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Editor: Professor Ian Ramsay, Director, Centre for Corporate Law and Securities Regulation

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1. RECENT CORPORATE LAW AND CORPORATE GOVERNANCE DEVELOPMENTS

(A) US CONGRESS PASSES PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT OF 2002

On 25 July 2002 the US Congress approved the Public Company Accounting Reform and Investor Protection Act of 2002. The Act represents a substantial overhaul of the regulatory framework for the US accounting profession and aspects of US corporate law.

The Act was approved by a vote of 423 to 3 in the House of Representatives and 99 to 0 in the Senate. It now goes to US President George Bush for signature. The White House has said that President Bush will sign the legislation.

The key features of the Act are:

(1) Public Company Accounting Oversight

Board - Establishes the Public Company Accounting Oversight Board to: (1) oversee the audit of public companies that are subject to the securities laws; (2) establish audit report standards and rules; and (3) investigate, inspect, and enforce compliance relating to registered public accounting firms, associated persons, and the obligations and liabilities of accountants.

(2) Auditor Independence - Amends the Securities Exchange Act of 1934 to prohibit a registered public accounting firm from performing specified non-audit services contemporaneously with a mandatory audit. Requires preapproval for non-audit services not expressly forbidden by statute. It also mandates: (1) audit partner rotation on a five-year basis; and (2) auditor reports to audit committees of the issuer. The Act prohibits a registered public accounting firm from performing statutorily mandated audit services for an issuer if the issuer's senior management officials had been employed by such firm and participated in the audit of that issuer during the one-year period preceding the audit initiation date.

(3) Corporate Responsibility - Vests the audit committee of an issuer with responsibility for the appointment, compensation, and oversight of any registered public accounting firm employed to perform audit services. Requires committee members to be a member of the board of directors of the issuer, and to be otherwise independent. The Act requires the chief executive officer and chief financial officer of an issuer to: (1) certify that periodic financial statements filed with the United States Securities and Exchange Commission (SEC) fairly present, in all material respects, the operations and financial condition of the issuer; and (2) forfeit certain bonuses and compensation received following an issuer's accounting restatement owing to non-compliance with securities laws.

(4) Enhanced Financial Disclosures - Instructs the SEC to require by rule: (1) disclosure of all material off-balance sheet transactions and relationships that may have a material effect upon the financial status of an issuer; and (2) the presentation of pro forma financial information in a manner that is not misleading, and which reconciles it with the financial condition of the issuer under generally accepted accounting principles.

The Act also (1) prohibits a corporation from making personal loans to its corporate executives (with some limited exceptions); (2) reduces the mandatory period for senior executives and principal stockholders to disclosure changes in ownership of securities (or security-based swap agreements) to two business days after changes were executed; and (3) directs the SEC to issue rules requiring a code of ethics for senior financial officers of an issuer.

(5) Analyst Conflicts of Interest - Mandates adoption by the SEC of rules designed to address conflicts of interest in securities research.

(6) SEC Resources and Authority - Authorises appropriations for the financial year 2003 to the SEC for: (1) additional compensation, salaries and benefits; (2) enhanced oversight of auditors and audit services; and (3) additional staff for fraud prevention, risk management, market regulation, and investment management.

(7) Studies and Reports - Mandates studies and reports to Congress by: (1) the Comptroller General regarding the consolidation of public accounting firms, and its impact upon the capital formation and securities markets; and (2) the SEC regarding the role and function of credit rating agencies in the operation of the securities market.

(8) Corporate and Criminal Fraud Accountability - Introduces new criminal offences such as knowingly destroying, altering, concealing or falsifying records with intent to obstruct or influence an investigation in a Federal matter or in bankruptcy.

(9) White-Collar Crime Penalty Enhancements - Amends Federal criminal law to (1) increase criminal penalties for (a) conspiracy to commit an offence or to defaud the United States, including its agencies; and (b) mail and wire fraud; (2) require senior corporate officers to certify in writing that financial statements and the disclosures therein fairly present in all material aspects the operations and financial condition of the issuer.

(B) NASDAQ TAKES NEW ACTIONS ON CORPORATE GOVERNANCE REFORM

On 25 July 2002 the Nasdaq Stock Market, Inc announced that its Board of Directors approved more than 25 new corporate governance reform proposals designed to increase accountability and transparency in relation to companies listed on Nasdaq. Nasdaq is the world's largest stock market with more than 4,000 companies listed on it.

Actions taken by the Nasdaq board include the following:

(1) Increase board independence

(a) Majority of board members will be independent

(b) Regular meetings of independent directors in executive session

(c) Further tightening of definition of "independence"

- Excludes large shareholders, relatives of executives, and employees of outside auditor
- Establishes a three-year cooling off period for all non-independent directors before they can be considered independent

(2) Empower audit committees

(a) Sole authority to hire and fire independent auditors

(b) Sole authority to approve all non-audit related services

(c) Authority to retain legal, accounting and other experts

(3) Strengthen the role of independent directors in compensation and nomination decisions

(a) Executive officer compensation must be approved by an independent compensation committee or by a majority of the independent directors

(b) All director nominations must be approved by an independent nominations committee or by a majority of the independent directors

(c) Allow one non-independent director to serve on compensation or nomination committees under certain disclosed circumstances

(4) Mandate director continuing education

(a) The Nasdaq Board indicated the desire for companies to require continuing education for all directors. The board has asked the Nasdaq Listing and Hearing Review Council to develop appropriate rules.

(5) Stock options

(a) Consistent with the recommendations of US President George Bush, Nasdaq will require shareholder approval for all stock option plans

(b) Existing exemptions for ESOP and inducement options will be retained

(6) Codes of conduct

(a) All companies must have codes of conduct

(b) Each code must address conflicts of interest and compliance with applicable laws

(c) Must have enforcement mechanisms

(d) Must disclose waivers to officers/directors

(e) Must be publicly available

(7) Mandate accelerated disclosure of insider transactions

(a) Mandate that companies disclose insider transactions in company stock within two business days for transactions exceeding $100,000

(8) Non-US Companies

(a) Must disclose all exemptions to corporate governance listing standards due to contrary home country practice

(b) Must file with the SEC and Nasdaq semi-annual and interim reports, including statement of operations and balance sheet, prepared in accordance with rules of home country marketplace

For more information <http://www.nasdaq.com>

(C) UK REVIEW OF AUDIT AND ACCOUNTING ISSUES

On 24 July 2002 the United Kingdom Secretary of State for Trade and Industry published the interim report of the Coordinating Group on Audit and Accounting Issues. The Coordinating Group was set up by the Chancellor of the Exchequer and the Secretary of State for Trade and Industry to review the UK's current regulatory arrangements for audit and financial reporting. The interim report draws upon a number of international reports and studies including the report of Professor Ian Ramsay on auditor independence commissioned by the Australian Government last year.

A summary of the key recommendations contained in the interim report follows:

(1) Audit committees

The role and membership of audit committees must be strengthened and it must be clear that they act on behalf of and report to the shareholders, particularly in relation to appointment and remuneration of auditors, upholding auditor independence and monitoring audit quality. In particular, the report proposes that the audit committee should approve the purchase of non-audit services and the audit committee should have the principal responsibility for making recommendations on auditor appointment to the shareholders. The report invites the Financial Reporting Council to set up a group to develop guidance for audit committees. The report also states that the Government should carefully consider underpinning the role and responsibilities of audit committees through company law.

(2) Auditor independence

The report requests further work to identify the types of non-audit services which are incompatible with the principles underlying auditor independence. There should be improved disclosure of the nature and value of non-audit work.

The requirement for rotation of the audit engagement partner should be for at least every five years rather than every seven years as at present. Rotation should extend beyond the lead audit partner.

(3) Transparency of accounting firms

The major accountancy firms should improve their own openness and transparency, by providing better information on their processes and practices, publishing full financial statements and accounts, and making more information publicly available on the structure of their international networks.

(4) Financial reporting

The report endorses a continuing emphasis on accounting standards which stress the need for "substance over form". The report emphasises the importance of having in place for 2005 a robust set of international standards which promote transparency in company accounts and address issues such as accounting for share-based payments and revenue recognition. There should be more proactive and wide-ranging enforcement of accounting standards in financial statements made by companies.

(5) Other aspects

The Department of Trade and Industry and the Treasury should discuss with the Office of Fair Trading whether there are any competition implications of the high concentration in the market for audit and accountancy services and whether any of the proposals in the report have competition implications.

Also on 24 July 2002, the UK Secretary of State for Trade and Industry announced the Government's response which is broadly supportive of the recommendations in the interim report. In particular, the Government agrees that the role of audit committees must be strengthened and enhanced. They should be made up entirely of independent non-executive directors. The Government also agrees that the principle of audit partner rotation should be extended to other senior members of the audit team and that the time-scale for rotation of the audit partner should be reduced from seven to five years. The Government would also investigate the need for further tightening of the rules governing the extent to which auditors can provide non-audit services to audit clients.

Both the interim report and the UK Government's response are on the website of the UK Department of Trade and Industry at [www.dti.gov.uk/cld/post\_enron.htm](http://www.law.unimelb.edu.au/bulletins/archive/www.dti.gov.uk/cld/post_enron.htm)

(D) ASIC CHAIRMAN SPEECH ON CORPORATE GOVERNANCE

On 16 July 2002, Australian Securities and Investments Commission Chairman Mr David Knott delivered a speech titled "Corporate Governance - Principles, Promotion and Practice". The speech was the inaugural lecture for the Monash Governance Research Unit. In his speech, Mr Knott made a number of points, including:

(1) Many years of sustained economic growth, and Australia's survival of the financial crisis in Asia, had led to a period of complacency about corporate governance. Over time, it became institutionalised and compliance focused, more driven by process and legal liability management for corporate officers than by notions of shareholder protection and wealth creation.

(2) What was underestimated were "some quite pernicious and endemic factors at play - a new outbreak of management greed, the failure of Boards to put a brake on excessive and structurally unsound remuneration practices, and the many commercial pressures that influence management and Boards to focus on short-term payoffs".

(3) It is not necessarily the case that the excesses evident in the US capital markets are as serious in Australia and Mr Knott stated that he has no reason to believe that the types of accounting abuses uncovered in the US such as improper capitalisation of expenses, wrongful recognition of revenue, and non-consolidation of controlled entities, are widespread in Australia.

(4) Mr Knott raised for consideration whether the traditional approach of leaving responsibility for corporate governance and compliance with Boards, shareholders and auditors is still valid. He asked whether we should be thinking about extending the scope of prudential supervision more pervasively throughout the business community so that the corporate regulator could, for example, have rights to enter, inspect and even seize records without cause. He noted that these would be radical notions for a corporate regulator and would represent a major shift in managing governance responsibilities.

(5) Mr Knott spoke about the role of the Australian Stock Exchange in corporate governance. He stated that the ASX "has specifically disavowed any intention to endorse best corporate governance practices". He also stated that "we should be mindful that, unlike the NYSE, ASX is a "for profit" corporation; and regulatory responsibility often sits uncomfortably alongside the profit motif". He stated that time will tell whether the current Australian arrangements are sustainable or whether the ASX will accept extended responsibility in the area of corporate governance. He noted that it is always possible that additional governance obligations will be legislated or that ASIC will be charged with increased responsibilities in the corporate governance area.

(6) Mr Knott also commented upon executive remuneration. He stated that "the disproportionate inclusion of options in a CEO's remuneration package is an affront to the general body of shareholders and to principles of good governance. All developed countries should support urgent adoption of international accounting standards to expense such options in company accounts. The commitment of national leaders to tackle the structural causes of poor governance should be judged by their willingness to support not only this initiative, but other urgent reforms to our accounting standards".

(7) Mr Knott stated that Boards need to do more to improve their own accountability. "It is incongruous that we accept the need for sophisticated performance management techniques across most staffing levels of our corporations - but seldom extend the same disciplines to Board level".

(8) Finally, Mr Knott commented upon the continuous disclosure regime. He stated that there are genuine concerns about the ambiguity of the continuous disclosure obligations under the listing rules. He stated that ASIC believes " that the rules should be redrafted to clarify the existing exclusions, shifting the balance in favour of disclosure in all but very limited circumstances. We also believe that the previous obligation for a company to respond to market rumour in certain circumstances should be restored. We accept this is a vexed question. We understand the frustration of company managers about the non-accountability of the financial press who report false rumours. Nevertheless, I have to say that I have experienced more cases of press rumours having a sound factual basis than those which have not. If the publication of a story starts to move the share price, creating a disorderly and uninformed market in the stock, then in my view the company should do all within its power to improve the market's state of knowledge".

The full text of Mr Knott's speech is available on the ASIC website at [www.asic.gov.au](http://www.law.unimelb.edu.au/bulletins/archive/www.asic.gov.au)

(E) TESTIMONY OF CHAIRMAN ALAN GREESPAN TO CONGRESS - STOCK OPTIONS, CEOs AND CORPORAGE GOVERNANCE

On 16 July 2002 Mr Alan Greenspan, Chairman of the US Federal Reserve Board, presented the FRB's semi-annual monetary policy report to the Congress in the US Senate. Following is an extract from his report:

"Given the key role of perceptions of subdued profitability in the current period, it is ironic that the practice of not expensing stock-option grants, which contributed to the surge in earnings reported to shareholders from 1997 to 2000, has imparted a deceptive weakness to the growth of earnings reported to shareholders in recent quarters…

"The difficulties of judging earnings trends have been intensified by revelations of misleading accounting practices at some prominent businesses. The resulting investor skepticism about earnings reports has not only depressed the valuation of equity shares, but it also has been reportedly a factor in the rising risk spreads on corporate debt issued by the lower rung of investment-grade and below-investment grade firms, further elevating the cost of capital for these borrowers. Businesses concerned about the impact of possible adverse publicity regarding their accounting practices on their access to finance could revert to a much heavier emphasis on cash generation and accumulation. Such an emphasis could slow new capital investment initiatives…

"Our market system depends critically on trust--trust in the word of our colleagues and trust in the word of those with whom we do business. Falsification and fraud are highly destructive to free-market capitalism and, more broadly, to the underpinnings of our society.

"In recent years, shareholders and potential investors would have been protected from widespread misinformation if any one of the many bulwarks safeguarding appropriate corporate evaluation had held. In too many cases, none did. Lawyers, internal and external auditors, corporate boards, Wall Street security analysts, rating agencies, and large institutional holders of stock all failed for one reason or another to detect and blow the whistle on those who breached the level of trust essential to well-functioning markets.

"Why did corporate governance checks and balances that served us reasonably well in the past break down? At root was the rapid enlargement of stock market capitalizations in the latter part of the 1990s that arguably engendered an outsized increase in opportunities for avarice. An infectious greed seemed to grip much of our business community. Our historical guardians of financial information were overwhelmed. Too many corporate executives sought ways to "harvest" some of those stock market gains. As a result, the highly desirable spread of shareholding and options among business managers perversely created incentives to artificially inflate reported earnings in order to keep stock prices high and rising. This outcome suggests that the options were poorly structured, and, consequently, they failed to properly align the long-term interests of shareholders and managers, the paradigm so essential for effective corporate governance. The incentives they created overcame the good judgment of too many corporate managers. It is not that humans have become any more greedy than in generations past. It is that the avenues to express greed had grown so enormously…It is incumbent upon us to apply the lessons of this recent period to inhibit any recurrence in the future.

"A major focus of reform of corporate governance, of course, should be an improved functioning of our economy. A related, but separate, issue is that shareholders must perceive that corporate governance is properly structured so that financial gains are fairly negotiated between existing shareholders and corporate officeholders. Shareholding is now predominately for investment, not corporate control. Our vast and highly liquid financial markets enable large institutional shareholders to sell their shares when they perceive inadequacies of corporate governance, rather than fix them. This has placed de facto control in the hands of the chief executive officer. Shareholders routinely authorize slates of directors recommended by the CEO. Generally, problems need to become quite large before CEOs are dislodged by dissenting shareholders or hostile takeovers.

"Manifestations of lax corporate governance, in my judgment, are largely a symptom of a failed CEO. Having independent directors, whose votes are not controlled by the CEO, is essential, of course, for any effective board of directors. However, we need to be careful that in the process, we do not create a competing set of directors and conflicting sources of power that are likely to impair a corporation's effectiveness. The functioning of any business requires a central point of authority.

"In the end, a CEO must be afforded full authority to implement corporate strategies, but also must bear the responsibility to accurately report the resulting condition of the corporation to shareholders and potential investors. Unless such responsibilities are enforced with very stiff penalties for non-compliance, as many now recommend, our accounting systems and other elements of corporate governance will function in a less than optimum manner.

"Already existing statutes, of course, prohibit corporate fraud and misrepresentation. But even a small increase in the likelihood of large, possibly criminal penalties for egregious behavior of CEOs can have profoundly important effects on all aspects of corporate governance because the fulcrum of governance is the chief executive officer. If a CEO countenances managing reported earnings, that attitude will drive the entire accounting regime of the firm. If he or she instead insists on an objective representation of a company's business dealings, that standard will govern recordkeeping and due diligence. It has been my experience on numerous corporate boards that CEOs who insist that their auditors render objective accounts get them. And CEOs who discourage corner-cutting by subordinates are rarely exposed to it.

"I recognize that I am saying that the state of corporate governance to a very large extent reflects the character of the CEO, and that this is a very difficult issue to address. Although we may not be able to change the character of corporate officers, we can change behavior through incentives and penalties. That, in my judgment, could dramatically improve the state of corporate governance.

"Our most recent experiences clearly indicate, however, that adjustments to the existing structure of regulation of corporate governance and accounting beyond addressing the role of the CEO are needed. In designing changes to our regulatory framework, we should keep in mind that regulation and supervision of our financial markets need to be flexible enough to adapt to an ever-changing and evolving financial structure. Regulation cannot be static or it will soon distort the efficient flow of capital from savers to those who invest in plant and equipment. There will be certain areas where Congress will choose to provide a specific statutory direction that will be as applicable thirty years from now as today. In other cases, agency rule-making flexibility under new or existing statutes is more appropriate. Finally, there are some areas where private supervision would be most effective, such as that of the New York Stock Exchange, which requires certain standards of governance for listing.

"Above all, we must bear in mind that the critical issue should be how to strengthen the legal base of free market capitalism: the property rights of shareholders and other owners of capital. Fraud and deception are thefts of property. In my judgment, more generally, unless the laws governing how markets and corporations function are perceived as fair, our economic system cannot achieve its full potential."

The full text of the speech is on the website of US Federal Reserve Board at [www.federalreserve.gov](http://www.law.unimelb.edu.au/bulletins/archive/www.federalreserve.gov)

(F) SEC EXPANDS SHAREHOLDER POWER TO VOTE ON EQUITY COMPENSATION PLANS

On 15 July 2002 the staff of the US Securities and Exchange Commission announced a change in policy regarding the opportunity of shareholders to approve equity compensation plans.

The SEC's Division of Corporation Finance published Staff Legal Bulletin No 14A announcing that it had changed its position regarding the application of Exchange Act Rule 14a-8, the "shareholder proposal" rule, to equity compensation plans.

Previously, the Division applied the rule to permit the exclusion of shareholder proposals relating to broad-based equity compensation plans on the basis that they were related to a company's "ordinary business" matters.

The Division announced that, going forward, a public company may not rely on the rule's "ordinary business" provision to omit the following proposals from its proxy statement:

- Any proposal that focuses on equity compensation plans that may be used to compensate only senior executive officers and directors; and
- Any proposal that focuses on equity compensation plans that potentially would result in material dilution to existing shareholders, regardless of who participates in the plan.

Unlike existing proposals of the New York Stock Exchange and the Nasdaq, the new staff interpretation applies to all public companies, not only companies listed or quoted on those markets.

(G) THE WORLD'S LARGEST COMPANIES

In its 15 July 2002 issue Business Week published its list of the top 1,000 companies based on the share price of these companies as at 31 May 2002. Companies from the following countries make up the list:

Australia - 19; Austria - 1; Belgium - 10; Britain - 85; Canada - 39; Denmark - 6; Finland 6; France - 51; Germany - 35; Greece - 3; Hong Kong - 15; Ireland - 5; Italy - 24; Japan - 142; Netherlands - 19; New Zealand - 1; Norway - 5; Portugal - 3; Singapore - 6; Spain - 15; Sweden -17; Switzerland - 20; and United States - 473

(H) THE COCA-COLA COMPANY AND OTHER COMPANIES TO EXPENSE ALL STOCK OPTIONS

A particularly controversial corporate governance issue is whether companies should expense stock options - see, for example, the recent speeches of ASIC Chairman David Knott (item 1(D) of the this Bulletin) and US Federal Reserve Chairman Alan Greenspan (item 1(E) of this Bulletin). On 14 July 2002, in what is regarded as an important initiative, the Coca-Cola Company announced it would expense the cost of all stock options the company grants, beginning with options to be granted in the fourth quarter 2002.

To determine the fair value of the stock options granted, the company intends to use quotations from independent financial institutions. The option value to be expensed will be based on the average of the firm quotations received from the financial institutions to buy or sell Coca-Cola shares under the identical terms of the stock options granted.

Since the Coca-Cola announcement, other major US corporations, including the Washington Post Co and Bank One Co have also announced they will expense stock options.

(I) US PRESIDENT BUSH'S MOST RECENT INITIATIVES ON CORPORATE RESPONSIBILITY

In New York on 9 July 2002, United States President George Bush called for a new ethic of responsibility in America's corporate community. The President unveiled new criminal penalties and enforcement provisions. In summary he:

- signed an Executive Order creating a Corporate Fraud Task Force to provide direction for investigations and prosecutions of criminal activity. The Task Force will provide oversight and enable improved inter-agency coordination of civil and criminal investigations.
- proposed doubling the maximum prison term for mail fraud and wire fraud to ten years (mail fraud and wire fraud statutes are often used in cases involving corporate wrongdoing).
- called on the US Sentencing Commission to enhance prison time for criminal fraud when committed by corporate officers and directors.
- proposed strengthening laws that criminalise document shredding and other forms of obstruction of justice.
- proposed new provisions to strengthen the ability of the Securities and Exchange Commission (SEC) to freeze improper payments to corporate executives while a company is under investigation.
- called on public companies' compensation committees to prevent corporate officers from receiving loans from their companies.
- said that CEOs should comply with the spirit of existing disclosure rules by explaining how their compensation packages are in the best interests of their companies' shareholders, and describing in plain English in their companies' annual reports every detail of their compensation packages.
- asked Congress to take immediate action to pass the $20 million funding increase requested earlier this year so that the SEC can hire 100 new enforcement officers. The President also asks Congress to provide an additional $100 million in financial year 2003 to enable the SEC to hire more enforcement officers and provide them with state-of-the-art technology. The new funds combined with the President's proposed financial year 2003 budget - represent more than a 20 percent increase for the SEC in financial year 2003.
- called on the nation's stock markets to require that a majority of a company's directors be truly independent so that they have no material relationship with the company. The President also said that all members of a company's audit committee, nominating committee, and compensation committee should be truly independent.
- called on the nation's stock markets to require listed companies to receive shareholder approval for all stock option plans.

(J) THE BUSINESS ROUNDTABLE STATEMENT ON RESTORING INVESTOR TRUST

On 8 July 2002 the chief executive officers of The Business Roundtable, representing many of the largest companies in the United States, stated that they have been "appalled, angered and, finally, alarmed at the stream of revelations which have emerged in the past six months concerning a number of public companies".

The most important issues which The Business Roundtable (BR) feels must be addressed are:

Full and accurate disclosure: The BR supports the SEC's proposals to require CEOs to certify that their financial statements completely and accurately reflect the true condition of the company.

Trust and accountability: Corporate leaders must be held accountable for any abuse of public trust. The BR believes that executives should be required to return monies they received as a result of fraudulent accounting practices.

Independence: Boards of directors must exercise independent judgment and a substantial majority of board members must be independent of management, as advocated in the BR's Principles of Corporate Governance. The three key committees of the board - the audit, compensation and governance committees - must be made up entirely of independent directors.

Auditing reform: The BR supports strong oversight of the accounting profession to ensure independence of auditors and credibility of the auditing process.

Stock options: The BR supports shareholder approval of all company stock option programs to help restore confidence in our compensation systems.

Insider trading: The BR supports stronger controls on and disclosure of stock trading by insiders.

(K) UK REVIEW OF SAVINGS PRODUCTS

On 8 July 2002 the United Kingdom Sandler Review of medium and long-term retail savings published its final report, putting forward proposals for a set of simple and clear savings products accessible to the mass market.

The Review has identified two core problems in the UK savings market:

- Competitive forces in the industry do not work effectively to deliver cost efficiency or value-for-money investment practices.
- Savings levels are insufficient, particularly amongst the less well-off, in part because of the high cost of serving this segment.

These problems have various root causes:

- The UK retail savings market is extremely complex, with a vast array of subtly differentiated products and complex charging structures.
- There is considerable opacity. Price and performance are generally hard to compare and are often not even identifiable at all. This is particularly true for with-profits products.
- Consumers rely heavily on advice from intermediaries but have little or no understanding of the costs of advice, and are unable to gauge its quality. The advice itself is often compromised by the incentive effects of commission paid by product providers.
- Consumers require substantial regulatory intervention to protect their interests. The cost of this intervention contributes to pricing many lower and middle income savers out of the market.

The evidence of ineffective competition is widespread according to the Review. For example, life industry cost efficiency has declined steadily in recent years. Charges for near-identical products can differ widely. In comparison with institutional behaviour, the prevalence of active management for retail funds is surprisingly high. The investment performance of unit trusts bears no relationship to their charges, and the average unit trust significantly under-performs the market.

The Review's recommendations for the Financial Services Authority (FSA) and the Government include:

- The introduction of a suite of simple regulated products, with capped charges, restrictions on investment profile and the ability to exit on reasonable terms. These products would be sold without the need for regulated advice; the regulation of the products themselves would provide the basis for consumer protection.
- A clearer and simpler structure for with-profits products. Although this cannot be delivered quickly - it will require consultation and staged implementation over time - it offers a sustainable long-term basis for future policies where performance is transparent, unnecessary jargon is removed, and effective competitive pressures can operate properly.
- A new model for independent advice, building on the work of the FSA. Only advisers who were not paid by providers would be permitted to call themselves "independent advisers". Payment for advice could still be contingent on a sale, as commission is today, but it would have to be negotiated between the adviser and the consumer, not the adviser and the product provider.
- Tax simplification measures, including abolition of the "qualifying policy" regime for life savings policies and an overhaul of pensions taxation. Over time, the tax system for retail savings products has become very complex, and simplifying it will help empower consumers. The Review believes that future Government action in this area should focus on simplification, and not on attempts to stimulate savings levels with tax incentives.
- Measures to boost consumer education in financial matters, including more financial resources, a ring-fenced budget and higher profile within the FSA.
- More stringent investment qualifications for financial advisers.
- A set of principles for retail savings products based on the Myners principles of investment, setting out what providers should disclose to consumers about their investment strategy.

A copy of the report is available on the UK Treasury website at [www.hm-treasury.gov.uk](http://www.law.unimelb.edu.au/bulletins/archive/www.hm-treasury.gov.uk)

(L) ADOPTION OF INTERNATIONAL ACCOUNTING STANDARDS BY 2005

On 3 July 2002 the Chairman of the Australian Financial Reporting Council (FRC), Mr Jeffrey Lucy, AM, announced that the FRC had formalised its support for the adoption by Australia of international accounting standards by 1 January 2005.

Subject to the Government's support at the appropriate time for any necessary amendments of the Corporations Act, this will mean that, from 1 January 2005, the accounting standards applicable to reporting entities under the Act will be the standards issued by the International Accounting Standards Board (IASB). After that date, audit reports will refer to companies' compliance with IASB standards.

Mr Lucy said he understood that the 1 January 2005 timing is somewhat later than the Government would have liked. However, it is determined by the decision of the European Union to require EU listed companies to prepare their consolidated accounts in accordance with IASB standards from that date, in support of the EU single market objective. Mr Lucy also expressed his support for efforts to encourage the United States to further converge its standards with IASB standards with a view to eventual adoption.

For further information, please contact the secretariat of the Financial Reporting Council, c/- The Treasury, Langton Crescent, Parkes ACT 2600.

Mr Michael Kooymans
Tel: (02) 6263 3984
Fax: (02) 6263 2770
E-mail: mkoovmans@frc.gov.au
Or visit the FRC's website at [www.frc.gov.au](http://www.law.unimelb.edu.au/bulletins/archive/www.frc.gov.au)

(M) GLOBAL INVESTOR OPINION SURVEY 2002: KEY FINDINGS

Corporate governance remains of great concern for institutional investors according to the 2002 Global Investor Opinion Survey released in July by McKinsey & Company, with strengthening the quality of accounting disclosure as the top priority. The key findings of the survey are:

(1) Corporate governance is at the heart of investment decisions

(a) Investors state that they still put corporate governance on a par with financial indicators when evaluating investment decisions.

(b) An overwhelming majority of investors are prepared to pay a premium for companies exhibiting high governance standards. Premiums averaged 12-14% in North America and Western Europe; 20-25% in Asia and Latin America; and over 30% in Eastern Europe and Africa.

(c) While the relative significance of governance appears to have decreased slightly since 2000, this highlights that (i) many countries have implemented governance-related reforms that have been welcomed by investors, and (ii) more than 60% of investors state that governance considerations might lead them to avoid individual companies with poor governance with a third avoiding countries with poor governance.

(2) Financial disclosure is a pivotal concern

(a) In pursuit of better accounting disclosure, investors express strong support for the introduction of a single unified global accounting standard, with 90 percent favoring such a move. However, investors are split down the middle on the preferred standard.

(b) Investors are unified on expensing stock options in profit and loss statements, with over 80 percent supporting such a change.

(3) Reform priorities focus on rebuilding the integrity of the system

(a) Investment behavior is affected by a broad spectrum of factors, not just those at the corporate level. The quality of market regulation and infrastructure is highly significant, along with enforceable property rights and downward pressure on corruption.

(b) After strengthening corporate transparency, investors believe companies should create more independent boards and achieve greater boardroom effectiveness through such steps as better director selection, more disciplined board evaluation processes and greater time
commitment from directors.

(c) Specific policy priorities include strengthening shareholder rights, improving accounting standards, promoting board independence and tighter enforcement of existing regulations.

The survey can be downloaded from the McKinsey & Co website at [www.mckinsey.com/governance](http://www.law.unimelb.edu.au/bulletins/archive/www.mckinsey.com/governance)

(N) MODERNISING COMPANY LAW IN THE UNITED KINGDOM - WHITE PAPER PRESENTED TO PARLIAMENT BY THE UK SECRETARY OF STATE FOR TRADE AND INDUSTRY

In July 2002 the United Kingdom Secretary of State for Trade and Industry presented to Parliament a White Paper titled "Modernising Company Law". The White Paper is the Government's response to the earlier Company Law Review which put forward extensive proposals for reform of the UK's Companies Act 1985.

Following is a summary of the White Paper.

(1) Company decision-making

The Government proposes to modernise and simplify the ways in which companies take decisions, including by:

- removing the requirement for private companies to hold Annual General Meetings (AGMs) unless members want them;
- simplifying the rules on written resolutions to make it easier for private companies take decisions.

The Government also wants to increase transparency. In future:

- company constitutions will be a single document. There will be simpler, clearer models for both private and public companies;
- AGMs will be held within six months of the financial year-end for public companies and ten months for private companies;
- shareholders will be able to require a scrutiny of a poll; and
- proxies will have extended rights.

The Government is also keen to see institutional investors playing a more effective role
in corporate governance.

(2) Directors

The Government agrees with the Company Law Review that the primary role of directors should be to promote the success of the company for the benefit of its shareholders as a whole, and that directors' general duties to the company should be codified, broadly as proposed by the Review. The Government also proposes to prepare clear guidance for new directors on what these duties mean.

(3) Reporting and auditing

The Government believes that company reporting should provide accurate, accessible information at reasonable cost.

The Government proposes to replace the current directors' report. For small companies all that will be needed is a short, simple, supplementary statement. The Government also proposes to simplify the accounts for around 15,000 companies by increasing the definition of a small company for accounting purposes to the EU maximum (£4.8 million turnover, £2.4 million balance sheet total, 50 employees). As it is important that company accounts should be generally available, the Government will abolish the option for small and medium-sized companies to file abbreviated accounts at Companies House. The Government also proposes to reduce the time allowed to file accounts to seven months for private companies, and six months for public companies.

The very largest companies will have to provide an Operating and Financial Review (OFR), ie a narrative report on a company's business, its performance and future plans. Quoted companies will also be required to prepare a directors' remuneration report.

For the first time quoted companies will also be required to publish their accounts on their website, within 4 months of their year-end.

The Government does not propose to adopt the idea of an independent professional review as an alternative to audit for some small company accounts. The Government will however assess the impact of the July 2000 increase in the audit threshold for small firms to £1 million before deciding whether to propose a further increase.

Other aspects of auditing are under consideration as part of the work to improve corporate governance following the collapse of Enron.

(4) Keeping the law up to date

It is important to keep the law up to date and ensure it continues to meet all users' needs. The Government proposes therefore largely to follow the Review's recommendations to put those elements which are likely to need regular amendment into secondary legislation, and to enable some detailed rule-making to be devolved to one or more specified bodies.

As part of this the Government is considering a single body, based on the current Accounting Standards Board (ASB), but with suitably adapted membership and constitution, making detailed rules on matters such as the form and content of financial statements (except where international accounting standards apply), disclosure requirements for the OFR, and the form and content of the summary statement. A successor body to the Financial Reporting Review Panel (FRRP), with a broader remit, will enforce these 'form and content' rules on public and large private companies in the same way that the FRRP enforces current accounting law and standards. Companies House will continue to enforce these rules for smaller private companies.

The rule-making body would also take over from the UK Listing Authority responsibility for making rules to require listed companies to disclose their compliance with the Combined Code on Corporate Governance. The body should also decide when any further review of the Code is necessary, though the Code will remain a nonstatutory document.

The Government does not intend to pursue the Review's recommendations to create a statutory Company Law and Reporting Commission and a Private Companies Committee. While the Government shares the Review's objectives, these can be achieved without legislation.

(5) Other areas

The Government will simplify and update the law on company formation and capital maintenance, particularly for private companies. It will also abolish the requirement for private companies to appoint company secretaries (although they will of course be free to do so voluntarily).

The Government also proposes to simplify the law regulating companies incorporated overseas and operating in Great Britain.

Responses to the White Paper are invited by 29 November 2002 and should be sent to:

Edwin James
Companies Bill Team
Ground Floor
4 Abbey Orchard Street
London SW1P 2 HT

Tel: (020 7215 0759
Fax: (020 7215 0794
Email: edwin.james@dti.gov.uk

The White Paper is available from the Modernising Company Law pages on the Department of Trade and Industry's website at [www.dti.gov.uk/companiesbill](http://www.law.unimelb.edu.au/bulletins/archive/www.dti.gov.uk/companiesbill)

(O) SEC PUBLISHES LIST OF COMPANIES WHOSE OFFICERS ARE ORDERED TO CERTIFY ACCURACY AND COMPLETENESS OF RECENT ANNUAL REPORTS

On 28 June 2002 the United States Securities and Exchange Commission published a list of 945 companies whose chief executive and chief financial officers are now required to personally certify-in writing, under oath, and for publication-that their most recent reports filed with Commission are both complete and accurate. Officers who make false certifications will face personal liability.

"This is an unprecedented step to help restore investor confidence,' said SEC Chairman Harvey L. Pitt. "We are demanding that CEOs and CFOs swear that the numbers they've reported in their financial reports are correct and that they've left nothing important out."

The order is intended to assure the investing public and the SEC that the corporate disclosure in reports already filed this year with the Commission is in compliance with federal securities laws, or, provide information quickly about those companies where that is not the case. The Commission's order applies to companies with reported annual revenues in excess of $1.2 billion.

The order requires the principal executive and financial officers of SEC-registered companies to each file with the Commission a sworn written statement in which the officer must personally attest that the company's most recent periodic reports are materially truthful and complete or explain why such a statement would be incorrect.

The officers are required to file their written statements with the Commission no later than the close of business on the first date that their company is required to file a Form 10-K or Form 10-Q with the Commission on or after Aug. 14, 2002. The SEC intends to make the certifications available to the public on the SEC Web site. The certifications will apply to:

- the company's most recent Annual Report on Form 10-K filed with the Commission;
- all of the company's reports on Form 10-Q, all reports on Form 8-K and all definitive proxy materials filed with the Commission subsequent to the filing of the most recent Form 10-K; and
- any amendments to any of the above.

The Commission's order and list of companies covered by the order have been posted on the SEC website at <http://www.sec.gov/rules/other/4-460.htm>.

(P) REVIEW OF AUDIT REGULATION AND CORPORATE DISCLOSURE

On 27 June 2002 the Australian Commonwealth Treasurer, the Hon Peter Costello MP and the Parliamentary Secretary to the Treasurer announced a process which will review audit regulation and the wider corporate disclosure framework as the next phase in the Government's Corporate Law Economic Reform Program (CLERP).

According to the Treasurer, the process will commence with the release of an issues paper (CLERP 9) in August which will address the Ramsay report on auditor independence together with a number of other issues on financial disclosure.

Final implementation of reforms in the audit area will take account of any relevant recommendations of the HIH Royal Commission, work currently being undertaken by the Joint Committee of Public Accounts and Audit and developments overseas, particularly in the United States in response to the Enron collapse.

The Government will also examine the effectiveness of other corporate disclosure mechanisms, including a review of Australia's present continuous disclosure regime and ways of further encouraging shareholder participation in companies.

Extensive consultation continues to be a key feature of the CLERP process. The Government will develop the proposals in the discussion paper in consultation with the Business Regulation Advisory Group. Such a group was first established in 1997 to provide feedback on the earlier CLERP reforms and proved successful in providing professional and business advice early in the process.

The Government will seek comments on the issues and proposals in the discussion paper by mid-October and release exposure draft legislation for further public comment by early December. It plans to introduce legislation into Parliament in 2003. This will allow final implementation to take account of any relevant recommendations of the HIH Royal Commission and further developments overseas.

The key issues to be addressed in the discussion paper are:

(1) Audit reform

(a) audit reform, including:

(i) the market for audit and non-audit services;

(ii) the institutional framework for setting auditing standards and whether they should be given the force of law;

(iii) the rules and practices governing the audit engagement including appointment and removal of auditors and related corporate governance arrangements;

(iv) auditor independence issues canvassed in the Ramsay report including:
- proposed amendments of the Corporations Act to strengthen the independence objective, require an annual independence statement from auditors, and strengthen provisions relating to employment, financial and business relationships between auditors and their clients;
- proposals to require disclosure of individual non-audit services and fees, address the question of limits on the provision of non-audit services, and strengthen the role of audit committees in relation to auditor independence;
- whether a new oversight body is needed to monitor and advise the Government on auditor independence issues, including a role in monitoring the adequacy of independence processes used by audit firms and compliance by companies;

(v) the structures for oversight of the profession, including disciplinary procedures, ethical rules, external quality assurance, educational requirements, professional development, competency standards etc; and

(vi) liability issues, drawing on current work in the context of public liability and medical indemnity insurance, including the question of incorporation of audit firms.

(2) Disclosure framework

(a) a review of the present continuous disclosure regime;

(b) conflicts of interest in relation to the provision of financial product advice; and

(c) review of the current disclosure requirements for shares and debentures including:

(i) whether they should be merged into the general financial product disclosure requirements inserted by the Financial Services Reform Act;

(ii) placements and other disclosure issues; and

(iii) the sophisticated investor test.

(3) Shareholder participation

(a) consideration of possible amendments to the Corporations Act to encourage investors to become more active in companies they invest in (eg. simplification of notices of meetings).

(Q) CLERP 8: CROSS-BORDER INSOLVENCY LAWS TO BE REVIEWED

On 25 June 2002 the Parliamentary Secretary to the Treasurer, Senator Ian Campbell, announced a review of cross-border insolvency law, including possible adoption of an international model law aimed at improving the chances of tracing assets overseas and returning them to Australia.

Senator Campbell said the review was the next phase of the Government's Corporate Law Economic Reform Program. It would be called CLERP 8.

He said he planned to introduce legislation before the end of this year. A discussion paper would be released shortly to stakeholders as part of a consultation process.

Senator Campbell said there was wide support within Australia for the model, developed over three years by the United Nations International Commission on Trade Law. Those in support included the Insolvency Trustee Service of Australia, Insolvency Practitioners' Association of Australia, Law Council of Australia and the judiciary.

He said the key objectives of the model were:

- cooperation between courts and other authorities;
- increased legal certainty for trade and investment;
- protection of the interests of creditors;
- protection and maximisation of the value of assets; and
- increasing the prospects of rescuing financially-troubled businesses, protecting
investment and saving jobs.

2. RECENT ASIC DEVELOPMENTS

(A) COURT FINDS NRMA LIMITED PRESIDENT NICHOLAS WHITLAM BREACHED HIS DUTIES AS A DIRECTOR

On 19 July 2002 Mr David Knott, Chairman of ASIC, welcomed the decision handed down by Mr Justice Gzell of the Supreme Court of New South Wales in ASIC's civil penalty action against NRMA Limited President Mr Nicholas Whitlam.

The Court found that Mr Whitlam had breached his duties as an officer of NRMA Limited under the Corporations Law.

The breaches related to NRMA Limited's 1998 Annual General Meeting, when Mr Whitlam as Chairman failed to vote certain proxy votes against a resolution relating to the remuneration of the company's directors.

Mr Whitlam was found to have breached section 232(2) (duty to act honestly) (now section 181 of the Corporations Act), section 232(6) (improper use of position) (now section 182 of the Corporations Act) and section 250(A) (duty as a proxy holder) of the Corporations Law.

'It is important to understand that this was never a case about a technical or unimportant breach of voting procedures. At the centre of this case lies the obligation of directors to observe proper standards of conduct when discharging their responsibilities', said Mr Knott.

Mr Justice Gzell found that Mr Whitlam had deliberately omitted to sign the poll paper. 'He had the deliberate intent to disenfranchise the members who had appointed him proxy and required him to vote against resolution 6 and he was seeking, deliberately, to override the intent of the members of NRMA which he knew to be against the passing of resolution 6 as a special resolution', Justice Gzell said in his judgment.

The Court also found that Mr Whitlam had failed to exercise due care and diligence (in breach of section 180(1) of the Corporations Act) when he amended the proposed minutes of the August 2000 Board meeting of NRMA Insurance Group Limited. However, the Court exercised its discretion to relieve Mr Whitlam from any penalty for this breach.

ASIC has claimed banning orders and pecuniary penalties against Mr Whitlam. Penalties will be the subject of a separate hearing.

(B) ACCOUNTING SURVEILLANCE

On 12 July 2002 Mr David Knott, Chairman of ASIC, announced a new accounting surveillance project directed to areas of accounting abuse of the type recently uncovered in the USA.

ASIC had previously foreshadowed that it would focus on compliance with the new accounting standard AASB 1005 'Segment Reporting' in its review of full-year financial reports.

However, in the current climate and following recent events in the USA, it has been decided to give higher priority to capitalised and deferred expenses, recognition of revenue, and recognition of controlled entities and assets. The surveillance will relate to the full-year financial reports of selected listed companies for the financial year ended 30 June 2002.

'While ASIC has no reason to believe that abuses such as those recently uncovered in the USA are prevalent in Australia, the Commission has decided that a targeted surveillance of these issues will assist to maintain confidence in the reliability of public company financial reporting in our market', Mr Knott said. 'I am writing to the Chairmen of all listed companies, drawing their attention to this surveillance project and inviting them to directly involve their Boards in ensuring compliance with the relevant accounting standards', Mr Knott said.

ASIC is assembling a special task force for this project comprising representatives from ASIC's Office of Chief Accountant and from its Corporate Finance and Enforcement directorates.

The primary focus of the task force will be compliance with accounting standards relevant to these matters. The principal standards under review are:

- AASB 1040 Statement of Financial Position;
- AASB 1018 Statement of Financial Performance;
- AASB 1004 Revenue; and
- AASB 1024 Consolidated Accounts.

Surveillance of compliance with AASB 1005 will be deferred pending the completion of this more important project.

The task force will consult appropriately with the accounting profession during the course of its work and will be expected to report its preliminary findings by 31 December 2002.

Companies or their accountants who have doubts about the correct accounting treatment of transactions covered by the relevant standards are encouraged to contact ASIC at an early stage prior to finalisation of their financial reports. It is expected that such matters would ordinarily be discussed with the company's auditors and the technical partners of their audit firms prior to contacting ASIC.

Such contacts should be directed to accountingproject@asic.gov.au, preferably no later than 6 September 2002 in the case of listed companies and other disclosing entities.

(C) ASIC CLOSES ANSETT AND AIR NZ INVESTIGATIONS

On 11 July 2002 ASIC announced that it has closed its investigation into the collapse of the Ansett Holding Ltd group (Ansett).

On 1 March 2002, ASIC advised that while no action would be commenced against Ansett or its former directors, consideration would be given to commencing a representative action for damages against Air New Zealand Limited (AIZ) in relation to the level of its financial disclosures during 2001.

ASIC's March statement made it clear that several complex issues would require additional investigation and assessment before ASIC could finally decide on the merits of commencing proceedings against AIZ.

Over the intervening four months, ASIC has given a high priority to evaluating the prospects of successfully litigating against AIZ on behalf of former shareholders or creditors. The investigation has included interviewing more than 350 parties who say they suffered financial loss as a result of Ansett's failure; consultation with market and other experts; and obtaining legal advice from external counsel on a range of legal issues.

On the basis of the advice received, ASIC is unable to dismiss the possibility that AIZ's level of disclosure concerning its own and/or Ansett's forecast losses for the 2000-2001 financial year may have been, at certain times during that year, misleading and deceptive within the meaning of the Trade Practices Act.

However, after considering the evidence compiled by ASIC since March, Counsel, including Senior Counsel, have concluded that only a minority of purchasers of shares are likely to be in a position to prove that they relied directly on AIZ's conduct and suffered financial loss.

Moreover, Counsel have advised that owing to the differing positions of individual creditors, it would not be possible for ASIC to pursue creditor claims by way of a single group proceeding or class action. Instead, ASIC would be required to bring each claim as a separate proceeding or, at best, as a number of proceedings on behalf of different groups of plaintiffs. In those circumstances, the Commission has determined that the public interest would
not be served by incurring the cost and risk of commencing proceedings against AIZ.

For further information contact:

Jamie Orchard
Director, Enforcement
ASIC
Tel: (03) 9280 3470
Mobile: 0411 549 037

(D) ASIC GUIDANCE ON THE HAWKING PROHIBITIONS

On 1 July 2002 ASIC released "The hawking prohibitions: an ASIC guide, a guidance paper on the hawking prohibitions in the Corporations Act 2001".

Copies of the new guidance paper may be obtained from the Financial Services homepage of the ASIC website on [www.asic.gov.au](http://www.law.unimelb.edu.au/bulletins/archive/www.asic.gov.au), by emailing ASIC's Infoline at infoline@asic.gov.au or by calling 1300 300 630.

Under the hawking prohibitions, a person must not offer financial products for issue or sale in the course of, or because of, an unsolicited meeting or telephone call with a retail client. The hawking prohibitions aim to prevent pressure selling of financial products to retail clients (such as badgering and boiler-room practices).

The hawking prohibitions are set out in the following sections of the Corporations Act:

- s736 - securities (eg shares and debentures);
- s992AA - managed investments (eg units in trusts); and
- s992A - other financial products (eg superannuation, life and general insurance,
derivatives and deposit products).

The Guide is based on the hawking prohibitions in the Corporations Act and associated regulations as at 1 July 2002.

On 18 June 2002, notice to move that regulation 7.8.22 be disallowed was given in the Senate. Regulation 7.8.22 deals with the permissible hours of telephone contact for contact that is not subject to the hawking prohibition in s.992A.

There are specific parliamentary processes dealing with disallowance notices. Until those processes are complete, the regulations continue with effect.

(E) REVIEW RELATING TO MANAGED DISCRETIONARY ACCOUNTS

On 28 June 2002 ASIC announced that it had commenced a review of its policy on the regulation of managed discretionary accounts (MDA).

An MDA is generally a trading account operated for a specific client by a licensed dealer where:

- the client's funds are held in trust for that client; and
- the dealer has the discretion to make investments using the funds in the account without prior reference to, or approval by, the client.

The review will consider the adequacy and appropriateness of the current arrangements for regulating MDAs in light of the changes to the Corporations Act 2001 arising from the Managed Investments Act 1998 and the Financial Services Reform Act 2001. The review will also consider industry developments and any consumer concerns about the operation of MDAs.

As part of this review, ASIC plans to consult widely with all stakeholders, and issue a Policy Proposal Paper on the topic some time between October and December 2002.

ASIC expects to complete the review within 12 months and will give reasonable notice of any transitional arrangements resulting from any change in policy.

Pending the outcome of the review, ASIC has extended its Class Order relief given to participants of Sydney Futures Exchanges Limited and SFE Corporation Limited (WE) in relation to MDAs operated by them. The relief has been extended for a further period of 12 months from 1 July 2002 to 1 July 2003 (see Class Order [02/679] which extends Class Order [01/1598], and Class Order [02/715], which extends Class Order 02/1861).

ASIC notes that SFE has made a decision to discontinue associate participant status from 1 October 2002. The current associate participants of SFE who do not wish to become full participants (discontinuing participants) will not be able to rely on the current Class Order relief for the operation of their MDAs from 1 October this year.

To minimise any possible disruption to the operation of MDAs by these discontinuing participants, ASIC intends to extend the terms of the current relief until 1 July 2003. This planned extension of relief will be subject to conditions that produce similar outcomes (eg disclosure to retail clients) to those under the conditions that currently apply to all SFE participants. ASIC will implement this relief by a separate Class Order in the coming months.

ASIC will also continue until 1 July 2003 its no-action approach to MDAs operated by participants of the Australian Stock Exchange Limited. See ASIC Policy Statement 169 Disclosure: Discretionary powers and transition at [PS 169.371 for details of this no-action position.

A copy of ASIC Policy Statement 169 and Class Orders [02/679], [01/1598], [02/186] and [02/715] can be obtained from ASIC's Infoline on 1300 300 630, or from the ASIC website at [www.asic.gov.au](http://www.law.unimelb.edu.au/bulletins/archive/www.asic.gov.au).

For further information contact:

Mark Adams
Director, Regulatory PoIicy
ASIC
Tel: (02) 99112622
Mobile: 0402 428 025

(F) DISCUSSION PAPER ON DISCLOSURE FOR ON-SALE OF FINANCIAL PRODUCTS

On 28 June 2002 ASIC released a discussion paper on "Disclosure for on-sale of securities and other financial products".

The discussion paper sets out the key issues relating to the disclosure requirements under the on-sales provisions in the Corporations Act (the Act) and ASIC's proposals to address these issues.

ASIC is of the view that relief from the on-sale provisions could be given in certain circumstances without defeating their legislative anti-avoidance purpose and the level. of investor protection they provide to retail clients', said Mr Malcolm Rodgers, ASIC's Executive Director, Policy and Markets Regulation. 'ASIC has also extended the current interim relief under Class Order 02/072 by a further 3 months from 11 September 2002 to 11 December 2002 to allow for six weeks for public consideration and comment an the proposals', he said.

The on-sales provisions are sections 707(3) and (4), and sections 1012C(6) and (7) of the Act.

These provisions are designed to minimise the opportunity for product issuers to avoid preparing offer documents (such as prospectuses or Product Disclosure Statements) by first issuing the product to an intermediary who then on-sells them in the wider market.

ASIC is seeking public comment on the discussion paper by 8 August 2002.

Comments should be sent to the postal or email address set out in the discussion paper.

The discussion paper in available on the ASIC website at [www.asic.gov.au](http://www.law.unimelb.edu.au/bulletins/archive/www.asic.gov.au).

(G) A GUIDE TO GOOD DISCLOSURE OF TRANSACTION BANKING FEES

On 26 June 2002 ASIC released a guide promoting improved disclosure of transaction fees for retail payments and deposit products (transaction accounts) offered by banks, credit unions and building societies.

The guide provides an easy reference for institutions and consumers to current disclosure requirements contained in legislation and codes of practice as well as ASIC's views on what constitutes good transaction fee disclosure. The guide sets out five principles of good disclosure for the five times at which ASIC believes transaction fee disclosure is particularly important:

- when a consumer is selecting a product or product provider;
- when changes are made to the level of fees or when, why or how they are charged;
- when a statement is received;
- when a consumer is actively seeking information (this time may coincide with one of the other four times); and
- immediately prior to making a transaction.

The guide was developed with the assistance of a working group of industry, consumer and government representatives.

3. RECENT ASX DEVELOPMENTS

(A) EXPOSURE DRAFT - PROPOSED ASX LISTING RULE AMENDMENTS - ENHANCED DISCLOSURE

On 19 July 2002 ASX released an Exposure Draft of proposed Listing Rule amendments to take effect on 1 January 2003. The title of the Exposure Draft is "Enhanced Disclosure", and the document is available on the ASX website [www.asx.com.au](http://www.law.unimelb.edu.au/bulletins/archive/www.asx.com.au).

The Exposure Draft is divided into four sections and aims to do the following:

- provide an overview and discussion of how the continuous disclosure framework works in practice;
- provide detailed analysis of internal ASX data which demonstrates that the continuous disclosure framework continues to achieve a high level of disclosure and transparency in the Australian market. ASX believes that the level of disclosure is still increasing;
- outline a number of proposed ASX Listing Rule amendments to enhance the existing disclosure regime and clarify certain aspects of the requirements.

The amendments focus on three key elements of the disclosure framework:

(1) Listing rule 3.1 - continuous disclosure, confidentiality and false markets;

(2) mandating electronic lodgment of announcements by ASX listed companies; and

(3) Appendix 4B - periodic financial reporting.

4. RECENT TAKEOVERS PANEL MATTERS

(A) DECISION IN RELATION TO ISIS COMMUNICATIONS

On 9 July 2002 the Takeovers Panel advised that it had declined to make a declaration of unacceptable circumstances in response to an application on behalf of the directors of Radly Corporation Limited (Receivers and Managers Appointed). The application related to an agreement on 14 June 2002, by the receivers of Radly to sell 19.9% of the shares in Isis Communications Ltd, in equal shares to Investec Australia Pty Ltd and MGB Equity Growth Pty Ltd. Radly held 43% of the shares in Isis.

The Panel considered that the wording of the agreement may have caused a contravention of the Corporations Act by giving MGB and Investec a relevant interest in the remaining 23% of Isis held by the receivers. One clause of the agreement purported to require the receivers not to vote in favour of any resolutions that would materially alter the nature of Isis for the two week period between signing and completion of the sale of the 19.9% to MGB and Investec. The Panel was advised that the problem in the wording of the clause was noticed at the eleventh hour but the agreement was signed because of impending commercial deadlines. It nonetheless seems inappropriate to the Panel for the contract to have been signed in the face of a concern of this nature. However, the Panel received evidence, and accepted it, that the clause had no effect, and was never capable of doing so, as no meetings were, or could be, held during that period.

A further clause required the receivers to use their best endeavours to cause Isis to convene a meeting to approve any further business, but it imposed no obligation on the receivers' voting or disposal of the remaining 23%.

Notwithstanding the Panel's concerns about the possible contravention of the Corporations Act resulting from the agreement, the Panel did not consider that the evidence supported a conclusion that the agreement had caused unacceptable circumstances.

Similarly, the Panel received evidence, and accepted it, that the agreement was never intended to restrict, and at no time restricted, the receivers' ability to dispose of the remainder of the Isis shares, nor was it intended to create or evidence any association between the parties.

The Panel reviewed the other elements of the agreement and the other aspects of the matter and decided that there were no other issues or circumstances the acceptability of which it should consider.

The Panel notes that the parties to the agreement, when it was suggested that parts of the agreement might be unacceptable, voluntarily deleted the relevant clauses. While not affecting its decision, the Panel welcomes the willingness of the parties to remove possible causes of contention.

The sitting Panel for the application was Alison Lansley (sitting President), Jeremy Schultz (sitting Deputy President) and Marian Micalizzi.

The Panel will advise when its reasons are published on its website.

(B) TAKEOVERS PANEL DECISION IN RELATION TO AUSDOC GROUP LTD

On 28 June 2002 the Takeovers Panel advised that it had declined to make a declaration of unacceptable circumstances in relation to a Deed of Undertaking entered into between Ausdoc Group Ltd and ABN AMRO Capital (Belgium) N. V. on 22 May 2002. The decision relates to an application brought by ASIC on 14 June 2002.

The Panel's decision followed undertakings to the Panel by ABN AMRO and Ausdoc waiving ABN AMRO's right to the break fee under the Deed that would be payable if ABN AMRO did not reach or waive its 90% minimum acceptance condition and there had been no rival bidder for Ausdoc.

In reaching its decision, the Panel noted its view of the operation of the exclusivity arrangements, and in particular the disclosure obligations, in the Deed.

(1) Break fee arrangements

The terms of the Deed were disclosed in Ausdoc's announcement to ASX on 22 May 2002. The Deed provides for Ausdoc to pay ABN AMRO a break fee, of up to $3.5 million, in a number of different circumstances. The amount of the break fee depends on which of those circumstances apply and, in some cases, the level of actual costs incurred by ABN AMRO. The maximum break fee of $3.5 million is approximately 1.87% of ABN AMRO's bid value of $187.6 million.

With one exception, the Panel decided that the break fees provided for in the Deed did not give rise to unacceptable circumstances. The Panel considered the break fees in light of the relevant factors set out in its Guidance Note on Lock-up Devices. It decided that the size of the break fees is not likely to have the effect of impeding competition in the market for control of Ausdoc, despite exceeding the Panel's benchmark of 1% of the value of the bid.

ABN AMRO submitted, and the Panel has accepted, that the quantum of the break fees is no more than necessary to reimburse ABN AMRO for the actual costs it has reasonably incurred in its takeover bid for Ausdoc. Those costs were higher than 1% in the particular circumstances of this case for a number of reasons, including the number and complexity of Ausdoc's businesses, and the fact that Ausdoc is a relatively small company.

(2) The 90% break fee

The aspect of the break fee arrangement that the Panel found unacceptable is the "90% break fee". The 90% break fee would require Ausdoc to pay $2.5 million to ABN AMRO if ABN AMRO proceeds with its bid and no higher bid is made, but ABN AMRO's defeating condition requiring 90% acceptances is not satisfied or waived.

The Panel agreed with ASIC's argument that the 90% break fee may have the effect of coercing shareholders into accepting ABN AMRO's bid. The Panel considered that the proposed fee therefore was not consistent with the Panel's Guidance Note on Lock-up Devices.

However, the Panel declined to make a declaration of unacceptable circumstances in relation to the 90% break fee following an undertaking by ABN AMRO to the Panel and Ausdoc that it would waive all rights to the 90% break fee. Ausdoc also provided an undertaking to the Panel that it would not pay the 90% break fee to ABN AMRO, or provide any benefit in substitution for the 90% break fee.

(3) Exclusivity arrangements

If Ausdoc receives, and responds to, a rival offer or expression of interest in relation to shares in Ausdoc, the exclusivity arrangements in the Deed of Undertaking require Ausdoc to disclose certain relevant information about the rival offer to ABN AMRO (Ausdoc's disclosure obligation). Initially, the Panel was concerned that the exclusivity arrangements and Ausdoc's disclosure obligation extended for the period of ABN AMRO's bid, and that might inhibit the market for control of Ausdoc.

However, Ausdoc's obligations under the exclusivity arrangements are subject to an exception if the directors of Ausdoc reasonably consider that complying with them would involve a breach of their fiduciary obligations to the shareholders of Ausdoc. The Panel considers that Ausdoc's disclosure obligation would not apply where disclosure of a potential rival bid might prevent a better outcome for the shareholders of Ausdoc. For example, a rival, although prepared to offer more than ABN AMRO, may decline to negotiate with Ausdoc if its approach would be disclosed to ABN AMRO. In such a case, the directors of Ausdoc would be obliged not to make that disclosure to ABN AMRO.

Therefore, the Panel considers that the fiduciary exception means that Ausdoc's disclosure obligation is unlikely to give rise to unacceptable circumstances.

The sitting Panel in this matter was Mr Michael Tilley (sitting President), Professor Ian Ramsay (sitting Deputy President) and Ms Luise Elsing.

The Panel's reasons for decision will be posted on its website at <http://www.takeovers.gov.au/Content/Decisions/decisions.asp>

5. RECENT CORPORATE LAW DECISIONS

(A) WHEN IS A COMPANY REQUIRED TO ACT ON A REQUISITION TO CALL A GENERAL MEETING?
(By Robert Armstrong, [Corrs Chambers Westgarth](http://www.corrs.com.au))

DVT Holdings Limited v Bigshop.com.au [2002] NSWSC 571, Supreme Court of New South Wales, Windeyer J, 26 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/june/2002nswsc571.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

The recent decision of Windeyer J in the New South Wales Supreme Court supports the view that there is residual common law power for the members of a company in general meeting to appoint directors notwithstanding the company's constitution specifying otherwise. Such a residual power may be exercised in situations where resolutions for the removal of director(s) are passed that result in the number of the company's directors falling below the minimum statutory requirement.

Windeyer J's judgment provides a good discussion of whether a company is required to act on a requisition to call a general meeting to consider resolutions for the appointment of directors when the company's constitution gives power to do so only at annual general meetings; and whether a company is required to call a meeting for the removal of directors if it would result in the company having less than the number of directors required by statute.

(2) The facts

DVT Holdings Limited ("DVT"), a public company with four directors at the time the case was considered, was requested by the defendants to call a general meeting of the company to consider certain resolutions. The defendant requisitionists, who were members with at least five percent of the votes which could be cast at a general meeting, encountered no challenge to their standing to call the meeting.

By notice dated 22 April 2002, given pursuant to section 249D(1) of the Corporations Act 2001 ("Act"), the following resolutions were to be considered at the meeting:

- Resolutions 1, 2 and 3 proposed the appointment of three new directors respectively with effect from the closure of the meeting; and
- Resolutions 4, 5 and 6 proposed the removal of three existing directors respectively with effect from the closure of the meeting.

DVT did not act on the request and instead commenced proceedings on 10 May 2002 seeking declarations that the requisition was invalid and ineffective and that DVT was not obliged to act upon it.

On 17 June 2002 the defendants notified DVT of their intention to call a meeting in view of DVT's failure to do so.

On 18 June 2002 DVT filed a notice of motion for an interlocutory injunction to restrain the defendants from calling the meeting until the determination of the proceedings.

On 19 June 2002, when the hearing commenced, it was agreed that the matter would go forward that day as a final hearing on amended pleadings, rather than on the notice of motion for interlocutory relief. It was heard on 19 June as a final hearing.

DVT claimed that the members' power to appoint directors was limited by clause 14.2 of DVT's constitution which stated that the company may appoint a person to be a director by ordinary resolution at an annual general meeting ("AGM"). DVT also claimed that the resolutions for removal were invalid for various reasons. Accordingly, DVT sought an order restraining the defendants from calling a meeting to consider any or all of the proposed resolutions.

The defendants maintained that the meeting they requisitioned was not required to be an AGM, and even if it was and their requisition was valid only for the removal resolutions, then a meeting must be called to address the valid removal resolutions.

(3) Decision

(a) Resolutions for appointment

The defendants argued that there is an inherent power at common law for a general meeting to appoint directors by ordinary resolution, which can only be displaced by clear language evincing an intention to do so. Windeyer J held that there was a clear intention for the inherent power to be displaced in this case on the basis that clause 14.1 of DVT's constitution gave the directors some powers and the members at the AGM certain powers to appoint directors.

This intention was also made clear on the basis that clause 3 of the constitution excluded all replaceable rules in the Act (including section 201G of the Act which provides that a company may appoint a person as a director by resolution passed in a general meeting) and that this replaceable rule was substituted by clause 14.2 of the constitution..

The defendants relied on Link Agricultural Pty Limited v Shanahan McCallum & Pivot [1999] 1 VR 466 as authority to suggest that the provisions of a constitution could not take away a common law right to appoint directors in a general meeting. Windeyer J, however, stated that the question in that case was whether or not the power remained in light of the articles of association. The point of the decision in that case is that the particular article conferring the power upon the directors to appoint a director in certain cases does not deprive the company of an inherent power to nominate and appoint its own directors. The case is not authority for a general principle that a constitution could not take away a common law right to appoint directors in a general meeting.

His Honour stated that while the provision in clause 14.2 of DVT's constitution was unusual, it clearly intended for a director to be appointed at an AGM and not at a general meeting. This meant that the proposed resolutions 1, 2 and 3 would be invalid if passed. Given the resolutions could not be put, the company was not required to call a meeting to consider them and the requisitionists were consequently restrained from themselves calling a meeting for the purposes of considering them.

(b) Removal of directors

Section 203D(1)(a) of the Act, which is not a replaceable rule, states that a public company may by resolution remove a director from office despite anything in the company's constitution.

DVT contended that the proposed resolutions were invalid because (i) they were part of a package including the invalid resolutions for the appointment of directors; and (ii) the resolutions, if passed, would cause the company to be in breach of the Act since section 201A(2) requires a public company to have three directors.

With regard to contention (i), Windeyer J held that the defendants did not indicate that the resolutions were a package and as such DVT's argument failed. However, his Honour reiterated that in Turner v Berner [1978] 1 NSWLR 66, Needham J held that if a requisition proposed a resolution which a company in general meeting had no power to pass, the directors were justified in excluding reference to that resolution in a notice of meeting. But, this was not to say that the directors were not obliged to convene a meeting for the valid resolutions.

With regard to (ii), it is an offence for a public company to have fewer than three directors. On this basis DVT contended that it was not bound to call a meeting to consider resolutions for the removal of three directors which would reduce the number of directors to one. DVT relied on Corpique (No 20) Pty Ltd v Eastcourt Ltd (1989) 7 ACLC 794 and Claremont Petroleum NL v Indosuez Nominees Pty Ltd (1986) 10 ACLR 520. Both cases considered resolutions to remove directors which would result in the number of directors falling below the minimum statutory requirement.

In the Claremont case the court held that for a company to be without the required number of directors for a short period of time when it was envisaged that new directors would be appointed almost immediately, was not a sufficient reason to refuse to summon the meeting required by the requisitionists.

In the present case, Windeyer J asserted that if one director remained on DVT's board, that director would have the power to take immediate action to appoint directors to make up the minimum number. His Honour suggested that the court should not assume that such immediate action would not be taken.

The power to remove directors in general meeting is one given by the Act and cannot be altered by the constitution. His Honour noted that in circumstances where a company has deleted a replaceable rule and replaced that rule with one limiting the powers of the company in general meeting to appoint directors, a court should be very careful before coming to a view that resolutions for removal of directors cannot be validly passed if this would result in the company having fewer than the required number, at least for a short period. The court should assume that the remaining director, if all removal resolutions succeeded, would carry out his/her statutory obligations.

Windeyer J also noted that it was possible that, notwithstanding clause 14 of DVT's constitution, there may be some residual power in the members (rather than some inherent power) in a case of necessity to appoint directors in general meeting. His Honour stated that he did not consider that a company is necessarily stultified and unable to act at all if the number if its directors is reduced below the statutory number and if any remaining directors refused to act to fill any casual vacancy. This was the subject in CIC Insurance Ltd v Hannan & Co Pty Ltd (2001) 38 ACSR 245 at 247 where Barrett J held that there is residual common law power for the members in general meeting to appoint directors in such situations.

Overall, Windeyer J held that a declaration should be made that the proposed removal resolutions were valid and that the proposed appointment resolutions were invalid. As such, DVT was required to act on the requisition to call a general meeting to consider the valid resolutions notwithstanding that such resolutions, if passed, would result in the company having less than the number of directors required by the Act.

(B) EXTENSION OF TIME TO CALL MEETINGS REQUESTED MY MEMBERS
(By Grace Pagliaro, [Corrs Chambers Westgarth](http://www.corrs.com.au))

NRMA v Snodgrass; NRMA v Dupree [2002] NSWSC 590, New South Wales Supreme Court, Windeyer J, 26 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/july/2002nswsc590.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

The judgement concerns an order sought by NRMA under section 1322(4)(d) of the Corporations Act ("the Act") to extend the time within which it is required to call a general meeting of members. The requisitions were advanced by two separate groups, who were represented by Mr Snodgrass and Mr Dupree respectively.

(2) The Snodgrass proceedings

A request was made to call a meeting under section 249D(1) of the Act to consider resolutions for the removal of eight named directors, namely, Mrs Callaghan, Mr Coyne, Ms Carnell, Mr Paciullo, Mr Sanchez, Mr Spicer, Mr Toovey and Mr Whitlam. It was asserted that they were not acting in the best interests of the company [as a whole].

(3) The Dupree proceedings

The Dupree requisitionists requested a meeting for the purpose of considering resolutions for the removal of the six remaining NRMA directors, namely, Mr Geeson, Ms Keating, Dr Lennane, Ms Singleton, Mr Sutherland and Mr Talbot. The notice requesting the meeting described the directors in question as "disruptive influences on the NRMA Board and not to be acting in the best interest of the members". The Dupree requisitionists also consented to the meetings being held at the same time.

(4) Corporations Act - relevant sections

Section 249D(1) - The directors of a company must call and arrange to hold a general meeting on the request of:

(a) members with at least 5% of the votes that may be cast at the general meeting; or
at least 100 members who are entitled to vote at the general meeting;

(1A) The regulations may prescribe a different number of members for the purposes of the application of paragraph (1)(b) to:

(a) a particular company; or
(b) a particular class of company.

Without limiting this, the regulations may specify the number as a percentage of the total number of members of the company.

(5) The directors must call the meeting within 21 days after the request is given to the company. The meeting is to be held not later than 2 months after the request is given to the company.

Section 1322(4)(d) provides that the Court may make an order extending the period for doing any act. Section 1322(6)(c) provides that the Court must not make an order in the circumstances which arise here unless it is satisfied that no substantial injustice has been or is likely to be caused to any person.

(5) NRMA arguments for extension

NRMA sought an order extending the time fixed under the Act for the calling and holding of the meetings to coincide with the time of calling and holding the 2002 annual general meeting of members in November. In support of NRMA's claim for an extension, it was argued first, that a further meeting would be too costly, second, that the statutory times would be impossible to comply with, and third, that as the meeting date at the earliest would be in September, a delay of two months for the meeting to coincide with the annual general meeting would not cause prejudice or injustice to the requisitionists.

NRMA's group secretary and general counsel, Ms Kelly estimated the cost of calling a meeting separate from the annual general meeting would be approximately $2.6 million as opposed to approximately $1.4 million if the meetings were held on the same day. In addition, Ms Kelly argued that it would be impossible to call the meeting within twenty-one days as it takes a minimum of two weeks to close the register of members and determine the eligibility of members to vote.

Moreover, the calling of a separate meeting would necessitate the performance of further administrative tasks, namely, (a) determining the venue, time and date of the meeting, (b) obtaining the venue, (c) preparing and approving the notice of meeting, and (d) distributing the notices of meeting to approximately 1.8 to 2 million members.

The Court accepted that NRMA is not an ordinary company and as such the required notice of meeting could not be forwarded within twenty-one days as provided for in the Act. The Court thus concluded that a time of two months is necessary for the drafting and distribution of the notice of meeting. Given the cost and work involved in calling separate meetings, NRMA sought an order that the meeting to determine the resolutions be held on the same day as the annual general meeting.

(6) Arguments for the Snodgrass requisitions

The Court accepted that the NRMA board is split into two factions. The Snodgrass requisitionists support the directors whom the Dupree requisitionists sought to remove and vice versa. Of particular concern was a proposed reduction in services and an increase in members' fees. The requisitionists argued that information provided to members during the demutualisation process confirmed that fixed services would remain and fees would not be altered until 30 June 2001 and subsequently would fall in line with the Consumer Price Index.
Ms Kelly gave evidence that while the proposed increases were suggested by management, they were approved by the directors. Any undertaking from NRMA to refrain from increasing prices was unacceptable given that the company could change its mind at any time.

In addition, the requisitionists were concerned about financial losses and the fact that half yearly figures were not being published. The requisitionists claimed that (a) they were entitled to have a meeting convened, (b) the issue of fees and services was central to the Company, (c) members were entitled to rely upon statements regarding service and proposed fee increases, and (d) the increased disharmony on the board should be settled before the annual general meeting.

(7) Discussion and decision

Windeyer J observed that:

"It seems to me extraordinary that in a company limited by guarantee with about 2 million members a general meeting can be summoned by requisition of 100 members, namely one in every 20,000 or .005 percent."

In handing down its judgment, the Court decided that the NRMA's annual general meeting was not a suitable forum to debate "blanket type factional resolutions". The Court questioned whether the financial and other statutory business of the annual general meeting would be given proper attention amidst the heated atmosphere generated by the proposed resolutions.

The Court considered holding the meeting on the day prior to the annual general meeting, however rejected this alternative on the basis that its outcome could throw the annual general meeting into disarray.

Finally, the Court considered the possibility that as a result of the meeting the company would have no directors. The Court observed that members may be so disillusioned with the conflict at directors' level that they would vote in favour of both the Snodgrass and Dupree resolutions believing that administration in some form may be preferable to the current position. It was acknowledged that this outcome could also occur if the resolutions were part of the business at the annual general meeting.

In considering the issues the Court concluded that the order as sought should not be made, stating it could cause some injustice to the requisitionists. The Court was satisfied that a period of two months was necessary in which to call a meeting and that an additional four weeks should be added to the time within which the meeting must be held. Out of caution, a further week was added to both dates. The Court ordered the meeting be summoned by 10 September 2002 and held by 17 October 2002.

(C) LEAVE FOR A LIQUIDATOR TO JOIN MULTIPLE DEFENDANTS IN PROCEEDINGS FOR THE RECOVERY OF UNFAIR PREFERENCES
(By Tristram Cleminson, [Blake Dawson Waldron](http://www.bdw.com.au))

Dean-Willcocks v Air Transit International [2002] NSWSC 525, Supreme Court of New South Wales, Austin J, 12 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/june/2002nswsc525.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

This case concerned two proceedings in which a company liquidator, Mr Dean-Willcocks, wanted to recover alleged unfair preferences. In the first proceeding he was the liquidator of three subsidiary companies in the Austral Group, and in the second proceeding he was the liquidator of the parent company.

The normal practice in large liquidations is for the liquidator to commence separate proceedings against each defendant for the recovery of unfair preferences. The liquidator successfully attempted to establish a new model by running two consolidated proceedings against multiple defendants.

(2) Background

The subsidiary companies conducted a bus manufacturing and refurbishment business. One of the subsidiaries operated five bank accounts for itself and on behalf of the Austral Group. The alleged preferential payments were made from these bank accounts to creditors of the Austral Group. The total amount of potential claims of ordinary unsecured creditors against the three subsidiary companies was $92,923,438.

Initially there was a total of 58 and 13 defendants in the first and second proceedings respectively. The number of defendants was reduced to 16 and 10 as a result of discontinuance and compromise. The vast majority of them were in New South Wales.

(3) Consolidated proceedings

It is common in large liquidations for the liquidator to want to commence proceedings for the recovery of unfair preferences. Common questions with respect to insolvency will arise for each claim. It is the usual practice in the New South Wales Supreme Court for the liquidator to bring separate proceedings against each defendant. The court is usually able to case manage the proceedings together. Section 588E(8) of the Corporation Act (2001) provides that a presumption is created if various things have been proved in relation to the company in another recovery proceedings.

The liquidator attempted to consolidate two proceedings against the two groups of defendants. The first proceeding involving the subsidiary companies involved multiple plaintiffs as well as multiple defendants.

The advantages to the liquidator of running consolidated proceedings are:

- claims are pursed in the same Court;
- the decision of the Court is binding on all parties and is not affected by presumptions which can cancel each other out; and
- there is a single court filing fee.

(4) Supreme Court rules

The liquidator maintained that a consolidated proceeding was permitted by the NSW Supreme Court Rules. Part 8 rule 2 provides that plaintiffs or defendants may be joined where there is a common question of law or fact, and the claim arises out of the same transaction or series of transactions; or where the Court gives leave.

(a) Common questions of law or fact

Austin J held that the issue of solvency was a common question of law and fact in each of the two proceedings. The issue of whether the relevant company was insolvent, and if so at what point in time it became insolvent is relevant for each of the claims against the defendants. The question is less clear with respect to the first proceeding since there are three plaintiffs. However, as all payments were made by one of the subsidiaries on behalf of the others, a common question of fact arises. His Honour noted that in some cases the plaintiff could run their case in a way that requires separate determinations for the date of solvency. In the present case, a single determination of insolvency in the period between 26 May 1998 and 26 November 1998 is sufficient.

(b) Same transaction or series of transactions

The Court rejected the liquidator's submission that its claims arose out of the same series of transactions. Each particular preferential transaction does not arise out of the events leading up to the insolvency. There must be some link or interdependence uniting each of the transactions as the same series.

(c) The discretion to grant leave

In Bishop v Bridgelands Securities Ltd (1990) 25 FCR 311, Wilcox J observed that the Court's discretion to join must not result in unfairness to either party and must also have regard to practical matters. His Honour said that the discretion depends on the facts of the case. In some cases the similarities between the claims may be outweighed by their differences or the sheer number of claims. Austin J agreed that the Court should be concerned with the efficent use of the resources of parties and the Courts.

Unfairness does not arise merely because a defendant is joined to a large proceeding. Austin J held that disadvantage and the possibility of unfairness, may arise if:

- the case against one defendant hampers another defendant from making out its defence;
- joinder leads to cost or delay materially greater than if there were separate proceedings; or
- the defendant is forced to defend in a inconveniently located Court or in a higher and more expensive Court than would have been used if the proceedings were separated.

The Court can minimise some of these disadvantages through case management. The disadvantages to the defendant must be considered in light of the advantages to the plaintiff in having the proceedings consolidated.

Austin J held that an important public policy outcome is the adoption of a quick, inexpensive and efficient procedure. This should facilitate proceedings where there appears to be a reasonable prospect of success. His Honour held that given the public policy considerations, it is unlikely that the additional cost of proceedings in a higher Court will have any significant weight.

The Court agreed with the liquidator's submission that the two consolidated proceedings should be case managed until the defences have been filed and the scope identified. The length of the proceedings could be oppressive to some defendants, however, the Court can determine this and identify the matters in issue after the defences have been filed. Austin J held that it was not a significant concern that there was no interrelationship between defendants as the proceeding is based on the commonality of the assertions.

(5) Decision

Austin J held that the two consolidated proceedings had not been improperly constituted. In the first proceeding, leave was granted to join the 3 plaintiffs and 58 defendants. In the second proceeding, leave was granted to join the 13 defendants listed in the originating process.

(D) WHETHER A COMPANY MAY RELY ON A STATUTORY OFFSETTING CLAIM WHERE THE PROCEEDING TO ENFORCE IT HAS BEEN TEMPORARILY STAYED
(By Will Crawford, [Blake Dawson Waldron](http://www.bdw.com.au))

Basil Maniotis and Peter Maniotis v Valimi Pty Ltd [2002] VSCA 91, Supreme Court of Victoria, Callaway and Eames JJA and O'Bryan AJA, 24 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/vic/2002/june/2002vsca91.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Summary

In an unanimous decision of the Supreme Court of Victoria Court of Appeal, Callaway and Eames JJA and O'Bryan AJA rejected an appeal by Basil and Peter Maniotis ("the appellants") to dismiss the orders that Valimi Pty Ltd ("the respondent") had an offsetting claim in the primary proceedings which was not affected by the temporary stay over the hearings ordered by Bongiorno J. Central to this finding was the Court's interpretation of the definition of offsetting in section 459H(5) of the Corporations Act 2001 (Cth) (the "Act"). This states that offsetting means "a genuine claim that the company has against the respondent". It was held that in this context "has" does not mean "effective (at the time of the hearing) to enforce by action" as suggested by the appellants, but rather means possesses or holds and is not used in the sense of being operative or actually in effect. The Court also held that it was unnecessary to consider the decision of Warren J to use her discretion under 459J to set aside the statutory demand on the ground of "some other reason".

(2) Background

In the primary proceeding the respondent and one of its dual director-shareholders, Con Thyssen, brought proceedings against the appellants and David John Beatty claiming damages in excess of $1 million for breach of fiduciary duty, tortious conspiracy and negligence. Valimi Pty Ltd conducted a business in partnership with Peter and Basil Maniotis known as V & V Nurseries, which went into receivership on January 1990.

In the primary proceeding the appellants obtained costs orders against the respondents totalling $33,630.90, while the respondents obtained cost orders against the applicants totalling $5,624.60. In February 2001, the appellants caused a statutory demand to be served on the respondent pursuant to section 459F of the Act for the amount of $30,220.90, being the costs payable pursuant to the orders of Master Wheeler. There was no dispute between the respondent company and the appellants about the existence or amount of the debt to which the demand related.

In the primary proceedings the respondent and Thyssen sought a stay of execution in respect of interlocutory cost orders made against them until the completion of their trial or further order. The applicants sought by summons dated 15 January 2001 that the primary proceeding be dismissed pursuant to Rule 63.03(3) of the Supreme Court (General Civil Procedure) Rules 1996 on the ground that such interlocutory costs had not been paid. The Master granted the respondents' application for a stay of execution and dismissed the applicants' summons for an order that the primary action be dismissed.

In response to this, the appellants appealed the orders made by the Master. Bongiorno J upheld the appeal and ordered the stay of execution be dismissed. He further ordered that the respondent's and Thyssen's action be stayed until the respondent and Thyssen paid the appellants the costs totalling $33,630.90 less the amount payable to them.

The respondent and Thyssen then applied for leave to appeal the decision of Bongiorno J on the grounds that a bankruptcy and liquidation proceeding were pending against the respondent and Thyssen. This appeal was dismissed by Chernov and Vincent, JJA.

The respondents then made an application to set aside the statutory demand served on it, pursuant to section 459G of the Act in February 2001. The application was heard before Warren J on 27 July 2001. In Her Honour's judgment, she was satisfied the formal requirements of section 459G had been met and that the respondent had an offsetting claim in the primary proceeding. Her Honour also concluded that the stay order made by Bongiorno J did not affect the genuineness or validity of the offsetting claim. In addition, Warren J said that she was satisfied in the terms of section 459J(1)(b) "there is some other reason why the demand should be set aside". The appellants were given leave to appeal this decision to the Court of Appeal in the current proceeding.

(3) The issues

The chief grounds of appeal which emerged were :

(a) Did the respondent continue to have an offsetting claim after the stay order in respect of the primary proceeding was made by Bongiorno J on 24 May 2001?

(b) Was Warren J entitled to be satisfied that there was some other reason why the demand should be set aside pursuant to section 459J of the Act?

(4) The offsetting claim

Section 459 H(5) of the Act provides a definition of "offsetting claim" which states that an "offsetting claim means a genuine claim that the company has against the respondent by way of counterclaim, set off or cross-demand".

O'Bryan AJA considered the claim by the appellants that the respondents did not have a genuine and effective offsetting claim at the moment of the hearing of the application to set aside the demand. By effective, the appellants meant enforceable by action. Thus, the appellants contended that as a result of the stay order, the respondents did not have an entitlement to enforce an offsetting claim against the appellants.

O'Bryan AJA examined the authority the appellants relied on in making this contention. In the case of Re G E B A Debtor [1903] 2 KB 340 ("Re GEB") which concerned similarly worded legislation requiring the court to be satisfied that an individual "has a counterclaim" before granting set-off, Vaughan Williams LJ determined that the debtor did not have a set-off in respect of which, at that moment, he could bring an effective set-off which he could enforce by action. His Honour, O'Bryan AJA, noted Vaughan Williams LJ's own "considerable self doubt" in coming to this finding. His Honour then distinguished Re G E B from the present case by citing the definition of offsetting claim in section 459H(5) which produced a significant difference by defining an offsetting claim as a "a genuine claim that the company has against the respondent." His Honour then concluded that in light of this definition, "has" for the purposes of section 459H(1) "means possesses or holds and is not used in the sense of being operative, or actually in effect at the relevant time".

His Honour, O'Bryan AJA also rejected the relevance of the case Re A Bankruptcy Notice [1934] Ch 431 on the grounds that despite considering whether the debtor "had" a counterclaim, set-off or cross demand which equalled or exceeded the amount of the judgment debt, the decision turned on whether the amount exceeded the judgment debt. His Honour also distinguished Mideb Nominees Pty Ltd v Begonia Pty Ltd (Receiver & Manager appointed) (1994) 15 ACSR 70 because this case involved contingent claims which were yet to have accrued. By contrast, the facts in the present case which gave rise to the respondent's claim had already occurred.

O'Bryan AJA also examined the appellants reliance on the case of Advanced Ship Design Pty Ltd v D J Ryan t/as Davies Collison Cave and did not find it "inconsistent in any way with the decision of Warren J". This case involved the application of section 459H(1) to offset a claim for breach of contract and negligence. The Master said: "the definition of an offsetting claim in subsection (5) of section 459H requires not only that the claim be a genuine claim, but that it be in respect of a cause of action which has accrued and that it cannot relate to a cause of action which is not presently in existence."

Callaway JA and Eames JJA agreed with the decision of O'Bryan AJA in rejecting the appellant's submission that the notion of an "effective" claim is incorporated into 459H by the presence of the word "has".

(5) Discretion to set aside section 459J

O'Bryan AJA, Callaway and Eames JJA, all held that it was unnecessary to consider the decision of Warren J to use her discretion under 459J to set aside the statutory demand on the ground of "some other reason" on the ground that the offsetting claim was the threshold point of the appeal and this had failed. However, O'Bryan AJA noted that the first reason given by Warren J was merely a repetition of the reasons why the stay order did not affect the genuineness or validity of the offsetting claim. His Honour did not comment directly on the second reason given by Warren J except to quote a passage which suggested that the respondent was subjected to double jeopardy by the imposition of both a stay in proceedings and a statutory demand for payment simultaneously.

(E) DERIVATIVE ACTIONS: PRINCIPLES TO BE APPLIED WHEN SEEKING LEAVE
(By Sam Cottell and Tanya Vaysman, [Clayton Utz](http://www.claytonutz.com))

Swansson v Pratt [2002] NSWSC 583, Supreme Court of New South Wales, Palmer J, 20 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/july/2002nswsc583.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) The facts

Ms Swansson was a director and shareholder of R A Pratt Properties Pty Ltd ("RAPP"). Ms Swansson was also the former wife of Mr Highland. Mr Highland was a director of RAPP between 1992 and December 1997. Ms Swansson and Mr Highland were formally divorced in May 1997 after a Deed of Settlement between Ms Swansson and Mr Highland was entered into and approved by the Family Court on 3 September 1996 pursuant to section 87 of the Family Law Act 1975 (Cth).

During January 2002, Ms Swansson applied for leave from the New South Wales Supreme Court (Palmer J), pursuant to section 237(1) of the Corporations Act 2001(Cth) ("Act"), to bring proceedings against Mr Highland on behalf of and in the name of RAAP in relation to alleged contraventions by Mr Highland of his statutory duties as a director of RAAP under sections 180, 181 and 182 of the Act and under the general law, such as breach of fiduciary duty. The allegations were based upon payments which were made during 1994 by RAPP to two private companies associated with Mr Highland following the sale by RAPP of an interest held by it in a property at Cronulla. Ms Swansson alleged that these payments had not been taken into account by the Deed of Settlement.

At the time of her application for leave, 25% of the shares in RAPP were held by Ms Swansson. The remaining 75% were held by Ms Swansson's mother (50%) and by Ms Swansson's brother (25%), neither of whom wished RAPP to take proceedings against Mr Highland.

(2) Summary

Ms Swansson's application for leave was rejected. In essence, the Court considered that the real issues between Ms Swansson and Mr Highland would be more appropriately dealt with by way of Ms Swansson applying to the Family Court for revocation and adjustment in respect of the Deed of Settlement.

However, the application did give the Court the opportunity to consider the terms of the statutory derivative action provisions of the Corporations Act (Part 2F.1A). As the Court noted, the criteria for granting leave to commence derivative proceedings have received little judicial consideration in Australia.

(3) Analysis of the criteria

Apart from a 14 days notice requirement, section 237 contains 4 criteria which must be satisfied before a Court will grant leave in relation to an application to commence derivative proceedings:

(a) Inaction by the company: it is probable that the company will not itself bring the proceedings (section 237(2)(a)) ;

(b) Good faith: the applicant is acting in good faith (section 237(2)(b));

(c) Best interests: it is in the best interests of the company that the applicant be granted leave (section 237(2)(c)); and

(d) Serious question: there is a serious question to be tried (section 237(2)(d)).

Before considering each of these criteria, the Court stated that case law in respect of the New Zealand and Canadian legislation (from which section 237 was derived) offered little assistance in interpreting section 237 because section 237 is so different from such legislation.

The Court stated that the onus was upon Ms Swansson, as the applicant, to satisfy the Court that the criteria were satisfied. This onus had to be satisfied on the balance of probabilities. As a general comment, the Court considered that leave to bring a derivative action must not be given lightly.

(4) Section 237(2)(a) - inaction by the company

Sometimes this will be clear cut. For example, there may be a board resolution or a rejection by the company of a request by the applicant that the company take proceedings. However, in the absence of either of the foregoing, the answer may not be so clear, such that it is necessary for the Court to infer that the company will not commence proceedings (eg, if the company has insufficient funds to commence proceedings, even if it wished to do so).

In the present case, affidavit evidence before the Court established that the other 2 shareholders of RAPP (who between them held 75% of the shares in RAPP) did not wish RAPP to take proceedings against Mr Highland. Accordingly, this criteria was satisfied.

(5) Section 237(2)(b) - good faith

The Court had regard to the range of persons who are permitted by section 236 of the Act to apply for leave to commence derivative proceedings. The Court also had regard to the fact that Part 2F.1A of the Act does not empower the Court to grant relief to a person other than the company itself in the event that derivative proceedings instituted in the name of the company are successful. In light of the foregoing, the Court concluded that a person may be acting in good faith even if the person does not have a financial interest in the company or involvement in the company's present management.

That said, the Court considered it unwise at this early stage in the development of the law on this topic to state comprehensively the considerations to which Courts will have regard in determining whether an applicant is acting in good faith.

Nevertheless, the Court identified at least two important and interrelated factors relevant to determining whether the good faith requirement of section 237(2)(b) is satisfied.

(a) Honest belief - whether the applicant honestly believes that a good cause of action exists and has a reasonable prospect of success. Whilst honesty is subjective, the Court acknowledged an objective element by commenting that an applicant may be disbelieved if no reasonable person in the circumstances would hold that belief.

(b) Collateral purpose - whether the applicant is seeking to bring the derivative action for a collateral purpose. If so, this would amount to an abuse of process.

Given these factors, the Court considered that an applicant would readily be able to satisfy the good faith requirement if the applicant was a current shareholder and the derivative action sought to recover company property so that the value of the applicant's shareholding would be increased. Likewise, if the applicant were a current officer, good faith would readily be satisfied if the applicant had a legitimate interest in the welfare and good management of the company (eg, recovery of company property or prevention of unlawful acts by the majority of shareholders or directors which would be detrimental to the company as a whole).

On the other hand, if the applicant were a former shareholder or officer, the Court would scrutinise with particular care the purpose for which the derivative action was said to be sought (eg, where a former shareholder who was also a current creditor of the company was seeking to recover company property, or where a former shareholder with a history of grievances against the current majority shareholders sought to institute proceedings for the purpose of satisfying a private vendetta).

In cases where a wrong has been done to the company, the Court considered that a derivative action should only be permitted by those persons who would suffer a real and substantive injury if the derivative action did not proceed. Furthermore, the Court considered that:

(a) the relevant injury must be necessarily dependent upon or connected with the applicant's status; and

(b) the remedy afforded by the action must be reasonably capable of redressing the injury.

Applying these general principles to the example of the creditor/former shareholder referred to above, it appears that a creditor/former shareholder would fail this criteria because the relevant injury (ie the injury which the applicant would suffer by reason of its status as a creditor if the company defaulted on payment of the debt) would be unconnected with the applicant's status under section 236(1) as a former shareholder of the company.

Finally, the Court also considered that the good faith requirement would not be satisfied if the benefit sought to be received by the derivative action could not in good conscience be retained by the applicant (eg double recovery). An applicant would also be lacking in good faith if the purpose of the action was to derive a benefit from the applicant's own wrongdoing.

At an evidentiary level, the Court observed that for the purposes of section 237(1), the question of good faith is required to be determined on a final, not interlocutory, basis. In the present case, the Court was particularly uncomfortable about deciding this issue on the basis of documentary evidence submitted by the parties in respect of which neither party had sought to cross examine. This made it difficult for the Court to assess the credit of the witnesses; a matter which seems inextricably interwoven with issues of good faith.

Applying the foregoing principles to the present case, the Court held that Ms Swansson had failed to satisfy the Court that she was acting in good faith. Essentially, there was a lingering doubt that double recovery would result to Ms Swansson by reason of the 1996 Deed of Settlement approved by the Family Court if the application were to be granted. Hence the Court was not satisfied on the balance of probabilities that Ms Swansson was acting in good faith, even though it had not in fact been proved that double recovery would result.

Although the Court held that Ms Swansson failed the good faith criteria, the Court nevertheless proceeded to consider the remaining criteria. The Court's comments in this regard are therefore obiter dicta, but they provide useful guidance.

(6) Section 237(2)(c) - best interests of the company

The Court stressed that this criterion carries a high threshold. It is insufficient for the applicant to merely demonstrate that the proceedings "may be, appear to be, or are likely to be" in the best interests of the company or are in the best interests of the company only in a "prima facie" way. Section 237(2)(c) requires the Court to be satisfied that the proposed derivative action actually "is", on the balance of probabilities, in the best interests of the company. Again, this is a factual matter which can only be determined by taking into account all of the relevant circumstances. The Court therefore considered that the onus was on the applicant to provide evidence as to the following matters.

(a) the character of the company (eg whether it is a large public company or a small closely held private company);

(b) the business of the company, so that the effects of the conduct of the litigation can be appreciated;

(c) evidence enabling the Court to determine whether the redress sought by the applicant is available by a means which does not require the company to be brought into litigation against its will (eg, is there an alternative avenue which would be more appropriate for the applicant to pursue instead of a derivative action?); and

(d) evidence as to the ability of the defendant to meet at least a substantial part of any judgment in favour of the company in the proposed derivative action (ie, whether the defendant has any assets); if not, then the proceedings would ultimately be fruitless even if they were successful. This would not be in the best interests of the company.

In the present case, the Court considered that Ms Swansson had a far more direct and appropriate means of seeking satisfaction than through the derivative action - namely, applying to the Family Court for revocation and adjustment orders in respect of the Deed of Settlement. The Court was of the opinion that the Family Court would be "far better able to do substantial justice" between the parties than would be the case pursuant to a derivative action. Ms Swansson did not explain why she had chosen to pursue a derivative action rather than the Family Court alternative. The Court also found that no evidence had been adduced to demonstrate that Mr Highland would be able to meet any part of a judgment if the proceedings were ultimately successful against him. Hence, Ms Swansson failed to establish that it was in the best interests of RAPP that leave be granted.

It should be noted that the Court was not asked to consider the negative rebuttable presumption in relation to whether proceedings are in the best interests of the company, as described in section 237(3) of the Act.

(7) Section 237(2)(d) - serious question

In determining whether there was a serious question to be tried, the Court considered that the applicant has the same relatively low threshold to surmount as in the case of an application for an interlocutory injunction. Hence, cross examination on the merits of the proposed derivative action will usually be permitted only with leave of the Court and only to a limited extent. Apart from the foregoing, the Court did not expand upon the principles applicable to this criteria.

In any event, the Court found that there was no serious question to be tried in relation to the alleged breaches of statutory duties since such claims were barred by reason of the 6 year limitation period contained in section 1317K of the Act. However, the Court held that Ms Swansson had satisfied this criteria in relation to the alleged breaches of fiduciary duty.

(F) ATTEMPT TO REMOVE LIQUIDATOR - ALLEGED LACK OF INDEPENDENCE BY LIQUIDATOR
(By David Cowling, [Clayton Utz](http://www.claytonutz.com), and Robert Newlinds, barrister at law)

National Australia Bank Ltd v Wily [2002] NSWSC 573, Supreme Court of New South Wales, Burchett AJ, 27 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/june/2002nswsc573.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Summary

In this matter, the National Australia Bank unsuccessfully moved for orders removing a liquidator pursuant to section 503 of the Corporations Act. The principal basis for that application was the retention by the liquidator of solicitors who were also acting on behalf of directors of the companies over which the liquidator was appointed.

It was said that the inherent conflict between the position of the directors and that of the liquidator compromised the liquidator's independence.

(2) The facts

Between 1997 and 1999, a group of companies known as the "Roberts Group" ("the Companies") entered into a series of financing arrangements with the National Australia Bank, such financial arrangements being secured by way of charges, real property security and personal guarantees by Mr and Miss Roberts, the directors of the Companies.

On 1 June 2000, the Bank appointed receivers to three of the Companies.

On 6 February 2001, the Bank commenced guarantee enforcement proceedings against Mr and Miss Roberts. Mr and Miss Roberts retained Mr Fordyce to act on their behalf in their defence of the Bank's litigation.

On 12 February 2001, the Companies were placed into voluntary administration, Mr M Holzman being appointed the Administrator.

On 9 March 2001 the Companies were placed into voluntary liquidation, Mr Holzman becoming the liquidator of each of them.

On 16 January 2002, a meeting of creditors of the Companies was held. There, Mr Holzman resigned as liquidator, and Mr Wily was appointed in Mr Holzman's place.

The resignation of Mr Holzman came about as a result of a condition imposed by a proposed litigation funder to the effect that funding would only be available if Mr Wily was appointed liquidator. A motion to that effect was passed, together with a further motion, without prior notice, to the effect that the liquidator carry out public examinations of officers of the Bank and the Receivers. Mr Fordyce proposed each such motion.

Mr Wily then retained Mr Fordyce as his solicitor to obtain examination orders and the issue of summonses for the production of documents.

Mr Wily knew that Mr Fordyce had acted and was still acting for Mr and Miss Roberts.
In March 2002, Mr Fordyce was instructed to proceed with the necessary applications for the public examinations.

On 26 March 2002, Mr Wily received a copy of a report prepared by the Receivers for the Bank. This report alleged that many items of equipment (involving lease finance provided to the Companies by the Bank in excess of $1.5 million) did not exist, and that fraud had been practiced on a substantial scale by Mr and Miss Roberts, in collusion with others, in order to obtain working capital for the Companies.

On 16 May 2002, the National Australia Bank applied under section 503 of the Corporations Act 2001 for an order removing Mr Wily as the liquidator of Companies and for an order setting aside the examinations.

(3) The plaintiff's case

Essentially the Bank's case rested on the real and perceived consequences of the liquidator's retainer of Mr Fordyce, to advise and act in relation to the proposed examinations and summonses for the production of documents.

The Bank claimed that the engagement of Mr Fordyce tainted the liquidator and compromised his independence irremediably because Mr Fordyce had acted, and continued to act, for Mr and Miss Roberts, against whom the liquidator had a potential claim.

(4) The judgment

Burchett AJ noted that there was no objection, in itself, to the engagement by a liquidator of a solicitor who was also acting for one of the parties interested in the liquidation. It does, however, depend very much on the circumstances. Sometimes such a solicitor has special knowledge which is advantageous in the winding up.

In support, his Honour cited Re Allebart Pty Limited (in liquidation) [1971] 1 NSWLR 24 as authority for the proposition that:

"it is essential that the independence and the impartiality of a liquidator should at all times exist in substance, and be manifestly seen to exist".

In Re Allebart, Street J concluded that there had been extraordinary circumstances, in which the liquidator appeared:

"to have been to some extent and some respects insensitive of the extreme personal animosity lying behind the matters and the consequential need to take particular care to avoid allowing the windings up to become or appear to have become an instrument of pursuing these personal conflicts".

Street J held that there were aspects of the case which tended to "suggest that the liquidator had yielded up some degree of initiative to the petitioning creditor and which present some appearance of mere automatic acquiescence by the liquidator in the wishes of the petitioning creditor".

Burchett AJ noted with approval the comments of Street J in Re Allebart Pty Limited that a liquidator's appointment of solicitors concurrently also acting for a party interested in the outcome of the liquidation is, without more, both "innocuous" and "common place".

Burchett AJ concluded that the liquidator's removal was not required because he was unable to identify any "extraordinary" circumstances.

With respect to the order sought by the Bank that the proposed examinations and the order for production of documents be set aside, his Honour refused the application, as Street J refused a similar application in Re Allebart Pty Limited.

Burchett AJ therefore dismissed the proceedings with costs.

(5) Commentary

This decision reflects the Courts' attitude as expressed in Re Biposo Pty Ltd (1995) 17 ACR 730 at 734 that, if granted too readily, challenges to liquidators might be used as instruments "to stop them doing their duty".

The judgment also stresses the importance of liquidators acting independently rather than themselves being the "tools" of disgruntled directors/litigants. However, the facts of this case were not sufficient to persuade the Court to exercise its power to ensure the real and perceived independence of liquidators.

There is obviously a tension between, on the one hand, the acceptance by the Courts that liquidators can and often do retain solicitors who also act for parties interested in the outcome of the liquidation (more often than not for creditors) and, on the other hand, the Courts' insistence that liquidators be impartial and be seen to be impartial.

The present state of the authorities allows that tension to be resolved by the Courts allowing this common practice unless satisfied that there is some exceptional circumstance demonstrated.

Obviously each case will be decided on its own facts, but liquidators do need to approach with care the question of who they retain to act for them, especially when that person may also act for potential defendants.

(G) AT WHAT POINT DOES A COMPANY BECOME INSOLVENT?
(By Tammy Kingsley, [Phillips Fox](http://www.phillipsfox.com))

Crossroads Fashions Pty Ltd (in liq) v Gavin [2002] QSC 179, Supreme Court of Queensland, Muir J, 20 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/qld/2002/june/2002qsc179.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

This was an application by Crossroads Fashions Pty Ltd (in liquidation) ('Crossroads') and its liquidators to order the respondent director to pay for loss suffered by creditors as a result of insolvent trading under section 588M of the Corporations Act 2001 ('the Act').

(2) The company's trading history

The company had an issued share capital of $1 and commenced trading as a retail women's clothing business in early 1997. The company opened 5 shops in its first year, all from leased premises, and ceased trading between November 1998 and January 1999. Although the liquidators' report claimed that the company may have been insolvent since December 1997, the applicants could not ascertain the exact date, as the company's financial records were incomplete.

(3) Applicants' claim

The applicants relied upon section 588E(4) of the Act to found a presumption that Crossroads had been insolvent since July 1997, on the basis that it had failed to maintain accurate financial records in relation to that period, or alternatively, that it had failed to retain those records for the required period of 7 years.

In support of that claim the applicants pointed out that they had not been provided with various company documents, including invoices and correspondence with creditors; management accounts; general ledger accounts; a detailed cash book and a creditors ledger for periods in 1997 and 1998. Those documents were not provided because the company's accountant had ceased to work due to non-payment of accounts rendered for the preparation of the company's 1997 accounts and other work.

The applicants also relied on deemed admissions by operation of Rule 189(2) of the Uniform Civil Procedure Rules, namely that the respondent, in failing to respond to a notice to admit on its solicitors, was deemed to have admitted that Crossroads had failed to keep and maintain records from 1 July 1997. Muir J expressed doubt as to when the respondent first saw the notices to admit, and had previously adjourned the matter to give the respondent time to obtain and consider the documents.

(4) Indications of insolvency

The company's accounts for the period ending 30 June 1997 revealed that the company made a net profit of $4,369 on sales of $364,199. The cost of goods sold was $175,172 and expenses $171,790.

The applicants pointed to the following indications of insolvency:

- A deficiency of liabilities over assets of $294,000 at 31 August 1999;
- Majority of debts owed to creditors were outstanding for 90 days or more from November 1997;
- Legal demands were made by various creditors and legal proceedings brought against the company throughout 1998;
- 7 company cheques were dishonoured between May 1998 and October 1998, including cheques in favour of the Australian Tax Office;
- Arrears of insurance of $7,085.25 for the period prior to 1 July 1998;
- Outstanding group tax of $37,555 as at 30 June 1998 that included arrears from October and November 1997;
- A number of suppliers would only deal with the company on a cash on delivery basis in 1998;
- Some employee superannuation contributions were not made as early as June 1997; and
- Arrangements were made with creditors to pay debts by instalments in July and August of 1997.

Muir J considered the last 2 points to be the strongest evidence of insolvency.
Muir J held that the above matters demonstrated insolvency as at December 1997, but not before that date as the company had indicated a trading profit, albeit small, for the period prior to 30 June 1997.

(5) Respondent's defence

Muir J noted that the respondent's affidavit material did not address any defence to deemed insolvency under section 588E or any defence potentially available under section 588H.

In relation to the former defence, the respondent swore that the missing documents identified by the liquidators were lost by the respondent's landlords and their agents, rather than through her own fault. His Honour was not satisfied, on the balance of probabilities, that the respondent had established the facts necessary to satisfy the requirements of section 588E .

Muir J observed that the presumption under section 588E of the Act operates 'except so far as the contrary is proved' (section 588E(9)). His Honour ruled that as the company traded at a profit up to December 1997 and there were no dishonoured cheques or actions by suppliers, the 'contrary was proved' and thus the company was solvent in December 1997.

Once December 1997 was established as the date of insolvency, Muir J then considered whether the respondent had reasonable grounds to expect, and did expect, that the company was solvent in and after that date, and would remain so even if it incurred any debt the subject of the liquidator's claims and any other debts that it incurred at that time.

Muir J referred to Tourprint International Pty Ltd (in liq) v Bott (1999) 32 ACSR 201 where Austin J observed that the defence requires an actual and reasonable expectation that the company was and would continue to be solvent, and that a director cannot hide behind ignorance of the company's affairs which is of their own making or otherwise contributed to by their own failure to make necessary enquiries.

Muir J held that it was impossible for the respondent to rely on the defence for debts incurred after November 1997, but could rely on that defence for debts incurred prior to December 1997.

(6) Quantification of the applicant's claim

The respondent claimed that certain of the alleged debts incurred for supply of stock totalling $54,932 related to stock repossessed on or about the day the company ceased trading, much of that stock being the subject of a retention of title clause. Muir J rejected this evidence as unreliable and held that in the circumstances it was not appropriate to require all matters concerning stock recoveries to be formally proved.

His Honour found that all debts set out in the amended schedule of debts were incurred while the company was insolvent, save for debts incurred in relation to 3 tenancies, which were not shown to have been incurred after 30 November 1997.

Of these leases, one was dated 4 February 1998, although Crossroads had taken possession in August 1997. Muir J held that there was probably at least an agreement for the lease to be in existence prior to 1 December 1997 with equivalent rental obligations. His Honour followed Russell Halpern Pty Ltd v Martin (1983) 10 ACLR 539, where it was held that where rent accrues after insolvency under a lease entered into prior to insolvency, the debts arising as the rent falls due are not incurred for the purposes of section 588G.

The liquidators submitted that in this case, rent falling due after insolvency gave rise to debts incurred after insolvency, as the relevant lease post-dated insolvency. His Honour rejected this argument for several reasons. First, the company did not incur any additional liability for rent by executing the formal lease. Secondly, it was difficult in such circumstances to regard the respondent as having failed to prevent the company incurring the debt. Finally, Muir J held that in these circumstances it was doubtful that the persons to whom the debt was owed would have 'suffered loss or damage in relation to the debt' (section 588M). Crossroads therefore did not 'incur a debt' for the purposes of section 588G at the time the lease was entered into.

With respect to the other 2 tenancies, no formal leases could be located. In relation to the first such tenancy, Muir J inferred that a lease existed and that it predated Crossroads entering possession.

In relation to the other lease, the respondent had executed an 'offer to lease' dated 1 November 1997 on behalf of the company. Muir J inferred that the company went into possession under that document or an agreement for lease and that the rent was payable pursuant to such an instrument.

(7) Conclusion

Muir J ordered the respondent to pay $135,094.49 to the applicants, being the total of the amounts in the schedule of debts less excluded amounts (as discussed above). The respondent was also ordered to pay the costs of the second applicant.

The applicants claimed interest from 1 July 1997 at 9.5% per annum to the date of payment or judgment. Although there was suggestion of wilful destruction of documents by the respondent, his Honour was not satisfied that this in fact occurred or that the respondent failed to co-operate appropriately. However, Muir J found that the respondent did bear the responsibility for the loss of the company's records and for failure to keep appropriate records, which had made the liquidators' task more difficult. Muir J therefore exercised his discretion and ordered the respondent to pay interest on the sum of $135,094.49 at 9% per annum for 18 months.

(H) WHETHER A DIRECTOR'S LIABILITY FOR INSOLVENT TRADING APPLIES TO THE INCURRING OF PARTNERSHIP DEBTS
(By Nghi Tran, [Phillips Fox](http://www.phillipsfox.com))

Woodgate v Davis [2002] NSWSC 616, New South Wales Supreme Court, Barrett J, 12 July 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/july/2002nswsc616.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

Mr Davis ('defendant') was the sole director of two companies, Chircan Holdings Pty Limited and Mahiya Holdings Pty Limited, both of which were in liquidation. The defendant had previously placed both companies in voluntary administration. The winding up was, in both cases, a creditors' voluntary winding up deemed under section 446A of the Corporations Act 2001 (Cth) ('Act'). Mr Woodgate ('plaintiff') was the liquidator of both companies.

The two companies carried on business in partnership. The plaintiff claimed that the defendant had failed to prevent the companies from incurring certain debts at a time when they were insolvent, thereby contravening section 588G of the Act. On this basis, the plaintiff sought to recover a total of $3,373,038.58 from the defendant pursuant to section 588M of the Act.

(2) The questions the subject of preliminary determination

The defendant argued in paragraph 17 of its defence that sections 588G and 588M of the Act did not apply because the debts had been incurred by a partnership where all or one or more of the partners were companies.

On 13 May 2002, Barrett J ordered by consent that the following preliminary questions be determined:

Question 1: whether paragraph 17 of the defence provided a complete defence to the statement of claim.

Question 2: if the answer to question 1 is yes, whether the statement of claim should be struck out.

(3) Answers to the preliminary questions

Based on the parties' submissions, Barrett J answered the preliminary questions in the following way:

Question 1: No.

Question 2: Does not arise.

In so answering the questions, his Honour held that a director of a company carrying on business in partnership could be liable under section 588G for incurring partnership debts while the company was insolvent. Therefore the defendant could be found liable for insolvent trading under section 588G of the Act and the liquidator could recover money from the defendant under section 588M of the Act.

(4) The defendant's submissions

The defendant claimed that the insolvent trading provisions of the Act did not apply in these circumstances. Barrett J noted that, in light of the 'important social purpose' served by section 588G and related provisions, 'very clear words' would be required to justify such a conclusion. The defendant sought to argue that where a company was a member of a partnership and debts were incurred as 'debts and obligations of the firm' (as referred to in section 9 of the Partnership Act 1892 (NSW)), section 588G and related provisions could not apply to directors of that company (in relation to those debts). In making out this argument, the defendant sought to demonstrate either that:

(a) a company operating in partnership could not be regarded as incurring a debt within the meaning of section 588G; or

(b) there would be anomalies in an insolvency law context if a liquidator was entitled to recover from a director of a corporate partner for insolvent trading under section 588G; or

(c) Part 5.7 of the Act demonstrated a legislative intention that section 588G liability will not apply independently to or in relation to a company which is a partner, at least in relation to its liability for partnership debts.

(5) Can a company operating in partnership be regarded as incurring a debt within the meaning of section 588G?

Under section 9 of the Partnership Act 1892 (NSW), a partner is jointly liable with the other partners for all debts and obligations of the firm incurred while they are a partner. Barrett J considered the question of whether the partner had 'incurred a debt', for the purposes of section 588G of the Act, when the partner became jointly liable for partnership debts. The defendant submitted that it was the partnership which incurred the debt and not the partner. To determine this issue, Barrett J first considered section 9 of the Partnership Act 1982 (NSW) and then considered the meaning of 'incurring' under the Act.

(a) Section 9 of the Partnership Act 1892 (NSW) subjects a partner to joint liability in respect of partnership debts

Barrett J interpreted the liability of partners for partnership debts to which section 9 refers as joint liability, as distinct from several liability or liability that is both joint and several.

Barrett J briefly examined the legal and equitable treatment of partnership debts and concluded that, regardless of whether a partner's liability for partnership debts is regarded as joint or several, the fact remains that the partner is exposed to liability in respect of the whole amount of the debt and may suffer judgment accordingly (albeit in circumstances where contribution may be sought from other partners). Each partner must therefore be regarded as indebted for the full amount of a partnership debt.

(b) The 'incurring' question

Barrett J then considered several authorities on the meaning of the word 'incurs'. In Hawkins v Bank of China (1992) 26 NSWLR 562, Gleeson CJ regarded the word 'incurs' as 'apt to describe, in an appropriate case, the undertaking of an engagement to pay a sum of money at a future time …'. Kirby P stated: 'the act of 'incurring' happens when the corporation so acts as to expose itself contractually to an obligation to make a future payment of a sum of money as a debt'. Barrett J accepted the above approaches, stating that 'incurring' is the act or omission of a company through which its exposure to a monetary obligation arises.

Barrett J referred to section 6 of the Partnership Act 1892 (NSW), stating that section 6 was merely declaratory of the common law rules governing agency and master/servant relationships. A consequence of this was that, by becoming and remaining a partner, a person accepts being bound by the acts or omissions of another partner (or of an employee or agent of the partnership).

On this basis, Barrett J stated that a partner which is a company could 'incur a debt' under section 588G, when a partner acts (within the scope of the partnership business) in such a way as to give rise to a payment obligation which became one of the 'debts and obligations of the firm' referred to in section 9 of the Partnership Act 1892 (NSW). Because the partnership itself is not a person, Barrett J rejected the defendant's submission that only the partnership incurred the debt and not the partners.

(6) Supposed anomalies

The defendant identified several supposed anomalies that it claimed would result under insolvency law if a liquidator were entitled to recover from a director of a corporate partner for insolvent trading.

The defendant submitted that to allow recovery from a director of a corporate partner in respect of a partnership debt would subvert the natural order of things under insolvency law. The defendant referred to section 110 of the Bankruptcy Act 1996 (Cth), which had been imported by section 553E of the Corporations Act, and argued that partnership creditors can only partake in a distribution of the assets of the separate estate of a partner after all creditors of the separate estate have been satisfied. In other words, partnership creditors have an entitlement only to the surplus, if any, in the separate estate; it is the joint estate which is to be applied in the first instance to meet the joint debts.

Barrett J held that the consequences of allowing recovery from a director of a corporate partner who has wrongfully permitted a joint debt to be incurred, was not so anomalous as to justify the conclusion that the Act could never have intended such recovery to be available. His Honour stated that the principles embodied in section 110 are concerned with the equities of the partners among themselves. They do not cause joint claims to be confined to joint estate and separate claims to be confined to separate estate.

Counsel for the defendant also identified a number of anomalies supposedly arising from provisions of the Partnership Act 1892 (NSW) relating to dissolution, as well as principles concerning the appointment of a receiver to effect winding up. Barrett J considered these supposed anomalies to be more imagined than real.

Ultimately, Barrett J was of the opinion that all the matters considered under the heading of 'supposed anomalies' would resolve themselves in light of the plaintiff's submission that an unpaid partnership creditor may sue all or any of the partners, and that the creditor's rights to recovery and enforcement are not limited to partnership property or by the ways in which partners may be called upon to contribute and account among themselves.

(7) Does Part 5.7 of the Act demonstrate a legislative intention that section 588G does not apply to a director of a corporate partner that incurs partnership debts?

The defendant's final argument was based on Part 5.7 of the Corporations Act which confers on the Court a power to order the winding up of a 'Part 5.7 body'. The expression 'Part 5.7 body' is defined by section 9 of the Act as including 'a partnership, association or other body (whether a body corporate or not) that consists of more than 5 members and is not a registrable body'. A partnership in the sense recognised by the Partnership Act 1892 (NSW) is not a 'registrable body'.

It follows that a partnership of more than five members is a 'Part 5.7 body' and that the court has jurisdiction under section 583 of the Act to order the partnership itself to be wound up. The defendant argued that the insolvent trading provisions in section 588G (and related sections contained in Part 5.7B of the Act) apply to a partnership having more than 5 members. Therefore, it was claimed, there is a general legislative intention that section 588G liability is to operate in the partnership context only in cases contemplated by Part 5.7, with the result that it does not apply independently to or in relation to a company which is a partner, at least so far as its liability for partnership debts is concerned.

Barrett J rejected these arguments as being unsustainable. His Honour stated that for the purposes of Part 5.7B of the Act (and therefore section 588G), Part 5.7 and the special meaning of 'company' derived from paragraph (c) of section 9's definition of 'company' are not intended to deal 'comprehensively and exhaustively' with the position under section 588G of companies which are members of partnerships. Part 5.7 is no more than a series of provisions extending the Act's general mechanism of winding up to a variety of bodies, both incorporated and unincorporated.

(8) Conclusion

The defendant failed to demonstrate that it was exempt from the insolvent trading provisions of the Act. Barrett J rejected all arguments put forward by the defendant in support of the proposition that the insolvent trading provisions did not apply to the incurring of a debt by a company which is a partner in a partnership. His Honour noted that section 588G and related provisions are based on a concern for creditors' welfare, and that the defendant had failed to provide sufficient evidence that the policy should be displaced when a company operates not as a sole trader, but in partnership. Otherwise, directors of any company could avoid their obligations to be attentive and act responsibly simply by causing their company to carry on business in partnership.

(I) DISTRIBUTION OF ASSETS FOLLOWING WINDING UP OF UNREGISTERED MANAGED INVESTMENT SCHEME
(By Alex Vynokur, Associate, [Baker & McKenzie](http://www.bakernet.com))

ASIC v Commercial Nominees [2002] NSWSC 576, New South Wales Supreme Court, Barrett J, 28 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/june/2002nswsc576.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Summary of application

The applicant, Mr Prentice, was, by order made on 12 February 2001, appointed by the court to be the receiver to an unregistered managed investment scheme which the court ordered be wound up pursuant to section 601EE(1) of the Corporations Law (as it then was).

In his capacity as receiver so appointed, the applicant sought the assistance of the court in determining the correct and appropriate method of distributing among beneficiaries of the trust (that is the unregistered managed investment scheme) the net cash proceeds resulting from the applicant's exercise of his powers as receiver.

(2) Background facts

The scheme was constituted by a deed between Flinders Asset Management Limited as manager and Commercial Nominees of Australia Limited as trustee. A central characteristic of the trust was that an investor could select the way in which funds entrusted by him or her to the trustee were to be invested. In broad terms, an investor could require that funds be invested in cash securities or in equity securities, with an opportunity, within the equity sector, to choose among various types of investment.

Thus, this trust was different from the more common form of unit or investment trust under which an investor or beneficiary cannot point to any interest (in a broad sense) in particular assets in the hands of the trustee.

Where an election in favour of cash investments was made, the funds concerned were invested in units of a cash management trust operated by interests associated with the trustee of the fund itself. As it turned out, the vast bulk of the cash resources in the cash management trust was lost, with the result that realisation of units of the cash management trust yielded very much less than would have been yielded had the loss not occurred. Equity investments of the fund, on the other hand, were not subjected to any such abnormal loss and even increased their value.

The question arising in these circumstances was, in essence, where the fund's loss attributable to the investment in units of the cash management trust should fall as regards investors in the fund itself.

In the course of determining the outcome of the application, his Honour resolved a number of issues.

(3) The decision

(a) What is the nature of and the basis for the court's jurisdiction?

It was argued that there were three relevant statutory provisions providing the court with the jurisdiction to deal with the application:

(i) section 601EE(2) of the Corporations Act 2001 (Cth) ("Corporations Act" or "the Act") which empowers the court to make "any orders it considers appropriate for the winding up of the scheme";

(ii) section 424(1) of the Act under which a "controller of property of a corporation" may apply to the court for directions in relation to any matter arising in connection with the performance or exercise of any of the controller's functions and powers as controller; and

(iii) section 63 of the Trustee Act 1925 under which a trustee may apply to the court for its opinion, advice or direction on any question respecting the management or administration of the trust property, or respecting the interpretation of the trust instrument.

In addition, the applicant sought to invoke the court's inherent equitable jurisdiction.

Barrett J was of the view that the best way to proceed, in a jurisdictional sense, was to regard section 601EE(2) as the source of jurisdiction to order the appropriate basis of distribution of surplus and for the completion of the winding up; and to entertain, by reference to the court's general equitable jurisdiction, the receiver's application for a direction to complete the winding up in accordance with the section 601EE(2) order.

His Honour doubted the applicability of section 424 of the Act and section 63 of the Trustee Act in the circumstances of this case, but decided not to express any concluded view on this question.

(b) Distribution of surplus in the scheme

His Honour noted that the Corporations Act does not attempt to prescribe any general framework according to which a section 601EE winding up is to occur.

In Australian Securities and Investments Commission v Koala Quality Produce Ltd [2002] NSWC 451, his Honour observed that, by analogy with Part 5C.9, that gap may be filled by section 601EE(2) order, taking into account the terms of the constitution of the unregistered scheme to the extent that they deal appropriately with the matter. Where they do not deal with it appropriately or cover only part of the necessary field, the court may, by order under section 601EE(2), supply other necessary provisions.

Taking this approach as the point of reference, His Honour considered the two distribution options proposed by the applicant.

Proposal 1 - to distribute the fund after adjusting the loss in the fund first, by debiting the loss against the cash component (but not the equity component) of each investor's account; or

Proposal 2 - to distribute the fund among all investors on a proportional basis, based on the notional value of the investments in the fund, so that the loss in the fund is debited against all investments, both equities and cash, and not just the cash component of each investor's account.

In determining the appropriate distribution option, his Honour considered the provisions of the trust deed (in particular, clause 19) relating to the termination of the trust. Barrett J noted that although those provisions were not directly applicable in the winding up pursuant to section 601EE of the Act, they provided useful guidance as to expectations of investors.

Having reviewed the relevant provisions in clause 19 of the trust deed, Barrett J reiterated that the scheme is not one of the commonly encountered kind where each investor, by investing, comes to occupy a position vis-à-vis other investors distinguishable only by reference to the amount of the investment. The present scheme was viewed by his Honour to be one in which, by virtue of elections made by investors in such a way as to be binding as among them and upon the trustee and the manager, each investor has what the deed terms "a beneficial interest" in separate elements of the assets held by the trustee and constituting the fund. His Honour considered that the position of an individual investor, in terms of risk of loss or prospect of profit, is made referable to assets or asset categories of the fund specifically identified with the particular investor.

Hence, it was held that the most appropriate method of allocating value over the whole body of investors is what the applicant described as Proposal 1. That method provides recognition that the loss incurred in relation to the cash assets is allocated in such a way as to fall upon the investors who elected to have cash assets held on their behalf, and so that the loss does not impact the positions of investors who elected for equity assets as distinct from cash assets.

His Honour considered Proposal 2 to be consonant with the notion of equality which prevails in company winding up generally and finds favour in the eyes of equity. However, Barrett J thought that the principle of equality was displaced is this case by the identification of different forms of investment and the termination provisions in the trust deed.

(c) Other issues

His Honour also considered applications made on behalf of several investors that had cash investments which were unauthorised in the sense that the extent of the cash investments was inconsistent with instructions given. In essence, Barrett J concluded that the trustee had failed to obey instructions from some three investors to convert cash investments to equity investments.

It was held that the investors in question should, in the winding up, be treated as if the instructions had been complied with. In support of his view, Barrett J had drawn an analogy with the case of company winding up in which a person whose name appears in the register as a holder of shares carrying an unpaid liability claims rectification of the register so that his or her name is not included in the list of contributories. One situation specifically within this rectification jurisdiction is that where default or unnecessary delay occurs in entering in the register the fact that a person has ceased to be a member.

His Honour considered it a clear policy that a person should not be left merely to such remedies as may be pursued against those responsible for the default or delay and are entitled to be treated as if that which ought to have been done had been done - which is, in any event, consonant with general equitable principle.

As a result, Barrett J ordered under section 601EE(2) that, in essence, Proposal 1 be followed in the winding up of the scheme on the footing that there are attributed to the three investors referred to above beneficial interests in the equity sector commensurate with the position that would have applied had their instructions been implemented. His Honour noted that such an adjustment will work to the disadvantage of others but this adjustment was considered to be equitable.

His Honour directed the applicant to proceed with the winding up in accordance with the section 601EE(2) order.

(J) COURT APPROVAL FOR A LIQUIDATOR TO ENTER INTO A LITIGATION FUNDING AGREEMENT - WHAT ARE THE CRITERIA?
(By Naomi Munz, Solicitor, [Mallesons Stephen Jaques](http://www.mallesons.com))

In the matter of ACN 076 673 875 Ltd [2002] NSWSC 578, New South Wales Supreme Court, Austin J, 26 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/june/2002nswsc578.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Summary of findings

This case deals with an application by a liquidator for court approval to enter into a litigation funding agreement under section 477(2B) of the Corporations Act 2001 (Cth).

Austin J made an order which approved the liquidator entering into the litigation funding agreement.

In this case no funds were available to the liquidator to pursue examinations under section 596A of the Corporations Act of the directors and former directors of the company in relation to suspected insolvent trading. The court approved the litigation funding agreement without being able to accurately assess the likely success of the proceedings on the basis that it was (a) in the interests of creditors (without the litigation funding agreement, the creditors were unlikely to receive any dividend); and (b) in the public interest, that examinations be conducted.

Austin J restates matters relevant to a decision by the court whether or not to approve a litigation funding agreement under section 477(2B).

(2) Facts

The plaintiff, Graham Ross Bendeich as liquidator of ACN 076 673 875 Ltd (Receivers & Managers Appointed) (in liquidation), applied to the court for approval under section 477(2B) to enter into a liquidation funding agreement. Three directors of the company opposed the application.

The application arose as a motion for the creditors of the company to approve the agreement was defeated. The evidence indicated that the creditors who voted against the resolution were interests associated with the directors. His Honour took this evidence into consideration in making his order.

The liquidator gave evidence that he believed that, in relation to the company, there may have been contraventions of the insolvent trading provisions in section 588G of the Corporations Act. Examination summons had been issued to directors and former directors of the company, but there were no funds available to enable the liquidator to conduct the examinations or pursue any consequential litigation against directors for insolvent trading unless litigation funding was obtained.

Under the proposed litigation funding agreement, Insolvency Management Fund Ltd ("IMF") would provide funding for the public examinations up to a fixed cap with an option to fund any resultant proceedings by the liquidator in return for 15% of any amount recovered on settlement of the action (within a certain time) and 40% of any amount recovered in respect of proceedings thereafter.

(3) Legal issues

Austin J cited the decision of Fryberg J in Re Imobridge Pty Ltd (1999) 18 ACLC 29 which also considered an application to approve entry into a litigation funding agreement under section 477(2B). Fryberg J held that the court should form some opinion in relation to the likely outcome or success of the proposed proceedings as well as give consideration to the liquidator's commercial judgment.

Austin J applied the following three factors of the factors which Fryberg J identified would affect the exercise of the court's discretion to approve a litigation funding agreement:

(a) The liquidator's prospects of success in litigation

In this case claims that not much work had been done by the liquidator were not accepted as grounds for describing the proposed proceedings as speculative. The evidence of the liquidator that he held a belief that there may have been insolvent trading was sufficient to show that there is justification for a litigation funding agreement of the kind proposed.

(b) The interests of the creditors

While accepting that the litigation funding agreement may benefit the lawyers and the financier, Austin J found that the agreement also created a prospect of benefits for unsecured creditors. Austin J indicated that if there was evidence that the law firm to provide legal services under the litigation funding agreement controlled IMF, there may be an argument that litigation would be pursued to generate legal costs which would not necessarily be in the interests of creditors but no such evidence had been presented.

(c) Oppression

Austin J rejected an argument that the examinees would be prejudiced because IMF is party to a similar litigation funding agreement for a related company and conflicts will arise. His Honour held that conflicts of interest "are not so inevitable as to required separate solicitors and even separate financiers to be used, especially when one takes into account the advantages of cost and efficiency".

Austin J also cited as applicable the considerations relevant to the decision of Mansfield J in Re Addstone Pty Ltd (1998) 16 ACLC 1320 in reviewing the entry into a litigation funding agreement by a liquidator. After noting that the power given to a liquidator by section 477(2)(c) of the Corporations Act to dispose of property "creates a statutory exception to the law of maintenance and champerty", Mansfield J identified the following as a non?exclusive list of considerations relevant to a decision of the court to approve a litigation funding agreement:

- "the nature and complexity of the cause of action;
- the amount of costs likely to be incurred in the conduct of the action and the extent to which the financier is to contribute to those costs;
- the extent to which the financier is to contribute towards the costs of the defendant in the event that the action is not successful, or towards any order for security for costs by the court before which the action is to be heard;
- the extent to which the liquidator has canvassed other funding options;
- the level of the financier's "premium";
- the risks involved in the claim; and
- the liquidator's consultations with the creditors of the company."

His Honour stated that it would be desirable to obtain alternative tenders for funding before making an application for approval to the court. Austin J cited other decisions which allow the courts to exercise their own judgment as to what would be an excessive profit for the financiers under a litigation funding agreement. His Honour cited Buiscex Ltd v Panfida Foods Ltd (1998) 28 ACSR 357 in which Hodgson CJ held that 75% of the outcome of proceedings was not excessive in the circumstances of that case. There was a public interest in that case that proceedings be brought and, although creditors did not approve the funding agreement, the interest of minority shareholders were also taken into account.

Austin J held that while the motion for creditors to approve entry into the funding agreement was defeated: (a) the creditors who defeated the motion were interests associated with the directors and there was concern that those who voted against the motion did so for the purpose of preventing the proceedings during which it was likely that their conduct would be in question; and (b) a large creditor of the company indicated that it would have voted for the motion (ensuring its success) and that it supported the funding agreement.

Austin J concluded that, although the prospects of successful recovery against the directors were, at this stage, unclear, there is a public interest in investigating and, where appropriate, bringing an action against directors for insolvent trading, and that accordingly the funding agreement should be approved.

(K) APPLICATION FOR THE WINDING UP OF A MANAGED INVESTMENT SCHEME - NEED FOR INDEPENDENT LIQUIDATOR
(By Erica Martin, [Mallesons Stephen Jaques](http://www.mallesons.com))

Bells Securities Pty Ltd v LPG Mourant [2002] QSC 156, Supreme Court of Queensland, Wilson J, 4 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/qld/2002/june/2002qsc156.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Facts

The applicant, Bells Securities Pty Limited ("Bells Securities") was the operator of a solicitor's mortgage lending business. Beginning in 1996, lenders contributed varying amounts which were pooled to make individual loans, referred to as "contributory loans", secured by contributory mortgages over real property. The loans were made and corresponding securities taken by Bells Securities as trustee. Through this scheme, Steindl Bell Lawyers lent clients' money to borrowers on the security of mortgages taken over real property.

The scheme is an unregistered managed investment scheme. Bells Securities sought an order for the winding up of the scheme pursuant to section 601EE of the Corporations Act, with Bells Securities to be responsible for the winding up, under the supervision of two chartered accountants in Hall Chadwick.

ASIC intervened in the application to oppose the appointment of Bells Securities to wind up the scheme. In its submission, independent liquidators ought to be appointed. Over the life of the scheme, 84 loans were made. Of those, four remain - each loan is in default.

(2) Legislation

Under section 610EE (2) of the Corporations Act, the Court "may make any orders it considers appropriate for the winding up of the scheme." The following factors were identified by her Honour as relevant to the exercise of this wide discretion:

(a) the conduct of Bells Securities, including the circumstances of the four remaining loans;

(b) the potential that the applicant, the operator of the scheme, may face a conflict of duty and interest, in winding up its own scheme;

(c) the interests and wishes of contributories;

(d) the comparative costs of the applicant's proposal and those of a winding up by independent liquidators; and

(e) the public interest in the integrity of the system of investor protection for which the Corporations Act stands (see ASIC v Chase Capital Management Pty Ltd (2001) 36 ACSR 778 at 795 per Justice Owen).

(3) The conduct of the mortgage lending business

Her Honour found that in all four remaining loans, Bells Securities relied on valuations supplied by the borrowers when making the advances. The loans have been in default for periods ranging from 21 to 44 months, and the total amount owing was approaching $12 million. Hall Chadwick have already been involved as receivers and managers with respect to two of the loans, and unidentified receivers and managers have been involved in a third. All attempts to sell have been unsuccessful.

Her Honour stated that Bells Securities had not provided a satisfactory explanation for this.

(4) Conflict of interests

Her Honour raised the possibility of the contributories having recourse against Bells Securities as a real one, with the potential for conflict between Bells Securities' duty to the contributories and its own interests.

(5) The interests and wishes of contributories

Her Honour noted that in the case of each loan, a substantial majority in number and value of the contributories voted in favour of Bells Securities winding up the scheme. They expressed confidence in the applicant's capacity to wind up the scheme and concern at the costs which would be incurred if independent liquidators were appointed.

(6) Costs of winding up

In respect of costs, Bells Securities proposed that:

- if appointed to wind up the scheme, it would not charge a day to day management fee.
- the accountants from Hall Chadwick would charge $150 per hour for reviewing actions taken by Bells Securities and advisory work and reserved "the right to charge their normal rates as recommended by the Insolvency Practitioners Association of Australia if ... requested to investigate and make decisions."
- any legal work would be performed by Steindl Bell Lawyers. Fees for work performed would be deferred until the conclusion of the winding up and then charged at reduced rates.

ASIC proposed the appointment of Messrs Moloney and Geroff as liquidators. They proposed charging in accordance with the Insolvency Practitioners Association scale for all work.

Her Honour concluded that the appointment of independent liquidators would probably result in higher charges than those proposed by Bells Securities.

(7) Decision

Her Honour stated that the expressed wishes of the contributories were a significant factor in the exercise of the discretion as to what to do in respect of the winding up of the scheme, as was the very real possibility that Bells Securities' proposal would be less expensive than the appointment of independent liquidators.

However, her Honour also noted that "there is a significant public interest in ensuring the transparency of the winding up process and the safeguarding of the rights of the contributories. There is good reason to be concerned that the contributories may not be fully apprised of all the circumstances surrounding the making and management of the four loans in question, and that if Bells Securities' proposal were approved in response to their understandable concern to contain costs they might never appreciate the full extent of their rights."

Weighing up these factors, Her Honour decided that independent liquidators should be appointed, in support of ASIC's intervention.

6. NEW PUBLICATION

(A) THE NEW TAKEOVERS PANEL - A BETTER WAY?

The Centre for Corporate Law and Securities Regulation at The University of Melbourne, the Takeovers Panel and CCH Australia Limited have jointly published a new monograph titled "The New Takeovers Panel - A Better Way?"

The author is Nicole Calleja who is with Allens Arthur Robinson. She was previously seconded to work as a member of the Executive of the Takeovers Panel.

As a result of the enactment of the Corporate Law Economic Reform Program Act, which commenced on 13 March 2000, the Takeovers Panel, which was previously known as the Corporations and Securities Panel, became the recipient of increased powers. It therefore has a new and important role to play regarding the adjudication of disputes involving takeovers.

The chapters in the book are:

(1) Introduction

(2) Overview of the Powers of the New Panel

(3) The History of the Board

(4) The Functions and Responsibilities of the New Panel

(5) International Perspective

(6) The Performance of the New Panel

(7) Assessment of the Panel's Performance to Date and Current Challenges

(8) Conclusion

The monograph is $70 including postage plus $7 GST ($77) for Australian purchasers only. To order the monograph, contact:

Ms Ann Graham
Administrator
Centre for Corporate Law and Securities Regulation
Faculty of Law
The University of Melbourne
Victoria
Australia 3010

Tel: 61 3 8344 5281
Fax: 61 3 8344 5285
a.graham@unimelb.edu.au

7. RECENT CORPORATE LAW JOURNAL ARTICLES

S Watson, 'Who Hides Behind the Corporate Veil? Finding a Way out of "The Legal Quagmire"' (2002) 20 Company and Securities Law Journal 198

Limited liability is a cornerstone principle of company law. For that reason, the courts are reluctant to lift the corporate veil to make shareholders liable for the debts of the company. But if it could be shown that when the corporate veil is lifted, it is not individuals acting in their capacity as shareholders who are made liable, this conceptual difficulty disappears. In this article, the writer argues that on the rare occasions when the courts make the decision to lift or pierce the corporate veil, they are recognising that the company was not a legal entity separate from its controller. Once that decision is made, the capacity in which the controller acted within the company becomes irrelevant.

Note, 'When Amounts are Required to be Withheld on Account of Taxation from Priority Payments under s 556(1)(e) of the Corporations Act 2001 (Cth): Deputy Commission of Taxation v Applied Design Developments Pty Ltd (in liq)' (2002) 20 Company and Securities Law Journal 215

Note, 'Auditor Independence - Provision of Non-audit Services by Top 100 Company Auditors during 2000-2001' (2002) 20 Company and Securities Law Journal 220

Note, 'Amendments to the Singapore Companies Act (Cap 50) (1994 rev ed): the Singapore Companies Amendment Act (2000)' (2002) 20 Company and Securities Law Journal 226

Note, 'Individual Share Futures in Australia' (2002) 20 Company and Securities Law Journal 232

Note, 'Balancing the Rights of Majority and Minority Shareholders - Has Part 6A.2 Failed?' (2002) 20 Company and Securities Law Journal 236

Y Wen, K Rwegasira and J Bilderbeek, 'Corporate Governance and Capital Structure Decisions of the Chinese Listed Firms' (2002) 10 Corporate Governance: An International Review 75

A Cuervo, 'Corporate Governance Mechanisms: A Plea for Less Code of Good Governance and More Market Control (2002) 10 Corporate Governance: An International Review 84

H Jang and J Kim, 'Nascent Stages of Corporate Governance in an Emerging Market: Regulatory Change, Shareholder Activism and Samsung Electronics (2002) 10 Corporate Governance: An International Review 94

A Oquendo, 'Breaking On Through to the Other Side: Understanding Continental European Corporate Governance' (2001) 22 University of Pennsylvania Journal of International Economic Law 975

N Georgakopoulos, 'Corporate Defence Law for Dispersed Ownership' (2001) Vol 30 No 1 Hofstra Law Review

The Company Lawyer, Vol 23 No 5, May 2002. Articles include:

- Changing the Investment Services Directive: Broker-Dealers and Institutional Investors
- Regulating Company Accounts
- Australia and New Zealand: The Contributory Negligence of Company Directors
- Some Characteristics of the Belgium SPRL

University of California Davis Law Review, Vol 35 No 3, February 2002. Special Symposium Issue on Corporations Theory and Corporate Governance Law. Articles include:

- Selective Disclosures in the Public Capital Markets
- Using Behavioural Economics to Show the Power and Efficiency of Corporate Law as a Regulatory Tool
- Team Production and the Progressive Corporate Law Agenda
- Corporate Social Responsibility in an Era of Economic Globalisation
- Contract, Property, and the Role of Metaphor in Corporations Law

International and Comparative Corporate Law Journal, Vol 3 No 4, 2001. Articles include:

- The Pre-emptive Right in Greek Company Law
- Piercing the Corporate Veil: A UAE Perspective
- Overcoming the Crisis: Korean Corporate Restructuring Law in the Context of Chaebol Reform
- Reform of the Jordanian Securities Commission: A Personal View
- Insider-dealing Regulation in the United Kingdom and Germany: Comparing Regulatory Policy on the Implementation of Key Aspects of the EC Insider-dealing Directive

M Eppenstein, 'International Investors' Rights and Remedies in the Adjudication of Disputes with US Securities and Commodities Firms in the Context of US Arbitral Forum Selection' (2002) 27 Brooklyn Journal of International Law 443

W Friedman, 'One Country, Two Systems: The Inherent Conflict Between China's Communist Politics and Capitalist Securities Market' (2002) 27 Brooklyn Journal of International Law 477

E Carson, 'Factors Associated with the Development of Board Sub-Committees' (2002) 10 Corporate Governance: An International Review 4

E O'Higgins, 'Non-Executive Directors on Boards in Ireland: Co-option, Characteristics and Contributions' (2002) 10 Corporate Governance: An International Review 19

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G Walker and T Reid, 'Upgrading Corporate Governance in East Asia: Part 1' (2002) 17 Journal of International Banking Law 59

G Walker and T Reid, 'Upgrading Corporate Governance in East Asia: Part 2' (2002) 17 Journal of International Banking Law 96

P Wooldridge, 'Changes in Financial Patterns in the International Banking Market' (2002) 17 Journal of International Banking Law 89

C Buchan and S McAree, 'Hong Kong: Corporate Governance Review' (2002) Vol 17 No 1 Asia Pacific Legal Developments Bulletin 4

C Hodgens, A Marriott and A Takada, 'Japan: Changes to Japanese Share Capital Rules' (2002) Vol 17 No 1 Asia Pacific Legal Developments Bulletin 9

B Chia, 'Malaysia: Changes in Company Law' (2002) Vol 17 No 1 Asia Pacific Legal Developments Bulletin 13

K Urapeepatanapong, 'Thailand: Changes in Company Law' (2002) Vol 17 No 1 Asia Pacific Legal Developments Bulletin 29

M Murray, 'Defences to Tax and Insolvency Claims' (2002) 2 Insolvency Law Bulletin 131

M Murray, 'Insolvent Trading Trusts' (2002) 2 Insolvency Law Bulletin 146

C Symes, 'Is it Time to Repeal or Relocate Part 5.1?' (2002) 2 Insolvency Law Bulletin 151

C Symes, 'Statutory Demands - The Need to Have a Present and Unconditional Obligation to Pay a Certain Amount (2002) 2 Insolvency Law Bulletin 154

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