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| **1. Recent Corporate Law and Corporate Governance Developments** |
| **1.1. High Court rules that the privilege against exposure to a penalty applies to Corporations Act civil penalties**  On 22 April 2004 the High Court of Australia ruled that the privilege against exposure to a penalty applies to proceedings brought under the civil penalty regime in the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). In so doing, the High court upheld the appeal of Jodee Rich and Mark Silbermann in an action brought against them by the Australian Securities and Investments Commission and overturned the decision of the New South Wales Court of Appeal. The decision of the High Court means that Rich and Silbermann will not be required to give discovery and file witness statements until the conclusion of evidence by ASIC’s witnesses during its civil penalty proceedings. These proceedings are scheduled to commence on 5 July 2004 before Justice Austin of the New South Wales Supreme Court.  The background to the appeal is that in December 2001, ASIC commenced civil penalty proceedings in the Supreme Court of New South Wales against Rich, Silbermann and two other former directors of One.Tel, seeking orders that each of the defendants be disqualified from managing or being a director of any company for such period as the court thinks fit. ASIC is also seeking compensation of $ 93 million from the defendants, being the reduction in the value of One.Tel over a period of approximately eight weeks during which time One.Tel continued to trade because of the alleged failure of the defendants to properly discharge their responsibilities.  ASIC obtained an order in its Supreme Court proceedings that the defendants are required to give discovery and file witness statements prior to the commencement of the proceedings. This order was appealed by Rich and Silbermann, initially to the New South Wales Court of Appeal and then to the High Court, which overturned the order.  The High Court has not yet handed down its reasons. The appeal was heard on 22 April 2004 and on that same day the High Court issued its decision and said that its reasons would follow at a later date. The transcript of the appeal is available on the website of the High Court at [http://www.hcourt.gov.au](http://www.hcourt.gov.au/" \t "_new)   The issue before the High Court (and before the lower courts) was whether the appellants are entitled to resist the orders for discovery and for the filing of witness statements on the basis of the privilege against self-exposure to a penalty. The lower courts concluded that the fact that disqualification orders were a principal component of the relief sought by ASIC did not make it appropriate to classify the proceedings as proceedings for the imposition of a penalty for the purpose of the privilege invoked by the appellants. The courts relied on case law which characterised orders such as disqualification orders as protective rather than punitive in nature.   The decision of the New South Wales Court of Appeal was discussed in the December 2003 issue of this bulletin (Bulletin No 76). The decision of the High Court will be the subject of further analysis in this bulletin when the High Court publishes its reasons.  **1.2 Ernst & Young found to breach auditor independence rules**  On 19 April 2004 the United States Securities and Exchange Commission announced that an Administrative Law Judge has issued an Initial Decision finding that Ernst &  Young LLP (Ernst & Young) was not independent when it  audited the  financial  statements of PeopleSoft Inc.  (PeopleSoft)  for fiscal years 1994  through 1999.    The independence violations occurred while Ernst & Young was PeopleSoft's auditor.  Ernst & Young held a PeopleSoft license, which made possible a software product for which Ernst & Young paid  royalties to PeopleSoft, and Ernst & Young worked with PeopleSoft to obtain contracts to implement PeopleSoft software.       The judge concluded that Ernst & Young's conduct violated Rule 2-02 of securities and Exchange Commission's (Commission) Regulation S-X, caused PeopleSoft to violate Sections 7(a) and 10(a) of the Securities Act of 1933, Sections 13(a) and 14(a) of the Securities Exchange Act of 1934 (Exchange Act), Rules 13a-1 and 14a-3, and Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice.  The Initial Decision orders Ernst & Young to:           cease and desist from violating  and  causing violations of the  statutory  provisions  cited above;            disgorge audit fees of US $1,686,500 and prejudgment  interest; and            retain an independent consultant to review its procedures  and practices   on  auditor  independence  in  connection  with   business relationships  with audit clients.  The Initial Decision also suspends Ernst & Young from accepting audit engagements for new Commission registrants for  six months.  **1.3 Code of Standard Practices aims to restore confidence in credit rating system**  In a move designed to restore confidence in the credit rating process, three prominent global treasury and corporate finance associations announced on 14 April 2004 the release of an Exposure Draft of a "[Code of Standard Practices for Participants in the Credit Rating Process](http://www.afponline.org/pub/pdf/code_std_practices.pdf" \t "_new)." The Code of Standard Practices is designed to restore confidence among issuers, credit rating agencies, investors and the regulators who oversee the credit rating process by creating enhanced transparency, protecting non-public information, guarding against conflicts of interest, and improving communications with market participants.  The Association for Financial Professionals (AFP), an organization of 14,000 corporate finance and treasury professionals in the United States, along with the United Kingdom's Association of Corporate Treasurers (ACT) and France's Association Française des Trésoriers d'Entreprise (AFTE), together took the initiative to develop the Code of Standard Practices for participants in the credit rating process. The three associations undertaking this effort are each leaders in their geographic regions and collectively they represent more than 18,500 corporate treasury and finance professionals. The Code of Standard Practices is further supported by the International Group of Treasury Associations (IGTA) and the Euro Associations of Corporate Treasurers (EACT).  The Associations are soliciting comments from interested parties through 31 May 2004 on the Exposure Draft and regarding the appropriate manner in which to incorporate the final Code into the credit rating process.  Concerns about the credibility and reliability of credit rating agencies and the credit rating process have heightened during the past several years due to the unforeseen collapse of Parmalat, Enron, WorldCom, and other companies. These concerns prompted the United States Securities and Exchange Commission (SEC) to conduct hearings in November 2002 and issue a Concept Release in June 2003 on rating agencies and the use of credit ratings under Federal securities laws. The G7, Financial Stability Forum, and European Parliament are also looking into ways to regulate rating agencies, yet up to now, these concerns have not materialized in any specific action.  The Code of Standard Practices for participants in the credit rating process is intended to improve investor and issuer confidence in the credit rating agencies and the judgments they promulgate in their reports. The Code includes recommendations for regulators, credit rating agencies and issuers of debt. The Rating Agency Code of Standard Practices includes recommendations to improve the transparency of the rating process, protect non-public information that is provided to credit rating agencies, protect against conflicts of interest, address the issue of unsolicited ratings, and improve communication with issuers and other market participants.  Regulatory recommendations focus on the credibility and reliability of ratings, transparency in the rating agency recognition process and improving ongoing regulatory oversight of approved rating agencies. Regulatory recommendations also include removing barriers to competition in the credit rating agency marketplace.  Recognizing that the credibility and reliability of credit ratings is heavily dependent on issuers providing accurate and adequate information to the credit ratings agencies, the Issuer Code of Standard Practices outlines issuer obligations in the credit rating process. These obligations are intended to improve the quality of the information available to the credit rating agencies during the initial rating process and on an ongoing basis, and to ensure that issuers respond appropriately to communications received from credit rating agencies.  The Exposure Draft of the [Code of Standard Practices for Participants in the Credit Rating Process](http://www.afponline.org/pub/pdf/code_std_practices.pdf) is available at [www.AFPonline.org](http://www.afponline.org/index.html" \t "_new), [www.treasurers.org](http://www.treasurers.org" \t "_new), [www.afte.com](http://www.afte.com" \t "_new).  **1.4 New Zealand Insolvency Law Reform Bill released**  On 14 April 2004 the New Zealand Commerce Minister Margaret Wilson released the draft Insolvency Law Reform Bill for public consultation.   The Bill introduces a voluntary administration procedure for companies that can be rehabilitated. This will bring New Zealand into line with other OECD countries. The procedure is closely modelled on Australia's voluntary administration regime, making it easier to conduct business rehabilitation involving trans-Tasman businesses.  The Bill also introduces a new no-asset procedure. This reflects a concern that some of the more punitive restrictions of bankruptcy are not appropriate for individuals that have few or no assets and may have become insolvent through no fault of their own. The no-asset procedure will provide them with a better opportunity for a fresh start.   The Government is also seeking feedback on two remaining policy issues - regulating insolvency practitioners and the priority of employee entitlements to wages in lieu of notice.   The insolvency review began in 1999 with the release of Law Commission Reports on priority debts and cross-border insolvency. The government has also considered ways to facilitate business rehabilitation, the need for alternatives to bankruptcy for debtors with few or no assets, and the role of the State in insolvencies.   The Bill is available at [http://www.med.govt.nz/ri/insolvency/review/draft-bill/](http://www.med.govt.nz/ri/insolvency/review/draft-bill/" \t "_new)   Submissions should arrive at the Ministry by the close of business onFriday, 11 June 2004**.** They can be sent either by e-mail (in Microsoft Word 2000 format or compatible) to [insolvencyreview@med.govt.nz](mailto:insolvencyreview@med.govt.nz), or in hard copy to: Insolvency Law Review, Ministry of Economic Development, PO Box 1473, Wellington, Attention: Kristina Ryan, Regulatory and Competition Policy Branch.  **1.5 US SEC adopts fund disclosure rules**  On 13 April 2004 the United States Securities and Exchange Commission voted to adopt disclosure requirements for investment companies regarding their policies and procedures on market timing, fair valuation and selective portfolio disclosure.The Commission voted to adopt amendments that are designed to improve transparency of policies and procedures of mutual funds and variable insurance products with respect to market timing. The amendments will also require mutual funds and insurance company managed separate accounts that offer variable annuities to disclose the circumstances under which they will use fair value pricing and to disclose their policies and procedures regarding disclosure of portfolio holdings.  **(a) Disclosure of market timing policies and procedures**  The amendments will:           require a mutual fund to describe in its prospectus the risks, if any, that frequent purchases and redemptions of fund shares may present for other shareholders;          require a mutual fund to state in its prospectus whether or not the fund's board of directors has adopted policies and procedures with respect to frequent purchases and redemptions of fund shares and, if the board has not adopted any such policies and procedures, state the specific basis for the view of the board that it is appropriate for the fund not to have such policies and procedures;          require a mutual fund to describe with specificity in its prospectus any policies and procedures for deterring frequent purchases and redemptions of fund shares;          require a mutual fund to describe in its Statement of Additional Information any arrangements to permit frequent purchases and redemptions of fund shares; and          require similar disclosure for insurance company separate accounts offering variable insurance contracts.  **(b) Disclosure regarding fair value pricing**  The amendments will clarify that mutual funds and insurance company managed separate accounts that offer variable annuities are required to explain in their prospectuses both the circumstances under which they will use fair value pricing and the effects of using fair value pricing.  **(c) Disclosure of policies regarding disclosure of fund portfolio holdings**  The amendments will require mutual funds and insurance company managed separate accounts that offer variable annuities to describe in their Statements of Additional Information any policies and procedures with respect to the disclosure of portfolio securities and ongoing arrangements to make available information about portfolio securities to any person.  Initial registration statements, and post-effective amendments to effective registration statements, filed on or after 5 December 2004, must include the disclosure required by the amendments.  Further information is available on the SEC website at [http://www.sec.gov/](http://www.sec.gov/" \t "_new)  **1.6 UK Accounting Standards Board issues standard on share options**   On 7 April 2004 the United Kingdom Accounting Standards Board (ASB) issued FRS 20 (IFRS 2) "Share-based Payment". The new FRS requires companies to recognise an expense, measured at fair value, in respect of their employee share option plans, share purchase plans, and other share-based payments.  It is mandatory for accounting periods beginning on or after 1 January 2005 for listed entities and 1 January 2006 for all other entities.  The new standard has the effect of implementing in the UK IFRS 2 "Share-based Payment", which was published in February by the International Accounting Standards Board (IASB).  The requirements of FRS 20 are identical to those of IFRS 2, except that implementation of the standard for unlisted entities has been deferred one year to allow more time for unlisted entities to prepare themselves for implementation and entities applying the Financial Reporting Standard for Smaller Entities (FRSSE) are exempt from the standard.  Announcing the decision, Mary Keegan, Chairman of the ASB, said:  "This is an important standard which addresses a weakness in the existing requirements.  At last there will be comparability between companies that use share-based payments to pay employees and other suppliers and those that don't.  Implementing an international accounting standard in this way also shows how committed we are to the convergence process, a process which is to the benefit of preparers and users alike."  "Share-based payments" include:           all executive share option and share purchase plans and all employee share option and share purchase schemes, including all Save As You Earn (SAYE) plans and similar arrangements;           arrangements such as share appreciation rights, where a cash payment is made, the amount of which depends on the share price; and transactions with suppliers that involve a share-based payment being made in exchange for goods or non-employee services.  Further information relating to FRS 20 is available from the ASB website at [http://www.frc.org.uk/asb](http://www.frc.org.uk/asb" \t "_new)  **1.7** **New study of US option grants**  On 7 April 2004 the Investor Responsibility Research Center (IRRC) published a study showing that although potential dilution from stock-based incentives continued to rise last year, results from *IRRC’s Stock Plan Dilution 2004: Overhang from Stock Plans at S&P Super 1,500 Companies* show the rate of option grants beginning in 2002 was cut by companies, a trend that’s likely to continue. Findings also show that the rising overhang levels were largely attributable to stock options that remained underwater at the end of 2002 and into 2003.  The study measures equity dilution disclosed by companies in the S&P 500, MidCap, and SmallCap indices—for this edition, a total of 1,466 companies that filed documents related to fiscal 2003 prior to 1 August 2003, the latest comprehensive information available, were analysed.  IRRC calculated each company’s overhang by dividing the sum of outstanding stock option grants, plus shares reserved for future awards (including new shares authorized in 2003), by the number of total common shares outstanding. Overhang is one way that shareholders gauge the potential dilution to their holdings from the equity being transferred to employees via stock incentive programs. Overhang and grant rate comparisons were also analysed and compared in 10 economic sectors and within cross-sections by market cap and economic sector.  **(a)** **Dilution “creep” continues**  Overall equity overhang rose for the seventh consecutive time since the initial release of the study in 1997. The average potential dilution from stock plans at all S&P 1,500 companies as of 2003 stands at 17 percent, up from 15.7 percent the prior year. Median overall dilution is 16.3 percent, compared with 14.8 percent previously. Other key findings include the following:           Dilution levels rose in all three S&P indices. Generally, the smaller the market capitalization of a peer group, the higher its dilution level. The average dilution of S&P 500 companies is 16.9 percent in 2003, up from 15.4 percent the prior year; the average for MidCap companies is 17.4 percent, up from 16.7 percent; and the average for S&P SmallCap companies rose to 19.3 percent from 17.7 percent.           Nine of the 10 industry sectors analyzed showed an increase in dilution from the previous year—average dilution decreased only for companies in the Industrials group, to 14 percent, which was down just 0.3 percentage points from the prior year.           Information Technology companies continue to have the highest average dilution, at 25.7 percent, while Energy and Utility companies still maintain relatively low average dilution, 8.9 percent and 9.4 percent, respectively.           The biggest 1-year increase was recorded in the financial sector, which had reported lower than average dilution rates from 2000 to 2002, but showed the highest increase of any sector most recently—16.6 percent in 2003, as compared to 13.8 percent the prior year. At least some of that may be explained by enhanced disclosure requirements for non-shareholder approved plans. Goldman Sachs had the highest overhang among all study companies, a large 98 percent, driven primarily by a newly adopted stock plan with a share replenishment (“evergreen”) feature.           An increasing number of companies have very high dilution levels. In 2003, a total of 67 companies in the study (or 4.6 percent) had dilution levels above 40 percent. In 2002, 3.6 percent of study companies had overall dilution above 40 percent, while in 2001 a total of 3 percent of study companies had such high dilution rates.  **(b) Run rates reverse course as use of restricted stock grows**  The bear market and financial scandals have reduced the popularity of stock options. “For long-term investors, the focus on short-term earnings and stock price that options seem to motivate can be counterproductive,” says study author Annick Dunning, a senior analyst and project manager in IRRC’s Governance Research Service. Companies seem to have gotten the message. For the first time since 1997, it appears that most trimmed their option grants in 2002, according to disclosures made last year. The average option run-rate—the total number of options granted, divided by total outstanding common shares—dropped over both the latest one-year and average three-year periods. The change is most dramatic when comparing the one-year average grant rates, which fell to 2.5 percent from 2.9 percent the prior year.  Most companies that have announced they will reduce or eliminate option grants are switching to more restricted stock awards. The trend is also evidenced when comparing stock incentive plans adopted in 2003 with those adopted in 2000. While only 69 percent of stock plans launched in 2000 allowed for time-lapsing restricted stock grants, 81 percent of those adopted in 2003 do so.  **(c)** **Voting opposition flat last year**  Despite the continued rise in overall dilution levels, opposition to stock-based incentive plans decreased very slightly for the second consecutive year and now stands at 21.9 percent (down a slight 0.3 percentage points from 2002.) Nevertheless, voting practices indicate that the higher the dilution, the more likely shareholders are to vote against a stock plan. Stock plan proposal dilution that exceeds 10 percent often triggers a vote against a stock plan by institutional investors. Similarly, overall company dilution of above 20 percent raises a red flag for investors, and stock plans at these companies face stiff shareholder opposition.  **(d)** **About the study**  IRRC extracted data on dilution from company proxy statements, annual reports and 10K forms. The 2004 edition of the study includes:           487 S&P 500 companies          391 S&P MidCap companies          588 S&P SmallCap companies  Stock Plan Dilution details the specific factors contributing to each company’s overhang level. It also includes analysis by peer groups, as well as separate sections dealing with stock plan features such as awards types and repricing policies; stock purchase plans; regulatory developments; and trends in shareholder voting on stock incentive plan proposals.  **1.8 News Corporation to reincorporate in the United States**  On 6 April 2004News Corporation announced that it will pursue a reorganization that would change the Company's place of incorporation from Australia to the United States. In connection with this reorganization, News Corporation would also acquire from the Murdoch Interests the 58% controlling holdings in Queensland Press Pty Ltd (QPL) not currently owned by the Company.  According to the News Corporation announcement, the proposed reorganization would benefit all shareholders by increasing the scope and depth of the Company's shareholder base and increasing its liquidity, while maintaining News Corporation's listings on the Australian Stock Exchange. The proposal also reflects News Corporation's presence in the U.S., where more than 75% of the Company's revenues and profits are generated. For various Australian purposes, News Corporation is already treated as foreign-owned. The transactions contemplated in this proposal will be non-taxable to the vast majority of shareholders.  The proposal is subject to shareholder approval. The Murdoch family interests will not vote with other shareholders on any of the proposed transactions and the Murdoch voting interests will not increase if shareholders approve the proposal.  The Board has established a special committee of non-executive directors to evaluate the reorganization and the QPL transaction and the benefits to the Company's shareholders. The completion of the reorganization and the QPL transaction will be subject to obtaining regulatory clearances, court approvals, certain tax rulings and the requisite vote of the Company's shareholders and option holders. In addition, the reorganization and QPL transaction will be subject to obtaining independent appraisals and fairness opinions.  The special committee will retain independent legal counsel and investment banking advice to assist the committee in evaluating the reorganization and the QPL transaction. If approved by the special committee and subsequently by the Board of Directors, the transactions will be presented to an Australian court and then submitted to News Corporation's shareholders and option holders for approval. If approved, the reorganization is expected to be completed by the end of this calendar year.  **(a)** **Reorganization** The proposed reorganization will be accomplished under Australian law whereby existing holders of News Corporation's ordinary and preferred shares, including those ordinary shares and preferred shares represented by American Depositary Shares (ADRs), will exchange their shares for equivalent shares of voting and non-voting common stock in New News Corporation, a Delaware corporation that will become the new parent company. The new shares will have essentially the same rights as the Company's existing ordinary and preferred shares. The exchange is expected to be tax-free for the vast majority of News Corporation's shareholders.   Following the reorganization, the Board of Directors of New News Corporation would consist of the existing directors of News Corporation and New News Corporation will be renamed News Corporation.   **(b)** **Benefits to shareholders** The reincorporation is expected to benefit all shareholders by increasing the scope and depth of the shareholder base, improving trading liquidity, enhancing access to the capital markets and making the Company's shares eligible for inclusion in a variety of U.S.-based indices.   In addition, many U.S. investment institutions have formal or informal limits on ownership of non-U.S. companies securities and on ownership of preferred shares, such as News Corporation's preferred shares. These limitations would not restrict the ownership of the non-voting common stock of News Corporation after the proposed reorganization.   The Company believes the increased demand for News Corporation stock following a US reincorporation may narrow the historic trading discount of the non-voting shares relative to the voting shares, thereby reducing the Company's cost of capital.   The Company expects that after the reincorporation News Corporation's primary stock exchange listing will be on the New York Stock Exchange and, in addition to the Australian Stock Exchange, the Company intends to maintain a secondary listing on the London Stock Exchange.   **(c)** **QPL transaction** As part of the proposed arrangements, the special committee of the Board will also consider the acquisition by the Company of entities which own the approximately 58% controlling interest in QPL from certain entities and trusts, the beneficiaries of which include Mr. Rupert Murdoch, members of his family and certain charities (the Murdoch Interests). News Corporation currently owns the approximately 42% remaining interest in QPL. QPL, one of Australia's most profitable newspaper publishing groups, is the publisher of the Courier-Mail, Sunday Mail and other fast-growing newspapers. In addition, QPL owns an approximately 15.2% voting interest in News Corporation, currently controlled and voted by the Murdoch Interests.   The Murdoch Interests will receive voting common stock in New News Corporation in exchange for the value of their pro-rata ownership of the newspaper publishing business held by QPL and sold to the Company. The amount of New News Corporation shares issued for the Murdoch Interests holdings of the QPL publishing business will be based on a mutually agreed valuation of the net value of that business which will be reviewed by independent appraisers and the special committee of the Board. The Board of Directors believes the QPL transaction provides News Corporation with a unique opportunity to acquire 100% ownership and control of QPL, thereby simplifying the ownership of QPL, eliminating related-party considerations, and permitting consolidation of QPL for financial and tax purposes.  **(d)** **Resulting ownership by Murdoch Interests** As part of the reorganization, certain of the related entities comprising the Murdoch Interests will be conveyed to News Corporation in return for shares in New News Corporation (net of certain debt being assumed by the Company). As a consequence, the Murdoch Interests will directly own shares in New News Corporation, rather than indirectly owning shares in News Corporation through various entities. Like all other shareholders, the Murdoch Interests will receive identical voting and non-voting shares in New News Corporation in exchange for the shares in News Corporation that they own directly. In addition, in connection with the QPL transaction, the Murdoch Interests will receive directly shares in New News Corporation representing their pro-rata 58% ownership in each class of the News Corporation shares currently held by QPL.   Based upon the Company's current assumptions of the value of the QPL business and the current price of News Corporation Ordinary Shares, after the completion of the proposed transactions the Murdoch Interests will directly own slightly less voting equity of New News Corporation than the voting equity of News Corporation presently held and controlled by the Murdoch Interests. In addition, the Murdoch Interests will have a slightly greater percentage of economic interest in New News Corporation resulting from the exchange of their interests in the QPL publishing business for voting stock in New News Corporation.  **(e)** **Required approvals** The holders of ordinary shares, preferred shares and employee stock options, each voting as a separate class, must vote to approve the transactions. In order to be approved, 75% in number of shares held by holders in each class that vote and 50% of the number of holders in each class that vote must approve the transactions. Before the shareholders meeting, all News Corporation shareholders and option holders will receive an Information Memorandum, including opinions of independent experts, explaining the terms of the transactions.   The reorganization and the QPL transaction are subject to obtaining certain regulatory approvals, including approval of the Australian Foreign Investment Review Board and obtaining for New News Corporation a primary listing on the New York Stock Exchange and a full foreign listing on the Australian Stock Exchange and obtaining appropriate tax rulings.  The News Corporation Limited (NYSE: NWS, NWS.A; ASX: NCP, NCPDP) had total assets as of 31 December 2003 of approximately US$52 billion and total annual revenues of approximately US$19 billion. News Corporation is a diversified international media and entertainment company with operations in eight industry segments: filmed entertainment; television; cable network programming; direct broadcast satellite television; magazines and inserts; newspapers; book publishing; and other. The activities of News Corporation are conducted principally in the United States, Continental Europe, the United Kingdom, Australia, Asia and the Pacific Basin.   Information regarding the reorganization and QPL transaction, including questions and answers, is posted on the News Corporation web site, [www.newscorp.com/reorg](http://www.newscorp.com/reorg" \t "_new)  **1.9 Group of 100 seeks 12 month deferment of 2005 deadline for International Accounting Standards**  On 6 April 2004 the Group of 100, which represents the CFOs of Australia's largest companies, issued a statement reiterating that deferment in the introduction of International Accounting Standards for 12 months is appropriate but with the option for Australian companies to adopt all standards from 1 January 2005, if they wish. The statement follows the Financial Reporting Council's in principle decision not to defer the implementation of international accounting standards on 1 January 2005.   The National Executive of the Group of 100 said that while it continues its strong support for IASB Standards it believes implementation of the FRC's Year 2005 strategy should be deferred for 12 months or until the European Union endorsement of all the standards occurs, in particular IAS 32 and IAS 39 which relate to financial instruments. The Group of 100 stated that it strongly supports the objectives of the 2005 strategy but is concerned with the delays in the acceptance of IAS 32 and IAS 39 in Europe and the potential for substantial amendments to the Australian equivalents.  Copies of submissions made to the FRC on this subject may be accessed from the **[Error! Hyperlink reference not valid.](file:///C%7C/Documents%20and%20Settings/stephen/Desktop/..%5C..%5C.%5C..%5CDOCUME%7E1%5Cejjack%5CLOCALS%7E1%5Csubmissions%5Cdefault.htm" \t "_new)** ([www.group100.com.au](http://www.group100.com.au/" \t "_new)).  **1.10 Benchmarking company secretariat functions in Australia**  On 6 April 2004 Chartered Secretaries Australia (CSA), released its second survey, *Benchmarking Company Secretariat Functions in Australia.*  **(a) About the study**  The aim of the survey was to understand the standards and practices of company secretariat functions in Australian companies.  Following an earlier survey in 2001, the second survey was conducted late in 2003. The survey examines the following areas:           **company secretaries’** roles and functions and the staffing and structure of secretariats          **management of boards and their committees**, including the impact of technology and performance indicators for the management of boards and their committees          **governance**, including directors’ deeds and corporate governance          **shareholder management**, including annual reports, annual general meetings, webcasting, electronic communication with shareholders and corporate compliance          **share management**, including registry management and dividend payments and          **costs and salaries**, including shareholder servicing costs, the indicative costs of company secretariat functions and salaries paid for company secretariat roles.  The survey was issued to Australia’s top 200 listed companies and saw a response rate of 33.5 per cent, which is a statistically valid sample representative of small, mediumsized and large companies. It should be noted that all results are susceptible to some statistical aberrations from changes in survey respondents. Typically, survey respondents represented companies that were:           publicly listed          had market capitalisations of between $500 million and $10 billion          had annual turnovers of between $500 million and $10 billion          had between 10,000 and 50,000 shareholders          had fewer than 10 subsidiaries in Australia and fewer than 10 overseas subsidiaries.  **Table: Size of companies surveyed**   |  |  | | --- | --- | | **Breakdown by company size** | **% of survey respondents** | | Small Companies: <$500m market capitalisation | 16.4% | | Medium Companies: Between $500m–$3bn market capitalisation | 35.8% | | Large Companies: >$3bn market capitalisation | 41.8% | | Did not answer | 6.0% |   **(b) Summary**  The following is extracted from the study’s executive summary.  **(i) A changing landscape**  The role of the company secretary is clearly still evolving. The focus on corporate governance and investor scrutiny, expanded and delineated by the new ASX Corporate Governance Council’s *Principles of good corporate governance and best practice recommendations (*ASX CGC guidelines*)*, continues to change the landscape of the company secretary in many ways.  The findings of the study show that the company secretary’s traditional responsibilities, timely management of the meetings of the board, its committees and shareholders and facilitation of continuous disclosure, are among the few things which remain the same in today’s corporate environment.  The company secretary is still the key person making certain that the board operates in an optimal and well-informed manner. But the job has grown in complexity and workload. It is therefore unsurprising that there has also been a large increase in salaries. Two years after the first report, a snapshot of the 2003 boardroom reveals some major differences.           Boards meet more frequently than in the past. Expectations of directors have risen, along with the workload, and companies of all sizes are holding more board meetings.          There are a lot of extra people in the boardroom: general counsel and investor relations managers have become regular attendees, reflecting higher levels of sensitivity to both legal issues and shareholder impact. Even the CFO is a more frequent attendee than in the past, as is the corporate affairs manager.          The board pack has come into its own, increasing dramatically in size. There are more issues to address and the board expects more information of a higher calibre on which to base its decisions. In a larger company, directors are expecting the company secretary to deliver, on average, 202 pages of reading for each board meeting.          Board meetings are shorter in duration, at least for medium to larger-sized companies. The average 10.3 hours for board meetings in larger companies, recorded in 2001, has eased to a more manageable 4.7 hours. Smaller companies are resisting this trend, increasing the duration of meetings.          Corporate governance casts a long shadow in the boardroom, and the company secretary has primary responsibility for implementing governance policy in 95 per cent of Australian companies. The new ASX CGC guidelines have increased the amount of time spent on corporate governance (by about 10 per cent in 40 per cent of companies).          Paradoxically, the company secretary’s traditional responsibility for compliance issues has decreased slightly. Others appear to have taken up these duties, reflecting the increased workload of the company secretary in other areas, including governance.          Quite possibly, the company secretary is also too busy compiling the minutes of the meetings, that take more time to run, and this responsibility takes longer to complete and distribute than ever before.  **(ii) Shareholders**  Seemingly, the power of the shareholder has never been greater. The survey provides an interesting picture of shareholders, who seem decidedly unenthusiastic about much of what is offered to them in the form of traditional communications.  Shareholders in 2003:           continued to record lower attendances at annual general meetings (AGMs). About one third of companies have fewer than 300 shareholders, or about 1.5 per cent, attending AGMs and they have halved their costs in response. More AGMs are now held in Sydney, with Melbourne’s popularity dropping dramatically.          showed little interest in webcasting of AGMs. Nearly two-thirds of companies offered a webcast, but only between 300-1300 shareholders used it to view the AGM.          failed to respond well to the electronic distribution of reports, preferring the traditional full report or no report at all. Larger company shareholders have returned in strength to the full report, while shareholders across all companies are less interested in receiving concise reports and increasingly ask to be sent no report at all.          demanded more fact-based, ‘plain vanilla’ communication, allowing companies to further decrease their annual report costs.          were not offered the option of electronic or telephone proxy voting by most companies, although electronic voting was flagged as a future possibility.          continued to hang on to the delight of the dividend cheque. Although shareholders receiving their dividends by direct credit rose slightly, more than a third of all shareholders still like to receive a cheque.  **(iii) The company secretary in 2004**  This survey provides a real indication that the company secretary’s role is evolving. The broad-ranging brief which once characterised the role, reflecting the broad-ranging subject matter which they were expected to bring to the board table, is now following the corporate trend of increasing specialisation.  The survey showed that responsibilities such as investor relations, risk management and running general meetings are increasingly being handed over to others, either internal managers or external consultants. This allows the company secretary of 2004 to focus more strongly than ever on the growing level of professionalism and detail required by board directors in assessing and addressing board matters, along with the increasing demands of stringent corporate governance.  **1.11 Public exposure of draft guidelines for the release of price-sensitive information by government departments and agencies**  The Hon Ross Cameron MP, Parliamentary Secretary to the Treasurer, on 5 April 2004 released for public comment draft guidelines for the release of price-sensitive information by Australian Government departments and agencies.  The draft guidelines have been released for a six week public consultation period. They are available on the [Treasury website](http://www.treasury.gov.au/" \t "_new).  The aim of the guidelines is to support the continuous disclosure regime which seeks to ensure that investors have timely and equal access to materially price sensitive information. Continuous disclosure of such information should ensure that the price of securities on secondary markets reflects their underlying economic value.  ‘Adoption of the guidelines would not reduce the obligation on the listed entity to release the required information or involve the disclosure of information which a listed entity would not itself be obliged to disclose,’ Mr Cameron said.  ‘They would form a back-up mechanism, with departments and agencies complying on a best endeavours basis,’ he said.  The guidelines would not impose rigid and expensive new procedures on government departments or agencies, but instead would raise awareness of this issue. Their purpose is to encourage departments and agencies to consider whether they make price-sensitive decisions and, if so, to consider, in consultation with the market operator, their own procedures for announcing them.  Mr Cameron encouraged all with an interest in this issue, particularly listed entities, to consider the draft guidelines and provide their comments within the consultation period.  **1.12 New Australian study of executive and board remuneration**  There has been a considerable level of change in the area of executive and board remuneration over the past 12 to 18 months according to a new study published in April 2004. Ernst & Young has carried out an analysis of the executive and non-executive director remuneration practices of the major listed companies in Australia. The analysis is based on information disclosed by ASX 200 companies for the 2003 reporting cycle. The report also considers trends in key aspects of executive remuneration such as:           Fixed remuneration levels          Long-term incentive award levels and plan designs          Short-term incentive payments          Non-executive director fees          Superior performing companies and corresponding remuneration trends.  The following is a summary of the key findings.  **(a) Remuneration levels – executives**  The analysis indicates that remuneration levels increased with company size. Generally, the larger the company and the more senior the role, the proportion of pay at risk increased. Long-term incentives continued to play a key role in executive remuneration, particularly in larger companies. The following tables show the median levels for each remuneration element by market capitalisation and position.  **Fixed remuneration – median levels ($’000s)**   |  |  |  |  |  | | --- | --- | --- | --- | --- | | **Position** | **Market Capitalisation** | | | | |  | Below $400 million | $400 million to $1 billion | $1 billion to $5 billion | Above $5 billion | | Managing Director | 408 | 670 | 969 | 1,481 | | Chief Financial Officer | 256 | 336 | 500 | 730 | | Business Unit Head | 233 | 344 | 488 | 688 |   **Short-term incentive payments – median levels ($’000s)**   |  |  |  |  |  | | --- | --- | --- | --- | --- | | **Position** | **Market Capitalisation** | | | | |  | Below $400 million | $400 million to $1 billion | $1 billion to $5 billion | Above $5 billion | | Managing Director | 156 | 201 | 504 | 982 | | Chief Financial Officer | 52 | 86 | 139 | 489 | | Business Unit Head | 71 | 70 | 160 | 518 |   **Long-term incentive awards – median levels ($’000s)**   |  |  |  |  |  | | --- | --- | --- | --- | --- | | **Position** | **Market Capitalisation** | | | | |  | Below $400 million | $400 million to $1 billion | $1 billion to $5 billion | Above $5 billion | | Managing Director | 152 | 291 | 1.584 | 2.683 | | Chief Financial Officer | 96 | 91 | 733 | 1,077 | | Business Unit Head | 77 | 76 | 308 | 720 |   **Total remuneration – median levels ($’000s)**   |  |  |  |  |  | | --- | --- | --- | --- | --- | | **Position** | **Market Capitalisation** | | | | |  | Below $400 million | $400 million to $1 billion | $1 billion to $5 billion | Above $5 billion | | Managing Director | 509 | 918 | 1,612 | 3,787 | | Chief Financial Officer | 356 | 435 | 708 | 1,715 | | Business Unit Head | 288 | 395 | 699 | 1,771 |   **(b) Short-term and long-term incentives**  In looking at the use of short-term and long-term incentives, the analysis indicated that Managing Directors had the highest proportion of total remuneration delivered through long-term incentives. Share options continued to be the most common long-term incentive plan type, however this was more distinct in the ASX 100 to 200 companies than in the top 100. Total Shareholder Return (TSR) was the most common performance measure for executive long-term incentive plans, and larger companies were more likely to re-test performance. In addition:  The incidence of short-term incentive payments was higher in larger companies – 95% of companies with market capitalisations above $5 billion made short-term incentive payments compared to 66% of companies with market capitalisations of less than $400 million.           One fifth (20%) of companies did not operate a specific long-term incentive plan for executives.          Of those companies that did operate an executive long-term incentive plan, almost half (48%) did not make grants during the year.          Share option plans remained the most prevalent type of executive plan (62% of companies) with performance rights plans the second most common (16% of companies).          Performance measures used in executive long-term incentive plans varied according to company size. Total Shareholder Return (TSR) was the most common measure in plans operated by larger companies (and the most prevalent measure overall). Smaller companies were more likely to use share price as a measure in their executive long-term incentive plan – more than a quarter of plans operated by companies with market capitalisations less than $400 million used share price as a performance measure.          Almost one-quarter of executive long-term incentive plans did not incorporate a performance measure for vesting purposes.  **(c) Non-executive director remuneration**  Increases in the fee pool for non-executive directors from 2002 to 2003 were uncommon – the majority of companies analysed (68%) did not change the pool. Non-executive director retirement benefits were still prevalent (two thirds of companies have a plan in place) but many plans are being wound up or closed to new participants.           As with executive remuneration, the level of fees paid to non-executive directors increased with company size. Median base fee levels for a non-executive chairman, for example, range from around $84,000 for the smallest companies (by market capitalisation) to $311,000 for the largest companies.          The median fee pool ($1.5 million) for companies with market capitalisations greater than $5 billion was almost five times the median pool for companies with market capitalisations less than $400 million.          A significant proportion (almost two-thirds) of organisations still offer retirement benefits to non-executive directors. However in many cases these plans are being phased out.  **(d) ‘Superior’ performing companies**  In order to understand the remuneration practices of ‘superior’ performing companies compared to other organisations, an analysis was undertaken of the relative performance of the ASX 200 companies. ‘Performance’ for this purpose was determined by reference to three measures for each company: growth in earnings per share, growth in return on invested capital and Total Shareholder Return. Companies were ranked in order of performance based on each measure and based on these, an ‘average’ overall ranking was determined for each company. Those companies in the upper quartile based on overall ranking were defined as ‘superior’ performers for the purpose of this analysis.  The analysis is indicative only and was undertaken to enable the remuneration data to be looked at from an alternative perspective. Although the methodology used does not provide a definitive analysis of the remuneration practices of ‘high performing’ companies, it does present some interesting results.  Within the group of the largest companies, the superior performing companies generally had greater levels of variable remuneration. Superior performing companies were more likely to use a share price related performance measure (such as TSR) for their executive long-term incentive plans. Non-executive director fee pools were generally greater for superior performing companies. Larger organisations were less likely to be superior performers.  **(i) Remuneration levels**  Managing Directors of superior performing companies tended to have lower fixed remuneration and greater levels of short term and long-term incentive awards.  **(ii) Short-term and long-term incentives**  Executives in superior performing companies were more likely to earn a short-term incentive than executives in other companies, and were more likely to incorporate some deferral of the payment.           Superior performers had a higher prevalence of executive long-term incentive plans than other companies.          Over 70% of superior performing companies made long-term incentive grants during the year, compared with around 50% of the other companies.          Superior performers were more likely to use a share price related performance measure (such as TSR) in their executive long-term incentive plans.  For further information, please contact Michael Hogan at [michael.hogan@au.ey.com](mailto:michael.hogan@au.ey.com) or Robert Carroll at [robert.carroll@au.ey.com](mailto:robert.carroll@au.ey.com)  **1.13 New study of directors’ and institutional investors’ views on board governance**  In April 2004 the consulting firm McKinsey published a study which is a survey of directors’ and institutional investors’ views on board governance. 150 US corporate directors serving as members of boards of more than 300 public companies were surveyed as well as 44 US-based fund managers representing both public and private funds with a total of US$ 3 trillion in assets under management.  The key finding is that the directors and investors wanted to see changes in three areas in particular: separating the roles of chairman and CEO, improving board accountability, and reforming executive compensation.  In response to the question to what extent have recent reforms improved board governance, 28% of directors responded a lot with 41% responding moderately and 22% a little. 83% of institutional investors responded a little or moderately, with 12% responding a lot.  In response to the question how much additional governance reform is needed, 22% of directors responded a lot, 28% a moderate amount, 26% a little, and 23% none. 55% of investors responded a lot, 43% a little or moderate amount, and 2% none.  In response to the question what are the greatest impediments to improving board performance, directors said the two greatest impediments are directors’ motivation and time commitment, and resistance from CEOs. Investors responded that the two greatest impediments are resistance from CEOs and resistance from directors.  In response to the question do you support or oppose splitting chair-CEO roles, 40% of directors said they supported this very much while 69% of investors gave this response.  In response to the question to what degree did remuneration plans lead to recent corporate scandals, 59% of directors responded largely while 61% of investors also responded largely.  In response to the question how would you describe executive remuneration today, 39% of directors responded too high, with 13% responding far too high, 43% responding about right, and 5% responding too low.  In response to the question should remuneration be tied to company performance 75% of directors responded either completely or largely while 77% of investors responded completely or largely. When asked whether remuneration was tied to company performance 5 years ago, only 20% of directors responded largely with 19% of investors giving the same response.  Further information about the study is available on the McKinsey website at [http://www.mckinseyquarterly.com](http://www.mckinseyquarterly.com/" \t "_new)  **1.14 UK Financial Services Authority to bring in more flexible rules for collective investment schemes**  The Financial Services Authority published on 23 March 2004 more flexible rules for UK authorised collective investment schemes. These largely confirm the proposals put forward last year in [Consultation Paper 185](http://www.fsa.gov.uk/pubs/cp/185/) (The CIS Sourcebook – a new approach) and halve the length of the rulebook covering this sector. Retail investors will have access to a wider range of investment opportunities and product features, together with better information about the progress of their investments, while schemes available only to professional investors will benefit from a reduction in regulation.  New launches or existing authorised funds that wish to convert will be able to operate under the new rules from 1 April 2004. The rules will then apply to all authorised funds from 13 February 2007, to coincide with the implementation of the UCITS Management Directive.  The new regime is intended to:           provide a type of fund (now called Qualified Investor Schemes) for investment by institutional and expert investors;           remove the existing categorisation of non-UCITS authorised funds (separate categories of UCITS authorised funds were removed in November 2002) and to provide more flexible rules on authorised fund investments;           provide further flexibility for fund managers to manage their funds;           set out a framework to determine when investors should be consulted and to provide more useful information for investors in regular reports;           allow limited redemption of units in certain circumstances;           introduce unit classes for Authorised Unit Trusts, align rules on expenses and allow performance fees; and           retain the current governance structure, pending further review following discussion with the industry.  The FSA consultation did not propose the introduction of UK-authorised hedge funds. However, the widening of investment and borrowing powers and the ability to undertake short selling proposed for qualified investor schemes would allow funds to employ some investment approaches commonly adopted by hedge funds.  CP185 also proposed additional guidance on fair value pricing (FVP) to help fund managers counter the detrimental effects that can arise for continuing investors if arbitrageurs buy and sell units in order to exploit stale pricing (an activity known as "market timing"). The additional guidance, which the FSA Board has now made, clarifies that funds have the ability to refuse to sell units to persons whose dealing activities may cause detriment to continuing unit-holders. Separately, FSA is also working with the Investment Management Association on the development of an industry code on the use of FVP.  The details of the new regime are set out in a [policy statement](http://www.fsa.gov.uk/pubs/policy/04_07/" \t "_new) (The CIS Sourcebook - a new approach), published on the FSA website at [http://www.fsa.gov.uk](http://www.fsa.gov.uk/" \t "_new)  **1.15 UK Financial Services Authority publishes final rules on managing conflicts of interest in investment research**  On 22 March 2004 the UK Financial Services Authority published final rules on managing conflicts of interest in investment research.  Regulated firms will now have to develop and publish policies to ensure that their research analysts do not compromise their objectivity. Final rules announced by the Financial Services Authority address conflicts of interest in the production of investment research that is held out to clients as being objective.  Firms will be required to publish and implement their policies by 1 July 2004. Each firm's policy will have to make clear which of the material it produces it considers to be objective research. Firms will need to have measures that ensure their analysts impartiality and these measures will need to be clearly set out in the policy statement. Without such policies, firms will not be allowed to claim or imply that their research was objective.  The [new proposals](http://www.fsa.gov.uk/pubs/policy/04_06/) have been refined slightly from the proposals in CP205 to clarify the regulatory intent. These measures will focus firms' attention on the real conflicts and how they are perceived. These refinements reflect comments made during the last consultation.  Firms are responding to the growing international focus on conflicts management generally, and the revised Investment Services Directive will bring in provisions that will oblige them to manage conflicts across the whole of their business.  The new rules are available on the FSA website at [http://www.fsa.gov.uk](http://www.fsa.gov.uk/" \t "_new)  **1.16 Corporate representation at shareholder meetings – new guidance**  In March 2004 the Institute of Chartered Secretaries and Administrators (UK) issued a new Guidance Note on corporate representation at annual general meetings.   According to the Institute, increased shareholder engagement has resulted in several institutional shareholder organisations considering how they can best be represented at general meetings of the companies in which they invest. As a corporation has no physical presence it cannot attend in person and must therefore appoint someone to represent it. Company Law provides for two alternative methods by which this can be done; the appointment of proxies and corporate representatives. There is some confusion as to the restrictions, rights and obligations attached to these two alternatives.   The object of the Guidance Note is to attempt to clarify both the legal position and practice that has developed in this area. The Guidance Note is free to download at [www.icsa.org.uk/news/guidance.php](http://www.icsa.org.uk/news/guidance.php" \t "_new)  **1.17 Ranking of governance at Hong Kong Exchange**  Standard & Poor’s (S&P) has ranked Hong Kong Exchanges and Clearing Ltd’s (HKEx) corporate governance and given it a Corporate Governance Score of CGS-8.3. HKEx operates the only exchange-based stock and futures market in Hong Kong.  Under the current structure, HKEx consists of three principal wholly owned subsidiaries, The Stock Exchange of Hong Kong Ltd, Hong Kong Futures Exchange Ltd and Hong Kong Securities Clearing Co  Ltd. Since its listing on the Hong Kong Main Board on June 27, 2000, HKEx has undertaken dual responsibilities, that is, to create value for its shareholders and to safeguard the integrity of Hong Kong capital market.  According to S&P, the score and the updated analysis reflect a number of improvements in the areas of shareholder rights and transparency and disclosure of financial and nonfinancial information but also incorporate concerns regarding the balance of power and responsibility on the board of directors. However, recent changes to S&P's analytical methodology and some tightening of the scoring criteria have also impacted the updated score. The analytical framework now places increased emphasis on external stakeholder relations and board structure and effectiveness.  These changes to the methodology in turn reflect the rapidly evolving nature of corporate governance global best practices and investor concerns over a broader range of governance issues. On the other hand, S&P's analysis continues to recognize the special status of the HKEx given its role as both a publicly listed company as well as the sole exchange controller in Hong Kong with a clear public interest function.   The full report is available at [http://www.acga-asia.org/loadfile.cfm?SITE\_FILE\_ID=216](http://www.acga-asia.org/loadfile.cfm?SITE_FILE_ID=216" \t "_new)  **1.18 European Commission consults on directors' remuneration**  The European Commission has launched a consultation on directors' remuneration. Responses will be taken into account in the Commission's forthcoming Recommendation to Member States on this issue, scheduled for September 2004. The consultation covers among other things disclosure of remuneration policy and of individual remuneration and shareholder approval of directors' share option schemes.   The main issues on which the Commission is seeking responses are:           should the Recommendation invite Member States to take regulatory measures to ensure that listed companies comply with all its provisions? This would contrast with the approach in some Member States which deal with the issue in a non-legislative way, for example via a Corporate Governance Code.           should the Recommendation cover only listed companies or also non-listed companies?           how should the Recommendation define "directors" given the wide range of board systems used in EU Member States?           how each EU listed company should disclose in its annual accounts and annual report (or in the notes to the annual accounts) the remuneration policy for directors for the next financial year? Which elements for example the performance-related elements of directors' remuneration, supplementary pensions and contract policy should be included in that disclosure? Should such information be an explicit item on the agenda of the annual general meeting (AGM) and should it be submitted to a vote?           what information on the remuneration of individual directors should be disclosed? Disclosure of the remuneration of individual directors - both executive and non-executive or supervisory - in the preceding financial year is important so shareholders can assess the appropriateness of the remuneration in the light of the overall performance of the company. The consultation paper proposes that such information should include at least information on salary and other fixed elements of remuneration, share option schemes and supplementary pension schemes. It also proposes specific additional disclosure for non-executive and supervisory directors.           should variable remuneration schemes, under which directors are remunerated in shares or share options, and any substantial change in such schemes be subject to the prior approval of the annual general meeting of shareholders? Such approval would relate to the scheme in itself, in other words the system of remuneration and the rules applied to establish individual remuneration under the scheme, rather than to the remuneration of individual directors.  The consultation paper is available at: [http://europa.eu.int/comm/internal\_market/company/directors-remun/index\_en.htm](http://europa.eu.int/comm/internal_market/company/directors-remun/index_en.htm" \t "_new)  **1.19 Expensing stock options – the US debate**  A brief article on the current state of debate on expensing stock options has been published by the Wharton Business School. The article summarises recent developments in this area and also discusses who is supporting the move to expense stock options and who is opposing this move.  The article is available at [http://knowledge.wharton.upenn.edu/index.cfm?fa=whatshot](http://knowledge.wharton.upenn.edu/index.cfm?fa=whatshot" \t "_new)  **1.20 New study of corporate codes of ethics**  A new study of codes of ethics adopted by US companies has been published by Delloitte. A questionnaire was sent to 5,000 directors of the top 4,000 publicly traded companies. A 7.5% response was achieved with 373 questionnaires returned.  The key findings of the study are:           83% of companies surveyed have developed formal codes of ethics or conduct.           98% of survey participants agree that an ethics and compliance program is an essential component of corporate governance.          Only 75% of companies that have a code responded that they actually check to see if it is being adhered to.          Only about 68% of companies surveyed provided training to their employees on the requirements and responsibilities contained in their code of ethics.          When asked if their company has an ethics officer (either full or part time), only 55% answered in the affirmative.  Further information about the study is available on the website of Deloitte at: [http://www.deloitte.com/dtt/section\_node/0,2332,sid=5601,00.html](http://www.deloitte.com/dtt/section_node/0,2332,sid=5601,00.html" \t "_new) |
| **2. Recent ASIC Developments** |
| **2.1 ASIC action relating to defective prospectuses**  The Australian Securities and Investments Commission (ASIC) on 22 April 2004 provided an overview of the action it has taken since January 2004 to protect investors from defects in fundraising documents involving equity securities (equity prospectuses).  Since 1 January 2004 to date, ASIC has obtained supplementary disclosure in five matters, issued 16 interim stop orders and eight final stop orders involving equity prospectuses seeking to raise more than $1.5 billion from the public.  'ASIC continues to undertake a risk-based review of selected fundraising documents to ensure that investors have adequate information upon which to make their investment decisions' ASIC Director of Corporate Finance, Mr Richard Cockburn, said.   'ASIC publishes the details of defects identified in our review of fundraising documents as a guide for issuers and their advisers in preparing their own disclosure documents on what to look out for, and what pitfalls to avoid.  'We are therefore disappointed that some of the issues identified as part of our review were not addressed during the due diligence process associated with the prospectus', Mr Cockburn said.  Common defects identified since January 2004 include:           Issuers raising money from the public to run investment businesses without holding an Australian Financial Services Licence. Such activity is prohibited under the *[Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default)* (the Act)*;*           The failure of issuers to include the assumptions upon which financial forecasts in the fundraising prospectuses were based. All advisers and independent experts must be aware of, and comply with the requirements of Policy Statement 170 *Prospective financial information* [PS 170];           The inclusion of statements where companies implied that they would be seeking a listing on a financial market in the future. Such statements are prohibited under the Actunless an application for listing is made to the relevant financial market within the statutory timeframe;           Issuers attempting to use a transaction-specific short form prospectus when the issuer had been listed for less than 12 months;           Issuers skewing the balance of information in the prospectus by highlighting positive information in the first few pages of the prospectus while burying negative information in the back of the prospectus; and           Lack of disclosure of the methodology used, and assumptions applied, for the valuation of options in the prospectus. There was also concern that the option valuation methodology used had not taken into consideration probability or discounting factors.  The majority of the final stop orders were issued with the consent of the relevant company after they made the decision not to proceed with the particular prospectus, rather than to address the disclosure deficiencies.  **2.2 Disclosing the impact of international accounting standards: an ASIC guide**  The Australian Securities and Investments Commission (ASIC) released on 22 April a guide to disclosing the impact on financial information in disclosure documents of International Financial Reporting Standards (IFRSs) being adopted as Australian accounting standards.  Disclosure documents are prospectuses, product disclosure statements, offer information statements, takeover documents, scheme of arrangement documents, and relevant related party transaction documents.  The guide does not replace the law, so disclosure that does not follow the guide will not necessarily breach the law. However, as the guide sets out ASIC's view of what good disclosure is, following this guide may minimise the potential for non-compliance.  The new standards will apply to financial reports prepared under the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) for years commencing on or after 1 January 2005.  ASIC considers that a document issued before the first annual financial report of an entity prepared under the new standards should contain information on the impact of adopting the new accounting standards.  The nature and extent of the information presented on the basis of the existing standards and the new standards will depend on factors including the timing of the document's release, the periods to be covered by any financial forecasts, and the size and effect of the differences between the figures reported on each basis.  The guide is available on ASIC's website at [http://www.asic.gov.au](http://www.asic.gov.au/" \t "_new)  **2.3 Financial reports: valuing options, audit and international accounting standards**  The Australian Securities and Investments Commission (ASIC) revealed on 20 April 2004 the names of the 22 companies that provided, after ASIC questioned them, the required disclosure about the value of options paid to their directors and staff.  To date, ASIC has reviewed the directors' report of all listed companies with balance dates between 30 June and 31 December 2003.   The vast majority of companies that reported providing options to directors and the five employees with the highest remuneration also disclosed the value of the options. However, 22 companies only disclosed the value of the options after being contacted by ASIC. They are named below.  'Before the reporting period, we explained that the valuation of options would be a focus of our review and we welcome the high initial compliance with the legal requirement to value options for the purpose of disclosure in the directors' report', said Mr Greg Pound, ASIC's Chief Accountant.  'The 22 companies that failed to initially reveal the valuation of options did so following contact and discussions with ASIC', he said.  **(a) Audit issues** During its review of 2003 financial reports, ASIC also found that 20 audit reports did not appear to comply with auditing standards, or they were not qualified despite ASIC's view that the company's financial report did not comply with an accounting standard.  After further inquiry, ASIC is considering 16 matters for action. One matter is being referred to the Companies Auditors and Liquidators Disciplinary Board and several others are expected to follow.   The five common deficiencies identified during ASIC's review of the audits to date are:   |  |  | | --- | --- | | 1. | There was inadequate consideration of the significant accounting policies used by audited companies and inadequate documentation of the basis for the auditor's conclusion on those policies. | | 2. | Audit procedures were incomplete or inadequate in areas such as unrecorded liabilities, debtor/creditor confirmations, and subsequent events. | | 3. | Audit working papers were incomplete and/or did not provide evidence to support audit conclusions in significant areas of the audit. | | 4. | There was poor audit planning and poor use of audit programs that does not reflect what is required by the auditing standards. | | 5. | There was a lack of evidence of an independent review of audit work as part of the audit quality-control process. |   **(b) Defined benefit superannuation**  Also as a result of its review of financial reports, ASIC sought additional information from 19 companies about the reporting of deficits in their corporate-sponsored defined benefit superannuation plans.  ASIC can now confirm that six companies had appropriately recognised the deficits as a liability. A further company has changed its accounting policy. The remaining companies provided information that indicated that in their specific circumstances no legal liability existed for the deficit.   Companies have applied an appropriate 'due process' to clarify, assess and manage their relationship with their corporate-sponsored defined benefit plans and to reviewing their accounting policies to recognise a legal liability where it exists.   However, ASIC is concerned that uncertainty remains about financial reporting in this area. This uncertainty will be removed with the move to International Accounting Standards from 1 January 2005 that will specifically require recognition of the deficits in the financial report of the corporate sponsor.   This is just one of the benefits of moving to International Accounting Standards, according to ASIC.  During the period of transition to International Accounting Standards, the desired level of transparency should be achieved under the Australian Accounting Standards Board's proposed accounting standard, issued as Exposure Draft ED 129, 'Disclosing the Impact of Adopting IASB Standards' (as amended).  Under ED 129, companies would be required to disclose, in their 2004 financial report, the key differences that will arise in their accounting policies on adopting the new international standards. This should result in those companies that have relied on the strict legal model to disclose the potential impact of having to recognise the liability.   'From ASIC's perspective, the move to International Accounting Standard has always been about the quality of financial reporting. International Accounting Standards will provide a comprehensive set of integrated standards that cover a number of areas where Australia does not currently have standards', Mr Pound said.   'This will result in improved financial reporting in Australia and can only enhance the information available for decision-making. It is an important step in improving the relevance and reliability of financial reporting in the Australian marketplace and to also have that recognised in international capital markets', he said.  **(c) Companies that provided further information relating to the value of options**   |  |  | | --- | --- | | AERIS Technologies Ltd | ASX Announcement | | Broadtel Communications Limited | ASX Announcement | | EBET Limited | Lodged amended Directors' Report | | Fleetwood Corporations Limited | ASX Announcement | | Gale Pacific Limited | ASX Announcement | | Garratts Ltd | ASX Announcement | | H W W Limited | ASX Announcement | | Hudson Securities Corporation Limited | ASX Announcement | | Independence Gold NL | ASX Announcement | | MIA Group Limited | ASX Announcement | | Norwest Energy NL | ASX Announcement | | Peppercorn Management Group Limited | Lodged amended Directors' Report | | Prime Television Limited | Lodged amended Directors' Report | | Spotless Group Limited | ASX Announcement | | Stericorp Limited | ASX Announcement | | Supersorb Environmental NL | ASX Announcement | | Travel Holdings Limited | ASX Announcement | | Waterco Limited | ASX Announcement | | West Australian Metals | ASX Announcement | | Western Areas NL | ASX Announcement | | Winepros Limited | ASX Announcement | | WRF Securities Limited | Lodged amended Directors' Report |   **2.4 ASIC releases new and updated compliance plan commentaries**  The Australian Securities and Investments Commission (ASIC) released on 15 April 2004 five compliance plan commentaries as practical guidance for operators of managed investments schemes in meeting their compliance obligations under Chapter 5C of the *[Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default)*.  Included in the release are two new commentaries for mortgage schemes, and three revised compliance plan commentaries for financial asset, property and agricultural schemes. The commentaries provide guidance specific to the type of scheme, and should be considered alongside Policy Statement 132 *Managed investments: Compliance plans* [PS 132]. The commentaries do not replace [PS 132].  The new commentaries for mortgage schemes provide practical examples of better compliance plans. They include a precise guide on the recommended practice in areas such as borrower assessment, valuations and default handling procedures.   The commentaries have been tailored to the two main types of mortgage schemes: contributory and pooled. Industry members may find it beneficial to use these commentaries in developing their own compliance plans or compliance procedures.  The three revised compliance plan commentaries have been re-released to provide further examples of better compliance plans, in terms of quality and content.   The updates are based on a comprehensive review of a large number of compliance plans, breach notifications and compliance plan audit reports that have been lodged with ASIC over the last two years. The aim of this review was to determine what type of compliance plan might be more likely to result in a breach of the plan or in a determination that the compliance plan is inadequate. Surveillance activities relating to responsible entities have also been reviewed.   The commentaries are available via the 'Compliance' page on the ASIC website at [www.asic.gov.au/fs](http://www.asic.gov.au/fs" \t "_new)  **2.5 Companies make financial report changes following ASIC review**  The Australian Securities and Investments Commission (ASIC) announced on 13 April 2004 the names of the companies that have made changes to their financial reports or accounting policies following ASIC's review of general compliance with accounting standards.   To date, ASIC has reviewed the audited full-year financial reports of about 400 listed companies with balance dates between 30 June and 31 July 2003 for their general compliance with accounting standards.  'The review concluded that there is no indication of systemic non-compliance with accounting standards in any specific area, based on the review sample', Mr Greg Pound, ASIC's Chief Accountant, said.  'Where non-compliance has been identified, we are pleased that, in most cases, we have been able to achieve a transparent regulatory outcome without the need for litigation. We will, however, continue to pursue the outstanding matters to a resolution', he said.  Based on the review sample, ASIC had initial reservations about the financial reports of 27 companies. In addition, the financial reports of three other companies were identified by other programs. More information was sought from the 30 companies to determine whether there was significant non-compliance with the accounting standards.   'In six cases where our preliminary concerns were confirmed the companies have now taken appropriate action to rectify the problems identified', Mr Pound said.  In another thirteen cases, ASIC is assessing whether to issue an order preventing a company from using lower content prospectus provisions of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) or formally requesting improved disclosure in future financial reports.   Another two companies may still be the subject of further action. They are currently providing ASIC with more information or documents as further clarification is required. In the final nine companies, the matters of concern have proven not to require further action.   The review also identified 25 companies that have qualified audit reports that appeared to relate to compliance with an accounting standard by the company or some other matter. ASIC has asked the companies to explain why ASIC should not order that they may not use lower content prospectuses.   Such orders have already been made against Batavia Mining Limited, for failure to keep proper books and records, and Aquacarotene Limited, where the carrying value of certain non-current assets was not in accordance with Accounting Standard AASB 1010 'Recoverable Amount of Non-Current Assets'. Further enquiries are being made before a decision is made on the remaining matters.  ASIC also reviewed the financial reports of late lodging companies and, as a result of the exercise, ASIC has ordered that a further 27 companies may not use lower content prospectuses. Details of those 27 companies appear below.  ASIC's National Insolvency Coordination Unit is also reviewing three companies with a qualified audit report relating to the ability to continue as a going concern.  ASIC is now undertaking the next phase of its surveillance reviews which covers companies with balance dates from 1 August to 31 December 2003.  **Kaz Group Limited** agreed to amend the accounting treatment that incorrectly recognised revenue on the acquisition of the remaining interest in a subsidiary company. The company made an adjustment in the financial statements for the half-year ended 31 December 2003 and reported as a 'fundamental error'. This matter was disclosed in the company's ASX announcement of 24 February 2004.  **China West International Holdings Limited** agreed to amend its financial reporting to reflect that it did not control an entity that was consolidated in its 30 June 2003 financial statements. The Company made an ASX Announcement to this effect on 25 February 2004 indicating that the necessary adjustments would be reported as fundamental errors in its 31 December 2003 half-year report.   **OPSM Group Limited** announced on 30 January 2004 that the reason for the previously announced change in its method of revenue recognition was to comply with accounting standards. On 5 March 2004 it reported its half-year results to 31 December 2003 indicating that the impact of this change had been reported as a fundamental error in those accounts.   **Pacifica Group Limited** agreed to review their deferred expenditure, and consequently, wrote off some items of deferred expenditure, and reported the write off as a 'significant item' in its 31 December 2003 financial report.   **Newhaven Park Stud Limited**, in an ASX Announcement of 12 March 2004, has indicated that it would reissue its financial report for the year ended 30 June 2003 and half-year ended 31 December 2003. The company had incorrectly changed its policy at 30 June 2003 to record broodmares at cost rather than market value. This correction results in the reported net profit at 30 June 2003 becoming a net loss and an increase in the 31 December 2003 net profit.   **Child Care Centres Australia Limited**, in an ASX Announcement of 3 April 2004, reissued its half-year financial report to 31 December 2003. The company has expensed previously capitalised costs relating to the formation of a strategic alliance and consequent company restructure. This amendment resulted in the company reporting a loss at 31 December 2003.  Companies that may not use a lower content prospectus (Section 713(6) of the Corporations Act) are:   |  |  | | --- | --- | | **30 June 2003 Full-year Financial Reports** | **Expiry date** | | Adex Holdings Limited | 7 Jan 05 | | Advanced Engine Components Limited | 11 Dec 04 | | Advantage Telecommunications Limited | 17 Mar 04 | | Commsoft Group Limited | 26 Nov 04 | | Computronics Holdings Ltd | 11 Mar 04 | | Etick Limited | 22 Dec 04 | | Fashion Intimates Limited | 11 Dec 04 | | FSA Group Limited | 3 Mar 04 | | Service Stream Ltd | 30 Sept 04 | | Green Pacific Energy Limited | 12 Jan 05 | | IM Medical Ltd | 3 Feb 05 | | Intercard Wireless Limited | 27 Jan 05 | | Koala Corporation Australia Limited | 7 Jan 05 | | Motion Picture Company of Australia Limited | 13 Jan 05 | | Objectif Telecommunications Limited | 10 Mar 05 | | OFT Limited | 13 Jan 05 | | Powerise Technology Limited | 22 Dec 04 | | Preston Resources Limited | 21 Jan 05 | | Quadtel Limited | 21 July 04 | | Safe Effect Technologies Ltd | 27 Jan 05 | | Telemedia Networks International Limited | 9 Mar 05 | | Telezon Limited | 9 Mar 05 | | Verus Investments Limited | 18 Feb 04 | | Weboz Limited | 16 Jan 05 |  |  |  | | --- | --- | | **30 June 2003 Half-year Financial Reports** | **Expiry date** | | Pacific International Limited | 27 Jan 05 | | Strarch International Limited | 27 Jan 05 | | Sunbase China Limited | 27 Jan 05 |   **2.6** **ASIC releases results of preferential remuneration project**  The Australian Securities and Investments Commission (ASIC) released on 7 April 2004 the results of a surveillance project into payments of preferential remuneration by institutions to their financial advisers.   Preferential remuneration occurs where an adviser is paid higher commission for recommending an 'in-house' product than one offered by a third party fund manager.   ASIC undertook the project to identify the extent to which the payment of preferential remuneration for recommending in-house products affected the quality of advice available to consumers, and whether these payments were adequately disclosed to investors.   The surveillance visits for this project were conducted principally during the 2002-03 financial year, prior to the introduction of the [Financial Services Reform Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=58127" \t "default).   'ASIC conducted this project to help assess the issues involved with preferential remuneration, and to better design and target our future surveillance work', ASIC's Executive Director of Financial Services Regulation, Mr Ian Johnston, said.  The project's findings revealed that financial advisers do not always disclose adequate information about the payment of preferential remuneration when 'in-house' products are recommended. The project uncovered deficiencies in documentation kept by advisors regarding what consumers are told about commissions paid, and what they are told about the advice they are given.   'The disclosure requirements under the Financial Services Reform Act, and the associated need for more detailed record-keeping address many of the deficiencies identified during the conduct of this project, particularly in relation to the disclosure of preferential remuneration. The Act applies to all financial services businesses from 11 March this year, but did not apply when ASIC conducted the surveillance', Mr Johnston said.  During this project, ASIC focused on three key legal requirements regarding the selling of financial products:  1. commissions and other remuneration must be clearly disclosed to consumers; 2. advice given to consumers must be appropriate for the consumer; and 3. there must be a clear, concise and effective record of the remuneration paid to the adviser and the advice given to the consumer.  'Financial institutions are on notice that ASIC will be paying particular attention to the selling of their 'in-house' products and the use of their 'in-house' master trusts or wrap accounts. ASIC expects that any payment of preferential remuneration will specifically be disclosed to the investor, and that licensees maintain clear records of how they and they advisers are complying with their legal obligations', Mr Johnston said.   ASIC is aware that several institutions have reviewed their remuneration practices since ASIC undertook this work. ASIC acknowledges the work undertaken by industry bodies to assist their members comply with the requirements of the Financial Services Reform Act.  'ASIC will continue to work with industry to develop appropriate guidelines for the disclosure of remuneration, and will conduct further surveillances to monitor compliance with record-keeping obligations', Mr Johnston said.  The report is available on the ASIC website at [http://www.asic.gov.au](http://www.asic.gov.au/" \t "_new)  **2.7 ASIC seeks comment on draft CLERP 9 guidance**  On 5 April 2004 the Australian Securities and Investments Commission (ASIC) announced that it is seeking comment on three guidance papers relating to the new auditor registration, audit and financial reporting and product disclosure obligations proposed under the Commonwealth Government's Corporate Law Economic Reform Program (CLERP 9) proposals.   ASIC's consultation documents comprise three policy proposal papers titled:           Auditor registration;           Auditor and financial reporting obligations; and           Product disclosure.  'On the current timetable for CLERP 9, ASIC will be administering much of the new legislation from 1 July this year. This means that new policies and processes will need to be established by that date', ASIC Executive Director of Policy and Markets Regulation, Mr Malcolm Rodgers said.  'CLERP 9 strengthens the registration process for new company auditors, and allows for companies, as well as individuals, to apply for registration. However, current registered company auditors will not have to re-register.  'Under CLERP 9, auditors will also be obliged to report suspected significant contraventions of the Act. This obligation is new and we anticipate that it will result in auditors bringing more matters to our attention', Mr Rodgers said.  The [CLERP 9 Bill](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=74342" \t "default) requires disclosure documents (such as prospectuses) produced under Chapter 6D of the Act to be clear concise and effective. This mirrors the FSR regime for Product Disclosure Statements and aims to ensure investors have sufficient information to help them make informed choices when considering the purchase of securities.  In administering this new requirement, ASIC will apply its existing policy on Product Disclosure Statements in ASIC Policy Statement 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)*, to Chapter 6D documents to ensure that the disclosure regimes for securities and financial products are as consistent as possible.  The proposals outlined in the papers are based on the CLERP 9 Bill introduced into Parliament on 4 December 2003. They do not represent final ASIC policy. The timing and content of ASIC's policy and other publications depends on the timing of the CLERP 9 Bill's progress through Parliament and whether amendments are made to it during the legislative process.   Copies of the policy proposal papers are available from the ASIC website at [www.asic.gov.au/clerp9](http://www.asic.gov.au/clerp9" \t "_new)  **(a) Summary of the policy proposal papers** The Commonwealth Treasurer introduced the CLERP 9 Bill into Parliament on 4 December 2003 (see [http://www.aph.gov.au/bills/index.htm](http://www.aph.gov.au/bills/index.htm" \t "_new)). The CLERP 9 Bill was passed by the House of Representatives on 16 February 2004 and introduced into the Senate on 1 March 2004. The CLERP 9 Bill is currently the subject of an inquiry by the Parliamentary Joint Committee on Corporations and Financial Services.   ASIC understands that the earliest date for the commencement of the CLERP 9 legislation is 1 July 2004.   **(i)** **Policy proposal paper: Auditor registration**  Part 2 of Schedule 1 of the CLERP 9 Bill applies to **individuals** who wish to become registered as auditors. It amends the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) to:           revise the educational requirements for auditor registration to include completion of a specialist course in auditing;           allow for the practical experience requirements for auditor registration to be satisfied by completion of all the components of an auditing competency standard;           make an auditor's continued registration subject to compliance with any conditions that may be imposed by ASIC in accordance with the regulations; and           replace the requirement for auditors to lodge a triennial statement with a new requirement to lodge an annual statement with ASIC.  Part 4 of Schedule 1 of the CLERP 9 Bill applies to **companies** that wish to become registered as authorised audit companies and:           sets out the regulatory requirements for a company to be registered as an authorised audit company;           makes that company's continued registration subject to compliance with any conditions that may be imposed by ASIC; and           requires the authorised audit company to lodge an annual statement with ASIC.  ASIC's policy proposal paper sets out its approach to the registration of an individual as a company auditor or a company as an authorised audit company, how it will use the power to approve an auditing competency standard and also deals with the lodgement of annual statements by registered company auditors and authorised audit companies.  **(ii)** **Policy proposal paper: Auditor and financial reporting obligations**  Part 7 of Schedule 1 of the Bill applies to **auditors** who conduct an audit of a company, registered scheme or financial services licensee and imposes:           a new obligation requiring an auditor to report to ASIC circumstances which amount to an attempt:  (a)  in relation to the audit, by any person to unduly influence or coerce, manipulate or mislead a person involved in the conduct of an audit; or  (b)  by any person, to otherwise interfere with the proper conduct of the audit;           a new obligation for an auditor to report to ASIC circumstances which the auditor suspects amount to a significant contravention of the Corporations Act; and           an obligation for an auditor to report to ASIC a suspected contravention that is not significant, if the auditor believes that the breach would not be, or has not been, adequately dealt with by raising it with the directors or commenting on it in the audit report.  Parts 1 and 2 of Schedule 2 of the Bill applies to **directors**, **CEOs** and **CFOs** who are involved in the preparation of a listed company's financial statements and the directors' report and imposes:           a new obligation for the CEO and CFO to give a declaration to the directors that the entity's financial statements have been prepared in accordance with the Corporations Act and accounting standards and give a true and fair view of the company's financial position;           a new obligation that a director state that a declaration has been made by the CEO and CFO; and           a new obligation that the directors' report include an operating and financial review that covers certain matters.  Schedule 5 of the Bill applies to **directors** and:           amends the current obligation to disclose the remuneration of directors and senior managers in the directors' report by requiring that specific information be disclosed in the remuneration report;           imposes a new obligation that the directors must put, and allow shareholders to vote on a non-binding resolution as to whether the members adopt the remuneration report; and           amends the circumstances in which shareholder approval is required before a termination payment may be made.  ASIC's policy proposal paper sets out how it believes its existing policy publications will be affected by these new obligations, and provides guidance regarding the factors that might be relevant to determining when a suspected contravention is 'significant'.   **(iii) Policy proposal paper: Product disclosure**  Schedule 7 of the Bill applies to **issuers of securities and financial products** and:   * amends the disclosure obligations in Chapter 6D and Chapter 7 of the Corporations Act relating to the secondary sale of securities and the indirect issue of financial products by providing disclosure exemptions in certain cases; * introduces a transaction specific product disclosure statement (PDS) provision (modelled on s713 of the Act); * gives ASIC the power to exclude an entity from relying on these disclosure exemptions in certain circumstances; and * imposes a new obligation that the information in a Chapter 6D disclosure document must be worded and presented in a clear, concise and effective manner.   ASIC's policy proposal paper provides guidance on how ASIC will administer the new 'clear, concise and effective' disclosure rule, and its new powers relating to the disclosure exemptions.  **2.8 ASIC's approach to regulation of financial services: breach notification and disclosure**  The Australian Securities and Investments Commission (ASIC) confirmed on 25 March 2004 that it would be taking a practical approach to regulating the new licensing and disclosure regime introduced by the *[Financial Services Reform Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=58127" \t "default)* (FSR Act).   'ASIC is committed to ensuring that the outcomes of the FSR Act are delivered in a realistic manner. We recognise there are still areas of uncertainty, particularly in relation to disclosure and reporting of breaches under the FSR legislation, and we will continue to consult with industry and consumer groups over the next 12 months and to provide guidance where it is needed', ASIC Executive Director of Financial Services Regulation, Mr Ian Johnston said.  **(a)** **Licensee breaches**  'ASIC recognises that many licence holders will be regulated for the first time. Those that are genuinely attempting to comply with the new law will have little to fear from ASIC. We are more concerned about breaches that are deliberate or systemic', Mr Johnston said.   **(i) Technical breaches**  ASIC is aware that some AFS licensees may be in technical breach of their licence because they do not have all of the licence authorisations they need to carry on their financial services business. Examples of technical breaches include:           licensees acting under a binder who did not apply for the 'issue' authorisation for general insurance products;           licensees who are advising or dealing in consumer credit insurance but did not apply for that authorisation;           licensees who applied early in the transition period and were not able to select the authorisation to advise in managed investment schemes, including IDPS services; and           licensees providing services in relation to products that fall strictly outside the normal product class definitions. In this case, certain 'miscellaneous' authorisations may be required, eg. for managed investment warrants.  Licensees in technical breach of their licence should act to remedy this situation by immediately applying to vary their licence. To do this, they should complete and lodge form FS03, available from the ASIC website at [www.asic.gov.au/licensees](http://www.asic.gov.au/asic/asic_polprac.nsf/byheadline/Ongoing+AFS+obligations?openDocument" \t "_new).  Where licensees act quickly to remedy technical breaches, ASIC will not take action against them. Where a licensee has made a simple omission at the time a licence application was made and no further assessment would have been required at the time, ASIC will not carry out any further assessment in relation to the technical variation.   **(ii)** **Significant breaches**  Under the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), licensees are required to notify ASIC in writing of any significant breaches or likely breaches, as soon as practicable and in any event within five business days of becoming aware of the breach or likely breach. In judging whether a breach or likely breach is 'significant', licensees should have regard to the following factors:           the number or frequency of similar previous breaches;           the impact of the breach or likely breach on the licensee's ability to provide the financial services covered by the licence;           the extent to which the breach or likely breach indicates that the licensee's compliance arrangements are inadequate; and           the actual or potential financial loss to clients or the licensee arising from the breach or likely breach.  ASIC expects licensees to maintain a register of all breaches identified, and to document the reasoning behind their judgment as to whether a particular breach is reportable or not. When notified of non-compliance, ASIC also expects to be notified of the reasons why a breach has occurred and the actions undertaken to address this breach.  ASIC plans to issue further guidance regarding the notification of breaches in the coming months.  **(b)** **Clear, concise and effective disclosure**  'One of the central aims of FSR disclosure is to ensure consumers have sufficient information to help them make informed choices when considering the purchase of financial products and services. As such, ASIC discourages licensees from providing their clients with documents that are overly long, and contain unnecessary information', Mr Johnston said.   'As stated in [[MR 04-062]](http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/04-062+FSR+disclosure+to+be+clear%2C+concise+and+effective?openDocument" \t "_new), issued on Wednesday 10 March 2004, ASIC is concerned to help the industry produce clear, concise and effective disclosure documents. We have already begun to consider options that will help the industry tailor documents to the particular information needs of their clients. For example, we are considering the extent to which disclosure documents provided to existing clients can "incorporate by reference" information previously provided to the client. We will also offer to work with industry to assess the feasibility of publishing constructive examples of disclosure that is clear, concise and effective', Mr Johnston said.  ASIC's policy in relation to Product Disclosure Statements is explained in ASIC Policy Statement 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* and its policy in relation to Financial Services Guides and Statements of Advice in Policy Statement 175 *Licensing: Financial product advisers — conduct and disclosure*.   Policy Statement 168 sets out the Good Disclosure Principles, which are designed to help industry produce clear, concise and effective disclosure documents that satisfy statutory requirements. They suggest that the most important information in a disclosure document should be highlighted, all relevant information should be presented together or effectively cross-referenced, and industry and legal jargon that consumers do not understand should not be used.  **2.9** **ASIC clarifies category of wholesale clients**  The Australian Securities and Investments Commission (ASIC) announced on 25 March 2004 two class orders that clarify the category of wholesale clients in the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the Act), Class Order 04/150: *Wholly-owned subsidiaries of professional investors to be treated as wholesale clients* [CO 04/150] and Class Order 04/173: *Qualified accountant - amendment* [CO 04/173].  The class orders have been issued to clarify the regulatory requirements that apply to wholesale and retail clients, given the different treatment of each under the Act. As a general rule, lighter regulatory requirements are imposed where financial services are only provided to wholesale clients.   **(a)** **Wholly owned subsidiaries of professional investors**  [CO 04/150] is a new class order that expands the category of wholesale clients to include wholly-owned subsidiaries of professional investors. This class order took effect on 2 March, 2004 and has been issued on an interim basis until 31 December 2005. The relief is interim to enable any review of the legislation in this area.  Under the Act, wholesale clients include persons who are professional investors including various financial institutions, listed entities and related bodies corporate of listed entities (such as subsidiaries).  The class order permits financial services providers who are only licensed to provide services to wholesale clients, to also provide those services to the wholly-owned subsidiaries of professional investors. For practical purposes, many companies carry on different aspects of their business through various wholly-owned subsidiaries.   **(b)** **Foreign Accountants**  [CO 04/173] amends Class Order 01/1256: *Qualified Accountant* [CO 01/1256].  The amendment recognises certain foreign accountants as qualified accountants under the Act. Qualified accountants are able to give a certificate to allow an investor to be regarded as a wholesale client or sophisticated investor for the purposes of paragraphs 708(8)(c) and 761G(7)(c) the Act. This class order also took effect on 2 March 2004. This relief is not interim.  This amending class order expands the scope of who may be a qualified accountant to include any member of a eligible foreign professional body (see below) who:   |  |  | | --- | --- | | (a) | has at least three years of practical experience in accounting or auditing; and | | (b) | is only providing a certificate for the purposes of paragraphs 708(8)(c) or 761G(7)(c) of the Act to a person who is resident in the same country (other than Australia) as that member. |   In practical terms, the relief will mean that these foreign investors (who are in fact wholesale clients) may be able to more readily access financial services from Australian financial service providers who are licensed to provide financial services to only wholesale clients.   For the purposes of the foreign accountant's class order, an eligible foreign professional body covers:           the American Institute of Certified Public Accountants;           Association of Certified Chartered Accountants (United Kingdom);           Canadian Institute of Chartered Accountants;           Institute of Chartered Accountants of New Zealand;           The Institute of Chartered Accountants in England and Wales;           The Institute of Chartered Accountants in Ireland; and           The Institute of Chartered Accountants of Scotland.  Copies of class orders [04/150] and [04/173] can be obtained from ASIC's Infoline by calling 1300 300 630 or emailing [infoline@asic.gov.au](mailto:infoline@asic.gov.au) or from the ASIC website at [www.asic.gov.au](http://www.asic.gov.au/" \t "_new). |
| **3. Recent ASX Developments** |
| **3.1 Listing rule and other developments**  **(a) New Managing Director**  On 23 April 2004 ASX announced that its new Managing Director and CEO will be Mr Tony D’Aloisio, who is currently Chief Executive Partner of Mallesons Stephen Jaques, a major Australian law firm. Further information is available on the ASX website at [http://www.asx.com.au](http://www.asx.com.au/" \t "_new)  **(b) Split of the National Guarantee Fund**  Progress towards the proposed split of the National Guarantee Fund continues. Most recently, legislation relating to the tax treatment of a payment from the fund to Australian Clearing House has passed through both houses of Parliament. This approval followed a Senate Committee hearing. The process now requires a specific Ministerial direction to split the fund; drafting and tabling of regulations pertaining to the new roles and obligations of the Australian Clearing House and the National Guarantee Fund; and a period of Parliamentary non-disallowance for those regulations. ASX anticipates finalisation of these processes by the end of this financial year.  **(c) Corporate governance**  The Implementation Review Group released its conclusions on the ASX Corporate Governance Council's guidelines on 31 March 2004. The Review Group is an independent body commissioned by the Council to report on how well the guidelines have been accepted and understood and to make recommendations to the Council. The report, together with the Council's response can be found on the [corporate governance page](http://listedcompanies.optin.com.au/cgi-bin/Lots?rin=15128789-777539&campaign=00j&linkid=00h" \t "_new) on the ASX website.  ASX has also provided a summary highlighting relevant guidance for companies. More information is in item 3.2 below.  **(d) Listing Rule developments**  **(i) Guidance Notes**  A number of [Guidance Notes](http://listedcompanies.optin.com.au/cgi-bin/Lots?rin=15128789-777539&campaign=00j&linkid=00g" \t "_new) have also been updated to reflect certain technical changes and these are also available on ASX Online and the ASX website. The Guidance Notes are:           Guidance Note 5 - CHESS Depositary Interests (CDIs)           Guidance Note 7 - Regulation S           Guidance Note 15 - Schedule of Fees           Guidance Note 16 - Trading Halts, has also been amended and updated to better express ASX policy.           Guidance Note 18 - Market Codes and Trading Procedures          Guidance Note 19 - Non-Business Days and Non-Trading Days  **(ii) Mining Sector – Joint Ore Reserves Committee (JORC) Code**  ASX recently met with the Joint Ore Reserves Committee (JORC) and associated industry bodies to discuss amendment to the JORC Code (which is incorporated into the Listing Rules and applies to mining companies reporting on ore reserves) and monitoring of JORC compliance by companies. A joint plan was adopted for ensuring compliance and enhancing the reputation of this sector, which has been the subject of significant increased activity recently.  **(e) Market, Clearing and Settlement Rule developments**  **(i) Guidance note on trade errors, cancellations and dealing disputes**  A Guidance note has been released on trade errors, cancellations and dealing disputes (refer to Market Circular 127/04 released on 19 March 2004)  The purpose of the Guidance Note is to advise Trading Participants of the intent and general operation of the new ASX Market Rules that deal with trade errors and the available rectification steps for all Products made available for trading by ASX. These rules are set out in Section 15 of the ASX Market Rules.  Prior to the introduction of the ASX Market Rules on 11 March 2004, obviously erroneous trades in Products made available for trading by ASX were addressed predominantly by mutual agreement of the Trading Participants involved. Such agreements may have involved cancellation of trades.  Section 15 of the ASX Market Rules, which consolidate the previous powers in the Business Rules for ASX and ASXF, retain mutual agreement as the primary mechanism of resolving erroneous trades. Further, they extend the dispute resolution capacity to include any Products made available for trading by ASX. Dispute resolution action decided upon by ASX may include direction to Trading Participants to amend or cancel trades.  The principles underlying the use of these powers and the obligations upon parties involved are set out in detail in the guidance note which was released with the above referenced market circular.  **(ii) Discretionary Accounts**  Following the release of ASIC Policy Statement PS179 – Managed Discretionary Account Services and Class Order O04/194 – Managed Discretionary Accounts, ASX has recommended to Market Participants that they review their policies and procedures for Discretionary Accounts.  ASX is conducting a review of the Market Rules relating to Discretionary Accounts and will amend them as soon as possible to take account of the new Class Order and Policy Statement.  **(iii) ASX WorldLink**  The ASX World Link Custody Terms & Conditions have been updated due to the recent FSR changes that came into effect 11 March 2004. Updates include references to the ASX World Link Financial Services Guide (FSG) and changes due to FSR terminology changes. Full details are available in Market Circular 139/04 dated 25 March 2004.  **(iv) Sponsorship Agreements**  The ASTC Settlement Rules became effective on 11 March 2004 which affect obligations relating to Sponsorship Agreements. As a result of the amendments the ASX Group has issued blanket “no action” relief in certain circumstances. Full details are available in ASTC Bulletin P2004/115 dated 1 April 2004.  **(f) Review of ASTC Settlement Participant Direct HINS**  ASX Compliance Services will be conducting bi-annual reviews of the registration details of Direct HINs established in CHESS by ASTC Settlement Participants.  The purpose of these reviews is to ensure that ASTC Settlement Participants are establishing Direct Holdings in CHESS only if the Holder is the ASTC Settlement Participant or a related entity of the ASTC Settlement Participant as prescribed by the ASTC Settlement Rules.  ASTC Settlement Participants must not establish Direct Holdings and assert that the investor is a Related Body when the Body is not actually related. Where a Holder is established as a Direct Holder but should be sponsored and does not have a valid Sponsorship Agreement in place, the Holder may not be aware of their rights and obligations as a Sponsorship client.  Accordingly ASTC recommends to ASTC Settlement Participants that they immediately review their current Direct Holdings in CHESS. Full details are available in ASTC Bulletin P2004/108 dated 29 March 2004.  **(g) Historical Company announcements on asx.com.au**  Market announcements by listed companies made after 1 July 2003 are now being retained on the ASX website in PDF format. At the time of writing, there is now an archive of more than eight months of such files. This complements and enhances ASX’s long-standing commitment to maintaining website access to company announcements free of charge for a rolling period of three years (currently more than six years are available). Given the superior nature of the PDF format, the effect of this decision will be progressively to improve the readability and usefulness of the total body of information available on the website.  ASX has recently completed a major technical upgrade to the website that allows web users to locate and access announcements of companies that have delisted, changed their name or changed their ASX code. Previously, such events prevented web users from successfully searching the company announcements data base. As a result of this upgrade approximately 100,000 announcements, dating back to 1998, are now available for public access.  **(h) eLodgement of ASIC forms**  ASX has now introduced a new service, called ASX Online - Professional Advisors, that allows accountants, lawyers, etc to electronically lodge specific ASIC forms such as substantial shareholder notices directly with ASX for release to the market.  These ASIC forms are available on the new website, can be completed online, and no fees or charges apply. Simply convert to PDF format and then elodge the form with ASX. To join ASX Online - Professional Advisors or for more information, contact the ASX Online Help Desk on 1800 028 302.  **3.2 ASX Corporate Governance Council response to the Implementation Review Group Report**  On 31 March 2004 the ASX Corporate Governance Council (the Council) responded to the Implementation Review Group (IRG) report on issues arising from the Council’s ‘Principles of Good Corporate Governance and Best Practice Recommendations’ (the Guidelines).  The Council welcomes the strong endorsement by the IRG and by the community of the ‘if not why not’ disclosure based approach to corporate governance adopted in Australia under the Council’s Guidelines and ASX’s framework.  The IRG’s report outlines a number of important issues and suggestions for additional guidance from the Council. The Council broadly endorses the IRG’s findings and views. This document provides the Council’s commentary on the themes developed in that Report.  **(a) General Issues**  **(i) The Recommendations are not prescriptive**  The IRG highlights serious concerns from a number of companies that by describing the Recommendations as ‘best practice’, all other approaches will be considered less than best practice. The IRG notes that the actions of some market commentators have given weight to this view by using ‘box-ticking’ approaches to assess a company’s governance practices potentially resulting in simplistic analysis. The Council shares this concern. The Recommendations are not prescriptive and the Council cautions market commentators against so treating them. As the Council stated in the introduction to the Guidelines, there is no single model of good corporate governance. The Recommendations provide a framework to help companies provide meaningful and comparable disclosure about their governance practices. They form a central framework of reference to aid investor understanding. The Recommendations are aspirational statements, but will not represent best practice for all companies in all situations. Even larger companies may consider that the interests of the company and its shareholders are best served by a governance structure which differs from the Recommendations. The only obligation is for a company to disclose to what extent they have not followed the Recommendations and why.  The Council stresses that ‘best practice’ evolves over time. It will require different approaches by different companies at different times and according to different sets of variables. A prescriptive interpretation of the Recommendations will not best serve the business and investor community in Australia. Such an interpretation will be a disincentive to companies to continually evolve and improve their practices having regard to changing market needs and their own growth path and changing circumstances.  **(ii) Disclosure sits at the heart of the governance framework**  The Council notes the IRG’s concern that a number of companies and trusts feel compelled to ‘comply’ with the Recommendations. The Council does not consider unconsidered adoption of the Recommendations to be good practice.  The Council emphasises the importance of the interaction between a company’s process of determining best practice in its own particular circumstances and the communication with investors about these practices. It is this interaction which fosters greater awareness and broader understanding of the strengths of a company’s governance regime. This also fosters an environment of on-going review which creates a more robust regime than can be achieved through prescription. A prescriptive approach to governance removes the ability for innovation and runs the risk of creating false expectations: a company which ‘ticks off’ all the Recommendations may still not have effective governance structures in place.  The Council endorses the view that the regime should continue to apply to all listed companies. This reflects an additional strength of the disclosure-based approach in that companies are free to depart from the Recommendations, with adequate disclosure, making carve-outs unnecessary. The Council also endorses the view that collective investment vehicles with separate management companies should embrace the spirit of the Principles.  As the IRG states, effective governance practices will embody the spirit of each of the 10 Principles, in a way, which is relevant to and most effective for each company. The Council agrees that disclosure of alternative governance practices should include information on how these practices embody the spirit of the relevant Principle.  The Council also believes that investors will benefit from comprehensive disclosure, even where companies have implemented practices fully in line with the Recommendations. The more disclosure that is provided, the less susceptible the company is to an overly simplistic analysis of its practices.  **(iii) Listed companies need only disclose against the Recommendations**  The Council wishes to reiterate that there are 3 levels of information provided in the guidelines:           The 10 Principles          The 28 Recommendations; and          Commentary and guidance intended to help companies understand the intended scope of the Recommendations.  Under ASX listing rule 4.10.3, listed companies must disclose against the Recommendations in their annual reports for financial years beginning after 1 January 2003. Box 2.1, which is specifically referenced by footnote and contains a base framework for a determination of independence, forms part of Recommendation 2.1.  Accordingly disclosure concerning this Recommendation must incorporate discussion of the indicators relevant to a determination of independence noted in Box 2.1. All other boxed information is included simply as commentary and guidance, except where disclosure is indicated in the ‘guide to disclosure’ at the end of each Principle. Companies may usefully decide to disclose against this guidance to provide an additional layer of information for investors. However disclosure to this level is not required under the Listing Rules.  **(b) Specific issues**  **(i) Principle 2: Structure the board to add value**  The Council recognises the problematic nature of determining independence of directors. Box 2.1 offers a central frame of reference for the determination and relevant disclosure by companies and is designed to ensure that corporate disclosure in this area is meaningful and comparable by investors. However, it is not intended to be applied in any mechanistic sense. The Council acknowledges the IRG’s concern that notions of objectivity, responsibility and ethics cannot be effectively judged according to purely objective criteria. The determination of independence remains a matter for the board’s judgment, provided that it can explain its reasoning to investors by reference to the framework established in the Recommendation. This explanation should include disclosure of specific relationships and relevant and meaningful discussion of how either materiality or immateriality of those relationships was determined.  A specific relationship, such as one identified in Box 2.1, may or may not influence a director’s ability and willingness to operate independently and objectively and to challenge the board and management. For this reason, the board may determine a director to be independent, notwithstanding the existence of a specific relationship if they consider that this relationship does not impact his/her ability to operate independently and/or if the particular conflict emerging from the relationship can be effectively quarantined. The company should disclose the nature of the relationship and outline the reasons behind its decision so that investors are provided with sufficient information to enable a reasoned assessment of the likelihood that independent judgment will be exercised.  The Council supports the additional guidance given by IRG in relation to determining the materiality of identified relationships. Earlier guidance from the Council posted on [www.asx.com.au](http://www.asx.com.au" \t "_new) highlighted that the determination of materiality requires consideration of both quantitative and qualitative elements. AASB 1031 provides guidance in relation to a quantitative assessment of materiality. An item is presumed to be immaterial if it is equal to or less than 5% of the base amount. It is presumed to be material (unless there is evidence to the contrary) if it is equal to or greater than 10% of the appropriate base amount. This would seem a reasonable starting position for consideration by the Board in determining thresholds for the company and its directors.  The Board’s assessment should also embrace qualitative factors which may influence whether a relationship is considered material such as its strategic importance, the competitive landscape, the nature of the relationship and the contractual or other arrangements governing it and other factors which point to the actual ability of the director in question to shape the direction of the company’s loyalty, as well as how the director in fact behaves. There is also a cumulative aspect to determining whether relationships result in the loss of independence.  When determining appropriate thresholds, the board should consider all relevant perspectives. For example, when determining the materiality threshold for a director’s relationship with a customer there are several issues to consider.           The materiality of the customer. This will be influenced, as noted by the IRG, by the diversity of the company’s customer base. It will also be influenced by the diversity of the customer’s supplier base. For example a narrow customer or supplier base may warrant a lower materiality threshold because each customer or supplier is strategically more significant.          The nature of the director’s relationship to that customer. For example a board may consider questions such as: is the relationship through holding office or as a shareholder? Is any monetary value derived from this relationship material to the director?  The Council understands that adoption of Recommendation 2.1 poses particular issues for smaller companies. The Council notes that the overarching principle is that the company “Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties”**.**The Council re-emphasises that the objective of Principle 2 is for a company to create an effective board to drive the success of the company. This requires that the board be structured so that it has a proper understanding of, and competence to deal with, the current and emerging issues of the business and can effectively review and challenge the performance of management and exercise independent judgment.  Having a majority of independent directors is a significant method of ensuring robust debate and objective assessment of board decisions. It does not however guarantee the competence of those directors to understand and deal with the particular business environment. As stated by the IRG, it is not a panacea and it is not the only way in which the requisite objectivity can be achieved, since all directors are bound by their fiduciary duties to shareholders.  The Council recognises that for some companies, particularly smaller companies, a majority of independent directors may not be the optimal composition to add value to the company. In these instances companies should disclose how their board composition supports an effective board and how independent judgment is ensured. The IRG’s further guidance provides some useful suggestions for additional disclosure, which a company should consider to provide additional comfort to its shareholders.  **(ii) Principle 4: Safeguard integrity in financial reporting**  The IRG makes a number of recommendations in relation to audit committees. Specific requirements apply in relation to audit committees within the S&P/ASX All Ordinaries Index. Those companies are subject to ASX Listing Rule 12.7 and are required to have an audit committee which complies with the Recommendations of the Council. The IRG raises some serious concerns regarding the viability of the compulsory application of Recommendation 4.3 to the top 500 companies. These are largely linked to difficulties identified under Principle 2 in relation to achieving majority independent boards. Feedback to the IRG highlights that, for smaller companies even within the top 500, while there is strong support for appropriate mechanisms to safeguard the integrity of financial reporting, the cost-benefit analysis does not support the need for a mandated structure for the audit committee.  The Council has been aware from the outset of the practicalities of compliance for smaller companies within the top 500. This led to the formulation of transitional arrangements for companies within the All Ordinaries Index. The Council notes that the top 300 domestic companies by market capitalisation account for 90% of the dollar value of domestic equities quoted on ASX. Within the S&P/ASX All Ordinaries Index there is substantial divergence. Company 100 has a market capitalisation of $1.2 billion, Company 200 – $381 million and Company 300 – $175 million. By company 500, the market capitalisation is $16 million.  While smaller companies within the Index will benefit from the audit committee requirement and the focused attention on the integrity of the company’s financial statements this structure enshrines, the Council believes that a prescriptive approach to audit composition is not warranted for them. An appropriate balance must be struck between the benefit and the burden to the company and its shareholders. While the aspirations of committee composition remain relevant for these companies, the Council believes that an “if not, why not” accountability trigger is better suited to companies below the top 300.  Accordingly, the Council supports a change to ASX listing rule 12.7 to limit compliance with composition Recommendations to the top 300 companies. The amended listing rule will require the top 500 companies to have an audit committee, but only the top 300 companies to compose their audit committee in accordance with Recommendation 4.32.  The Council also considers that the use of outside expertise may be appropriate where a company is otherwise unable to compose an audit committee with sufficient expertise to fulfil its role and objectives. The IRG raises valid concerns that the use of external expertise should not be seen to reduce the board’s overall responsibility for the committee’s role. The Council considers that the reasons for using external expertise and the scope of their role within the audit committee should be disclosed. Investors should also be made aware of the method for determining the external expert’s independence.  The Council endorses the further guidance provided by the IRG for companies without an audit committee or with an audit committee that does not meet the Recommendations, as to additional disclosure which they may usefully provide. The Council considers it very important that such companies explain to shareholders how the functions of an audit committee are otherwise fulfilled and the integrity of financial reports protected.  The Council is aware of the current uncertainties surrounding director liability and is sensitive to the need to avoid inadvertent exposure of individual directors to unintended liabilities. The Council fully endorses the IRG’s view that the board retains responsibility for the effective discharge of tasks delegated to board committees.  The Council is concerned that the potential trend towards increased liability for individual directors who are deemed ‘experts’ could result in a movement away from enhanced disclosure to the market of directors’ competencies. This would be counterproductive. It is likely that this would limit enhanced disclosure to the market concerning candidates for election and may make directorships and committee positions unattractive to those individuals whose expertise is most valuable.  The Council notes the IRG’s comments concerning the ‘safe harbor’ [sic] protection created in the US for “audit committee financial experts”. The Council believes that similar protections should be afforded by Australian law and will support moves towards providing legislative protection.  **(iii) Principle 7: Recognise and manage risk**  The Council notes the degree of concern generated by Recommendation 7.2 that the CEO and CFO, or equivalent, provide written assurance to the board that risk management and internal compliance systems were operating effectively throughout the financial year and continue to do so.  The Council, together with the Group of 100, responded to early concerns in November 2003 by issuing additional guidance, some of which is replicated in the IRG report. The full document is available at [www.asx.com.au/about/pdf/Principle7\_additionalguidance.pdf](http://www.asx.com.au/about/pdf/Principle7_additionalguidance.pdf" \t "_new)  The Council wishes to reiterate that the aim of providing ‘sign-off’ is to provide a reasonable, but not absolute level of assurance. The Council does not intend sign-off to imply a guarantee against adverse events or more volatile outcomes arising.  The Council agrees with the IRG that, in order to achieve an effective sign-off, a company should consider whether its CEO and CFO will need access to additional information and if so, how this might best be achieved. The IRG’s suggestion that the CEO and CFO attend board meetings, subject to appropriate exceptions, has merit.  **(iv) Principle 8: Encourage enhanced performance**  The Council supports the IRG’s recognition of the importance of regular evaluation of board and director performance in enhancing the overall effectiveness of the board and its contribution to the company. As many companies have not previously had formal approaches to assessment, the Council expects that the processes and their disclosure will develop over the next few years.  **(v) Principle 9: Remunerate fairly and responsibly**  The Council supports the further guidance suggested by the IRG in relation to the nature and scope of remuneration disclosure. Remuneration disclosure has been variable and must be improved. Investors need to be able to understand the costs and benefits of the remuneration framework.  The Council also supports the IRG’s guidance regarding valuation of options. This is a complex and evolving area. Investors will benefit from more concrete examples of the implications of performance hurdles and share price movements.  In the context of the Council’s Recommendation to “clearly distinguish the structure of non-executive directors’ remuneration from that of executives”*,* the IRG has recommended flexibility in the use of options for non-executives, subject to detailed disclosure. In this regard, the IRG considers that smaller companies with limited cash would otherwise be unable to access the necessary director expertise.  The Council has reservations about the use of option-based remuneration for non executive directors as a general approach. It is difficult to avoid issues surrounding windfall profits and the perception of the temptation towards share price management, particularly for volatile stocks. However, Recommendation 9.3 does not proscribe this use of options. A company choosing to use options this way would still need to disclose to investors how the spirit of Principle 9 is embodied in the remuneration plan and how non-executive directors’ interests are aligned to long-term benefits for investors. The IRG provides valuable guidance in this regard. The Council also notes that IFSA provides guidance in its Blue Book that option schemes for non-executive directors should be under a separate scheme from executive options. The Blue Book also gives guidance on how the scheme should be structured to minimise investor concerns, including hurdles and size of grant.  The IRG’s reasoning for restricting the scope of Recommendation 9.4 to issues of new shares is that this provides the necessary protection to shareholders against their holdings being diluted. Purchases of shares on-market, funded by the company do not dilute shareholders’ interests and impact on a company’s earnings in the same way as any other cash payment. These transactions are also transparent as they are required to appear in a company’s remuneration schedule.  Whilst the Council supports this view, the Council wishes to emphasise that this does not diminish the entitlement of shareholders to proper disclosure of the entirety of the remuneration framework and its link to performance. |
| **4. Recent Takeovers Panel Decisions** |
| **4.1 Review of Guidance Note 7 – Panel seeks public comment**  The Takeovers Panel announced on 23 April that it proposes to review the existing Guidance Note 7 on Lock-up Devices (“GN7”). GN7 provides guidance on the Panel’s attitude towards lock-up devices such as break fees, no-talk agreements, no-shop agreements and asset lock-ups.  As a first stage of this process (“GN7 Review”), the Panel invites interested parties to provide feedback in relation to their observations of GN7’s operations and application so far and what aspects (if any) should be modified.  GN7 was first issued in December 2001. At that time, the Panel recognised that lock-up devices was an area that would continue to evolve in Australia. The Panel stated in GN7 that it would monitor the evolution of, and its own experiences with, lock-up devices, and would adapt GN7 to keep it current and relevant.  The Panel considers that there has been a substantial increase in the use of lock-up devices in Australia during the two and a half years since GN7 was issued. The Panel has also dealt with 5 proceedings with issues relating to lock-up devices in that time. The Panel thinks this is therefore an appropriate time to conduct the GN7 Review.  Some specific issues on which the Panel seeks views (without restricting the matters that may be raised) are:           Has GN7’s guidance on break fees made more transactions possible, or easier to consummate? If so, how? If not, why not?          Has the existence of GN7 played a role in encouraging parties to use lock-up devices in circumstances where they would not otherwise have been used?           Have there been circumstances where a break fee, which appeared to satisfy the formal requirements of GN7, has had an adverse effect on competition? That is, are you aware of examples of potential “counter-bidders” being deterred, or shareholders being coerced into accepting a proposal, by such a break fee?          Does the 1% limit continue to represent an appropriate guideline to be applied in considering the acceptability of break fees? Should the Panel alter or clarify its application of this guideline?          Are there any particular paragraphs of GN7 which the public has had difficulty understanding and applying in transactions relating to lock-up devices?          The Panel proceedings that have dealt with lock-up devices have rarely fallen neatly into the categories or examples set out in GN7. Would it be beneficial to expand the “case examples” approach in GN7 to include the additional scenarios and elements that have been considered by the Panel in those matters?          Does GN7 give parties who are negotiating a break fee sufficient practical guidance to assess whether the specific break fee being negotiated is likely to attract adverse comment from the Panel?          Does GN7 clearly explain the key criteria the Panel will apply in assessing the effect of a lock-up device on competition for control?          Should there be any specific restrictions or prohibitions in GN7 on break fees payable to a bidder who already controls the target?          Is it appropriate for a break fee to apply to a transaction that is subject to approval by the shareholders of the grantor (in general meeting)?          Should GN7 be expanded to provide guidance on when standstill agreements would be considered likely to infringe on the principle of an efficient, competitive and informed market?  Comments are sought on the GN7 Review by Friday, 28 May 2004. GN7 is available on the Panel's website at [http://www.takeovers.gov.au](http://www.takeovers.gov.au/" \t "_new)  **4.2 Investorinfo Limited: Conclusion of Panel proceedings**  The Takeovers Panel advised on 22 April 2004 that it has concluded the proceeding (the “Proceeding”) arising from the application made by Mr Gregory Bright (“Mr Bright”) on 11 March 2004 (the “Application”) in relation to the affairs of InvestorInfo Limited (“INV”). The Panel concluded the Proceeding without making a declaration of unacceptable circumstances under section 657A, following the lodgement of a supplementary prospectus dated 21 April 2004 (“Supplementary Prospectus”) by INV and the acceptance by the Panel of undertakings from Mr Anthony Young (“Mr Young”).  **(a) Background**  **(i) Rights offer and underwriting**  Mr Young is a director and substantial shareholder of INV. Mr Young and his associates constitute the largest shareholding group of INV. As at 10 February 2004, Mr Young and his associates held 13,952,026 ordinary shares, representing 25.98% of INV’s issued capital. The issued capital of INV does not include shares to be issued under the Rights Offer, unless otherwise stated.  Mr Bright is a founder and former director of INV. As at 19 February 2004, Mr Bright and his associates held 8,592,565 ordinary shares, representing approximately 16.00% of INV’s issued capital. Mr Bright resigned from the board of INV on 23 January 2004.  On 6 February 2004, INV announced to ASX its intention to undertake a pro rata renounceable rights offer (the “Rights Offer”) under which all existing Australian and New Zealand shareholders of INV would be offered an entitlement to one new ordinary share for each ordinary share held, at an issue price of 6.7 cents per share, to raise a total of approximately $3.6 million.  On 5 February 2004 (the day before the Rights Offer was announced) INV shares were trading at 6.95 cents per share, making the issue price a 3.6% discount to the market price. The average closing price of INV shares on the five days before the Rights Offer was announced was 7.11 cents per share, making the issue price a 5.7% discount to that average market price.  On 13 February 2004, INV issued the prospectus (“Prospectus”) for the Rights Offer, to which section 713 applied. The rights under the Rights Offer commenced trading on 19 February 2004 and ceased trading on 16 March 2004.  A feature of the Rights Offer was that it was fully underwritten (the “Underwriting**”**) by Mr Young. The Underwriting stated that Mr Young would receive a fee of $72,000 in connection with the Underwriting, being 2% of the amount sought under the Prospectus. No sub-underwriters were identified in the Prospectus.  The Prospectus stated that if no one (except Mr Young and his associates) made applications under the Rights Offer, Mr Young and his associates would hold 58.93% of the post-Rights Offer issued capital in INV. The Prospectus disclosed Mr Young’s potential interests in INV shares under various scenarios of applications under the Rights Offer.  The Prospectus stated (at page 1) that INV intended to use the proceeds of the Rights Offer to “fund future acquisition or investment opportunities consistent with INV’s growth and diversification strategy”. As at 31 December 2003, INV held approximately $1.44 million in cash.  **(ii) Application**  The Application alleged that the Rights Offer and the Underwriting allowed Mr Young to acquire control over voting shares of INV in a way that was not effective or competitive. The Application also alleged that the Underwriting did not allow other INV shareholders a reasonable and equal opportunity to participate in any benefits accruing to Mr Young.  Mr Bright sought a declaration of unacceptable circumstances by the Panel and final orders to protect the rights or interests of Mr Bright and other INV shareholders (other than Mr Young) affected by the circumstances.  On 16 March 2004, the Panel received notices of appearance from two other INV shareholders advising their intention to be a party to the matter, being:           Mr Hiran Nicholas Selvaratnam, the beneficial owner of 4,050,000 ordinary shares, representing 7.54% of INV’s issued capital; and          Mr Jeffrey Bresnahan, the holder and beneficial owner of 1,015,915 ordinary shares, representing 1.89% of INV’s issued capital.  **(iii) ASIC stop order**  The Panel issued a brief to parties on 16 March 2004 seeking further details regarding the Rights Offer, the Underwriting and other relevant matters (including the seven elements listed below in relation to the Panel’s decision). The parties provided submissions in response to the brief on 18 March 2004.  On 19 March 2004, following receipt of parties’ submissions, ASIC issued an interim stop order under section 739(3) that no offers, issues, sales or transfers of shares in INV be made under the Prospectus. This interim order was replaced with a further order issued on 8 April 2004 on the same terms as the initial order. In its statement of its areas of concern, ASIC drew attention to deficiencies in the Prospectus’ disclosure regarding the proposed use of the Rights Offer proceeds.  **(iv) Supplementary Prospectus**  Following the interim stop order, INV agreed to issue the Supplementary Prospectus. The Supplementary Prospectus:           included additional disclosure regarding the intended use of funds and gave further details of potential acquisitions being investigated by the INV board in order to satisfy ASIC’s concerns;          at the suggestion of the Panel, gave shareholders an opportunity to subscribe for any shortfall shares under the Rights Offer (the ”Secondary Offer”) before those shares were dealt with under the Underwriting; and          in accordance with section 724(2), gave shareholders who had already made applications under the Rights Offer an opportunity to withdraw those applications.  The Supplementary Prospectus also provided additional details regarding sub-underwriting of the Rights Offer by Mr John Caldon. These sub-underwriting arrangements with Mr Caldon substantially reduced the potential shortfall that Mr Young may have been required to take under the Underwriting. INV has stated in the Supplementary Prospectus that Mr Caldon is not an associate of INV or any INV directors, including Mr Young and Mr Caldon has provided the Panel with a witness statement to this effect.  **(v) Mr Young’s undertakings**  Mr Young has undertaken to the Panel that he will sell any shares he is obliged to take up under the Underwriting which, when aggregated with the existing post-Rights Offer shares in which Mr Young or his associates have a relevant interest, exceed 28.3% of INV’s post-Rights Offer issued capital (“Excess Shares”).  28.3% is the maximum percentage to which Mr Young may have increased his voting power under the “creep” provision in item 9 of section 611.  Under the undertakings provided by Mr Young:           if the Excess Shares represent 5% or less of INV’s post-Rights Offer issued capital, Mr Young must sell those Excess Shares within 3 months of the date of their issue;           if the Excess Shares represent more than 5% INV’s post-Rights Offer issued capital, Mr Young must transfer those Excess Shares to a trustee (approved by the Panel) to be held on the basis that those Shares will be transferred back to Mr Young as and when Mr Young arranges for the sale of those Excess Shares. If not all the Excess Shares are sold within 3 months, then the trustee is to appoint a broker to sell the remaining shares within 1 month at the best possible price and the proceeds (net of costs) will be remitted to Mr Young via the trustee;           no sale of the Excess Shares is to be made to an associate of Mr Young or any of his associates; and          neither Mr Young nor the trustee will exercise any voting rights attached to the Excess Shares, or any voting rights attached to the same proportion of Mr Young’s existing shares as the Excess Shares represent of the whole of INV’s post-Rights Offer issued capital, until all the Excess Shares are sold.  **(b) The Panel’s decision**  In considering the Application, the Panel was keenly aware that rights issues (and their underwriting by persons connected with the issuer) are an important means of raising capital, particularly for smaller companies. The Panel was concerned not to create unnecessary regulatory restrictions for companies undertaking rights issues in the future.  In assessing whether or not the Rights Offer and the Underwriting constituted unacceptable circumstances, the Panel had reference to the indicative factors set out in Panel Guidance Note 1 ([1.25] to [1.27]) and ASIC Policy Statement 159 ([159.152] to [159.187]).  The Panel considered that the Rights Offer and the Underwriting contained a number of elements that, when taken together, may have led to control of INV passing in an unacceptable manner. Those elements include:           Mr Young’s current role as a director, his existing substantial shareholding and the potential for his voting power to increase to 58.93% through the Underwriting;          the INV board’s failure to obtain appropriate external advice regarding the Rights Offer and the Underwriting;          unsatisfactory efforts by the INV board to find an unrelated underwriter who was not an existing substantial shareholder of INV;          the small discount to market price represented by the Rights Offer price, which reduced the attractiveness to shareholders of the Rights Offer;          INV’s failure to clearly and fully explain in the Prospectus the proposed use of funds to be raised under the Rights Offer;          the INV board’s failure to seek shareholder approval for the entry by INV into the underwriting agreement with Mr Young, either in relation to item 7 of section 611 or Chapter 2E; and          INV’s relatively secure financial position and the lack of an explained and compelling need for urgent capital raising.  In the Panel’s view, the Rights Offer and the Underwriting would have resulted in unacceptable circumstances, having regard to the purposes of Chapter 6 set out in section 602, because:           INV shareholders (other than Mr Young) and the market would not have had sufficient information to make an informed assessment of the merits of the Rights Offer;          the deficiencies in the Prospectus would have inhibited an efficient, competitive and informed market in shares in INV; and          other INV shareholders may not have had a reasonable or equal opportunity to participate in the benefits accruing through the Rights Offer proposal under which Mr Young may have acquired a controlling interest in INV.  However, the Panel considers that the Supplementary Prospectus and Mr Young’s undertakings remove those circumstances which would have been considered unacceptable, by:           ensuring that Mr Young does not increase his voting power in INV through the Rights Offer or the Underwriting above the level to which he would be entitled to go under the “creep” exception in item 9 of section 611;          offering all INV shareholders an opportunity to participate on an appropriate proportional basis in any Rights Offer shortfall, in priority to Mr Young, through the Secondary Offer;          providing INV shareholders with enhanced disclosure regarding the proposed use of the funds to be raised under the Rights Offer, in response to ASIC’s concerns; and          allowing any INV shareholders whose decision to participate in the Rights Offer may have been affected by the inadequate disclosure in the initial Prospectus to withdraw their applications.  On this basis, the Panel concluded the Proceeding on the basis that it was not necessary or appropriate to make a declaration of unacceptable circumstances and no order was required. The sitting Panel comprised Les Taylor (sitting President), Peter Scott and Mark Paganin.  The Panel will post its reasons for this decision on its website ([http://www.takeovers.gov.au/](http://www.takeovers.gov.au/" \t "_new)) when they have been settled.  **4.3 Revised Rules for Panel Proceedings – Panel Releases consultation**  The Takeovers Panel advised on 20 April 2004 that it has conducted a review of its Rules for Proceedings and has posted the draft revised rules on its website.  The original Rules for Proceedings were adopted in November 2001 and the Panel decided that it was appropriate to review them in light of subsequent experience.  The Panel has been assisted in its review by a subcommittee comprising Panel members (Simon McKeon, Nerolie Withnall and Celia Searle) and interested practitioners from around Australia (Garry Besson (Gilbert & Tobin, Sydney), Bruce Dyer (Blake Dawson Waldron, Melbourne), Neil Fearis (Fearis Salter Power Shervington, Perth) and Richard Kriedemann (Allens Arthur Robinson, Sydney)).  The Panel seeks input from interested practitioners and market participants on the revised Rules. The revised Rules, marked to show changes from the current Rules, together with an explanatory note discussing the reasons for the more significant changes are at: [Public Consultation](http://www.takeovers.gov.au/display.asp?ContentID=10" \t "_new) ([http://www.takeovers.gov.au/display.asp?ContentID=10](http://www.takeovers.gov.au/display.asp?ContentID=10" \t "_new)).  Comments on the revised Rules are to be provided on or before 28 May 2004.  **4.4 Panel publishes final guidance on trust schemes**  The Takeovers Panel published on 7 April 2004 its Guidance Note on Trust Schemes. The final version has been significantly amended in response to comments received when the Panel released a draft for public consultation.  The Guidance Note is based on the Panel’s views that it has the power to examine whether a merger of listed unit trusts (and other listed managed investment schemes) involves unacceptable circumstances, but that these mergers may be effected by any lawful and effective means provided that the policies and protections contained in Chapter 6 of the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) are not thereby avoided.  The Panel has taken the opportunity not only to provide guidance on this issue but also on the disclosure and structural aspects of these transactions, using as a guide the approach of the Courts in supervising those schemes of arrangement between companies and their members which are functionally equivalent to a takeover.  The Guidance Note points out that the analogy between a company scheme and a trust merger scheme is imperfect because of the lack of a body like the Court exercising a supervisory review over a trust scheme. For this reason, the Guidance Note suggests that more of the provisions of Chapter 6 of the Act should be adopted in amended form in Trust Schemes so as to ensure that unacceptable circumstances do not arise.  The Panel has also published on its website a paper that sets out its response to the external comments that the Panel received on the consultation draft.  The Trust Schemes Guidance Note is available on the Takeover Panel’s website at [Guidance](http://www.takeovers.gov.au/display.asp?ContentID=122" \t "_new) and the Public Consultation Response Statement is available at [Consultation](http://www.takeovers.gov.au/display.asp?ContentID=10" \t "_new). |
| **5. Recent Corporate Law Decisions** |
| **5.1 Resignation during administration and the judicial validation of the 'resigned' directors' actions** (Jonathan Stewart, Blake Dawson Waldron)  Deputy Commissioner of Taxation v Chairmakers Pty Ltd [2004] VSC 109, Supreme Court of Victoria, Mandie J, 7 April 2004  The full text of the judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/vic/2004/april/2004vsc109.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2004/april/2004vsc109.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  Chairmarkers argued that sections 437C and 438B of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) operate to preclude a director from resigning whilst a company is under administration. Mandie J rejected this. Mandie J also held that Chairmakers' insolvency precluded the exercise of the judicial discretion to validate the Deed of Company Arrangement.  **(b) Facts**  On 31 May 2003, Mr Richard William Bult became a director and secretary of Chairmakers Pty Ltd. On 13 November 2003, administrators were appointed. On 12 December 2003, Mr Bult resigned, in writing, as director and secretary of Chairmakers; his written resignation along with the requisite notification were filed with ASIC. On 17 December 2003, Mr Bult purported to execute a deed of company arrangement on behalf of Chairmakers. The present litigation involved the DCT's attempt (as a creditor) to have the company wound up and set aside the Deed of Company Arrangement.  **(c) Issues for determination**  There were two main issues for determination:  1.                  Was Mr Bult's resignation effective? 2.                  Should the court exercise its discretion to validate the Deed of Company Arrangement?  **(i) Resignation during administration**  Chairmakers lawyer argued that Mr Bult's resignation on 12 December 2003 was not effective because the company was in administration. He argued that the prohibition, contained in section 437C(1) of the Corporations Act 2001 (Cth), that while a company is under administration, directors "cannot perform or exercise ... a function or power as an officer of the Company", meant that directors could not resign because the act of resignation was the performance or exercise of a function or power as an officer of the company. This construction, it was argued, was supported by the duty imposed on directors in section 438B to assist administrators: if directors were allowed to resign this obligation could be avoided.  Mandie J rejected this argument. In his view the "power" to resign was not within the functions and powers referred to in section 437C which are concerned with ensuring the administrator can effectively manage the company. In relation to the section 438B argument, Mandie J argued that it was irrelevant to the construction of section 437C. He suggested that section 438B should be addressed to former directors as well. It follows that directors are able to resign during administration.  Therefore, Mr Bult could and did resign as director on 12 December 2003. It followed that the Deed of Company Arrangement purportedly executed on 17 December 2003 was invalid.  **(ii) The discretion to validate the Deed of Company Arrangement**  The DCT argued that the Court should not exercise its discretion to validate the Deed of Arrangement on the basis that:           Chairmakers was insolvent; and          There were public interest considerations raised by related parties transactions.  Mandie J decided that the Deed of Company Arrangement should not be validated because the company was insolvent even if the debts discharged under the Deed were disregarded. Mandie J thought, on that basis, that the public interest considerations were irrelevant. Therefore, the Deed purported to be executed by Mr Bult's on 17 December 2003 was not valid and the court did not exercise its discretion to validate it.  **5.2** **Not just a rubber stamp: the Federal Court approach to negotiated settlements under the Trade Practices Act** by Tiffany Davy, Clayton Utz  Australian Competition & Consumer Commission v Chaste Corporation Pty Ltd (in liquidation) ACN 089 837 329 [2004] FCA 398, Federal Court of Australia, Spender J, 6 April 2004  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2004/april/2004fca398.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2004/april/2004fca398.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  Since the decision in Trade Practices Commission v Allied Mills Industries Pty Ltd (No 5) (1980) 60 FLR 38, the practice of the regulator and contravener making joint submissions in cases arising under section 76 of the [Trade Practices Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6426" \t "default) ('the Act') has been widely accepted. There is a long line of authority substantiating the public policy foundation for the approval of negotiated settlements which impose a pecuniary penalty. Australian Competition & Consumer Commission v Chaste Corporation affirms that the approval of negotiated settlements is subject to the Court having considered the relevant matters in section 76 of the Act and it being satisfied that the agreed penalty is within the permissible range.  **(b) Facts**  Between January and December 2000 Chaste Corporation promoted the sale of exclusive distributorships for the product "TRIMit", a weight loss pill. Mr Xenoudakis was engaged by Chaste as a sales representative between February and August 2000. During this period he recruited Area Managers to enter into exclusive distribution agreements with Chaste for the sale to retailers of "TRIMit". The recruitment process involved Mr Xenoudakis showing a video, providing documents and giving a scripted presentation. Mr Xenoudakis believed the contents of the documents, video and script to be true. However, he was aware that the materials did not disclose that Mr Peter Foster was involved in the company. His intention was to conceal the involvement of the Mr Foster as he believed the potential area managers would be less likely to buy a distributorship if they were aware that he was part of the company.  The documents provided by Mr Xenoudakis included an Area Management Agreement ('AMA') and an Area Management Proposal ('AMP'). The AMA contained a term under which Chaste would fix the price at which the Area Managers sold the product to retailers. This price was not to be discounted without the written permission of Chaste. The AMP also contained statements of price which could have been understood to indicate a price below which the stock was not to be sold to the retailers.  The ACCC commenced an action against Chaste Corporation and nine others, one of whom was Mr Xenoudakis, for the contravention of the resale price maintenance and misleading and deceptive conduct provisions of the Act.  The ACCC and Constantine Xenoudakis (the 7th respondent) filed consent orders with the Registry of the Federal Court pursuant to Order 35 rule 10 of the [Federal Court Rules](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=8830" \t "default). Order 35 rule 10(2)(a) provides that:  "if a written consent is filed, ... the Registrar must bring the matter before a Judge who, without any other application being made, may:  (i) make an order in accordance with rule 10A; or (ii) direct the Registrar, ... to draw up, sign and affix the stamp of the Court to an order in accordance with the terms of the consent."  The consent orders were accompanied by joint submissions setting out the agreed facts and arguments in support of the proposed orders. The ACCC alleged and Mr Xenoudakis admitted in the submissions that he was "knowingly concerned in or party to, and aided or abetted breaches" by Chaste Corporation of sections 48, 52, and 96 of the Act, and that $25,000 was the appropriate penalty.  **(c) Decision**  Spender J did not consider that an order pursuant to Order 35 rule 10 of the Federal Court Rules was an appropriate way for the Court to deal with this settlement. Rather, he held that the Court must have regard to section 76(1)(e) of the Act in granting orders giving effect to such a settlement. Section 76 provides that before the Court imposes a penalty for a breach of a provision of Part IV of the Act it must be satisfied that a person has "been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by a person of [a provision of Part IV]". In doing so, the Court must have "regard to all relevant matters including the nature and extent of the act or omission and of any loss or damage suffered as a result of the act or omission, the circumstances in which the act or omission took place and whether the person has previously been found by the Court in proceedings under this Part ... to have engaged in any similar conduct."  Spender J followed the principle set down by the Full Court in NW Frozen Foods Pty Ltd v Australian Competition and Consumer Commission (1997) 71 FCR 285 in which the Court said (at 298):  'The question is ... simply whether, in the performance of the Court's duty under s 76, this particular penalty proposed with the consent of the corporation involved and of the Commission, is one that the Court should determine to be appropriate."  and at 291:  'A proper figure is one within the permissible range in all the circumstances. The Court will not depart from an agreed figure merely because it might otherwise have been disposed to select some other figure, or except in a clear case."  This principle does not bind the Court to accept a penalty that is agreed between the parties. However, it does indicate that the Court is disposed to consider the proposed amount.  Spender J relied upon the arguments in support of the proposed sum of the penalty contained in the joint submissions made by the ACCC and Mr Xenoudakis when considering the relevant matters required by section 76. The parties identified that the penalty sum of $25,000 was a "50% reduction in what otherwise would have been recommended ... given the high level of co-operation [by Mr Xenoudakis] after proceedings were instituted." His Honour also noted that the "highest penalty imposed on an individual was $75,000" (see ACCC v Hugo Boss (Australia) Pty Ltd (1996) ATPR 41-536). Thus the penalty was within the permissible range. Spender J held that the penalty recommended by the parties was an order that was appropriate for the Court to make.  **5.3** **Corporations Act section 420A and a mortgagee’s duties in the event of sale.** (By Kristy Parsons, Corrs Chambers Westgarth)  Ultimate Property Group Pty Ltd v Lord [2004] NSWSC 114, Supreme Court of New South Wales Equity Division, Young CJ, 4 March 2004.  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/march/2004nswsc114.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/march/2004nswsc114.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  This case arose from a mortgage sale where the proceeds of the sale were inadequate to clear the outstanding balance. The mortgagor and guarantors sought to argue that they should not be responsible for the shortfall, on the basis that the price obtained for the property was below its proper value and/or that additional funds could have been raised had the mortgagee adopted a margin scheme so that no GST would have been payable on the sale. Although the case was decided on factual grounds, it contains a useful discussion of the duties owed by a mortgagee on realisation of an asset and in particular section 420A of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default).  **(b) Facts**  In this case the first plaintiff Ultimate Property Group (UPG) entered into a mortgage with St George Bank (SGB) over a property located in Silverwater. The performance of this mortgage was guaranteed by the three remaining plaintiffs.  In April 2000 Mr Lord was appointed by SGB to act, within the meaning of the Corporation Act, as “controller” of the mortgaged property. Pursuant to this, in December 2001 the defendants (Mr Lord and SGB) sold the property for a sum of $1,350,000, of which $1,227,273 was recouped following a required GST payment of $122,727. This sale price however left a deficit of $342,188,77, which pursuant to the guarantee, was to be paid by the three guarantors.  **(c) Discussion of section 420A of the Corporations Act**  In this case it was alleged by the plaintiffs that the defendants had breached their statutory obligations under section 420A of the Corporations Act. Section 420A provides that:  In exercising a power of sale in respect of property of a corporation, a controller must take all reasonable care to sell the property for:           if, when it is sold, it has a market value - not less than that market value; or          otherwise - the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold.  As noted by Young CJ, the difficulty which exists with applying section 420A is that although simply worded, the consequences of breaching this provision are not specified, in that section 420A is neither a civil, nor criminal liability section.  In an attempt to resolve this, Young CJ considered the history of this provision and its possible sources. In doing so Young CJ noted that section 420A as it stands bears no resemblance to the formulations originally suggested by the Australian Law Reform Commission. Instead as noted by Young CJ, section 420A more closely resembles provisions contained in New Zealand legislation, using at it does the phrases ‘market value’ and ‘reasonable care’.  In terms of the operation of section 420A, reference was made to two earlier decisions of the same court, these being Artistic Builders Pty Ltd v Elliot and Tuthill (Mortgages) Pty Ltd (2002) 10 BPR 19,565 and GE Capital Australia v Davis (2002) 11 BPR 20,529. In relation to Artistic Builders, Young CJ noted that in that case Campbell J adopted the approach that when considering section 420A, the key question for the court is whether the mortgagor exercised reasonable care throughout the sale process. For Campbell J then, the actual valuation of the property and whether its market value was achieved were unnecessary considerations. Young CJ however disagreed with this approach, arguing that given the wording of section 420A consideration does indeed need to be had as to whether the property upon sale reached its market price.  The GE Capital case involved an attempt by guarantors to invoke section 420A. This claim however proved unsuccessful as Bryson J was of the opinion that section 420A neither conferred any rights on guarantors, nor did it provide guarantors a right to common law damages. In the present case Young CJ agreed with this interpretation, holding that section 420A either takes precedence over traditional means of determining controller’s liability when selling mortgaged property, or alternatively comes into operation when accounts are made between a mortgagor and mortgagee of the sale proceeds. Young CJ also rejected the implication that no action could be brought under section 420A based simply on the fact that the legislature failed to proscribe consequences for its breach. Rather what Young CJ considered is that breach of section 420A can give rise to a private action for equitable damages.  **(d) Decision regarding section 420A**  Despite this interpretation, Young CJ held that the plaintiff’s submission failed, as neither a mortgagor’s general equitable duty to act in good faith (as discussed below), nor section 420A operate so as to entitle a wronged party to damages or compensation per se. Rather as mentioned above the operation of section 420A becomes relevant when accounts are taken.  In determining whether in the present case accounts needed to be made between the mortgagor and mortgagee, consideration was had by Young CJ as to the market value of the mortgaged property. After considering the various valuations which had been submitted regarding the mortgaged property, Young CJ determined that at the time of its sale its appropriate market value was $1,350,000.  In light of this it was held that there was no need to account under section 420A, as the land was not sold at an undervaluation. Young CJ similarly rejected the plaintiff’s submission that there had been a miscalculation as to the value of the land by a valuer of SGB. This conclusion was reached on the basis that Mr Lord the controller had in fact never relied upon this valuation when determining the sale price. So too did Young CJ reject the plaintiff’s second argument regarding the defendant’s failure to use a “margin scheme” so to avoid a GST payment, with Young CJ holding that although “there is an obligation to sell at a proper price, there is no duty to sell in a tax effective way.”  **(e) Discussion regarding common law and equitable duties of a mortgagee**  As well as discussing in depth the operation of section 420A, consideration was also had by Young CJ as to what obligations if any arose at common law and equity when a mortgaged property is sold. Consistent with earlier Australian authorities such as Pendlebury v Colonial Mutual Life Assurance Society Ltd (1912) 13 CLR 477, Expo International Pty v Chant [1979] 2 NSWLR 820 and Gomez v State Bank of NSW [2001] FCA 1059, Young CJ rejected the principle from the English case of Cuckmere Brick Co Ltd v Mutual Finance [1971] Ch 949 that a mortgagee, when exercising the power of sale, must take reasonable care to obtain the true market value of the property. Instead Young CJ adopted the equity based test of “good faith”, the operation of which imposes on mortgagees an equitable duty to act conscionably towards the mortgagor and those claiming through the mortgagor.  Accordingly for a mortgagor to merely prove that a mortgaged property was sold at less than its market value is insufficient. Instead redress can only be sought against a mortgagee when it can be shown that they have not acted in good faith and as such have wilfully or recklessly disregarded the mortgagor’s interests. On the facts however there was no suggestion that the defendants had acted in such a manner.  **5.4 Removal of administrator** (By Michael Crichton, Blake Dawson Waldron)  Paradise Constructors Pty Ltd (administrator appointed); Pong Property Development Pty Ltd v Sleiman [2004] VSC 92, Supreme Court of Victoria, Mandie J, 30 March 2004.  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/vic/2004/march/2004vsc92.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2004/march/2004vsc92.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  The Plaintiff (Pong Property Developments Pty Ltd) sought orders pursuant to the Court's general power to make orders under section 447A of the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) that the First Defendant ("Mr Sleiman") be removed as administrator of Paradise Constructions Pty Ltd ("Paradise"), and that the court appoint an alternative administrator independent of directors and creditors,. Alternatively the plaintiff sought an order that Paradise be wound up. The Plaintiff joined the Second Defendant ("Mr Strangio") who was the sole director of Paradise.  The Plaintiff's argument was that Mr Sleiman was biased against the Plaintiff, and in favour of Mr Strangio, and not independent nor able to properly serve the interests of the creditors. In addition, because Paradise was hopelessly insolvent, there was no point in the administration continuing, and a liquidator should be appointed.  Mandie J held that Mr Sleiman should be removed as administrator of Paradise for two reasons. First, Mr Sleiman showed an objective lack of independence. Secondly, he failed to properly carry out his duties as an administrator.  In addition, his Honour held that it was inappropriate and not in the public interest for Paradise to remain in administration.  Orders were made under section 447A of the Corporations Act to remove Mr Sleiman as administrator, to terminate the administration, and to wind up Paradise.  **(b) Facts**  Mr Strangio held all of the 12 issued ordinary shares of Paradise. He was also the company secretary.  Paradise commenced some building work for the Plaintiff in December 2001. However, for a number of reasons relating to the quality and timeliness of Paradise's work, the Plaintiff made a claim for damages against Paradise and Mr Strangio in the Victorian Civil and Administrative Tribunal. Paradise and Mr Strangio made a counterclaim for damages in excess of $300,000.  On 19December 2003, Mr Strangio appointed Mr Sleiman as the administrator of Paradise. At the first creditors meeting, Mr Sleiman was present not in person but via a telephone link from Sydney. At the meeting, Mr Burstyner, a lawyer for a creditor, at whose office the meeting was being held, prompted Mr Sleiman on a number of questions from creditors relating to the validity of Mr Sleiman's appointment as an administrator.  At a second creditors meeting, the administrator's report gave the opinion that it would be in the creditors' interests to accept a deed of company arrangement which paid two cents in the dollar for creditors. This was contrasted to the 'costs, uncertainties, and delays' involved in the winding up of Paradise.  Relevant facts to come out in evidence were:           Mr Sleiman was paid $10,000 to initiate the administration by a 'third party' who was later identified as Mr Strangio. A further $12,000 was arranged to be paid to Mr Sleiman by Mr Strangio when a deed of arrangement was entered into by the creditors.           The deed of arrangement was envisaged from the first discussion Mr Sleiman ever had with Mr Strangio.          Mr Sleiman used the cash books of Paradise in coming to the suggestion of a deed of arrangement for the creditors. He had no access to creditors' ledgers, profit and loss statements, or balance sheets. In addition, a list of debtors of Paradise couldn’t be compiled, and the list of creditors given to him by Mr Strangio couldn’t be independently verified by him because of a lack of these records.           Mr Sleiman gave the view that it wasn’t in the best interests of the creditors for Paradise to be wound up 'because there was a potentially valuable asset (the counterclaim against the Plaintiff) they were attempting to recover' and if there were not an asset, he wouldn’t have recommended a deed. However, Mr Sleiman conceded that if the deed of arrangement was approved, the company and not the creditors would receive the asset. Mr Sleiman had no evidence to suggest that the asset would be collectable in any event.           It was accepted that Paradise was hopelessly insolvent, and had been for some time.  **(c) Decision**  Mandie J was satisfied that the Plaintiff was an 'interested person' within the meaning of section 447A(4)(f), and therefore had standing to make this application pursuant to section 447A. The Plaintiff also made applications under sections 447(B)(2) and 449B. These sections provide for the application to be made by a creditor of the company concerned. His Honour felt there wasn’t enough evidence to determine whether the Plaintiff was in fact a creditor, and as such the Court dealt with the Plaintiff's application under section 447A only.  It was considered whether the Court had power to remove an administrator and/or to terminate the administration for the sole purpose of ordering the winding up of a company. The power conferred by section 447A is a broad and plenary power, according to Young J in Cawthorn v Keira Constructions Pty Ltd (1994) 33 NSWLR 607, 611. In this case, his Honour agreed with Wallwork J in Deputy Commissioner of Taxation v Woodings (1995) 16 ACSR 266, in so far as that case decided that the court had power in the public interest under section 447A, independently of any other empowering provision in the Corporations Act, to wind up a company and to terminate an administration for that purpose.  Thus in the present case, as it was disputed whether the Plaintiff was a creditor, the court did not have the power to make a winding up order under any other provision of the Act. Therefore, if it was just and appropriate to wind up Paradise in the public interest, section 447A fills a gap otherwise left in the legislation under Part 5.3A.  There were two reasons why Mandie J felt Mr Sleiman should be removed as administrator. The first is that his Honour felt Mr Sleiman had shown a lack of independence. Mr Sleiman appeared to have approached the administration with the object of achieving a deed of company arrangement, indicated by the content of his discussions with Mr Strangio prior to the administration relating to Mr Sleiman's funding. It was felt that he did not or did not appear to conduct his duties as administrator with an impartial frame of mind. This lack of independence was shown in the first creditors meeting.  The second reason is that Mr Sleiman failed to properly carry out his duties as administrator. His Honour was of the opinion that it was unlawful or at least inappropriate for the person presiding at a creditors' meeting under Part 5.3A to 'preside' by telephone. It wasn’t a satisfactory way of dealing with the creditors' concerns, nor did it provide an appropriate mechanism for counting the votes which were cast on resolutions at the meeting. In addition, his Honour felt Mr Sleiman failed to investigate adequately the affairs and financial circumstances of Paradise. The records provided to him were insufficient to form sound views about whether a deed of company arrangement was the best outcome for creditors. Mr Sleiman's failure to make an assessment on the possibility of collection of the large claim against the Plaintiff was a serious omission in the context of recommending a deed of company arrangement which offered a trivial two cents in the dollar to creditors.  The final point his Honour made was that it was inappropriate for Paradise to remain in administration under Part 5.3A for a number of reasons.  In cases where the affairs of the company are properly investigated, it may be better for creditors to agree to a deed of company arrangement, so as to receive some payment, however small. However, his Honour felt that it was not in the public interest to permit a deed of company arrangement to go forward where nothing was really known about a company or its financial affairs, and where the result of the deed would be an extremely small payment to creditors.  His Honour inferred that Mr Strangio's purpose in seeking a deed of company arrangement was one of self interest so he could either receive the benefit of Paradise's claim against the Plaintiff, or avoid potential liability for pre-administration transactions relating to insolvent trading, or both. Thus, in addition it was not in the public interest for the administration to continue and for Paradise to continue on as an insolvent company controlled by Mr Strangio.  Accordingly, his Honour was of the view that it was just and appropriate that Paradise be wound up in insolvency.  The Court ordered that Mr Sleiman be removed as administrator, and that Paradise be wound up in insolvency under the Corporations Act.  **5.5 Experience required for registration as an official liquidator** (By Celia Hogarth and Neil Jack, Freehills)  David Lofthouse v Australian Securities & Investments Commission [2004] AATA 327, Administrative Appeals Tribunal, Deputy President S A Forgie and Mr E Fice, 30 March 2004  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/aata/2004/march/2004aata327.htm](http://cclsr.law.unimelb.edu.au/judgments/states/aata/2004/march/2004aata327.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  The Administrative Appeals Tribunal has set aside ASIC’s decision to refuse an application by Mr Lofthouse for registration as an official liquidator.  The Tribunal found that ASIC should take into account a broader range of experience than that described in ASIC Policy Statement 24 when determining an application for registration as an official liquidator. Firstly, the policy statement’s focus on experience in insolvency windings up is unjustifiably narrow, in view of the context of the legislation and the broader role of an official liquidator. Secondly, when considering experience in insolvency windings up, the focus on involvement in the liquidation of insolvent companies is inconsistent with the statute. Experience and knowledge gained from other work as a liquidator in a voluntary liquidation, an administrator, a receiver, or a receiver and manager may be relevant. The most important consideration is whether, in the work the applicant has undertaken, they have shown the qualities required of a person who may be registered as an official liquidator.  **(b) Facts**  On 17 December 2002, ASIC refused Mr Lofthouse’s application for registration as an official liquidator under section 1283 of the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). Mr Lofthouse applied to the Administrative Appeals Tribunal for a review of that decision.  The evidence showed that Mr Lofthouse had been an insolvency practitioner since 1985. Between April 1997 and July 2002, Mr Lofthouse had been engaged either as the manager or the appointee in 275 corporate insolvency administrations.  **(c) Decision**  **(i) Relevant provision and policy**  The Tribunal examined the legislative provisions and policy statements relevant to an application for registration as an official liquidator. Section 1283(1) provides that “ASIC may register as an official liquidator a natural person who is a registered liquidator”.  Policy Statement 24 sets out how ASIC exercises its discretionary power under section 1283. In relation to experience, paragraph PS24.7 of that Policy Statement provides that a candidate for registration as an official liquidator must:           have had, since registration as a liquidator, at least two years continuous experience in insolvency administrations including windings up, receiverships and reconstructions, some of which are court appointed, working at the most senior level under the direct supervision of an official liquidator; and          show involvement in the liquidation of insolvent companies, including his or her contributions to decisions taken in the course of administering complex windings up ordered by the court.  The Tribunal acknowledged that a body such as ASIC may adopt a policy as a guide to decision-making. However, it quoted from Re Drake and Minister for Immigration and Ethnic Affairs (No 2) (1979) 2 ALD 634, where Brennan J stated: “Of course, a policy must be consistent with the statute. It must allow the Minister to take into account the relevant circumstances, it must not require him to take into account irrelevant circumstances, and it must not serve a purpose foreign to the purpose for which the discretionary power was created. A policy which contravenes these criteria would be inconsistent with the statute.”  **(ii) Consistency of PS24 with the statute**  The Tribunal examined the context of the Act to ascertain the limits of ASIC’s power to make a decision whether to register a person as an official liquidator. The Tribunal identified a number of qualifications and qualities which, in its opinion, would be relevant to whether or not a registered liquidator should be appointed as an official liquidator under the Act, including:           experience as a registered liquidator that demonstrates integrity, independence and impartiality that fits them to carry out the duties of an official liquidator as an officer of the Court and the fiduciary duties of an official liquidator;          experience as a registered liquidator that demonstrates knowledge of the duties and responsibilities of a registered liquidator and of an official liquidator and the capacity to undertake the range of work required of a registered liquidator and of an official liquidator under the Act, including windings up ordered by a Court;          staff and other resources to enable them to conduct the practice of an official liquidator; and          appropriate training and operational manuals.  The Tribunal noted that one of the criteria in PS24 focusses entirely on the applicant’s experience in “insolvency administrations”. The Tribunal found that it was unable to identify the reason for this focus. This would not include other work that may be performed only by an official liquidator such as windings up under Part 5.4A. To adopt such a narrow focus seemed to be inconsistent with the role and responsibilities imposed upon an official liquidator by the Act. Furthermore, not all “insolvency administrations” need be performed by an official liquidator (eg receiverships).  Secondly, the Tribunal examined the criteria in PS24 requiring the applicant to “show involvement in the liquidation of insolvent companies”. The Tribunal observed that a consideration of whether or not a person has the appropriate qualities to be registered as an official liquidator can in fact be gleaned from the full range of their work. It held that there is no reason why that consideration should be limited to insolvency work as a liquidator, as prescribed by Policy Statement 24. Thus experience and knowledge gained from other work as a liquidator in a voluntary liquidation, an administrator, a receiver, or a receiver and manager may be relevant. What is important is whether, in the work the applicant has undertaken, they have shown the qualities required of a person who may be registered as an official liquidator.  **(iii) Application to facts of case**  The evidence presented by Mr Lofthouse indicated that:           he had dealt with complex issues in a number of matters;          he had demonstrated an understanding of the fiduciary duties required of an official liquidator;          he was able to bring a dispassionate and balanced approach to the performance of his duties as is befitting an officer of the Court;          he had a wide understanding of the nature of the duties and responsibilities of the work of a registered liquidator; and          the range of work that he had undertaken over a long period of time indicated his capacity to undertake the range of work required of an official liquidator.  The Tribunal concluded on the basis of the evidence that Mr Lofthouse had appropriate experience and qualifications to be registered as an official liquidator. It ordered that ASIC’s decision be set aside and substituted its own decision that Mr Lofthouse be registered as an official liquidator pursuant to section 1283.  **5.6 Further guidance on the definition of a managed investment scheme** (By Anastassia Tchernova, Financial Services Group, Clayton Utz)  Australian Securities and Investments Commission v Drury Management Pty Ltd [2004] QSC 068, Supreme Court of Queensland, Jones J, 29 March 2004  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/qld/2004/march/2004qsc068.htm](http://cclsr.law.unimelb.edu.au/judgments/states/qld/2004/march/2004qsc068.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  ASIC successfully sought declarations that each of the four respondents contravened section 601ED(5) of the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) ("Act") by carrying on an unregistered managed investment scheme and infringed section 911A of the Act and its predecessors by carrying on a financial services business without being a holder of a relevant licence.  **(b) Facts**  Since 4 June 2002 ASIC had been investigating the affairs of the parties. A company (first respondent) through its 2 directors (second and third respondents) solicited funds from investors on an unsecured basis, evidenced by various documents. The terms of the arrangement provided for payment of interest to contributors at rates much higher than the prevailing commercial rates, and in some cases, guaranteed the return of investment capital. There were 118 contributors who have made contributions of capital of $7,970,206. The funds were applied to the purchase of stocks, bonds, real estate in Australia and overseas, and financing of loans to associated companies.  The fourth respondent was a company whose sole director was the wife of the second respondent.  As the parties argued that there was no managed investment scheme in existence, the question before the court was whether the receipt of the funds from contributors and the manner in which they were applied fell within the definition of a "managed investment scheme" in section 9 of the Act.  **(c) Decision**  The definition of a "managed investment scheme" in section 9 of the Act is a scheme that has the following elements:           contributions of money to acquire benefits produced by the scheme;          pooling of the contributions to produce financial benefits for the contributors; and          the members have no day-to-day control over the operation of the scheme.  The court confirmed the meaning given to the word "scheme" in Australian Softwood Forest Pty Ltd v Attorney General to the State of New South Wales (1981) 148 CLR 121 at 129 as being very wide and requiring that there should be "some programme, or plan of action".  **(i) Contributions**  The conduct of the parties had a distinct pattern in how the potential contributors were invited to make the contributions. The court found that the persons contributing money did so to acquire rights in the form of interest to be produced by the scheme.  **(ii) Pooling**  The court found that this part of the definition was satisfied, as the contributions were pooled in the two bank accounts in the name of the company. Three of the contributors were told by the second or the third respondent that the monies were to be pooled with the funds of other people.  The respondents argued that this element additionally required that there must be shown in the minds of the contributors an intention of this prospective action of pooling, or that there must be a scheme already in existence which is within the contemplation of the contributors. The court rejected these arguments and said that whether the contributions were to be pooled was a question of fact, and could be established in any of the following ways:           the scheme's promoters declared that contributions would be pooled;          the scheme could only be given effect if the funds were pooled; and          the funds were in fact pooled by the operators of the scheme, as this would evidence a previous intention by the scheme managers to do so.  This interpretation by the court confirmed the previous authority on the point in ASIC v Enterprise Solutions 2000 Pty Ltd [2000] QCA 452.  **(iii) Day-to-day control**  The contributors did not have the day-to-day control of the scheme. They could not give any direction to the respondents in relation to the receipt of the contributions and their disposition.  **(iv) Contraventions of section 601ED of the Act**  The court concluded that the conduct of the parties in obtaining funds from the contributors and their disposition constituted a managed investment scheme within the meaning of the Act, and thus had to be registered under section 601EB. The failure to register the scheme was a direct contravention of the Act.  The court considered the meaning of the word "operate", as one of the parties sought to argue that it was merely carrying on its business and was not operating a scheme. In ASIC v Pegasus Leveraged Options Group Pty Ltd [2002] NSWSC 310 at paragraph 55, "operate" was to be given its ordinary meaning. The term was not used to refer to ownership but rather to the acts which constitute the management or carrying out of activities which constitute the managed investment scheme. Thus, although that respondent did not have any contact with the contributors, it was an integral part of the scheme by receiving the scheme funds and disposing of them.  **(v) Contraventions of section 911A of the Act and its predecessors**  Further, the court found that the first three respondents breached section 911A of the Act and its predecessors, which prohibit a person from carrying on a financial services business without holding an Australian financial services licence covering the provision of the financial services.  In relation to the fourth respondent, the court had to consider whether it was carrying on a business. The court made a distinction between the meaning of the words "carry on" and "operate". In the context of the predecessors to section 911A, the term "carry on" was not equivalent to the term "operate". The term referred not to the operations of a business but to the proprietorship of the business: ASIC v Pegasus.  The court made the declarations sought by ASIC and, among others, made an order that the managed investment scheme carried on by the parties be wound up.  **5.7 Recovering proceeds of international fraud – the ‘exclusionary rule’ and constructive trusts** Sonia McMillan, Phillips Fox  Robb Evans of Robb Evans & Associates v European Bank Limited [2004] NSWCA 82, New South Wales Court of Appeal, Spigelman CJ Handley JA Santow JA,  25 March 2004.  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/march/2004nswca82.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/march/2004nswca82.htm" \t "_new) or  [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  The Appellant is the appointed receiver of Benford Limited, a company incorporated in Vanuatu. Between February and April 1999, the respondent deposited funds totaling US$7,527,900 into a deposit account in the name of Benford Limited. These funds formed part of the proceeds of fraudulent activity engaged in by the controllers of Benford against numerous credit card holders in the United States of America. The Respondent subsequently transferred these funds into an account in its own name with Citibank Limited in Sydney.  The Appellant brought proceedings in the Equity Division of the New South Wales Supreme Court to recover the funds from the Respondent.  The Trial judge, Palmer J, held that the claims made by the Appellant were unenforceable on the basis that the rules of private international law prevent an Australian court from entertaining an action for the enforcement of a foreign penal or public law, in this case the enforcement of the United States Federal Trade Commission Act.  Furthermore, it was held by Palmer J that even if the Appellant’s claim was enforceable within the court’s jurisdiction, the Respondent was not a constructive trustee of the funds held by Citibank for Benford Limited.  The Court of Appeal held that the exclusionary rule did not apply to this case and therefore the Appellant’s claim was enforceable, however a constructive trust had not been created and the Appellant had no equitable interest in the deposit held by Citibank.  The appeal was therefore dismissed.  **(b) Facts**  The fraudulent activity upon which the Appellant’s claim is based, began in 1997, when Mr Kenneth Taves purchased a database of nearly 1 million credit card numbers from Charter Pacific Bank. Mr Taves and his associated companies proceeded to use credit card numbers from this database to process unauthorised charges to those accounts.  By 1998, a total of US$47,512,530 had been fraudulently debited, most of which was transferred to an account in the Cayman Islands.  In 1999, the fraud was detected by the Federal Trade Commission (FTC) which subsequently filed a ‘Complaint for Permanent Injunction and other Equitable Relief’ in California. The FTC sought preliminary and permanent injunctive relief, rescission of contracts, restitution, disgorgement and other equitable relief against Mr and Mrs Taves and the Taves companies pursuant to the Californian Court’s general equitable jurisdiction, as well as under section 13(b) of the FTC Act.  Between February and April 1999, Mr Taves transferred some of the proceeds of the fraud from the Cayman Islands account to an account held by the Respondent, in the name of Benford Limited, a company incorporated in Vanuatu.  The Respondent subsequently transferred these funds to an account held by Citibank, in its own name, at a higher rate of interest. The account held funds totaling US$8,110,073.  It is the recovery of funds in the Citibank account which formed the basis of this appeal.  The Appellant claimed that the ‘exclusionary rule’ did not apply in this case, thus allowing an Australian court to enforce a foreign penal or public law. The Appellant also claimed that the funds were being held on constructive trust for Benford, giving rise to an equitable right over the deposit with Citibank.  **(c) The ‘exclusionary rule’**  Australian courts are prevented from enforcing foreign laws whose operation would secure a governmental interest of a foreign state when doing so exercises a ‘power peculiar to government’. This is known as the ‘exclusionary rule’.  Whether the enforcement of a foreign statute constitutes a governmental interest subject to the exclusionary rule depends upon the scope, nature and purpose of the provisions being enforced and the substance, rather than the form, of the proceedings.  The issue in this proceeding was whether, as a matter of substance, the Appellant, as the receiver, was seeking to enforce, outside the jurisdiction of the United States, the governmental interests of the United States, and in doing so, exercise powers peculiar to government.  Not all foreign statutes which serve the public interest fall within the exclusionary rule. For example, regulatory regimes providing consumer protection may serve a public interest and be classified as public laws, without constituting a governmental interest which falls within the scope of the exclusionary rule.  The Court of Appeal held that the exclusionary rule did not apply in this case. As the receiver of Benford Limited, the Appellant sought to recover funds to compensate defrauded credit card holders. It was therefore concluded by the Court, that neither the possibility of any undistributed surplus being returned to the United States Treasury, nor the fact that recovered funds would first be pooled, rather than directly refunded to particular defrauded credit card holders, should alter that characterisation of the proceedings.  The Court of Appeal went on to state that there was nothing in this case which could be characterised as a governmental interest within the meaning of governmental interest applied by Australian authorities (that is, an interest which enforced would give rise to the exercise of a power peculiar to government).  In accepting the exclusionary rule did not apply to this case, the Court of Appeal proceeded to consider the Appellant’s claim to an equitable interest in the deposit with Citibank.  **(d) Constructive trust giving rise to equitable right over funds**  The Appellant contended that Benford Limited was a constructive trustee for the defrauded credit card holders over the proceeds of the fraudulently deposited funds in the Benford Limited account held by the Respondent.  As receiver of Benford, with power to act in its name and assert its rights, the Appellant sought the Court’s assistance to fulfill Benford’s duty to get in the trust estate, by ‘tracing’ the funds into the Respondent’s deposit with Citibank.  The Appellant made 2 alternative submissions. First, it was argued that the Respondent was liable for the ‘knowing receipt’ of trust property (as the first limb of Barnes v Addy(1874) LR 9 Ch App 244), having received the funds for its own use and benefit.  Secondly, the Appellant argued that after the initial receipt (the original Benford Limited account in Vanuatu), the Respondent dealt with the funds in a manner inconsistent with the trust of which it was aware. It did this by investing the funds in its own name and receiving a higher rate of interest than it paid to Benford. The Appellant submitted that the Respondent should have kept those funds in a separate account in the name of Benford.  The Court of Appeal held that a constructive trust had not been created. Benford Limited held the stolen funds on a presumed or resulting trust for the defrauded credit card holders. Such a trust should be equated with an express trust for the purposes of the duty to get in the trust estate.  The Court further held that the duty to get in the trust estate did not confer upon the Appellant, as receiver of Benford Limited, an equitable right to trace into and claim the Respondent’s deposit with Citibank Limited.  The Court of Appeal explained this by stating that the Appellant represents the owner of a legally enforceable debt. In the absence of insolvency and where no issue of priority or of unjust enrichment has arisen, the legal owner of property who has a claim at law cannot elect to trace in equity. The Court stated that while in the present case it was possible to trace, in the sense of identifying a causal chain, from the Benford deposit with the Respondent into the Respondent’s deposit with Citibank, the identification did not of itself, establish a right of any kind. Something more is required. The terminology of a ‘right to trace’ can be, and in the present case was, misleading. The process of identification should not be confused with a proprietary right.  The Court of Appeal further held that equitable relief in personam was not available against the Respondent. The Respondent did not receive the Benford deposit for the purposes of the ‘knowing receipt’ principle of secondary liability in dealing with trust property. Nor according to the Court, did the Respondent deal with the Benford deposit in a manner inconsistent with the trust of which it had constructive knowledge. The respondent was more appropriately a ‘mere depository’ in receiving the Benford deposit.  **5.8 The Offset Alpine affair continues: A consideration of legal professional privilege in the context of foreign legal advice** (By Anna White, Mallesons Stephen Jaques)  Kennedy v Wallace [2004] FCA 332, Federal Court of Australia, Gyles J, 25 March 2004.  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2004/march/2004fca332.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2004/march/2004fca332.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  “This case involves some difficult questions as to the operation of legal professional privilege, some of which are novel.”  On 13 November 2003, officers of the Australian Federal Police accompanied by officers of the Australian Securities and Investments Commission (“ASIC”), executed a search warrant at the residence of the applicant, Trevor John Kennedy (“Kennedy”). Amongst other things, three documents were located and seized. These documents consisted of a notepaper from the Ritz Hotel London with handwriting, a notepaper from the Florhof Hotel Zurich with handwriting (“Handwritten Notes”), and a notepad from the Ritz Hotel with no visible handwriting (“Blank Notepad”).  Kennedy argued that the Handwritten Notes were protected from valid seizure by the existence of legal professional privilege. He also argued that the Blank Notepad was not properly within the description of documents in the search warrant. Kennedy sought orders for the return of all these documents. In response, ASIC denied the existence of legal professional privilege in the Handwritten Notes, and argued that any privilege that may have existed was waived or cannot be enforced by Kennedy under the doctrine of estoppel. ASIC also argued that the seizure of the Blank Notepad was authorised under the search warrant.  Gyles J denied relief in relation to the Handwritten Notes, refusing to give them the protection of legal professional privilege. He found that Kennedy did not establish that the dominant purpose for making the Handwritten Notes was to obtain legal advice, or that any legal advice that might have been related to the Handwritten Notes was in line with the rationale behind legal professional privilege of promoting the administration of justice and the proper functioning of the legal system in Australia. Gyles J also noted that any such advice to Kennedy would have related to how he could take advantage of Swiss laws and keep his dealings secret from ASIC and other Australian authorities. Gyles J did however grant relief in relation to the Blank Notepad. He found that it did not fall within the description of documents in the search warrant.  **(b) Facts**  On 30 October 2003, the Australian Financial Review newspaper (“AFR”) published a series of articles which indicated that Rene Rivkin (“Rivkin”) had given evidence to Swiss authorities that Kennedy had been the beneficial owner of approximately 12% of a parcel of shares in Offset Alpine Printing Group Limited (“Offset Alpine”). However, when Kennedy had been interviewed by officers of the Australian Securities Commission (predecessor to ASIC) in 1995, he had denied having any beneficial interest in Offset Alpine shares. Sackville J delivered the judgment in these proceedings, ordering the disposal of the shares. Sackville J however, did not order the disclosure of the identity of the beneficial owners of the shares (see Australian Securities Commission v Bank Leumi Le-Israel (1995) 134 ALR 101).  By about 10.30am on the morning of the publication of the AFR articles, Kennedy retained law firm Atanaskovic Hartnell (“Hartnell”) to act for him in relation to matters arising from the articles. The following day, Kennedy flew to London and set up a meeting with Benno Hafner (“Hafner”), a qualified Swiss lawyer who was based in Zurich. Kennedy argued that the Handwritten Notes were prepared by him, prior to meeting with Hafner, for the purpose of obtaining legal advice from Hafner. Kennedy met with Hafner in Zurich on 4 November 2004.  On 1 and 2 December 2003, Kennedy was examined by ASIC, pursuant to s19 of the [Australian Securities and Investments Commissions Act 1989 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6664" \t "default). In this interview, Kennedy accepted that he had realised that on publication of the AFR articles he may well be subject to another ASIC investigation. Gyles J found Kennedy’s responses to the s19 investigation to be unsatisfactory and “certainly far from a full and frank account of the dealings he had in Switzerland and his participation in them”. Gyles J also noted that it was “perfectly clear that Hafner was a good deal more than an arm’s length independent source of strict legal advice in relation to Kennedy’s financial affairs”, and that Kennedy liaised directly with Hafner, not through his Australian lawyers, Hartnell.  **(c) Decision**  **(i) Generally**  Gyles J considered the broad issue of the operation of legal professional privilege in relation to seeking or obtaining legal advice from a foreign lawyer. He stated that ASIC made an attractive case for reviewing the law in this area and denying privilege in this case. Gyles J canvassed a number of authorities dealing with legal professional privilege and foreign legal advice. He concluded that none of these authorities dealt squarely with issue in this case, as there was nothing in those cases to suggest that the foreign lawyer in question was acting in any other capacity other than as a lawyer. Gyles J also noted that the authorities did not satisfactorily deal with the choice of law implications in this situation, especially where communications between a lawyer and client may attract privilege in Australia, but not the lawyer’s home country.  Gyles J found that the authorities did not establish the proposition that all communications of a professional nature between an Australian client and a foreign lawyer concerning advice as to foreign law are privileged from seizure in Australia under a valid warrant issued pursuant to [Crimes Act 1914 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6050" \t "default). Furthermore, he viewed such a proposition as inconsistent with the rationale behind legal professional privilege. Gyles J regarded legal professional privilege as facilitating the administration of justice and the proper functioning of the Australian legal system. The granting of legal professional privilege to all foreign legal advice did not necessarily support such a rationale, particularly given that in this case, the likely purpose of Kennedy’s meeting with Hafner was to obtain advice in relation to hiding his dealings from ASIC and other Australian authorities.  Gyles J pointed out that the applicability of legal professional privilege to legal advice unconnected with litigation, was well established but not satisfactorily explained. He found it hard to see the connection between legal professional privilege and communications in a non-litigious matter. He stated that “[w]hether or not it is, as suggested by Dawson J in Baker v Campbell at 29, now too late to reconsider advice privilege in its application to communications in Australia, it is questionable whether there is any need to extend the principle to overseas legal advice … [t]here is no authority binding me to extend privilege in this way but refusal to do so to any extent would be controversial. I prefer therefore to assume for the purposes of this case that privilege may be accorded in some foreign communications and examine whether the applicant has established that what occurred here is entitled to the benefit of such privilege”. The privilege sought by Kennedy in this case was advice privilege, not litigation privilege.  **(ii) Handwritten Notes**  Kennedy led evidence that the Handwritten Notes were prepared prior to meeting with Hafner and for the purpose of meeting with Hafner. Gyles J stated that the onus was on the party claiming legal professional privilege to establish such privilege. He noted that with Australian lawyers, the assumption was that legitimate legal advice is sought when that lawyer is communicated with on a professional basis. No such assumption exists for foreign lawyers. Gyles J looked into whether the Handwritten Notes were made for the dominant purpose of Kennedy obtaining legal advice. He thought it impossible to separate the legal from the non-legal commercial advice Kennedy sought from Hafner. He also pointed out that Kennedy did not claim privilege when the Handwritten Notes were seized. Gyles J felt that it would go beyond any binding authority to accord privilege to communications with Hafner that had not been clearly and unequivocally identified as seeking or obtaining legal advice. Therefore, Gyles J found that although he was satisfied that a significant purpose of meeting with Hafner was to obtain legal advice, he was not satisfied that this was the dominant purpose.  In any event, a dissection of the meeting was only necessary if parts of the Handwritten Notes may relate to communications seeking legal advice that attract legal professional privilege. Gyles J found that the overwhelming inference was that Kennedy’s dominant underlying purpose in meeting Hafner was to take all available steps to preserve or enhance the secrecy from Australian authorities. He stated that it may not be unlawful for an Australian to seek advice for such a purpose or to act upon it, but there is no reason to extend the benefit of legal professional privilege to such communications. In Gyles J view, the purpose of the communications, to assist someone to avoid disclosure, has “no conceivable connection” with the rationale for legal professional privilege. He stated that “[t]hose seeking or taking legal advice for such purposes are not entitled to resist an otherwise lawful demand for disclosure of such documents on the grounds of legal professional privilege”.  **(iii) Blank Notepad**  Gyles J found that the Blank Notepad did not fall within the description of documents in the search warrant and thus granted Kennedy relief in relation to this claim.  **(iv) Waiver and estoppel**  As Gyles J did not find legal professional privilege in relation to the Handwritten Notes, he did not undertake a substantive consideration of this issue. However, Gyles J did endeavour to resolve and find disputed facts in the event that on appeal, a different view is taken by the court as to the existence of privilege.  **(v) Other issues**  In the hearing, Gyles J had ruled that for the purposes of s75 [Evidence Act 1995 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6191" \t "default) (“Evidence Act”), the proceedings were final but did not give reasons. Gyles J delivered his reasons for this ruling in the case. In addition, Gyles J had previously ruled that an alleged Rivkin interview was inadmissible, but had not given reasons. He delivered his reasons for this ruling (which were based on the discretion allowed in s135 of the Evidence Act), in the case.  **5.9 Principles of construction and termination of contract for a ‘quasi sole agency’** (By Lindsay Mackay, Freehills)  Décor Blinds Gold Coast Pty Ltd v Décor Blinds Australia Pty Ltd [2004] QSC 055, Supreme Court of Queensland, Atkinson J, 24 March 2004  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/qld/2004/march/2004qsc55.htm](http://cclsr.law.unimelb.edu.au/judgments/states/qld/2004/march/2004qsc55.htm" \o "http://cclsr.law.unimelb.edu.au/judgments/states/qld/2004/march/2004qsc55.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  The plaintiff, Décor Blinds Gold Coast Pty Ltd (‘Décor Gold Coast’), claimed an account of profits and damages for future profits against the defendant, Décor Blinds Australia Pty Ltd (‘Décor Australia’), under a sales and supply agreement between the parties. In this agreement, Décor Australia, a manufacturer of blinds and shutters, had agreed to supply Décor Gold Coast with its product in what Justice Atkinson interpreted as a ‘quasi sole agency agreement’.  Décor Australia had purported to terminate the contract on grounds including that Décor Gold Coast had not made payments on time. While Décor Gold Coast admitted this breach, Atkinson J found that the behaviour of Décor Australia in refusing to account for profits made through sales to other agents in breach of the agreement amounted to a repudiation of the contract and therefore Décor Australia had lost its entitlement to terminate for breach by Décor Gold Coast. Atkinson J found that the term ‘profits’ did not render the clauses concerned void for uncertainty but was ambiguous. Atkinson J was able to construe the meaning of this phrase based on a consideration of what calculation of profits was easily ascertainable from the contract and what made commercial sense in light of the commercial purpose of the contract.  Judgment was entered for the plaintiff in the Supreme Court of Queensland and Atkinson J ordered further submissions as to quantum of future profits.  **(b) Facts**  Décor Australia entered into a sales and supply agreement with Décor Gold Coast, agreeing to supply its product to Décor Gold Coast in a form similar to a sole agency agreement. Décor Australia did not want to create a franchise, but to offer an exclusive area to an agent that would operate in the Gold Coast.  Obligations of Décor Gold Coast under the agreement included paying Décor Australia within 14 days of being notified that ordered goods were available for collection, promoting the sale and distribution of the goods to the best of its ability and not damaging the commercial reputation of Décor Australia. Breach of these obligations would give rise to a right in Décor Australia to terminate the agreement.  The agreement did not express a sole or exclusive agency in terms, but various reciprocal responsibilities were agreed to loosely give the effect of this kind of relationship. Décor Gold Coast was to be the sole ‘agent’ in a defined area of the Gold Coast (‘Gold Coast area’), was entitled to an additional 5 percent discount off retail price offered to other agents and agreed not to sell or act as an agent for products of a competitor of Décor Australia. In clause 10, Décor Australia agreed to provide Décor Gold Coast with any sales leads in the Gold Coast area and agreed not to sell or supply goods to customers in that area without accounting to Décor Gold Coast for any profits made on such sales. In clause 18, Décor Australia agreed to account to Décor Gold Coast for the profits of any sales of products for installation in the Gold Coast area.  Décor Gold Coast became aware that Décor Australia had been breaching clauses 10 and 18 by providing no sales referrals and selling to other agents in the Gold Coast area. After a certain period of time and heated correspondence about what was owed by the parties to each other, Décor Gold Coast informed Décor Australia that they would return invoices for supplied goods until the accounting was settled. Décor Australia continued to supply goods and therefore waived its right under the contract to refuse to supply further goods without payment of outstanding invoices. Eventually Décor Australia sent a notice of termination to Décor Gold Coast on several grounds including that Décor Gold Coast had not made payment of goods under the terms of the contract and had not promoted the sale and distribution of goods to the best of their ability. Décor Gold Coast denied that Décor Australia had lawfully terminated the contract but closed down the business as Décor Australia was its only supplier of goods.  Décor Gold Coast claimed an account of profits under clauses 10 and 18 and damages for the future profit they would have earned under the contract had Décor Australia not stopped supplying goods.  **(c) Decision**  There were two main issues for consideration in this case:   1. construction and interpretation of clauses 10 and 18 where the term ‘profits’ was ambiguous; and 2. whether there had been breach and lawful termination of the contract.   **(i) Construction of terms of the contract**  Central to the dispute was interpretation of the word ‘profits’ in clauses 10 and 18. Atkinson J found that the clauses were not so uncertain that they were void, but that the meaning of the term ‘profits’ was ambiguous. Atkinson J held that the use of extrinsic evidence was admissible in this case to resolve the ambiguity, however post contractual conduct was not relevant in determining the objective meaning of terms in the contract.  Atkinson J listed the following principles that apply to the construction of a contract in a commercial context:           The primary task is to construe the meaning of the words used in the contract and this is how the common intention of the parties is to be determined.          Effect will be given to the plain meaning of words which are unambiguous no matter how unreasonable the result.          It is only when the parties have failed to express their common intention that there will be a consideration beyond the words of the contract and rectification of the contract will be necessary.  If there is ambiguity as to the meaning of a word or phrase, the construction will be preferred that:           is not unreasonable, capricious, inconvenient or unjust;          is considered in the light of surrounding circumstances and the contract as a whole;          is consistent with the contract as a whole;          makes commercial sense;           gives effect to the commercial purpose of the contract;           may not necessarily be the most obvious or grammatically correct; and          is construed fairly and broadly whether or not it was drafted with the assistance of lawyers.  Several different possible interpretations of the meaning of ‘profits’ in clauses 10 and 18 were given by the plaintiff and defendant. Atkinson J found that ‘profits’ meant the price at which Décor Australia sold the goods to the other agent minus the price they would have sold the goods for if they had sold them to Delta Gold Coast under the terms the agreement. Atkinson J preferred this construction because it:           was easily ascertainable within the terms of the contract and could be calculated from the retail price list which was known to both parties; and          made commercial sense in light of the commercial purpose of the contract.  Atkinson J rejected other possible constructions on the grounds that there would have been no ready mechanism to work out what the profit would have been based on the terms in the contract or that the construction defied commercial sense because it would result in an amount that did not actually represent a profit made.  To reach this conclusion, Atkinson J found that the commercial purpose of the contract was to create a ‘quasi sole agency’ whereby Décor Gold Coast would be compensated for the profit lost if Décor Australia sold to other agents in the area of the agency.  Therefore in this case it was not necessary to consider rectification. However, Atkinson J suggested that, had rectification been necessary in this case, the behaviour of the parties suggested that this was the interpretation they would have intended.  **(ii) Termination of the contract**  Atkinson J explained that whether the contract was lawfully terminated depends on the behaviour of the parties after the contract was entered into.  In terms of the alleged grounds for termination by Décor Australia, Décor Gold Coast accepted that it was in breach of the contract by failing to make payments within the specified time. Atkinson J found that a second ground for termination, that Décor Gold Coast had breached the agreement by failing to promote the sale and distribution of the products to the best of its ability, failed because the behaviour of Décor Australia in not passing on leads as it was obliged to do under clause 10, significantly contributed to its ability to promote the goods. The judge accepted that the director of Décor Gold Coast promoted the business to the best of his ability considering that he completely lacked experience in the industry.  Atkinson J found that Décor Australia was in breach of the contract by refusing to account for profits to Décor Gold Coast as required under clause 10 and 18. Further, this breach demonstrated that Décor Australia was not ready, willing and able to perform the contract and therefore had repudiated the contract and thus lost its entitlement to terminate for breach by Décor Gold Coast. Therefore Décor Australia’s purported termination was invalid. Décor Gold Coast was entitled to and did accept Décor Australia’s wrongful termination resulting in the contract being at an end.  Atkinson J entered judgment for Décor Gold Coast and ordered further submissions to determine the quantum of future profits that Décor Gold Coast might have made had Décor Australia accounted for profits under the contract and provided the sales leads which it was obliged to pass on.  **5.10 Voidable transactions: evidential requirements under section 588FG** (Nghi Tran, Phillips Fox)  Cook's Construction Pty Ltd v Brown [2004] NSWCA 105, New South Wales Court of Appeal, Young CJ, Hodgson JA and Santow JA, 22 March 2004  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/march/2004nswca105.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/march/2004nswca105.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Facts**  This was an appeal from Ainslie-Wallace J of the District Court, heard in the Court of Appeal before Young CJ, Hodgson JA and Santow JA. The case involved an alleged voidable transaction under section 588FF of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (‘the Act’). The respondents were the liquidators of DML Resources Pty Ltd (‘DML’), whose winding-up commenced on 24 October 1997. The appellant was a company engaged in hiring excavation and earthmoving equipment. DML hired machinery from the appellant. As the payment was made within six months of the commencement of the winding-up and whilst DML was insolvent, the payment would constitute a voidable transaction unless the appellant could prove that certain factors existed under section 588FG.  **(b) Section 588FG of the Act**  The payment by DML to the appellant would not constitute a voidable transaction if the appellant could prove that under section 588FG(2)(b) at the time when it became a party to the transaction:           it had no reasonable grounds for suspecting that the company was insolvent at that time or would become insolvent as mentioned in paragraph 588FC(b); and          a reasonable person in the appellant’s circumstances would have had no such grounds for so suspecting.  The other requirements under section 588FG, namely that the appellant became a party to the transaction in good faith and that there was valuable consideration, were conceded by the respondents.  **(c) Decision at first instance**  Ainslie-Wallace J held that the appellant had failed to establish the subjective test under 588FG(2)(b)(i) and accordingly ordered that the amount of the payments plus interest be paid to the liquidators. The only witness called by the appellant was its secretary, Mrs Trende, who had forwarded a letter dated 8 May 1997 to DML requesting finalisation of outstanding accounts. The text of the letter included:  ‘It is with deep regret that we have reason to write to you concerning the state of your account with our organisation. We have three …outstanding invoices which require your immediate attention.’  Mrs Trende claimed she had no recollection of what her belief or suspicion was at the time she wrote the letter. It was noted by the Court that other employees of the appellant who could have been in a position to say what they knew or what they suspected about DML’s solvency were not called. Given no explanation for this, Ainslie-Wallace J stated that:  ‘consistent with the authority of Jones v Dunkel (1959) 101 CLR 298, when a person who is presumably able to put the true complexion on the facts relied on to ground an inference has not been called as a witness and there is no sufficient explanation for his absence, that inference can more comfortably be drawn.’  **(d) Grounds of the appeal**  The grounds of the appeal were as follows:            the weight of the evidence supported the appellant’s defence;           the judge wrongly formulated the objective test;           the judge failed to give sufficient weight to key facts; and           the judge wrongly applied the rule in Jones v Dunkel.  **(e) The decision of the Court of Appeal**  Young CJ, Hodgson JA and Santow JA rejected each of the appellant’s grounds for appeal, dismissing the appeal with costs.  Young CJ noted the difficulty in ascertaining the intention or purpose of a corporation. The test applied was that stated by McLelland J in Spedley Securities Ltd v Western United Ltd (1992) 27 NSWLR 111 at 118-119:  ‘In the case of an organisational payee such as a corporation, the person or persons whose state of mind is relevant … are those officers, employees or agents of the organisation who were concerned in an executive capacity in the transaction whereby the payment was received.’  Young CJ rejected the assertion that the Court should focus entirely on Mrs Trende’s evidence. In Harkness v Commonwealth Bank of Australia (1993) 32 NSWLR 543, seven bank officers were called to give evidence. The Court reiterated the opinion that Mrs Trende was not the only person employed by the appellant who had knowledge of the transaction.  Jones v Dunkel was stated to be just one aspect of a wider principle, being that in judging evidence, the Court has regard to the material available to a party. If the person does not bear the onus of proof and subsequently fails to call a witness, the inference may be drawn that the witness is not likely to assist their case. However, if the person bears the onus and has a witness who is not called, then the Court can take this into account when assessing the entirety of the evidence. Young CJ thought it did not matter what conclusion was reached in relation to the objective test, because the appellant needed to satisfy both those tests.  Hodgson JA emphasised that the letter of 8 May 1997 written to DML stated: ‘Despite numerous verbal requests and promises for the February and March amounts to be paid on 30 April no payments have been forthcoming’.  This was thought to indicate that the appellant could have called evidence that would have directly dealt with the appellant’s knowledge of DML’s solvency:  ‘where a party has to prove something and prima facie has available evidence that would directly deal with the question, a court will be very hesitant in drawing an inference in that party’s favour from indirect and second-hand evidence, when the party doesn’t call the direct evidence that prima facie it could have called, at least unless some explanation is given, or the circumstances themselves provide an explanation.’  Santow JA dispelled any confusion between the requirement to act in ‘good faith’ and the subjective test in section 588FG(2)(b)(i), which has a somewhat hybrid character. Thus the person of relevance has to have “no reasonable grounds” for suspecting insolvency at the relevant time, being clearly objective. It is therefore possible for a person to receive payment honestly and thus in good faith, yet on an objective footing that person may have had reasonable grounds for suspecting insolvency. Despite good faith, the defence would fail.  **(f) Conclusion**  The appeal was dismissed. Their Honours were of the opinion that the primary judge was correct in not drawing in the appellant’s favour the inference that at the relevant time it had no reasonable grounds for suspecting that the company was insolvent  **5.11 Document drawn for improper purpose not protected by legal professional privilege** (By Caroline Hayward, Mallesons Stephen Jaques)  Gartner v Carter; In the matter of Gartner Wines Pty Limited, [2004] FCA 258, Federal Court of Australia, Lander J, 17 March 2004  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2004/march/2004fca258.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2004/march/2004fca258.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  The applicant (Gartner) sought a declaration that a document which had been inadvertently produced to the court was the subject of legal professional privilege. The document in question was entitled “strategic plan” and outlined several proposed transactions and suggestions for restructuring of the group of companies of which the applicant or with his wife were shareholders (Gartner Group) and the businesses of those companies. The effect would be to put certain assets beyond the reach of the security held by National Australia Bank (NAB) for repayment of financial facilities provided to the Gartner Group.  Lander J dismissed the application and found that a claim of legal professional privilege to a document could not be allowed where the document was created for an improper purpose.  **(b) Facts**  The Gartner family carried on a farming business in the Coonawarra district of South Australia. In late 1998 Mr Gartner became interested in becoming involved in a winery business. In May 2001, he retained Ernst & Young (EY) to raise capital for the construction of a winery by the Gartner Group. By letter dated 11 October 2001, NAB offered to provide financial facilities to fund the construction of the winery in the sum of $14.5 million. To secure the facility, each member of the Gartner Group granted NAB a fixed and floating charge over all of its assets. The facility was drawn down in December 2001. There was a shortfall in the funding required to complete construction, details of which were provided to NAB in January 2002.  In February 2002, NAB appointed the respondent to investigate the affairs of the Gartner Group. However, before the respondent provided its report, the facility was restructured in March 2002. In July 2002, NAB again commissioned the respondent to investigate the Gartner Group. In a report dated 2 August 2002, the respondent concluded that the Gartner Group was insolvent.  On 6 August 2002, NAB issued a notice of demand requiring repayment of the facility on 9 August 2002. Although the Gartner Group claimed in a letter dated 8 August 2002 that the shortfall derived from a “misunderstanding” concerning indebtedness which existed at the time the facility was provided, receivers and managers were appointed by NAB on 9 August 2002.  The respondent obtained an order for the production of books and records in the possession of the Gartner Group pursuant to section 596D of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). The documents produced by the applicant in compliance with the order were inspected by the respondent’s solicitors on 28 July 2003. By letter dated 7 August 2003, the respondent’s solicitors advised the applicant’s solicitors that certain documents which might attract a claim of privilege had been produced to the court and inspected by them. It was conceded by counsel for the respondent that the production of certain documents and the failure to claim legal professional privilege was inadvertent.  By the time the matter came before Justice Lander for hearing, the only document in dispute was the “strategic plan”. This document was contended by the respondent to have been generated in furtherance of a plan to put assets of the Gartner Group beyond the reach of NAB. The court was asked to view the proposed transactions collectively as constituting the intended fraud giving rise to the “exception” to the doctrine of legal professional privilege.  The strategic plan was said by the respondent to include a plan to:           cause debts owed to a Gartner company subject to a security held by NAB to be paid to an entity not subject to such security; and          transfer the profitable business operations of an entity which was subject to the security held by NAB to a new entity not subject to such security.  On the evidence, the court found that:           the redirection by the applicant of trade debtors of a Gartner Group company on the same date as that upon which the receivers and managers were appointed (9 August 2002), and where no steps were taken to ascertain whether any valuable consideration had been received, was significant;          the respondent had established a prima facie case that Mr Gartner did what he did on 9 August 2002 to frustrate NAB and to allow the family to continue to conduct that part of the Gartner Group’s business free of any liability to NAB;          the strategic plan reflected the transfer of profitable business operations of one Gartner Group company to another entity which had not given any security to NAB. As the appointment of receivers and managers to that Gartner Group company was imminent when it was divested of its primary assets, that part of the strategic plan had been drawn for an improper purpose.  Justice Lander also considered whether various other transactions and agreements were conducted so as to defeat NAB’s claim, but His Honour was not able to draw any inferences from the evidence provided.  **(c) Decision**  The test applied by Lander J for determining whether legal professional privilege attaches to a document was whether that document was made for the dominant purpose of obtaining or giving legal advice. His Honour noted that legal professional privilege is the result of balancing the public policy reflected in the privilege itself with the public policy that, in the administration of justice and investigative procedures, there should be unfettered access to relevant information (referring to the decision of the High Court in Esso Australia Resources Ltd v Federal Commissioner of Taxation (1999) 201 CLR 49, 72).  Justice Lander stated that the public interest in preserving confidentiality of communications between lawyer and client may be displaced in circumstances where the privilege is abused. Privilege does not attach to a communication which was made for the purpose of being assisted in the commission of a crime or a fraud. The public interest in those circumstances does not justify the privilege attaching (The Queen v Cox and Railtan (1884) 14 QBD 153).  Lander J stated that, in this context, fraud has a wide and extended meaning. A communication for the purpose of the client putting his assets beyond the reach of the legitimate claims of his secured creditors is a fraud on justice. His Honour held that there is no public interest in protecting that communication.  The respondent had the onus of showing reasonable grounds for believing that the document containing the communication for which legal professional privilege was claimed was created for some illegal or improper purpose, although it did not have to prove the fraud itself.  Lander J considered that the respondent established to the requisite level of satisfaction that at least part (but not all) of the strategic plan was created for the purpose of putting Gartner Group assets beyond the reach of NAB. His Honour noted that the question of whether legal professional privilege may attach to part of a document is not settled. However, no submission was made that part of the document might be privileged even if the remaining part of the privilege was lost and so the court did not decide on this point.  **5.12 Can a penalty be enforced as a proof of debt?** (By Elizabeth O’Donovan, Deacons)  Mathers & Anor v Commonwealth of Australia [2004] FCA 217, Federal Court of Australia, Heerey J, 12 March 2004  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2004/march/2004fca217.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2004/march/2004fca217.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  The Australian Competition and Consumer Commission (ACCC) brought proceedings against Fila Sport Oceania Pty Ltd (Fila) alleging breaches of section 46 and 47 of the [Trade Practices Act 1974](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6426" \t "default) (Cth) (TPA). The administrators of Fila (Applicants) sought directions under s 447D(1) of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), on whether a deed of company arrangement entered into by Fila will bind the Commonwealth, within the meaning of section 444D of the Corporations Act 2001, in relation to a penalty imposed on Fila under section 76 of the TPA.  In order to determine these issues, the court looked at whether a contravention of section 46 or 47 of the Act constitutes an ‘offence against a law’ within the meaning of s 553B of the Corporations Act 2001.  **(b) Facts**  The ACCC commenced the TPA proceedings against Fila, and although Fila defended the TPA proceedings, the defence was later withdrawn and the proceedings were adjourned to a later date to determine the quantum of penalty.  The Court proceeded on the basis that whether a penalty imposed under section 76 of the TPA was admissible as proof against Fila would depend on whether or not penalties imposed for any contravention were within s 553B of the Corporations Act 2001.  Section 553B of the Corporations Act 2001 provides that penalties or fines imposed by a court in respect of an offence against a law, or an amount payable under a pecuniary penalty order, within the meaning of the [Proceeds of Crime Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6210" \t "default), are not admissible proof against an insolvent company.  The Court referred to the Explanatory Memorandum (EM), produced at the time of the introduction of the predecessor of section 553 of the Corporations Act 2001, in the Corporate Law Reform Bill 1992. The EM did not adopt the recommendation by the Harmer Report that fines imposed before or after the commencement of a winding up should be admissible in corporate insolvency on the basis that after a company is wound up, there is no-one against whom the fine can be claimed and the fine is a claim by the community as a whole. The EM concluded that fines are intended to be a deterrent. In the case of a corporate insolvency, it is difficult to justify ‘penalising’ creditors for a wrong committed by the company.  Heerey J considered the express terms of the EM, and the fact that the [Bankruptcy Act 1966](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6559" \t "default) also provides that penalties or fines imposed by a court are not provable in bankruptcy. Heerey J noted the similarities between corporate insolvency and bankruptcy and his Honour held that, in the absence of strong policy grounds, it was not reasonable to infer that it was Parliament’s intention that a creditor with a debt would be entitled to prove that debt in a corporate insolvency but not in a bankruptcy.  The respondent submitted that the TPA itself provided the means for determining whether a breach of sections 46 and 47 of the TPA constituted an “offence” for the purposes of submitting a proof of debt in accordance with section 553B of the Corporations Act 2001. The TPA does delineate between the consumer protection provisions of Pt V (other than s 52), which attract criminal sanctions, and the competition law provisions of Pt IV, which includes sections 46 and 47, which do not. Therefore, a breach of section 46 and 47 of the TPA by Fila does not constitute a criminal offence.  His Honour then considered the meaning of “offence” at common law. His Honour referred to the definition of the word “offence” in the case of Kingswell v The Queen (1985) 159 CLR 264 at 276 which held that “offence” has no fixed technical meaning in the law. His Honour also relied on the general proposition that a failure to do something prescribed by a statute may be described as an offence although Parliament does not impose a criminal sanction upon it, but a mere pecuniary sanction which is to be recovered as a civil debt: Brown v Allweather Mechanical Grouting Co Ltd [1954] 2 QB 443 at 447.  To this end, his Honour held that an offence had been committed by Fila’s breach of sections 46 and 47 of the TPA which had incurred a penalty, within the meaning of section 553B of the Corporations Act 2001.  **(c) Decision**  The Court considered that a penalty imposed under s 76 of the Trade Practices Act 1974 (Cth) (TPA) was an “offence against the law” and it was therefore not admissible proof against an insolvent company. The Court directed, pursuant to s 447D(1) of the Corporations Act 2001, that the Applicants were entitled to refuse to accept a proof of debt from the Australian Government Solicitor in respect of any penalty imposed by the Court for a contravention of sections 46 or 47 of the TPA. The Court ordered that the costs were to be paid by the Applicants.  **5.13 Adopting a competitive tender process when exercising a power of sale – section 420A** (By Peter Brabant, Corrs Chambers Westgarth)  Jovanovic, Jovanovic and Fortson Pty Ltd v Commonwealth Bank of Australia [2004] SASC 61, Supreme Court of South Australia, Full Court, Mullighan, Gray and Besanko JJ, 3 March 2004  The full text of this judgment is available at: [http://cclsr.law.unimelb.edu.au/judgments/states/sa/2004/march/2004sasc61.htm](http://cclsr.law.unimelb.edu.au/judgments/states/sa/2004/march/2004sasc61.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  This cases examines whether in the course of selling an encumbered property, a controller has taken all reasonable care to sell the property for not less than its market value.  The Court assessed how the controller sold the property and determined that in the circumstances, the controller had an obligation, when exercising its power of sale, to appoint an agent, conduct a proper marketing campaign and put the property on the market. It was not sufficient for the controller to accept and provide finance for one bid when the only other bid was from a person the controller knew could not raise the necessary finance from an independent source.  The Court held that the controller thereby breached its duties it owed to the guarantor and mortgagor respectively in exercising its power of sale and by failing to secure a proper price for the property.  **(b) Facts**  In 1995 Mr Douglas Jovanovic and Mrs Irini Jovanovic (the ‘Jovanovics’), through Fortson Pty Ltd (‘Fortson’), purchased a property from Mr Slavko Govedarica and Mrs Milorad Govedarica (the ‘Govedaricas’) and Roclin Developments Pty Ltd (‘Roclin’), on which a hotel business was conducted. The Commonwealth Bank of Australia (the ‘Bank’) advanced $750,000 to Fortson to finance the purchase of the property. The Jovanovics guaranteed the obligations of Fortson, which they controlled. When Fortson defaulted in its obligations to repay moneys advanced by the Bank in July 1997, the Bank exercised its power of sale over the property pursuant to the mortgage. The Bank engaged Ernst & Young to advise it of its options to recover the moneys owed. Ernst & Young identified three options – sell the property to one of the parties if it can obtain finance independently (“clearly the preferred option”); extend the timeframe for either party to obtain finance by 4 to 8 weeks; or appoint an agent to put the hotel on the market. The conclusion and recommendations of Ernst & Young were identical with the Bank’s existing strategy, namely to sell the property to a party who can obtain finance independently.  Notwithstanding this position, the Bank adopted a closed tender process, open only to the Jovanovics and the Govedaricas, the former owners of the property. Neither party was in a healthy financial position. The property was sold to the Govedaricas through Roclin who the Bank itself financed. The hotel business, the plant, fittings and equipment and a newsagency on the property were not included in the sale.  **(c) Case history**  The Bank brought proceedings in the District Court to recover moneys advanced to the Jovanovics. The trial judge entered judgment for the Bank and dismissed a counterclaim brought by the Jovanovics and Fortson.  The Jovanovics and Fortson appealed to the Supreme Court of South Australia. The primary issue was whether the trial judge failed to properly consider or apply the provisions of section 420A of the Corporations Law, now known as the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default).  **(d) Section 420A of the Corporations Act**  Section 420A(1)(a) of the Corporations Act provides that in exercising a power of sale, a controller must take all reasonable care to sell the property for not less than its market value. Justice Besanko held that this involves a consideration of whether the controller “has failed to do what a reasonable and prudent person would do, or had done what a reasonable or prudent person would refrain from doing, in the circumstances”.  The Court considered the approach taken to comparable provisions in two State statutes and noted that the section requires “reasonable care” to be taken “to ensure” that the property is sold at market value. It is not a mere duty to take reasonable care in a general sense. Market value may be a relevant item of evidence on the question whether there has been a breach of duty, but it is by no means decisive. The Court cited with approval the comments of Brennan J in Commercial and General Acceptance Ltd v Nixon (1981) 152 CLR 491 where he commented that “the duty is defined in terms which look to the result of its performance – a sale at market value – and the phrase ‘reasonable care to ensure’ describes what is to be done to effect that result”.  Ambiguity arises from the fact that the section does not provide for the consequences of a failure to comply. As the section is fairly open to a liberal interpretation, to allow a guarantor to have the protection of the section, arguably, does not strain the language of the statute.  **(e) Interaction between statutory, equitable and common law duties**  As the Bank breached its statutory duty, it was considered unnecessary to define the limits of the duty to act in good faith or to determine whether the Bank’s duty would be limited if it were not for the statute. The Court held that the trial judge erred by treating the duty under section 420A as one of good faith.  Similarly, although noting that “a mortgagee exercising a power of sale does not owe a common law duty of care”, in view of the fact that the Court determined a breach of statutory duty, this issue was of little practical significance. It was relevant only to whether the Jovanovics could claim damages at common law.  **(f) Sale of the freehold title of the property**  The following conclusions, amongst others, were drawn about the process of sale:           It was contrary to the usual practice of the Bank.          It was contrary to the advice of Ernst & Young in that the property did not go to the market; it did not go to a competitive tender; there was no independent financier; and the sale price was not supported by the valuations.          The Bank negotiated with only the one possible purchaser.          The sale could only proceed because the Bank was prepared to act as a financier to the Govedaricas, and indeed provided finance for more than three-quarters of the purchase price.          The transaction provided the Bank with particular benefits, including $180,000 cash, a new debtor in Roclin and further guarantors (the Govedaricas).          The transaction was not an independent arms length transaction.  Drawing upon these conclusions, the Court held that the Bank breached section 420A by engaging in a sale that did not involve a “competitive tender process in any real sense”.  **(g) Alleged failure to sell the hotel business**  Additionally, the business conducted on the property was excluded from the sale. The lack of evidence before the trial judge did not permit findings to be made about the ownership or operation of the hotel business. Absent a positive finding of ownership, neither Forston nor the Jovanovics, could complain of any action the Bank took, or failed to take, in relation to the hotel business. The Court held that the Bank did not act in breach of duty in relation to the hotel business conducted on the property at the time of sale.  The only point of difference of the members of the Full Court was between Besanko J and Gray J (with whom Mullighan J agreed). Justice Besanko excluded Gray J’s finding that the Bank’s approach to the ownership and sale of the hotel business was a reason for concluding that the Bank acted in breach of section 420A.  **(h) Decision**  The Full Court unanimously held that the Bank acted in breach of its obligations under section 420A. It allowed the appeal and set aside the orders of the trial judge. The action was remitted to the trial judge for hearing and determination of market value of the property that would have been obtained but for the Bank’s breach of duty.  **5.14 Delaware Supreme Court decision on independent directors** Beam v Martha Stewart, Supreme Court of Delaware, Veasey CJ, Holland, Burger, Steele and Jacobs JJ, 31 March 2004  The full text of this judgment is available at: [http://courts.state.de.us](http://courts.state.de.us/" \t "_new)  **(a) Summary**  The Plaintiff, a shareholder in the company Martha Stewart Living Omnimedia, Inc (MSLO) brought a derivative action against certain officers and directors of MSLO. Under Delaware law, a shareholder may not pursue a derivative action to assert a claim against the company unless (a) the shareholder has first demanded that the directors pursue the corporate claim and they wrongfully refused to do so; or (b) such demand is excused because the directors are deemed incapable of making an impartial decision regarding the pursuit of the litigation. The Plaintiff alleged that a demand on the Board of Directors to pursue the litigation was futile because the majority of the directors were not independent. The Plaintiff asserted that the personal friendships of certain directors of MSLO with the CEO of the company (Martha Stewart) and her ability, as the controlling shareholder of MSLO, to remove these directors from office, meant the directors were not independent. The court rejected these allegations of the Plaintiff and said, in relation to social friendships, that: “Allegations of a mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director’s independence”.  **(b) Facts**  The Plaintiff shareholder (Monica Beam) alleged that Martha Stewart had breached her fiduciary duties of loyalty and care by illegally selling ImClone shares in December 2001 and by mishandling the media attention that followed, thereby jeopardising the financial future of MSLO. Stewart was, at all relevant times, the chairman and CEO of MSLO and controlled over 94% of the shareholder vote in MSLO.  The judge at first instance found that the Plaintiff had not alleged sufficient facts to support the conclusion that demand on the Board of Directors to pursue the derivative litigation was futile because the Plaintiff failed to raise a reasonable doubt that the directors, alleged by the Plaintiff not to be independent of Stewart, were in fact not independent. For the Plaintiff to succeed, it would need to be established that there was not a majority of independent directors on the Board of MSLO.  **(c) Decision**  The court dismissed the appeal by the Plaintiff and held that the Plaintiff had not established that there were insufficient independent directors to excuse the Plaintiff from making a demand on the Board of Directors or the company itself to pursue the derivative litigation.  The key allegation of the Plaintiff concerned the personal friendships of certain directors with Stewart. The court stated that a variety of motivations, including friendship, may affect independence. But to render a director unable to consider a demand to pursue derivative litigation, a relationship must be of a bias-producing nature. In the words of the court: “Allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director’s independence”.  The court noted that the allegations made by the Plaintiff largely boiled down to a “structural bias” argument which presupposed that professional and social relationships that naturally develop among members of a board impede independent decision making. The court noted that its task is to review the complaint to determine whether it states with particular facts indicating that a relationship – whether it preceded or followed board membership – is so close that the director’s independence may reasonably be doubted. This doubt might arise either because of financial ties, familial affinity, a particularly close or intimate or business affinity or because of evidence that in the past the relationship caused a director to act non-independently. In the case before it, the court held that this had not been done by the Plaintiff and that mere allegations that directors move in the same business and social circles, or a characterisation that they are close friends, is not enough to negate independence for demand excusal purposes.  The Plaintiff did put forward certain facts. In relation to one director (Seligman) the Plaintiff alleged that this director lacked independence because she called a publisher, at Stewart’s request, in order to prevent an unfavourable publication reference to Stewart. The court held that this did not establish that the director lacked independence. Indeed, the court noted that the director’s intervention on Stewart’s behalf was a benefit to MSLO and the company’s reputation, which is allegedly tied to Stewart’s reputation.  The Plaintiff alleged that another director (Moore) lacked independence because this director attended a wedding reception for the daughter of Stewart’s lawyer where Stewart was also present and a business magazine article focussed on the close personal relationship between this director and Stewart. The court stated that these social relationships did not create a reasonable doubt of independence.  The court distinguished a recent decision of the Delaware Court of Chancery (In re Oracle Corp Derivative Litigation, 2003). This case involved the issue of the independence of the Special Litigation Committee appointed by the Oracle Board of Directors to determine whether or not the company should cause the dismissal of a corporate claim by shareholder plaintiffs against directors. The Court of Chancery inquired into the relationships between the members of the Special Litigation Committee and Stanford University in the context of the financial support of Stanford by the company and its management. The court concluded that those relationships were too close for the purposes of the Special Litigation Committee analysis of independence. The court in Beam v Martha Stewart distinguished the Oracle decision on the basis of the different tasks and procedures undertaken by the Special Litigation Committee.  The court dismissed the appeal. |
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