7.9 Director and de facto director, who were not legally represented, found liable for insolvent trading under s. 588G of the Corporations Act 2001 for taxation liabilities**
*(By Simon Hong, King & Wood Mallesons)*

*Walsh Engineering Services Pty Ltd (in liq) v Walsh Group (Aust) Pty Ltd* [2021] VSC 206 (10 May 2021), Supreme Court of Victoria, Hetyey AsJ

**(a) Summary**

Mr and Mrs Walsh, as de facto director and director respectively, each contravened s. 588G of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) by failing to prevent Walsh Engineering Services Pty Ltd (the Company) from incurring an Australian Taxation Office (ATO) debt when the Company was insolvent, where there were reasonable grounds to suspect insolvency, and no statutory defences were made out. Because of the contravention of s. 588G of the Corporations Act, the directors were liable to compensate the Company in accordance with s. 588M of the Corporations Act. The Court found that the plaintiffs (the Company and its liquidators) were entitled to judgment against each of Mr and Mrs Walsh for $484,829.54 together with interest.

Separately, the Court found there was an inter-company loan between the Company and Walsh Group (Aust) Pty Ltd ("Walsh Group") and that the Company was entitled to recover $238,604.16, together with interest from the Walsh Group.

**(b) Facts**

Between 31 January 2017 and 21 November 2017 (the Relevant Period), the Company incurred debts of $484,829.54 to the ATO relating to PAYG withholding, GST and associated general interest charges.

The Company was placed into voluntary administration on 21 November 2017 and subsequently placed into liquidation following a meeting of creditors held on 6 July 2018 after failing to comply with a Deed of Company Arrangement.

Mr Walsh was a director between 17 September 2014 and 24 August 2015, however he ran the Company subsequent to this period and during the Relevant Period. Mrs Walsh was a formally appointed director during the Relevant Period.

The plaintiffs filed their originating process on 25 October 2019. The defendants' solicitors filed notices of ceasing to act on 12 May 2020. The court allowed the Walsh Group to be represented other than by a lawyer at trial, and for Mr Walsh to make submissions and refer to evidence on the company's behalf. None of the defendants were therefore legally represented at the trial on 14 December 2020.

**(c) Decision**

**(i) Section 588G**

A director contravenes s. 588G of the Corporations Act if they fail to prevent the company from incurring a debt if:

- they are a director when the company incurs the debt;
- the company is insolvent (or becomes insolvent because of that debt);
- there are reasonable grounds for suspecting the company is or would become insolvent; and
- the director is aware that there are grounds for so suspecting or a reasonable person would be so aware.

**(ii) Mr and Mrs Walsh were directors**

Mrs Walsh was a formally appointed director during the Relevant Period. The Court considered, among other things, that Mr Walsh confirmed that he ran the Company, that Mrs Walsh had no involvement in its operations, and that at all material times Mr Walsh was acting as a director of the Company and was its decision-maker. The court therefore found that Mr Walsh was a de facto director under s. 9(b)(i) of the Corporations Act.

**(iii) The Company incurred a debt**

The Company incurred a liability of $484,829.54 to the ATO during the Relevant Period relating to PAYG withholding, GST and associated general interest charges. Per *Hawkins v Bank of China* (1992) 26 NSWLR 562, a debt is incurred when a company "renders itself liable to pay a sum of money in the future as a debt". This includes statute imposed debt. The Court therefore determined that the taxation liabilities were considered debts for the purpose of s. 588G of the Corporations Act.

**(iv) This debt was incurred while insolvent**

Section 95A of the Corporations Act states that a company that cannot pay its debts as and when they become due and payable is insolvent. The Court noted this is a cash flow test and took into account that the Company was amassing increasing liabilities to the ATO and repeatedly failed to comply with agreed payment arrangements. By 31 January 2017, the Company had lost its key employee and two critical customers. Further, the Company's impaired financial performance was reflected in the 30 June 2017 internal accounts which disclosed a significant loss for that financial year. The Court therefore found that the Company was cash flow insolvent from at least 31 January 2017, and the debt was incurred while insolvent.

**(v) There were reasonable grounds to suspect insolvency**

The Court stated that the test for reasonable grounds for suspecting that a company is insolvent, or would so become insolvent, is an objective test which must go beyond mere wondering (*Hall v Poolman* (2007) 215 FLR 243). The Court found there were reasonable grounds for suspecting insolvency because the Company:

- was unable to comply with five consecutive ATO payment arrangements during the year prior to the Relevant Period, whilst its taxation liability continued to exponentially increase;
- did not comply with an ATO issued statutory demand on 3 April 2017; and
- experienced an immediate, noticeable and significant contraction of core business in January 2017.

**(vi) A reasonable person would be aware of grounds to suspect insolvency**

The Court found that a reasonable person in the position of a director of the Company would have been aware there were reasonable grounds for suspecting insolvency because they would have been aware of the escalating taxation liability, the repeated inability of the Company to meet ATO payment arrangements, the failure of the Company to comply with the ATO's statutory demand and the significant loss of business experienced by the Company in January 2017.

**(vii) Defences**

The Court noted that it appeared Mr and Mrs Walsh intended to rely on the defence in s. 588H(2) of the Corporations Act. This requires proving that at the time the debt was incurred, they had reasonable grounds to expect, and did expect, that the Company was solvent and would remain solvent even if it incurred that debt. Such an expectation of solvency involves a higher degree of satisfaction or certainty than mere hope or suspicion. Given the reasonable grounds for suspecting insolvency, the Court did not accept Mr and Mrs Walsh had an expectation of the Company's solvency that was reasonably based.

The Court noted that s. 588H(3) of the Corporations Act could not be relied upon because the relevant expert report was found to be unreliable and did not contain adequate information to satisfy directors of the Company about its solvency.

The Court noted that Mrs Walsh sought to rely upon s. 588H(4) of the Corporations Act. This defence requires proving non-participation in the management of the company due to illness or some other good reason. The Court found the medical evidence relied upon by Mrs Walsh was insufficient to establish this defence. The Court found that Mrs Walsh conducted herself in a manner consistent with being a director and participated in the management of the Company. Mrs Walsh signed the Company's financial statements for the year ended 30 June 2016, and upon apparently discovering that she was a director, she did not resign but instead appointed voluntary administrators over the Company and signed a Report as to Affairs on behalf of the Company on 21 November 2017. Further, Mrs Walsh had given evidence that she was a beauty therapist who runs her own company. The Court observed that her medical conditions had apparently not prevented her from undertaking the management of that business, and that the medical evidence relied upon by Mrs Walsh was insufficient. Therefore the Court found that Mrs Walsh was unable to rely upon this defence.

**(viii) Debt claim**

The Court found there was an inter-company loan between the Company and the Walsh Group. The Company was entitled to recover $238,604.16, together with interest.

**(ix) Conclusion**

The Court found Mr and Mrs Walsh each contravened s. 588G and should pay the Company $484,829.54, which is a debt pursuant to s. 588M, together with interest. The plaintiffs were also entitled to recover from the Walsh Group the sum of $238,604.16, by way of a claim in debt, together with interest.

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## 7.10 Just inn time: The impact of COVID-19 on the sale of a hotel

*(By Julie Wong, Charis Chan, Samy Mansour and Andrew Steele, Clayton Utz)*

*Dyco Hotels Pty Ltd v Laundy Hotels (Quarry) Pty Ltd* [2021] NSWSC 504 (10 May 2021), Supreme Court of New South Wales, Darke J

**(a) Summary**

In a pandemic world, parties to a transaction should pay particular attention to the terms of sale that govern the pre-completion period, and should be aware that courts will interpret those provisions in a commercially relevant way even if the usual exceptions to pre-completion conduct are not expressly contained in the agreement, or the nature of the business changes.

When the pandemic hit our shores, it was followed by a flurry of public health orders which significantly affected businesses. At the time, many flagged the possible challenges for commercial contracts and transactions, some of which are now being played out in the courts. The recent NSW Supreme Court decision of *Dyco Hotels Pty Ltd v Laundy Hotels (Quarry) Pty Ltd* demonstrates that even when the pandemic impacts the conduct or nature of a business, it may not be sufficient to result in a breach of a seller's pre-completion covenants or frustrate the relevant agreement.

**(b) Facts**

On 31 January 2020, Dyco Hotels Pty Ltd (the Purchaser) entered into a contract with Laundy Hotels (Quarry) Pty Ltd (the Vendor) for the sale of a freehold hotel property in Pyrmont known as The Quarrymans Hotel, along with its associated hotel licence, gaming machine entitlements and hotel business. Settlement was due to occur at the end of March 2020.

The sale contract contained various standard obligations that were applicable between the date of signing and settlement, including clause 50.1, which required the Vendor to "carry on the Business in the usual and ordinary course as regards its nature, scope and manner".

On 23 March 2020, the NSW Government's Public Health (COVID-19 Places of Social Gathering) Order 2020 commenced, which forced the closure of all licensed premises including pubs and hotels except for the purpose of providing takeaway to customers off-premises or those using the hotel for accommodation. The Vendor responded by closing its doors and attempting to maximise sales by remaining in operation so far as the regulations allowed, including through implementing a takeaway food service.

In response, the Purchaser argued that the contract for sale had been frustrated, or alternatively that the Vendor breached the contract as it was not able to comply with clause 50.1.

**(c) Decision**

**Key issue 1: Conduct of carrying on business between exchange and completion, and the parties' understanding**

A key question for the Court was to what extent, if at all, cl. 50.1 obliged the Vendor to carry on the business in a manner contrary to the public health orders issued after the contract was made. This, it said, turned on what a reasonable business person would have understood the contractual terms to mean, which would require consideration of the language used by the parties, the surrounding circumstances known to them and the commercial purpose or objects to be secured by the contract. The Court held that:

- the parties were both experienced in the operation of hotels in Sydney and so could be taken to have knowledge of the nature of the legal and regulatory environment within which hotels operate, including extensive and detailed legislative prescription and regulatory oversight - for example, the right to cancel or suspend licences, impose various penalties and interfere with hotel operations;
- on a true construction of the contract, the relevant clause did not oblige the Vendor to carry on the business in a manner contrary to the public health orders and the law; and
- as a result, the obligation was to carry on the business in the usual and ordinary course as far as it remained possible to do so in accordance with the law.

The Court noted that doing otherwise (that is, breaking the law) would place the future operation of the business pursuant to the hotel licence in some jeopardy, and diminish the goodwill of the business.

Therefore, it found that the Vendor did not breach its obligation to carry on the business in the usual manner.

**Key issue 2: Potential frustration of the contract**

In the alternative, the Purchaser alleged that the contract had been frustrated as the public health orders fundamentally changed the nature of the hotel business, and therefore the deposit should be returned.

This required the Court to consider whether these unexpected events gave rise to a fundamental commercial difference between the actual and contemplated performance of the contract, or a fundamentally different situation, such that it would not be just to hold the parties bound to the contract. Relevant considerations included the terms of the contract, the nature of the contract and any relevant surrounding circumstances.

In this case, the Court said that all of the components of the sale and purchase transaction remained transferable. Notably, the essential nature or purpose of the contract was a sale and transfer of particular assets for an agreed price, which could still be transferred (even if there was a temporary alteration in the nature of trading during the period between signing and settlement). The Court agreed with the Vendor that the obligations to carry on the business must not be regarded as of cardinal significance; rather, they were ancillary to the principal promises to sell and transfer the hotel assets and pay the agreed price. The Court also noted that the Vendor had given no warranties guaranteeing the future financial performance of the business, and that a reduction in value is a type of risk the Purchaser was apparently prepared to take.

The Court therefore held that the contract had not been frustrated and the parties remained bound by the contract. The Vendor was entitled to retain the deposit and received $900,000 in damages for loss of bargain.

**(d) What this means for transactions in the current or post-pandemic world**

Although brought on by an unprecedented once-in-a-century pandemic, the circumstances of this case:

- highlight the high watermark to prove frustration of an agreement; and
- remind parties of the need when drafting a contract to contemplate a reasonable range of scenarios that may arise in the pre-completion period. For example:
    - a seller can argue for pre-completion conduct of business covenants to include carve-outs permitting it to take any action to the extent required by law or a government authority, or reasonably required to respond to an emergency, including to protect the health and safety of any person; and
    - a buyer, if they are concerned about the need to walk away from a transaction in the event that the nature of the business changes in the pre-completion period, can consider negotiating material adverse change termination rights (being careful to consider whether or not known events should prevent the termination right from being triggered).

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**7.11 Full Federal Court abolishes peak indebtedness rule and provides guidance on continuing business relationships**
*(By Monica La Macchia, King & Wood Mallesons)*

*Badenoch Integrated Logging Pty Ltd v Bryant, in the matter of Gunns Limited (in liq) (receivers and managers appointed)* [2021] FCAFC 64 (10 May 2021), Full Court of the Federal Court of Australia, Middleton, Charlesworth and Jackson JJ

**(a) Summary**

In this case the Full Federal Court abolished the peak indebtedness rule in Australia. This means that liquidators can no longer apply the peak indebtedness rule in unfair preference claims involving running accounts.

**(b) Facts**

Gunns Limited (Gunns) was a timber business placed into voluntary administration in September 2012, followed by liquidation in March 2013. Badenoch Integrated Logging Pty Ltd (Badenoch) provided logging and transport services to Gunns. Badenoch received 11 payments from Gunns during the relation-back period, being the six-month period before liquidators were appointed. The liquidators argued that the 11 payments were unfair preferences liable to be set aside as voidable transactions pursuant to s. 588FE of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act).

Generally, liquidators may be able to claw back payments as unfair preferences where they are made to a creditor in respect of a debt in the six months prior to the debtor entering liquidation, if they result in the creditor receiving more than it would in a liquidation. Badenoch relied on the "running account defence" to avoid this occurring. Whilst not strictly a defence, s. 588FA of the Corporations Act provides that if a transaction is part of a continuing business relationship between the debtor and creditor and in the course of that relationship, the level of the debtor's net indebtedness to the creditor increases and decreases as part of a series of transactions, then that series of transactions will be viewed as a single transaction. The ultimate effect of the single transaction is then a consideration when determining whether the creditor received an unfair preference.

**(c) Decision**

**(i) Court found a continuing business relationship**

The Court held there was a continuing business relationship between Gunns and Badenoch, as Badenoch provided regular services to Gunns and received payment for those services. As such, Gunns' net level of indebtedness to Badenoch increased and reduced from time to time because of the transactions. This meant that there was a running account between Gunns and Badenoch, in accordance with s. 588FA of the Corporations Act.

**(ii) When a preference will be established**

The Court confirmed the principle from *Airservices Australia v Ferrier* (1996) 185 CLR 483 that there will be a preference if the sole purpose of a creditor's actions is to recover past indebtedness in priority to other creditors. However, if the purpose of the payment is to induce the creditor to provide further goods or services and also to discharge an existing indebtedness, then the Court will look to the ultimate effect of the transaction.

The ultimate effect is determined by reference to the rationale of s. 588FA(3) of the Corporations Act, which holds that payments to induce creditors to provide further goods or services do not cause disadvantage to the general body of creditors unless the total payments made exceed the total value of the goods or services acquired.

**(iii) Court abolished the peak indebtedness rule**

After a continuous business relationship is established, it is necessary to identify the start and end date of that relationship to determine the net result of the transactions. The liquidators sought to apply the peak indebtedness rule to determine the value of the preference claim, as it would allow them to choose any point in time during the continuing business relationship within the relation-back period. This results in the liquidators choosing the point of peak indebtedness, so that a maximum net result is available when claiming the preference.

However, the Court rejected the liquidators' argument by abolishing the peak indebtedness rule and holding that past authorities approving it were wrongly decided, as:

- the language of s. 588FA(3) points clearly against applying the peak indebtedness rule;
- the peak indebtedness rule cannot be reconciled with the doctrine of ultimate effect, as it holds that creditors are not disadvantaged by payments made to induce creditors to supply services of equal or greater value; and
- the abolition of the peak indebtedness rule is consistent with the purpose of Part 5.7B of the Corporations Act, which is to do fairness between unsecured creditors.



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