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**CONTENTS**

1. [RECENT CORPORATE LAW AND CORPORATE GOVERNANCE DEVELOPMENTS](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#1.recentcorporatelawand)  
(A) [Corporate governance at the Commonwealth Bank of Australia](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28A%29corporategovernanceatthe)  
(B) [Corporate Governance Council - statement by participants](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28B%29corporategovernancecouncil)  
(C) [UN study finds nearly 30 transnational corporations richer than many nations](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28C%29unstudy)  
(D) [Does good governance pay?](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28D%29doesgoodgovernance)  
(E) [US CFOs pressured to misrepresent financial results](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28E%29uscfos)  
(F) [New Code of Banking Practice](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28F%29newcode)  
(G) [Corporate governance at five failed companies](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28G%29corporategovernanceatfive)  
(H) [Singapore corporate law and governance review](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28H%29singaporecorporate)  
(I) [Scrutiny of corporate governance most intense since 1980s, according to new CARMA study](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28I%29scrutinyofcorporate)  
(J) [Australian Prime Minister's speech on corporate governance](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28J%29australianprime)  
(K) [NYSE approves measures to strengthen corporate accountability](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28K%29nyseapproves)  
(L) [FSA outlines options on analysts' investment research](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28L%29fsaoutlines)  
(M) [Modernising the UK listing regime](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28M%29modernisingtheuk)  
(N) [New research paper on compulsory acquisition of securities](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28N%29newresearchpaper)  
(O) [New study by PricewaterhouseCoopers calls for a more holistic approach to risk management](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28O%29newstudyby)  
(P) [Forecasting under scrutiny as profit warnings increase](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28P%29forecastingunder)  
(Q) [Study reveals CEO job security is declining globally](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28Q%29studyreveals)

2. [RECENT ASIC DEVELOPMENTS](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#2.recentasic)  
(A) [ASIC updates 'truth in takeovers' policy](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28A%29asicupdates)  
(B) [ASIC to release discussion paper on socially responsible investing disclosure obligations](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28B%29asictorelease)

3. [RECENT ASX DEVELOPMENTS](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#3.recentasxdevelopments)  
(A) [ASX convenes Corporate Governance Council](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28A%29asxconvenes)

4. [RECENT TAKEOVERS PANEL MATTERS](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#4.recenttakeoverspanel)  
(A) [Panel releases final Guidance Note on costs orders](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28A%29panelreleases)  
(B) [Takeovers Panel accepts undertaking by Placer Dome to vary broker inducement fee](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28B%29takeoverspanelaccepts)

5. [RECENT CORPORATE LAW DECISIONS](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#5.recentcorporatelawdecisions)  
(A) [Lodging financial reports - "unreasonable burden"?](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28A%29lodgingfinancialreports)  
(B) [Power of detention to assist ASIC investigation](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28B%29powerofdetention)  
(C) [Oppressive conduct: collateral use of derivative actions](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28C%29oppressiveconduct)  
(D) [Derivative actions in the context of a failed joint venture](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28D%29derivativeactions)  
(E) [Director/chairman's duties relating to proxy votes: the Whitlam decision](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28E%29director)  
(F) [Mortgagee receiver exercising power of sale in favour of appointor](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28F%29mortgagee)  
(G) [Reliance on information provided as a defence to director's liability for voidable taxation payments](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28G%29relianceon)  
(H) [Theme based music collaborations as managed investment schemes](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28H%29themebased)  
(I) [Court approval for scheme of arrangement](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28I%29courtapproval)  
(J) [Mortgages: unconscionable advantage and the duty to disclose](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28J%29mortgages)  
(K) [The court's power to award costs in relation to an application for approval of a compulsory acquisition](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#%28K%29the)

6. [RECENT CORPORATE LAW JOURNAL ARTICLES](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#6.recentcorporatelawjournalarticles)

7. [CONTRIBUTIONS](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#7.contributions)

8. [MEMBERSHIP AND SIGN-OFF](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#8.subscription)

9. [DISCLAIMER](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#9.disclaimer)

1. RECENT CORPORATE LAW AND CORPORATE GOVERNANCE DEVELOPMENTS

(A) CORPORATE GOVERNANCE AT THE COMMONWEALTH BANK OF AUSTRALIA

On 21 August 2002 the Commonwealth Bank of Australia made a statement concerning its corporate governance practices, including a number of changes to these practices. Following is a summary of some of these practices.

(1) Directors' benefits

(a) Directors are required to take a minimum of 20% of their fees in shares in the Bank, acquired at market price, and are required to hold these shares for ten years or until they leave the Board. Non-Executive Directors do not participate in any of the Bank's incentive plans.

(b) The Board has decided to close the Directors' retirement scheme, which was approved by shareholders at the 1997 Annual General Meeting. The entitlement for current Directors will be "grandfathered" and no new members will be admitted to the scheme.

(2) Audit Committee

The Charter of the Audit Committee incorporates a number of policies and practices to ensure that the Committee is independent and effective. Among these are:

(a) The Audit Committee consists entirely of non-Executive Directors, all of whom have familiarity with financial management and at least one has expertise in financial accounting and reporting. The Chairman of the Bank is not permitted to be the Chairman of the Audit Committee.

(b) At least twice a year the Audit Committee meets the external auditors and the Group Internal Auditor independently of management.

(c) The Audit Committee is responsible for nominating the external auditor to the Board for appointment by shareholders. The Audit Committee approves the terms of the contract with the external auditor, agrees the annual audit plan and approves payments to the auditor.

(d) The Audit Committee discusses and receives assurances from the external auditors on the quality of the Bank's systems, its accounting processes and its financial results. It also receives a report from the auditors on any significant matters raised by the auditors with management.

(e) All material accounting matters requiring exercise of judgment by management are specifically reviewed by the Audit Committee and reported on by the Committee to the Board.

(f) The Board has in place policies governing the nature of non-audit work which cannot be undertaken by the Bank's auditors for the Bank or its subsidiaries. There are also procedures in place governing approval of any other non-audit work before that work can be carried out. The objective of these approvals is to avoid prejudicing the independence of the Auditors and to prevent their developing undue reliance on revenue from the Bank.

Under the policy, the auditor will not provide the following services:

- bookkeeping or services relating to accounting records;  
- appraisal or valuation and fairness opinions;  
- advice on deal structuring and related documentation;  
- tax planning and strategic advice;  
- actuarial advisory services;  
- executive recruitment or extensive human resource functions;  
- acting as broker-dealer, promoter or underwriter; or  
- provision of legal services.

(g) The Bank currently requires that the partner managing the audit for the external auditor be changed within a period of five years.

(3) Executive remuneration - deletion of options

The Bank has restructured its long term executive incentive plan, effective from the beginning of the current financial year. Previously half the value of long term incentive benefits under the shareholder approved Bank's Equity Reward Plan were paid in options, valued on the Black-Scholes method, and the other half in performance shares valued at market price at the date of allocation. These options and shares only vest to the Executive provided the prescribed performance hurdles are met. From the beginning of this financial year options have been eliminated from the remuneration package of executives and the total value of the long term incentives allocated under the Equity Reward Plan will be in the form of reward shares.

A further change introduced is that whereas previously allocated options and shares vested upon the average Total Shareholder Return of peer institutions being exceeded, a sliding scale has been introduced so that 50% of allocated shares vest if the Bank's TSR is equal to the average return, 75% vest at the 66th percentile in the index and 100% when the return exceeds the 75th percentile, ie. when the Bank's return is in the top quartile.

Options and shares previously allocated under the Equity Reward Plan will continue until they vest upon the prescribed performance hurdles being met or they lapse.

Currently, restricted shares purchased on market to satisfy incentives earned by executives are charged against profit and loss as are incentives paid in cash and deferred shares. As from the beginning of the current financial year, total remuneration, which will include the full cost of the plan and also the distribution of shares to employees, will be expensed against profits. A basis of valuation, that takes account of the conditional nature of potential incentive benefits in the Australian environment, will be developed to reflect appropriately the cost to the company.

It is worth noting that of the total distribution of equity to employees in each of the last two years less than 20% went to the senior executive team and the rest to other employees.

(B) CORPORATE GOVERNANCE COUNCIL - STATEMENT BY PARTICIPANTS

On 15 August 2002 the Corporate Governance Council held its first meeting.

The meeting was convened by the Australian Stock Exchange (ASX), and attended by representatives of Association of Superannuation Funds of Australia Limited, Australasian Investor Relations Association, Australian Chamber of Commerce and Industry, Australian Institute of Company Directors, Australian Institute of Superannuation Trustees, Australian Shareholders Association, Business Council of Australia, CPA Australia, Chartered Secretaries Australia, Institute of Chartered Accountants in Australia, Investment and Financial Services Association, Group of 100, and Securities Institute of Australia.

Following is the text of the Council's statement announced on 15 August 2002.

(1) Immediate priorities: annual reports to shareholders 2001-02

The Council noted that Australian listed companies are currently preparing their annual reports to shareholders - including reporting, in line with ASX Listing Rules, on their main corporate governance practices. In these circumstances, the Council decided to issue an initial statement, to provide immediate guidance on a number of current governance issues. The Council urged companies to pay special attention to the following issues in reporting to their shareholders on the current (2001-02) reporting season. Where companies are unable to comply, the Council requested that they provide shareholders with a full explanation of the reasons for this inability.

(2) Share and options schemes

The Council urged companies to voluntarily and fully disclose the existence and conditions of all share and options schemes currently in operation, together with details of performance hurdles.

The Council noted that Section 300 of the Corporations Act requires the disclosure of options offered to directors and the five most highly remunerated officers, along with disclosure of the valuation basis underpinning these options. The Council was pleased to note further that the International Accounting Standards Board (IASB) has indicated its intention to release an exposure draft in October that will, among other issues, address the question of valuation and detailed disclosure of share and options schemes. The Council recognised that these standards will however take time to be implemented.

(3) Audit committees

The Council expressed strong support for the establishment of audit committees with appropriate expertise.

Listed companies are currently required under Listing Rules to report if they operate an audit committee and, if not, why not. The Council recognises that audit committees in no way diminish the responsibilities of all directors under the Corporations Act. The Council also recognised that further consideration will be given to audit committees within the framework of the CLERP paper to be issued by the Commonwealth Treasury. This will in turn draw upon the comprehensive discussion of Professor Ian Ramsay's Report on Independence of Australian Company Auditors.

Recognising the need to evaluate costs and benefits in individual circumstances, the Council expressed the belief that audit committees make a particularly appropriate contribution to larger companies and those with greater likelihood of attracting retail investors. Accordingly the Council strongly recommended that audit committees be established by at least the top 500 listed companies (that is, those that compose the All Ordinaries index).

As minimum requirements, audit committees should be composed of a majority of independent directors; should be chaired by an independent director who is not the chairman of the board; should not include management representatives as members; and should operate under a charter. The charter should address the key responsibilities, accountabilities and entitlements of the audit committee, including responsibility for proposing appointment of external auditors; should be reviewed annually; and should be made available to shareholders.

(4) External auditors

The Council called on companies to disclose a full analysis of the total fees paid to external auditors, including a break down of fees for non-audit activities - noting that Australian Accounting Standard Board (AASB) 1034 already requires disclosure of total non-audit fees.

The Council also called on companies to disclose when the audit firm was last appointed and the dates of rotation of the audit engagement partners. The Council believed external auditors should meet at least twice yearly with the audit committee and the full board without management in attendance, to ensure full and frank discussion of audit issues.

(5) Accounting standards

The Council called for greater voluntary disclosure by companies and meaningful management discussion and analysis in financial reports.

The Council noted with approval the decision of the Financial Reporting Council (FRC) to support the adoption by Australia of international accounting standards by 1 January 2005. This will represent a significant step towards international consistency, thereby removing impediments to the transparent understanding of Australian companies by international investors.

The Council noted that Australia is making a substantial financial contribution through the FRC to this effort. These funds are derived from Commonwealth, State and Territory Governments, the three accounting bodies, the ASX and the Financial Industry Development Account of the ASX. The Council urged the business community to fully support this initiative.

The Council particularly recommended greater disclosure by companies of their capitalisation policies and practices. This includes greater clarity by companies about the circumstances in which costs are capitalised against future income streams.

The Council also called on companies to disclose the extent of any contractual arrangements they have entered into, such as leases, which carry financial obligations for future years.

(6) Shareholder empowerment

The Council called on companies to disclose the measures they have in place to ensure provision of equal access to material information through the continuous disclosure regime.

The Council expressed the view that an essential criterion to assess the validity of corporate governance reforms should be whether they empower the shareholder, particularly through the provision of material information both within the company itself and via the marketplace as a whole.

Recognising the essential nature of equal investor access to material information, the Council agreed that continuous disclosure had made a core contribution to standards of corporate governance in Australia to date. The Council noted the ASX paper on Enhanced Disclosure issued on 19th July 2002, which proposed a number of changes to both the continuous and periodic financial disclosure regimes designed to enhance the provision of timely and relevant information for the benefit of all investors. The Council noted that at ASX's suggestion, the World Federation of Exchanges' Annual Meeting in Amsterdam in October will be debating continuous corporate disclosure as the best protection of investors. The Council fully supported this initiative.

The Council expressed the hope that individual shareholders would further participate in the debate about corporate governance practices in Australia. To this end, the Council accepted the offer of ASX to set up an email and fax hotline to receive and record comments and opinions of shareholders on corporate governance issues. Contributions forwarded by email to corporate.governance@asx.com.au and by fax to 02 9227 0885 will be passed on to the Council.

(7) Role and purpose of the Corporate Governance Council

The Council sees its role as a collaborative, industry-based body leading the adoption by Australian companies of corporate governance practices which reflect international best practice and which enhance the reputation of Australia's capital markets and Australian companies. The Council endorsed the view that corporate governance practices are evolutionary and must be regularly reviewed.

To this end, the Council agreed that good corporate governance must protect the rights of shareholders, recognise the interests of the general public, and ensure timely and accurate disclosure is made of all material matters regarding the corporation. Good corporate governance should also provide an appropriate framework for board and management to pursue objectives that are in the interests of the shareholders and the company, encourage the productive and efficient use of corporate resources and provide transparency and accountability in relation to the use of those resources.

In pursuit of these goals, the Council will undertake a wide-ranging work program including the following activities:

- review, and where necessary suggest input into, published guidance recommendations for corporate governance practice in Australia, also having regard where relevant to international models;  
- assist ASX in building understanding about best practice on the part of listed companies including, where appropriate, formulating suggestions as to any necessary amendments to Listing Rules and guidance notes;  
- recommend to regulators and Government where legislative amendment may be necessary;  
- provide information related to corporate governance to investors and the wider community;  
- regularly review compliance with best practice.

In particular, emerging from this work program, the Council reaffirmed the intention to issue statements of best practice corporate governance principles. The Council expressed the belief that these principles will carry a strong endorsement of expected practice by Australian companies. These will be well in place for companies reporting on their activities in the 2002-03 financial year, and will be regularly reviewed and updated in the future.

The Council agreed to meet again in September.

(C) UN STUDY FINDS NEARLY 30 TRANSNATIONAL CORPORATIONS RICHER THAN MANY NATIONS

On 13 August 2002 the United Nations Conference on Trade and Development (UNCTAD) produced new research which concludes that 29 of the world's 100 largest economic entities are transnational corporations, ranking both States and corporations.

Exxon Mobil, with a "value added" worth of $63 billion, is bigger in economic size than Pakistan, while General Motors, worth $56 billion, outpaces both Peru and New Zealand, according to the list.

UNCTAD also reports that Ford Motor and DaimlerChrysler, with value added of over $42 billion, are both larger than Nigeria, which is worth $41 billion. Kuwait, at $38 billion, is outranked by General Electric. And Honda, Nissan and Toshiba all have more value than Syria.

The rising importance of transnational corporations in the global economy is revealed in other statistics compiled by UNCTAD. The agency reports that the 100 largest companies accounted for 3.5 per cent of global gross domestic product in 1990 - a figure which jumped to 4.3 per cent in 2000. There were 24 corporations in the 1990 combined top 100 list of companies and countries, compared with 29 in 2000.

The report is available on the United Nations website at <http://www.un.org>.

(D) DOES GOOD GOVERNANCE PAY?

New research by McKinsey published in the most recent issue of The McKinsey Quarterly (No 3, 2002) shows that in emerging markets, companies that adopt good corporate governance practices are rewarded by investors.

The research examined 188 companies from six emerging markets (India, Malaysia, Mexico, South Korea, Taiwan and Turkey) and tested the link between market valuation and the corporate governance practices of these companies in 2001.

The researchers rated the performance of each of the 188 companies against some key components of corporate governance. These components included independent audits, independent directors (no more than half of the directors to be executives of the company and at least half of the non-executive directors should have no other ties to the company), one share one vote, use of internationally recognised accounting standards, and full disclosure of information on financial and operating performance, etc.

After allowing for the effect of characteristics such as financial performance (measured by returns on equity) and size on valuations, the researchers found that companies with better corporate governance had higher price to book ratios, indicating that investors will pay a premium for shares in well-governed companies. In addition, the reward for good corporate governance is large. According to the researchers, by moving from worst to best corporate governance, companies in the sample could expect, on average, to experience approximately a 10 to 12 per cent increase in their market valuation.

The researchers conclude by saying that "investors the world over are looking for high standards of good governance and will pay a premium for shares in companies that meet them".

The research is available on the McKinsey website at <http://www.mckinseyquarterly.com>.

(E) US CFOs PRESSURED TO MISREPRESENT FINANCIAL RESULTS

The August issue of the US publication CFO reports the results of a survey of chief financial officers. The survey was undertaken following the recent corporate collapses in that country and a number of prominent US companies restating their earnings.

Some of the findings of the survey are:

(a) Almost 60 per cent of the CFOs responding to the survey stated that their companies have disclosed more information to investors during the past 3 months and a similar proportion plan to disclose more during the next 12 months.

(b) Seventeen per cent of respondents reported being pressured to misrepresent their results by their companies' CEOs during the past 5 years.

(c) Five per cent of the respondents say their reporting practices have violated GAAP. These abuses most often involve reserves and revenue recognition.

(d) Forty-two per cent of the companies in the survey that use special purpose entities (SPEs) to keep debt off their balance sheets guarantee or otherwise protect the investment of third parties in those SPEs - the practice that led to Enron's downfall.

The survey was based on 180 responses to a questionnaire. The full text of the article is available on the CFO website at <http://www.cfo.com>.

(F) NEW CODE OF BANKING PRACTICE

On 12 August 2002 the Australian Bankers' Association (ABA) launched the new Code of Banking Practice which is the banking industry's customer charter on best banking practice standards.

Once a bank adopts the Code, it is explicitly committed to:

- act fairly and reasonably toward their customers in a consistent and ethical manner;   
- establish, through the ABA, a consultative forum to take account of community views about banking;  
- extend the Code to cover small business;  
- submit themselves to independent monitoring of their compliance with the Code and accountability for Code breaches;  
- with customers' agreement, to try and help customers suffering financial difficulties with their bank loan, overcome those difficulties;  
- provide information on chargebacks on a disputed credit card transaction;  
- ensure staff are trained to competently and efficiently discharge their authorised functions;  
- ensure the Code is promoted and that copies are made readily available;  
- comply with the ABA's Transaction Services and Branch Closure Protocol;  
- provide important and relevant information for prospective guarantors before they commit to guaranteeing someone else's debt;  
- review the Code every three years.

The Code comes into effect in August 2003, because banks need adequate time to change documentation, computer systems, update procedures and ensure staff are properly trained to ensure compliance with the Code.

This will be conducted simultaneously with banks' preparations for compliance with the Financial Services Reform Act which takes full effect in March 2004.

(G) CORPORATE GOVERNANCE AT FIVE FAILED COMPANIES

On 8 August 2002 Melbourne based consultancy firm Institutional Analysis released a report titled "A Report on Corporate Governance at Five Companies that Collapsed in 2001". Following is an extract from the report's Executive Summary.

The failed companies analysed:

- One.Tel (Telecommunications)  
- HIH (Insurance)  
- Pasminco (Resources)  
- Harris Scarfe (Retailing)  
- Centaur (Resources)

The report compares the core dimensions of corporate governance performance at these five failed companies with the average corporate governance performance of the 100 largest companies by market capitalisation on the Australian Stock Exchange.

The analysis revealed that a majority of failed companies were characterised by an ownership structure dominated by a single shareholder with effective control: 60% of the failed companies had a single shareholder with effective control, compared with 39% of companies in the S&P/ASX 100.

Boards at the failed companies tended to contain a below average number of independent directors. Founders and family members of founders, audit firm personnel and large shareholders were over -represented on the boards of the failed companies.

Analysis of the composition of audit committees at the failed companies revealed an above average number of audit firm personnel and former audit firm personnel. Big Five firms performed audits at only 60% of failed companies. By contrast, 99% of S&P/ASX 100 companies use a Big Five firm for their audit.

One.Tel's governance performance was particularly poor. There were major gaps in its reporting of information about directors' shareholdings, and 3 of its committees - audit, remuneration and corporate governance - were comprised of the same 2 board members. Neither was an independent director.

Related party transactions comprised over 10% of market capitalisation on average for the failed companies. Related party transactions were less than 1% of market capitalisation for the average S&P/ASX 100 company.

(H) SINGAPORE CORPORATE LAW AND GOVERNANCE REVIEW

The Company Legislation and Regulatory Framework Committee ("CLRFC") has issued a draft report on reform of Singapore corporate law and governance. The CLRFC was appointed by the Ministry of Finance, the Attorney-General's Chambers and the Monetary Authority of Singapore in December 1999. The terms of reference were "to undertake a comprehensive and coherent review of our company law and regulatory framework and recommend a modern company law and regulatory framework for Singapore which accords with global standards and which will promote a competitive economy".

The CLRFC's draft report comprises the following five chapters:

- Chapter 1: Business Vehicles and Small Business (22 recommendations)  
The CLRFC has reviewed the adequacy and completeness of the vehicles available under Singapore law for the conduct of domestic and international business. In addition, the CLRFC also reviewed the particular needs of small business in the context of the Companies Act, in particular, whether Singapore should have a separate legislative regime for small businesses or whether it would be preferable to continue to have a base model that is applicable to all companies, with overlays for companies that can raise capital from the public. Finally, with a view to streamlining and reducing compliance costs without sacrificing the integrity of information filed for public access, the CLRFC reviewed the incorporation, maintenance and dissolution processes for all companies (with special regard to small businesses).

- Chapter 2: Capital Raising, Capital Maintenance and Company Charges (23 recommendations)   
The CLRFC has reviewed the Companies Act and the Securities and Futures Act in relation to capital raising, capital maintenance and company charges. For capital raising, the CLRFC recommends the replacement of the ill-defined boundaries of public and private offerings with a comprehensive list of safe harbour prospectus exemptions. The CLRFC also recommends a common statutory regime for both public equity issues and public bond issues and consequently the repeal of statutory trustee and trustee covenants. The CLRFC recommends that the safe harbour prospectus exemptions be extended to collective investment schemes save for where a countervailing public interest is evident.

The CLRFC recommends the elimination of the par value and authorised capital concepts. The CLRFC recommends the simplification of capital reduction by dispensing with court approval and by requiring only supporting shareholders' approval and a directors' declaration of solvency. The CLRFC recommends that companies, supported by a directors' statutory declaration of solvency, be able to provide financial assistance in the following additional circumstances: (i) where less than 10% of the company's shareholders funds are involved, (ii) where there has been unanimous shareholder approval, (iii) by financial institutions and for the purposes of approved employee share schemes, and (iv) for representations and warranties by an issuer or vendor in the context of a public offering.

The CLRFC recommends that share buy-backs be permitted to be retained as treasury shares rather than to be cancelled and that treasury shares may be used by a company (i) to meet its obligations under employee share option schemes, (ii) to be issued to third parties to fund acquisitions, or (iii) to be sold to raise cash. The CLRFC recommends also that companies be permitted to enter contingent contracts to buy-back their shares.

- Chapter 3: Corporate Governance (19 recommendations)   
The CLRFC has reviewed and made recommendations to refine Singapore's current regulation of directors. In particular, the CLRFC recommends the adoption of the UK restatement of directors' duties. Other areas of review include definition of "directors", directors' qualifications, directors' duties, corporate governance, conflict of interests, shareholders' rights and general meetings and resolutions.

- Chapter 4: Corporate Insolvency (3 recommendations)   
The CLRFC has reviewed the current Singapore corporate insolvency regime in the light of the US, UK, Australian and New Zealand and Singapore experience. The CLRFC recommends that Singapore adopt an omnibus insolvency regime for personal and corporate insolvency, thereby consolidating the discrete treatment now accorded under the Bankruptcy Act and the Companies Act respectively. The CLRFC recommends the broadening of the range of insolvency practitioners to enable other qualifying financial and other professionals to be credentialed for insolvency practice and for the development of a professional organisation which will train and accredit insolvency practitioners for Singapore and the region. The CLRFC recommends the introduction of voluntary arrangements.

- Chapter 5: Boundaries and Concluding Recommendations (9 recommendations)   
The CLRFC recommends that the timelines for disclosure of substantial shareholdings and directors shareholdings be extended from 2 calendar days to 2 market days. To facilitate more efficient mergers, the CLRFC recommends that Singapore introduce a corporate merger/ amalgamation process modelled after Section 188 - Section 194A of the New Zealand Law Commission Company Law Reform: Transition and Revision Report No. 16. The CLRFC recommends that Section 215 of the Companies Act be amended to reflect the types of holdings that are to be excluded from the computation of the 90%-acceptances threshold, as has been enacted in the UK. The CLRFC recommends that the book-entry trading system governed by the Companies Act be extended to facilitate scripless trading in a wider range of securities.

Submissions on the draft report can be sent by email to clrfc@mof.gov.sg or via fax to 6337 4134.

The report is available on the Singapore Ministry of Finance's website at <http://www.mof.gov.sg/cor/clrfc.html>.

(I) SCRUTINY OF CORPORATE GOVERNANCE MOST INTENSE SINCE 1980s, ACCORDING TO NEW CARMA STUDY

A new CARMA study released on 7 August 2002, which is an analysis of more than 25 years of historical data, shows that scrutiny of corporate governance matters is the strongest it has been in well over a decade, according to CARMA International, Inc, a Washington, DC-based research company that has been analysing media coverage for nearly 20 years.

For six key business publications, interest in corporate governance reached record levels, culminating in President Bush's signing into law the Sarbanes-Oxley Act. The publications analysed were Business Week, Forbes, Fortune, the Wall Street Journal, the Financial Times (US edition) and the New York Times.

With the exception of the New York Times, the historical data available shows that each of these six publications has published more articles on corporate governance in July of 2002 than in any other month on record. The last time that the New York Times published so much coverage on corporate governance issues was back in the spring of 1988, when financier Carl Icahn unsuccessfully sought to take over Texaco's board of directors. Fortune magazine also tied its July 2002 output on corporate governance with coverage of the Icahn-Texaco issue back in January of 1989 and on other occasions in 1985 and 1984.

Forbes and Business Week each published more articles on corporate governance in July than in any other month on record, according to the 27 years of data that are available for each.

The data also reveal that for all six publications, July of 2002 is not just a fluke month. There is clearly a growing trend toward more attention being paid to corporate governance matters. Each publication has provided more coverage of corporate governance in the first seven months of 2002 than in an average year. In the case of the Wall Street Journal, it has already published more than four times as many stories on the topic than it usually does in an entire year.

Further details of the study are available on CARMA's website at <http://www.carma.com>.

(J) AUSTRALIAN PRIME MINISTER'S SPEECH ON CORPORATE GOVERNANCE

On 6 August 2002, the Australian Prime Minister, the Hon John Howard MP addressed the Securities Institute and the Institute of Chartered Accountants on the topic of corporate governance. Following is a summary of the points made by the Prime Minister:

(1) Competitive capitalism is the best way to generate national wealth and that belief lies at the core of the Government's approach to economic management. The reason corporate governance is so important as an issue is that it is part of the process which continues to underpin the success of competitive capitalism.

(2) No-one should underestimate the depth of public unease regarding corporate excesses. It is the responsibility of government and business to address that unease. The community will expect of the Government "a combination of improved self-regulation coupled with appropriate, but not excessive, levels of government involvement and intervention".

(3) The Australian community has expectations of corporate leaders: "They expect them to work unceasingly to ensure that good governance practices are met at all times, that those leaders must meet the highest levels of ethical behaviour, and that those corporate leaders as a matter of routine should continually review their governance practices and let their customers and their shareholders know that they are doing this."

(4) Much of the debate in Australia is influenced by what has happened recently in the United States. It must be understood in the context of some differences in the corporate governance approach between Australia and the United States. These differences are as follows. First, the practice has been followed in Australia, wisely in the view of the Prime Minister, of maintaining in most cases a separation between the office of chairperson of the board and the office of managing director or chief executive officer. This practice has not been followed to the same extent in the United States and blurring of the responsibilities between the two positions may have been at the heart of problems that have faced many US companies. Second, the United States has more of a rules-based approach to that adopted in Australia and some other countries. Australia has more of a principles-based approach. Third, Australia has requirements imposed on companies of continuous disclosure whereas the United States has the practice of periodic reporting. In some critical cases this can mean the difference between more timely disclosure and the concealment of information.

(5) According to the Prime Minister, some business people have been guilty of excesses and the responsibility of the Government and business leaders "is to fashion the response that will be effective, that is a response that doesn't do damage to the essentially healthy and ethical character of corporate behaviour in Australia".

(6) The Australian Government has had a major corporate law economic reform program since 1997 focused on principles such as investor protection and disclosure of relevant information. In addition, the Australian Securities and Investments Commission has made a very important contribution to Australia's stable corporate environment.

(7) Australia is very well served by a highly skilled and confident accounting profession. However, it is time for Australia to review its regulatory framework in this area. The report of Professor Ian Ramsay made recommendations to the Government designed to ensure the independence of auditors from the companies they audit. The Government will shortly release a discussion paper which will address issues raised in the Ramsay report together with a number of other issues on financial disclosure.

(8) There is a view in the community that executive remuneration practices adopted by companies are not always appropriate, particularly where there has occurred "some spectacular examples of high remuneration despite poor company performances". The Government has announced that, in the wake of the collapse of One.Tel, it will be amending the Corporations Act to permit liquidators to reclaim payments made by a company in the lead-up to the liquidation. The Corporations Act already contains provisions that permit liquidators to apply to the courts to reverse transactions made by a company while it is insolvent within certain time-limits. The Government is proposing to extend the existing ability of the liquidator to permit the liquidator to apply to reclaim unreasonable payments made to the directors in the four years prior to liquidation, regardless of whether the company is insolvent at the time or not. This proposal would not allow liquidators to reclaim reasonable payments made to directors while the company is solvent.

(9) In relation to executive remuneration, the Prime Minister stated that: "…whenever arrangements which amount to no more than plundering the assets of a company are agreed to or entered into, immense damage is done to the willingness of the general community to support the levels of remuneration that are needed to retain and attract the high quality people needed to run the major companies of Australia".

(K) NYSE APPROVES MEASURES TO STRENGTHEN CORPORATE ACCOUNTABILITY

On 1 August 2002 the New York Stock Exchange's board of directors approved significant changes in its listing standards aimed at helping to restore investor confidence by empowering and ensuring the independence of directors and strengthening corporate-governance practices.

The NYSE board adopted the final recommendations of its Corporate Accountability and Listing Standards (CALS) committee following a two-month comment period in which more than 300 comment letters were received. The Exchange will promptly submit a rule filing to the Securities and Exchange Commission for review.

Following is a list of selected final recommendations of NYSE Corporate Accountability and Listing Standards Committee and a comparison with current rules.

Final Recommendation - Independent directors must comprise a majority of a board. Companies must have a nominating committee, compensation committee (or committees of the company's own denomination with the same responsibilities) and an audit committee, each comprised solely of independent directors. Controlled companies are exempt but must have a minimum three-person audit committee composed entirely of independent directors.

Current Rule(s) - Listed companies must have a minimum three-person audit committee composed solely of independent directors. No requirement for establishment or composition of nominating or compensation committees.

Final Recommendation - Non-management directors must meet without management in regular executive sessions.

Current Rule(s) - No such requirement.

Final Recommendation - For a director to be deemed "independent," the board must affirmatively determine the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company).

Current Rule(s) - Existing definition precludes any relationship with the company that may interfere with the exercise of director's independence from management and the company.

Final Recommendation - Independence also requires a five-year "cooling-off" period for former employees of the listed company, or of its independent auditor; for former employees of any company whose compensation committee includes an officer of the listed company; and for immediate family members of the above.

Current Rule(s) - Cooling-off period is three years and references only former employees of the company. Board of directors can make an exception for one former officer, provided the reason is explained in the next proxy statement.

Final Recommendation - Every listed company must have an internal audit function.

Current Rule(s) - No current requirement.

Final Recommendation - Director's compensation must be the sole remuneration from the listed company for audit-committee members.

Current Rule(s) - No current requirement.

Final Recommendation - Shareholders must be given the opportunity to vote on all stock-option plans, except employment-inducement options, option plans acquired through mergers and tax-qualified plans such as ESOPs and 401(k)s. Brokers may vote customer shares on proposals for such plans only pursuant to customer instructions.

Current Rule(s) - Shareholder approval required of stock-option plans in which officers or directors may participate, but broad-based plans and one-time employment inducements are exempt. Brokers can vote customer shares without instructions as long as the proposal is not contested and the proposal does not cover more than 5 percent of outstanding stock.

Final Recommendation - Listed companies must publish codes of business conduct and ethics, and key committee charters. Waivers for directors or executive officers must be promptly disclosed.

Current Rule(s) - No current requirements.

Final Recommendation - Listed foreign private issuers must disclose any significant ways in which their corporate-governance practices differ from NYSE rules.

Current Rule(s) - No current requirements.

Final Recommendation - Each listed-company's CEO must certify annually that he or she is not aware of any violation by the company of NYSE corporate-governance standards.

Current Rule(s) - No current requirements.

Final Recommendation - The NYSE may issue a public reprimand letter for violation of a corporate-governance standard, in addition to the existing penalty of delisting.

Current Rule(s) - No current provision for a public reprimand.

Final Recommendation - The NYSE urges every listed company to establish an orientation program for new board members.

Current Rule(s) - No such recommendation has been made previously.

Final Recommendation - In conjunction with leading authorities in corporate governance, the NYSE will develop a Directors Institute.

Current Rule(s) - NYSE has generally supported educational initiatives, but this will be the first formalized program designed for directors.

(L) FSA OUTLINES OPTIONS ON ANALYSTS' INVESTMENT RESEARCH

On 31 July 2002 the United Kingdom Financial Services Authority (FSA) published a discussion paper on whether changes should be made to the FSA's regulatory approach to investment research in the UK. The options put forward for discussion range from no change to the current requirements, to new rules, or even a completely new approach under which some research reports would be clearly labelled as advice, promotion or marketing material.

Howard Davies, chairman of the FSA said:

"Our analysis shows that the UK market is different from the US market in a number of ways. In particular there are fewer individuals who invest directly in the UK and might therefore respond to analysts' recommendations and there is far less emphasis here on "star analysts". We also have not had any specific examples of bias and corrupted advice.

"On the other hand, the market here is dominated by the same firms who operate in the US market. And there is some evidence both that analysts' recommendations have been systematically more positive than market performance would justify and, more seriously, that analysts' recommendations in relation to companies with which their parent house has a relationship are systematically more positive than the average. The proportion of 'buy' recommendations made by firms acting as corporate brokers/advisors to the subject company is, at 80%, almost twice as high as the proportion of 'buys' where the analyst does not work for the corporate broker. It is difficult to see how the differential in "buy" recommendations can be justified on any objective grounds.

"The differences between the UK and US markets mean that whilst US-style disclosure requirements coupled with mandatory qualifications for analysts might be one way of dealing with a perceived problem, letting the market find its own solutions, improving consumer education or even completely changing the approach to research are also worth considering. The Discussion Paper on which we are especially interested in comment from investors, both institutional and individual, canvasses all the viable options."

Examples of market-based solutions in the UK include moves by some investment houses to address the imbalance of "buy" and "hold" recommendations. If the FSA were to set disclosure requirements these could include requirements to explain the meanings of the ratings and give the percentage of buy/hold/sell ratings. Research reports could also include more detailed disclosures on any relationship an investment house has which may affect the conclusions of report.

The FSA will use the responses to this paper to assess need for change in the UK. Feedback will also support the FSA's contributions to the work of the Committee of European Securities Regulators (CESR) on the proposed Directive on Market Abuse and to similar work by the International Organisation of Securities Commissions (IOSCO).

Comments should reach the FSA by 30 October 2002.

The FSA's discussion paper 'Investment Research: Conflicts & Other Issues' is available on <http://www.fsa.gov.uk/pubs/>.

(M) MODERNISING THE UK LISTING REGIME

On 30 July 2002 the United Kingdom Financial Services Authority started the process of modernising and simplifying the Listing Rules in the UK.

The Discussion Paper 'Review of the Listing Regime'raises 5 areas of the FSA's Listing Rules which the FSA believes require policy development. The Discussion Paper makes clear that changes to the Listing Rules may not be the only or most appropriate response.

(1) Corporate governance

The rules in this area have moved to centre stage following the collapse of Enron and concerns about the independence of non-executive directors.

(2) Corporate communication

The FSA intends to review the rules covering disclosure of price sensitive information to the market and the publishing of forward-looking information by companies.

(3) Shareholders rights and obligations

The UK is the only European country which provides detailed listing rules to ensure equal treatment for shareholders, for example in relation to major deals. The FSA asks for views on these rules.

(4) Financial information

Issues to be considered include the frequency, quality and timeliness of financial reporting and the independence of auditors.

(5) Sponsors

The UK has formalised the role of professional adviser to listed companies under the sponsor regime. The FSA asks whether this is effective.

The Review will be carried out by a number of teams comprising FSA staff and market participants overseen by a consultative committee representing stakeholders in the London market. The process is modelled on that used successfully for the recent Review of company law. The FSA is also publishing, as an annex to the Discussion Paper, a report commissioned from PricewaterhouseCoopers entitled 'Primary market comparative regulation study' which compares the UK regime with international counterparts. The report concluded that UK primary market regulation is considered generally to be on a par with the United States and superior in the area of corporate governance.

The FSA invites comments by 15 October 2002.

The Discussion Paper is on the FSA website at <http://www.fsa.gov.uk>.

(N) NEW RESEARCH PAPER ON COMPULSORY ACQUISITION OF SECURITIES

The Centre for Corporate Law and Securities Regulation at The University of Melbourne has published a research paper titled "How Section 667C of the Corporations Act Should be Interpreted and its Application to the Various Forms of Compulsory Acquisition".

The author is Allan Bulman who is with the Australian Securities and Investments Commission. Following is a synopsis of the research paper.

Two of the innovations arising from the Corporate Law Economic Reform Program Act 1999 were a new compulsory acquisition power and a statutory definition of fair value in s667C of the Corporations Act. Section 667C has brought to the forefront issues of fairness and valuation of consideration offered under compulsory acquisition.

This paper commences by considering the legislative background behind the new compulsory acquisition power in Part 6A.2 of the Corporations Act and s667C. There is a discussion about the various terminology used in valuing securities and an examination of the major valuation methodologies. There is consideration of the question as to how securities should be valued from a policy point of view for the purposes of compulsory acquisition. To assist in determining this policy question and in considering the application of s667C there is an analysis of valuation cases from the Supreme Court of Delaware.

There is also a consideration as to how s667C should be interpreted and an examination of the cases that have so far considered this provision in detail. In considering these cases, there is a particular consideration as to whether 'special benefits' should be included in determining fair value under s667C.

The paper concludes by considering the 'gravitational pull' of s667C on forms of compulsory acquisition other than Part 6A.2. There is a likelihood that s667C has a broad application to various forms of compulsory acquisition under the Corporations Act which may provide added protection to minority security holders.

This paper reflects the law as at 1 May 2002.

While the author is an employee of the Australian Securities and Investments Commission, the views expressed in this paper are the views of the author alone.

The paper is available on the Centre for Corporate Law website at <http://cclsr.law.unimelb.edu.au/> under "What's New".

(O) NEW STUDY BY PRICEWATERHOUSECOOPERS CALLS FOR A MORE HOLISTIC APPROACH TO RISK MANAGEMENT

Financial services companies should re-evaluate their risk management structures to favour a more practical and holistic approach, according a new study published by PricewaterhouseCoopers and the Economist Intelligence Unit (EIU).

"Taming Uncertainty: Risk Management for the Entire Enterprise" highlights the range of risks facing financial institutions, from high to low probability and from the quantifiable to the intangible. The study also provides an insight into what industry leaders are doing to ensure they understand the risks they face, and to align their risk management strategy with their corporate objectives.

According to the study, a number of factors need to coalesce in order to create the right framework for holistic risk management:

- board level management must seize the risk management agenda and make risk management a strategic priority;  
- management processes need to be set up to ensure that an awareness of risk informs corporate governance, decision-making, external reporting and compensation;  
- the right enablers -the people and systems that facilitate risk management decisions - must be put in place to deliver the information upon which managers can base their decisions.

As part of the study, PricewaterhouseCoopers identified ten attributes of a world-class risk management culture:

(1) An awareness of risk and the need to manage it pervades the enterprise .

(2) Risks are identified, reported and quantified to the greatest possible extent.

(3) Equal attention is paid to both quantifiable and unquantifiable risks.

(4) Risk management is everyone's responsibility and is not fragmented into compartments and silos.

(5) Everyone involved in monitoring risk, even non-financial risk, has a power of veto over new projects they consider too risky.

(6) The enterprise avoids products and businesses it does not understand.

(7) Scenario planning embraces uncertainty and factors all possible developments into decision making.

(8) Risk managers are monitored. Internal audit procedures ensure that systems are running properly and the right results are being reported.

(9) Risk management is recognised as a key contributor to value creation.

(10) The risk culture is defined and enshrined to give managers and employees the requisite freedom of manoeuvre to deliver long-term growth and value.

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(P) FORECASTING UNDER SCRUTINY AS PROFIT WARNINGS INCREASE

According to research by Ernst & Young, despite a relatively robust economy, Australian companies continue to report a growing number of profit warnings. Australian listed companies issued 88 profit warnings in the half year to 30 June 2002, 10 percent higher than the number of warnings in the previous half (81). The number of profit warnings in the latest half year period is the highest ever recorded by Ernst & Young and was higher than anticipated.

Profit warnings in the latest period came from companies in the Manufacturing industry (21) followed by companies in the Technology industry (19), then both the Finance (8) and Mining industries (8). The biggest decline in profit warnings came from the Telecommunications sector. Another interesting finding was the share price of companies reporting profit warnings in this half year period fell by an average of 15 per cent 24 hours after the warning was announced.

Ernst & Young believes the number of profit warnings reported in the latest half raises two important issues that should be addressed both by directors and shareholders. The first issue is the continuing evidence of optimistic forecasting means that companies need to be prepared to provide more detail to the market on the assumptions underpinning profit forecasts. The second factor is that it appears some companies and stakeholders continue to underestimate the forces of competition at the industry level.

To obtain a full copy of the report please email Yvonne Deans at yvonne.deans@ernstyoung.com.au

(Q) STUDY REVEALS CEO JOB SECURITY IS DECLINING GLOBALLY

Chief executive turnover is accelerating in the US and globally according to a survey of the 2,500 largest publicly traded corporations released by management and technology consulting firm Booz Allen Hamilton. Globally, the study paints a dramatic picture of growing shareholder impatience and board activism - not just in North America, but particularly in Europe, where the pace of forced CEO departure has greatly accelerated.

The study, published in the July issue of Strategy+Business magazine, examines the linkages between CEO tenure and corporate performance, comparing CEO turnover in major regions and in specific industry sectors. Among the key findings:

- Turnover of CEOs at major corporations increased by 53% between 1995 and 2001  
- During the same period, the number of CEOs departing because of their company's poor financial performance increased by 130%  
- Average tenure as a CEO declined from 9.5 years in 1995 to 7.3 years in 2001  
- Turnover among European CEOs is increasing twice as fast as turnover in North America  
- European CEOs are more likely to be removed for poor job performance than North American CEOs - 34% of the departures in Europe compared with 22% in North America  
- CEOs are entering and departing office at a younger age; in the West, the average CEO rises to office before his or her 50th birthday  
- CEOs have the longest tenure in the financial services industry, at more than 10 years on average; they are least safe in telecommunications services, where their tenure averages only four years.

The frequency of CEO turnover will continue to grow, the Booz Allen study concludes, because of shareholder-value pressures; the demonstrable drop-off in company performance during the second half of CEO tenures; and the growing pool of experienced former CEOs available to run companies.

(1) Key study findings

(a) The CEO "Revolving Door": The frequency of CEO "succession events," (eg, the departure of one CEO and the accession of another) nearly doubled, from 6% of the largest 2,500 global companies per year in 1995 to 11.2% in 2000. Although the number dipped in 2001, the frequency of succession is still more than 50% higher than in 1995. In the Asia/Pacific region, the number of transitions were essentially constant from 1995 through 2000.

(b) Quick Trigger Finger on Failure: The firing of poorly performing CEOs increased 114% from 1995 to 2000. In Europe, performance-related departures accounted for 34% of all successions in 2000 and 2001, well outpacing North America (22%).

(c) Short Leash for Poor Performers: When CEOs are dismissed for performance issues, their tenure is 5.4 years on average. CEOs terminated for performance reasons last 5.6 years in North America, while their European counterparts actually have a shorter span - 4.8 years on average.

(d) Youth is Served: CEOs are entering and departing office at younger ages. In North America in 1995, the average starting age of CEOs was 50.4; in 2001 it was 48.8. In Europe, the average starting age of CEOs was 52.3 in 1995; 49.4 in 2001. The exception to the rule is found in Asia, where the average starting age of CEOs was 57.0 in 1995; 60.4 in 2001.

(e) The Stock Market is the Market that Matters: There is a clear connection between a company's shareholder returns and a CEO's survival in North America and Europe. The difference between the shareholder returns of companies where the CEO is removed for performance and where the CEO achieves a regular transition is large, significant, and increasing in both North America and Europe. In Asia/Pacific, "performance" wasn't about returns to shareholders but rather about the rate of net income growth.

(f) Worse Over Time?: No matter their length of tenure or reason for departure, European and North American CEOs performed better for their shareholders in the first half of their tenures than in the second half. For CEOs whose tenures lasted 0-5 years, the median returns to shareholders relative to a broad index of publicly traded stocks were 2.7 percentage points per year worse than the index for the first half of tenure and 16.7 points worse during the second half. For CEOs whose tenures lasted 5-10 years, the median returns to shareholders normalized to the market index were 3.7% during the first half of their tenures, and dropped to -6% during the second half. For CEOs whose tenures were 10 years or greater, the normalized median returns were 5.9% during the first half of tenure and -0.9% in the second half of tenure.

(2) Industry-specific findings

(a) Most CEO Turnovers: The industries that saw the highest rates of CEO turnover were telecommunications services, followed by energy, and information technology. Lowest rates were among materials, utilities, and financial services.

(b) Average CEO Tenure: CEO tenure is longest in financial services (10.3 years) and energy (10.2 years), and shortest in utilities (7.3 years) and telecommunications services (4.0 years). The four year tenure of CEOs in telecommunications services is less than half the average tenure of CEOs in all industries.

(c) Average CEO Age at Accession: CEOs in the information technology (45.2 years) and telecommunications services (45.7) are amongst the youngest, whereas CEOs in the materials (53.7 years) and utilities (52.5) sectors are among the oldest. Across industries, the average CEO is 50 years on accession.

(3) Methodology

Booz Allen studied the 231 CEOs of the world's 2,500 publicly-traded corporations who left office in 2001, and evaluated both the performance of their companies and the events surrounding their departure. To provide historical context, Booz Allen evaluated and the compared this data to information on CEO departures for 1995, 1998 and 2000.

For purposes of the study, Booz Allen classified each CEO departure as either:

(a) Merger-driven, in which a CEO's job was eliminated when the CEO of the other company involved in the merger or acquisition assumed control of the enterprise.

(b) Performance-related, where the CEO was asked to leave by the Board of Directors or there was significant speculation in the business press that performance was the driver of the change, or where the CEO cited job stress as the reason for his or her resignation.

(c) Regular transition, in which the CEO retired on a long-planned schedule, died in office or left to become the CEO of another company.

2. RECENT ASIC DEVELOPMENTS

(A) ASIC UPDATES 'TRUTH IN TAKEOVERS' POLICY

On 22 August 2002 ASIC released an update of Policy Statement 25 on misleading statements in takeovers. The updated Policy Statement is part of a move by the Commission to raise standards of conduct in the market.

The policy statement focuses on 'last and final statements'. These are statements by a bidder, target or substantial holder (market participant) that it will or will not do something in the course of the bid. They are generally designed to influence the actions of target holders. For example, a bidder may say that it will not increase the price it offers for shares under the bid - its offer is final.

The updates to Policy Statement 25 confirm that ASIC will hold a market participant to its last and final statement.

'Bidders or targets often make last and final statements to induce holders into accepting or rejecting an offer. It is only if this tactic fails that the bidder or target may seek to depart from its statement. We expect people to honour statements they make in the market' , ASIC Director Corporate Finance, Richard Cockburn said.

'Bidders and targets may reserve the right to change their minds, however they must clearly state their intention to ensure that investors are not misled', Mr Cockburn said.

The market participant may reserve the right to depart from its statement by attaching a clear qualification. For example, a bidder may say: 'We do not presently intend to raise our bid price, but we reserve the right to do so'.

ASIC has finalised Policy Statement 25 following public comment on a consultation draft released in March 2002. The document also discusses correcting or updating statements using supplementary bidder or target statements.

Copies of the updated Policy Statement 25 can be obtained from ASIC's website at <http://www.asic.gov.au>.

(B) ASIC TO RELEASE DISCUSSION PAPER ON SOCIALLY RESPONSIBLE INVESTING DISCLOSURE OBLIGATIONS

On 31 July 2002 ASIC announced that it would issue a Discussion Paper later this year on possible guidelines for Socially Responsible Investing (SRI) disclosure.

The announcement was made at a forum on Finance and Sustainability hosted by Environment Australia and the Environment Protection Authority of Victoria. 'Any guidelines would aim to help ensure that consumers can choose a product which most closely matches their SRI investment objectives', said ASIC's Deputy Executive Director for Consumer Protection, Ms Delia Rickard. 'They would also aim to provide industry with greater certainty about meeting the disclosure requirements', she said.

'ASIC will not be seeking to prescribe the labour standards or environmental, social or ethical considerations of which SRI products should take account, nor the screening or other processes used by such funds', Ms Rickard said.

ASIC will seek broad consultation on the Discussion Paper, and will include a minimum of six weeks to receive submissions. No final decision will be made on whether or not to proceed with Guidelines until the consultation process is completed.

The recent reforms introduced by the Financial Services Reform Act included a requirement for investment products to disclose in their Product Disclosure Statements, the extent to which they take labour standards, and environmental, social and ethical considerations into account in the selection, retention or realisation of the investment.

The reforms also included a power for ASIC to make guidelines about disclosure in these areas, including a requirement that investment products comply with these guidelines.

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3. RECENT ASX DEVELOPMENTS

(A) ASX CONVENES CORPORATE GOVERNANCE COUNCIL

On 1 August 2002 Mr Richard Humphry, Managing Director and CEO of ASX, announced that the ASX would convene a Corporate Governance Council.

The Council will aim to develop an agreed set of corporate governance standards of best practice for Australian listed companies.

The Council will build on and complement the work of the industry Corporate Governance Roundtable - convened by ASIC - of which ASX is a member.

The ASX envisages that the conclusions of the Council will be made available for comment by the Corporate Governance Roundtable, the Financial Reporting Council, the Commonwealth Treasury and other interested parties.

Standards developed by the Council will be issued as a co-branded statement by all parties involved in their development, and as such would carry a strong endorsement of expected practice by companies.

Further, ASX will enhance current Listing Rule disclosure requirements where appropriate to ensure that listed companies fully report to the market and shareholders on their adherence to these standards.

The Council held its first meeting on 15 August 2002. For a summary of the Council's conclusions at this meeting see [Item 1(B)](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0060.htm#1.corporategovernancecouncil) of this Bulletin.

4. RECENT TAKEOVERS PANEL MATTERS

(A) PANEL RELEASES FINAL GUIDANCE NOTE ON COSTS ORDERS

On 19 August 2002 the Takeovers Panel advised that it had released a Guidance Note on the Panel's powers to make costs orders in Panel proceedings. The final version follows public consultation on a draft that the Panel released in January 2002.

The final Guidance Note is based on the Panel's underlying policy that:

- costs orders are made infrequently by the Panel, reflecting its function to resolve disputes expeditiously and informally;  
- the Panel has the power to accept written undertakings to pay costs ; and  
- costs will generally be limited to those actually, necessarily, properly and reasonably incurred in the course of proceedings before the Panel;

and the condition in section 657D(2 ) of the Corporations Act that the Panel may only make a costs order after it has made a declaration of unacceptable circumstances.

The Panel has also published on the Panel's website a paper that provides details of the Costs Sub-Committee's response to public submissions to the consultation draft. This document is on the Panel's website under the new "Consultation" tab, which is where the Panel will publish Consultation Drafts and Public Consultation Response Statements in the future.

The Costs Guidance Note and the Public Consultation Response are available at:

<http://www.takeovers.gov.au/Content/guidance/costs_orders.asp>  
<http://www.takeovers.gov.au/Content/consultation/costorders_response.asp>

(B) TAKEOVERS PANEL ACCEPTS UNDERTAKING BY PLACER DOME TO VARY BROKER INDUCEMENT FEE

On 6 August 2002 the Takeovers Panel advised that it had accepted an undertaking offered by Placer Dome Asia Pacific Limited (Placer Dome) in relation to the broker inducement fee which Placer Dome announced on 29 July 2002 under its takeover offers for AurionGold Limited.

The Panel had concerns that the size of the fee offered by Placer Dome had the possibility of inducing brokers to place undue, and possibly coercive, pressure on their clients to accept the Placer Dome offer.

Placer Dome has undertaken to vary the broker inducement fee to 0.75% of the value of the consideration payable to an accepting shareholder, up to a maximum of $750. Acceptances placed up to 1.30 pm on 6 August 2002 would be paid the originally announced fee. The Panel understands that this applies to something less than 1% of the total shares in AurionGold.

As a result of the undertaking the Panel decided that its concerns relating to the broker inducement fee had been addressed.

On this basis, the Panel decided not to commence proceedings in relation to the application by AurionGold dated Monday 5 August 2002.

The sitting Panel for the application was Marie McDonald (sitting President), Simon Mordant (sitting Deputy President) and Elizabeth Alexander AM.

5. RECENT CORPORATE LAW DECISIONS

(A) LODGING FINANCIAL REPORTS - "UNREASONABLE BURDEN"?  
(Robin Forster, [Blake Dawson Waldron](http://www.bdw.com.au))

"SRKKK" and "SRNNN" v Australian Securities and Investments Commission [2002] AATA 584, Administrative Appeals Tribunal, Mr R P Handley, 16 July 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/aata/2002/july/2002aata584.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

Pursuant to section 292(1) of the Corporations Act 2001 ("Act"), all large proprietary companies must prepare an annual financial report and directors report ("Reports"). Reports must be lodged with ASIC in accordance with section 319(1) of Part 2M.3 of the Act ("Audit Requirements").

SRKKK and SRNNN ("Applicants"), both anticipating a future change in company type from small proprietary to large proprietary within the meaning of section 45A(3) of the Act, applied to ASIC for a specific exemption order under section 340(1) relieving them from complying with the Audit Requirements. Relying on section 342(1)(c) of the Act, the Applicants contended that compliance would impose "unreasonable burdens".

ASIC refused the application. The Applicants sought review of the decision by the Administrative Appeals Tribunal ("Tribunal").

(2) The meaning of "unreasonable burden"

In deciding whether the Audit Requirements imposed "unreasonable burdens" on a company, the Tribunal noted that regard must be had to the factors set out in subsections 342(2) and (3) of the Act. These include the expected costs and benefits of compliance, any practical difficulties in compliance, any unusual aspects of a company's operations during the particular financial year, and any other relevant matters.

The Tribunal adopted Heerey J's interpretation of "unreasonable burden" in Incat Australia Pty Ltd v Australian Securities and Investments Commission [2000] FCA 58. The test is essentially one of fact requiring an evaluation of the evidence. The decision maker must take into account the public policy objective of the Act that companies of economic significance lodge accounts and the extent of the economic detriment (if any) likely to flow to the company as a result of compliance. In light of Re Incat (supra), the Tribunal warned that ASIC Policy Statement No 43 which equated the word "unreasonable" with "overwhelming" must be read with care.

(3) Grounds for relief

(a) Trading strategy exposed?

The Applicants argued that the Audit Requirements would publicly expose their trading strategy and scale of trading, jeopardising the Applicants' trading profitability in a competitive market.

The Tribunal noted that a company's accounts are historical documents recording its activities in past financial years. While disclosure may reveal trading volume and strategies, other trading entities of similar size will also be subject to similar accounting disclosure requirements. On this basis, the Tribunal was not satisfied that the Applicants would suffer a significant detriment in complying with the Audit Requirements.

(b) Private information revealed?

The Applicants argued that private information concerning their business and, in particular, the Applicants' sole director Mr Mitchell and his family, would be revealed to their detriment.

The Tribunal dismissed this argument, regarding disclosure of private information as an "incidental cost" of using particular corporate structures to conduct business or financial activities. The Tribunal held that the public policy objective underpinning the Audit Requirements and overall regulatory regime outweigh the competing interests of small companies and their proprietors in keeping their affairs private. Emphasis was placed on the importance of the Audit Requirements in both facilitating the oversight of companies by regulatory bodies and ensuring the availability of useful information to those conducting business or in contractual relationships with such companies.

(4) Finding

The Tribunal held that any detriment flowing to the Applicants was outweighed by the policy objective of the Act. The burden of compliance was therefore not so unreasonable in the circumstances as to justify the exercise of ASIC's discretion to grant relief under section 340(1) of the Act. The Tribunal affirmed ASIC's decision of 7 August 2001.

(5) Non-reporting entities

The Tribunal refused to make any determination on the parties' further submissions as to whether the Applicants, if large proprietary companies, could be classified as "non-reporting entities". The Tribunal did note that, even if such determination was adverse to the Applicants, it would not have affected the Tribunal's decision.

(B) POWER OF DETENTION TO ASSIST ASIC INVESTIGATION  
(Rebecca Preston, [Blake Dawson Waldron](http://www.bdw.com.au))

ASIC v Mauer-Swiss Securities Ltd [2002] NSWSC 684, Supreme Court of New South Wales, Palmer J, 2 August 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/august/2002nswsc684.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

An urgent application was made by ASIC for ex parte orders against the defendants, including an order under section 1323(1)(k) of the Corporations Act ("the Act") prohibiting the second defendant, Mr Goldman, from leaving Australia without the consent of the Court. At the time of the application, the investigations of ASIC were at an early stage.

(2) Facts

In 2000, a large number of Australian investors purchased shares in a Canadian company, Orbit E-Commerce Inc ("OECI"), which did not issue a prospectus in Australia. The shares were not listed on any stock exchange and it was only upon receipt of the share certificates that the investors were informed that there were restrictions on the sale of the shares purchased. The share price plummeted and the Australian investors were unable to sell the shares because of the applicable transfer restrictions.

On 25 October 2001 a wholly-owned subsidiary of OECI announced in a press release on its website that OECI was in the process of raising USD 16,000,000 in new equity capital and that MSS, a company incorporated in New Zealand, would sell OECI shares to its "retail and institutional" clients. MSS was created on 5 January 2001 and all of its issued share capital was held by Mr Mauerberger. Mr Goldman replaced Mr Mauerberger on 18 May 2001 as the sole director of MSS though, in reality, he acted under the instruction of Mr Mauerberger. MSS had never held financial services licenses and therefore was never entitled to sell shares to retail and institutional clients. Furthermore, the impression created by the press release that MSS was a well established business was completely false.

A second press release was issued on 7 November 2001 by OECI on its website informing readers that a company, Orbit Investor Relations Pty Limited ("OIR") had been appointed by OECI to answer any shareholder enquiries and to manage company communications in Australia. The press release stated that OIR staff had an understanding of the business and issues facing OECI, whereas, in reality, OIR staff were mere telephone operators and OIR had been established for the purpose of "fobbing off" enquiries from increasing numbers of concerned OECI investors.

It appears that callers to OIR were informed that MSS might be able to sell their OECI shares. At least one Australian investor was called by Mr Goldman himself who said that the transfer restrictions could be lifted if the investor became a client of MSS and when the sale of shares was effected, MSS would deduct a commission which would be lower if the client was a client of MSS. This call took place in April 2002. Approximately five months before the call was made, ASIC sent an e-mail to MSS advising it that it did not have a securities industry license in Australia and therefore must not carry on a business dealing in securities. In response to this e-mail, Messrs Mauerberger and Goldman independently notified ASIC that OECI's press release was unauthorised by MSS and that MSS would not offer OECI shares in Australia.

Nevertheless, both Mr Goldman and Mr Mauerberger, on a number of occasions, approached Australian residents directly for the purpose of inducing them to authorise MSS to sell their OECI shares and invest the proceeds, as well as additional money, in other investment schemes promoted by MSS. In one case, MSS not only invested the proceeds of sale of OECI shares against the express written instructions of an investor, but required the investor to provide additional funds for the balance of the acquisition price.

(3) Issues

ASIC issued a notice under section 33 of the ASIC Act to produce certain books and records for the purpose of identifying those persons in Australia with whom Mr Goldman and MSS had dealings which could constitute the carrying on of a financial services business in Australia.

Mr Goldman told ASIC that he had no such documents with him and, further, that there was no power to compel their production given that MSS is not a company registered in Australia. Mr Goldman offered to return to Australia at a later date to assist ASIC in its investigation if required, however he did not offer any security for his return, contrary to the Court's suggestion. His offer of return was regarded as worthless by Palmer J.

ASIC wished to keep Mr Goldman in Australia so that it could procure the necessary documentation with his assistance and further examine him on the content. ASIC argued that pursuant to section 1323(1) of the Act, such action was desirable for the purpose of protecting the interests of "aggrieved persons". It was argued on behalf of Mr Goldman, however, that the detention of a person in Australia for the purpose of enabling or assisting ASIC to carry out an investigation was not within the scope of section 1323 of the Act. The powers conferred are for the purpose of protecting aggrieved persons ie the investors, not for the purpose of assisting ASIC as ASIC cannot be described as an "aggrieved person". The only actual or potential claim by an aggrieved person against Mr Goldman or MSS that has been identified by ASIC is a claim for about USD12,000 which does not warrant detention.

(4) Findings

The argument that section 1323 of the Act could not be used for the purposes of assisting ASIC in its investigations was held to be without substance. The words in section 1323(1) "protecting the interests" of an aggrieved person are wide and deliberately so. Where the Court determines the interests of aggrieved persons are or may be prejudicially affected, it will be for the Court to decide what protection within the parameters of section 1323 should be given.

There are times when orders to preserve assets will be sufficient and there will be no need to detain a person in Australia. However, in other situations, there may be evidence to suggest a large scale fraud where many of the victims have no or little information about the fraud and no or little means for their own investigations or prosecutions. In such circumstances, the interests of such people are protected, within the meaning of section 1323, by enabling ASIC to conduct an investigation for the purpose of identifying the wrongdoers and exposing them to penalties under legislation and compensation for the victims.

In this case, the order for detention in Australia for the purpose of assisting ASIC's investigation was considered desirable for the purpose of protecting the interests of persons in Australia to whom Mr Goldman is, or may become, liable. It was accepted that such a decision must not be taken lightly but, at the same time, given the strong prima facie evidence of a wide scale fraud perpetrated by a foreign national whose return to Australia to submit to investigation was dubious, the court should exercise its discretion to detain the second defendant in Australia.

(C) OPPRESSIVE CONDUCT: COLLATERAL USE OF DERIVATIVE ACTIONS  
(By Sam Cottell, [Clayton Utz](http://www.claytonutz.com))

Goozee v Graphic World Group Holdings Pty Ltd [2002] NSWSC 640, Supreme Court of New South Wales, Barrett J, 25 July 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/july/2002nswsc640.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

Mr and Mrs Goozee (the "Goozees") were shareholders in Graphic World Group Holdings Pty Ltd ("Graphic"). Between them, the Goozees held 16.81% of the shares in Graphic. The remaining shares in Graphic were held by Mr Hoolahan ("Hoolahan") (69.86%) and Mr Thomas ("Thomas") (13.33%). Mr Goozee was a director of Graphic until approximately 3 May 2002. Thereafter, Hoolahan, Thomas and a Mr Parker (a non-shareholder) comprised the remaining directors of Graphic. Hoolahan was the managing director of Graphic and also acted as its chairman.

Graphic and its subsidiaries (of which there were 10) operated as a group (the "Graphic Group") and carried on a profitable business in the printing industry. Mr Goozee was employed as a sales officer by one of the subsidiaries, namely, Pyomon Pty Limited ("Pyomon").

(2) The oppression

In separate proceedings, the Goozees alleged, amongst other things, that the affairs of Graphic (being the relevant company in which the Goozees were direct shareholders) were being conducted in a manner which was oppressive or unfairly prejudicial to or unfairly discriminatory against the Goozees, or in a manner which was contrary to the interests of the members of Graphic as a whole. In those separate proceedings, the Goozees sought an order under section 233(1)(a) of the Corporations Act 2001 (C'th) (the "Act") that all of the companies comprising the Graphic Group be wound up.

The principle contention of the Goozees was Graphic's practice of not declaring any dividends. In fact, the Goozees had never received a dividend since the Graphic Group commenced business in approximately 1973. Additionally, whilst Mr Goozee received a salary as an employee of Pyomon, he did not receive any discretionary distributions from "employee bonus pools" which were created by Pyomon in 2000 ($300,000) and 2001 ($300,000). Furthermore, despite the Graphic Group earning significant profits, the Goozees alleged that these profits had not been reinvested in the printing business, but had instead been invested and held in term deposits. In short, the Goozees contended that Hoolahan was conducting the affairs of the Graphic Group in such a way so as to effectively neuter the Goozees' rights as a shareholder to receive a return on their shares by way of dividends. The relationship between the Goozees and Hoolahan became particularly acrimonious following unsuccessful negotiations in relation to the possibility of the Goozees selling their shareholdings in Graphic to Hoolahan.

(3) The derivative proceedings

In addition to the separate oppression proceedings brought by the Goozees in their own right, the Goozees sought leave under section 237 of the Act to commence derivative proceedings on behalf of Graphic and each immediate holding company within the Graphic Group. The derivative proceedings sought to be brought were identical to the separate oppression proceedings brought by the Goozees in their own right in respect of the non-payment of dividends. In other words, the Goozees sought to initiate proceedings on behalf of the relevant Graphic Group companies on the basis that the non-payment of dividends by their respective direct subsidiaries constituted conduct which was oppressive, unfairly prejudicial or unfairly discriminatory to them or was contrary to the interests of the respective direct subsidiaries' members as a whole. In each case, the relief sought in respect of the derivative proceedings was an order under section 233(1)(a) that the respective direct subsidiaries be wound up.

(4) Summary

The Court dismissed the Goozees' application for leave to commence derivative proceedings. Whilst the Goozees were not shareholders of the relevant immediate holding companies in respect of which they sought to initiate derivative proceedings, the Court nevertheless held that the Goozees had standing to apply for the leave sought. However, the Court held that the Goozee's were acting for a collateral purpose and hence were not acting in good faith. The Court also held that it was not in the best interests of each immediate holding company that the derivative proceedings be allowed. Additionally, the Court held that there was no serious question to be tried. Hence, the criteria for leave contained in section 237(2) had not been satisfied.

In general, the case indicates that the ability to bring derivative proceedings is likely to be limited in the context of an oppression dispute within a corporate group.

(5) Standing

As noted above, the Goozees were only direct shareholders in Graphic. They were not members of any other Graphic Group companies. In this regard, the Court referred to section 236 of the Act which prescribes who may bring derivative proceedings on behalf of a company. The Court held that the Goozees had standing by reason of section 236(1)(a)(i) of the Act. This conclusion flowed from the fact that the Goozees were members of Graphic (the ultimate holding company in respect of the Graphic Group) and were therefore, in relation to each other company within the Graphic Group, members of a "related body corporate".

(6) The section 237 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:

- Inaction by the company: it is probable that the company will not itself bring the proceedings (section 237(2)(a)) - this criteria was readily satisfied and is not discussed in this casenote;  
- Good faith: the applicant is acting in good faith (section 237(2)(b));  
- Best interests: it is in the best interests of the company that the applicant be granted leave (section 237(2)(c)); and  
- Serious question: there is a serious question to be tried (section 237(2)(d)).

The Court considered that it could only grant leave if all of these criteria were satisfied.

Rather than considering each of the criteria in the order in which they appear in section 237, the Court first examined whether there was a serious question to be tried.

(7) Serious question to be tried?

For the purposes of section 237, the test of whether there is a serious question to be tried is the same as that which is applicable to applications for interlocutory injunctions. This involves an assessment of whether there was any infringement of legal or equitable rights or the commission of some legal or equitable wrong (Australian Broadcasting Corp v Lenah Game Meats Pty Ltd (2001) 76 ALJR 1). In relation to the Goozees' application for leave, the test in effect required an assessment of each immediate holding company's likelihood of obtaining the winding up relief sought under section 232.

This assessment was made difficult because the Goozees did not put forward evidence in relation to each respective subsidiary's affairs in relation to each relevant immediate holding company. Rather, the evidence put forward by the Goozees focused exclusively on the affairs of the Graphic Group as a whole.

The Court also considered it possible, although somewhat unrealistic, that a sole member of a company, such as each of the immediate holding companies in relation to each of their wholly-owned respective subsidiaries, could be the "victim" of conduct within section 232. This view flowed from the ability of the sole member to cause the wholly-owned subsidiary to act in any way whatsoever that the sole member might lawfully require. If that caused harm to the sole member, then it only has itself to blame. Nevertheless, the Court considered that the purpose of section 232 is to prescribe statutory norms of conduct which, if departed from, will vest a cause of action. The Court further considered that these norms of conduct have a wholly objective content and exist independently of the identity and will of the totality of the shareholders or the sole shareholder.

The Court then proceeded to examine whether the failure to declare dividends amounted to a departure from the norms of conduct required by section 232. Prima facie, a failure to declare dividends is not sufficient to vest an action under section 232. However, such a failure may be actionable if it is the result of an improperly exercised commercial judgement. This in turn requires an assessment of the relevant company's history, policies, financial position and the general and economic surrounding circumstances. In the present case, the evidence before the Court in relation to profits and retained earnings etc related to the profits and retained earnings of the consolidated Graphic Group. In the absence of such information on an individual company basis, the Court considered it impossible to determine whether the failure to declare dividends was the result of an improperly exercised commercial judgement. Hence the Goozees were unable to establish that there was a serious question to be tried under section 232. Accordingly, the criteria in section 237(2)(d) was not satisfied and leave was refused.

Having reached that conclusion, the Court nevertheless proceeded to examine whether any of the other section 237 criteria were satisfied.

(8) Good faith?

The Court considered this criteria by reference to the two interrelated factors identified by Palmer J in Swansson v Pratt [2002] NSWSC 583 (3 July 2002):

- does the applicant honestly and reasonably believe that a good cause of action exists and has a reasonable prospect of success?  
- is the applicant seeking to bring the derivative action for such a collateral purpose as would amount to an abuse of process?

The Court considered that the first factor was not satisfied. This was due to the Court's finding that there was no serious question to be tried.

In relation to the second factor, the Court considered that the Goozees were acting for a collateral purpose which amounted to an abuse of process. Essentially, the Court looked through the derivative proceedings and viewed them for what they really were - a "pressure tactic" designed to enhance the possibility of dividends being paid or requiring Hoolahan to buy out the Goozees at a fair market value. In fact, the Court was satisfied that the Goozees did not intend to pursue the derivative proceedings to their conclusion, even if leave was granted. Rather, the Court viewed the derivative proceedings as a no more than a means of seeking to persuade the other shareholders (primarily Hoolahan) to procure dividend payments or otherwise buy out the Goozees. Hence, the Court considered that derivative proceedings were "foreign" to the attainment of the Goozees' real purposes. In other words, the proper and logical course open to the Goozees was to pursue the separate oppression proceedings rather than commence derivative proceedings.

(9) Best interests of the company?

The Court found that it was not in the best interests of each immediate holding company for their respective subsidiaries to be wound up, as this would effectively put an end to the business of the Graphic Group which was in good financial condition and trading profitably. In this regard, the "best interests" to be considered are those of the immediate holding company; not the Graphic Group as a whole. Hence, it was not possible to conclude that the derivative proceedings were in the best interests of each immediate holding company.

(D) DERIVATIVE ACTIONS IN THE CONTEXT OF A FAILED JOINT VENTURE  
(By Helen Lou, [Clayton Utz](http://www.claytonutz.com))

Metyor Inc v Queensland Electronic Switching P/L [2002] QCA 269, Supreme Court of Queensland, Court of Appeal, 30 July 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/qld/2002/july/2002qca269.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Facts

The plaintiffs (Metyor Inc ("Metyor") and Saracen Financial Services Limited ("Saracen")) are 2 members who each own 22.55% of the shares in a joint venture company conveniently referred to as JV Co. They are appealing from a decision of a Supreme Court Judge given on 7 July 2002 which refused their application for leave under section 236 of the Corporations Act 2001 (Cth) ("Act") to bring derivative proceedings on behalf of JV Co. The derivative proceedings sought to be brought were against the other members of JV Co who, together with Metyor and Saracen, were parties to a Subscription and Shareholders Agreement dated 21 March 2000 ("Contract"). In particular, Metyor and Saracen sought to join JV Co as a co-defendant in existing proceedings brought by Metyor and Saracen in respect of the Contract against the other members of JV Co.

The Contract provided that JV Co would be the medium for implementing a joint venture for the supply of various services, technology and equipment comprising automatic teller machines for use in the operations of the Bank of Queensland Limited (the "Bank"). Apart from Metyor and Saracen, JV Co's share capital was held by the Bank or its wholly owned subsidiary Queensland Electronic Switching Pty Ltd ("QES") as to 49.9% and Compaq Computer Australia Pty Ltd ("Compaq") as to 5% (the "defendants"). The Contract, to which JV Co was also a party, was subject to four express conditions subsequent, namely:

- the adoption of a business plan on terms satisfactory to the parties;  
- the adoption of a budget on terms satisfactory to them;  
- JV Co obtaining funding on terms satisfactory to the parties; and  
- the Bank and QES obtaining all necessary regulatory approvals in respect of their obligations under the contract also on terms satisfactory to the parties.

It was alleged by the plaintiffs that for commercial reasons of their own, and in breach of their express and implied duties in the Contract, the Bank and QES decided in early September 2000 to rid themselves of the Contract and their obligations under it. It was further alleged that the defendants repudiated the Contract by either preventing fulfilment of the above conditions subsequent or by acting in bad faith. As a result, the plaintiffs sought leave to join JV Co as a co-defendant in their action through a derivative action.

(2) Summary

The Court held that the plaintiffs were entitled to be given leave under section 237 of the Act to bring proceedings on behalf of JV Co against the defendants by joining JV Co in that action as a co-defendant. The Court found the plaintiffs satisfied the criteria for a derivative action as contained in section 237(2) of the Act.

The case is noteworthy because of the strong sentiments expressed by the Court in favour of allowing derivative actions in the context of a failed joint venture, particularly in circumstances where the relevant joint venture company is itself a party to the relevant joint venture agreement.

(3) Analysis of judgment

Section 236(1)(a) of the Act enables various persons (not only members) to bring proceedings on behalf of a company if the relevant person is acting with leave under section 237 of the Act. Apart from a 14 days' notice requirement, section 237 contains 4 criteria that must be satisfied before a Court will grant leave in relation to an application to commence derivative proceedings:

- Inaction by the company: it is probable that the company will not itself bring the proceedings (section 237(2)(a));  
- Good faith: the applicant is acting in good faith (section 237(2)(b));  
- Best interests: it is in the best interests of the company that the applicant be granted leave (section 237(2)(c)); and  
- Serious question: there is a serious question to be tried (section 237(2)(d)).

The Court considered that it would only grant leave if all of the above criteria were satisfied. Without providing any detailed reasons, the Court held that sections 237(2)(a) and (d) were easily met by the plaintiffs. Hence, the Court focussed on the analysis of what was required by the criteria contained in section 237(2)(b) and (c), but with a focus upon the latter requirement.

(a) Section 237(2)(b) of the Act - acting in good faith

The Court held that the plaintiffs were acting in good faith in making the application for leave to proceed on behalf of JV Co pursuant to section 237(2)(b) of the Act. An earlier leave application by the plaintiffs had been denied by the judge at first instance, as that judge found that the plaintiffs were acting for their own benefit rather than the benefit of the joint venture company. This was on the basis that the plaintiffs were seeking an order of specific performance of the contract in their own right and interest alone. Since that initial application was heard, the plaintiffs abandoned their claim to specific performance and amended their statement of claim to make it clear that if the derivative proceedings were ultimately successful in recovering damages which included damages for breach of contract in right of JV Co, then JV Co (not the plaintiffs) would be entitled to those damages to the extent that the damages awarded were referable to a violation of JV Co's contractual rights. Hence the plaintiffs were found to be making this application in good faith.

Interestingly, the Court did not consider the factors with respect to assessing good faith in the context of section 237, as identified by Palmer J in Swansson v Pratt [2002] NSWSC 583, 20 June 2002.

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

The Court rejected the defendants' proposition that in order for an application for leave to bring proceedings on behalf of a company to be successful, disputes between members must be resolved before such leave is granted. The Court considered that it would defeat the very purpose which the statutory provisions for leave to seek a derivative action were designed to serve if this proposition were to be accepted. The substance of the plaintiffs' complaint was that the defendant majority shareholders were denying JV Co its rights by having refused to perform their obligations under the Contract, or by having failed to institute legal proceedings on behalf of JV Co to enforce its rights. If the existing action proceeded without JV Co being a party to it, then JV Co would not be bound by the result of the proceedings regardless of whether the result is in or against JV Co's favour. Deferring the question of leave until the dispute between the shareholders is resolved therefore serves only to prejudice the best interests of JV Co and would only result in JV Co not receiving the benefit of any judgment that might otherwise go in its favour.

It was emphasised that this case scenario is exactly what sections 236 and 237 of the Act were designed for; the classic situation in which a derivative action should be granted is when there are 2 conflicting shareholder groups, and the minority is unable to set the company in motion to establish their rights, as the majority shareholders oppose the company doing so.  
The concept that one needs to have in mind a cost benefit analysis of possible outcomes of the prospective litigation in determining what is in the "best interests" of the company, pursuant to section 237(2)(c) of the Act, was clearly rejected by the Court. It held that this concept would result in assessments that would be almost impossible to make with any degree of confidence or accuracy.

In the current factual scenario, it would be the plaintiffs personally, and not JV Co, who will bear the costs associated with defeat in failing to establish that the defendants had deliberately set out to frustrate the Contract which would have led to a successful trading venture for JV Co. Yet, JV Co will reap the benefits should the plaintiffs ultimately win the case. As a result, the plaintiffs were found to have satisfied the criteria under section 237(2)(c) of the Act by having acted in the best interests of JV Co, and were thus granted leave to bring derivative proceedings.

The Court also rejected the defendants' submission that an application for derivative proceedings is only permitted if the leave sought is to "bring" proceedings "on behalf of" a company. The defendants had submitted that section 237 did not permit leave applications to be granted where the proceedings sought to be brought would result in the company being joined as a co-defendant, as distinct from initiating proceedings on behalf of a company as a plaintiff. Having regard to the litigation procedures historically adopted in respect of derivative actions and the terms of section 237, the Court considered that section 237 was not so confined.

Additionally, the Court concluded that it was in the best interests of JV Co for leave to be granted in favour of the plaintiffs, notwithstanding that the plaintiffs were pursuing their own purely personal interests in the existing proceedings against the defendants, being the proceedings to which the plaintiffs sought to join JV Co as co-defendant. The Court rejected the defendants' submissions that the plaintiffs' personal interests in the existing proceedings created a conflict with the interests of JV Co. Whilst acknowledging that it may sometimes be difficult for the extent of such potential conflicts to be assessed in advance, the Court noted that, in this particular case, it could fairly be expected that the defendants would vigorously defend the separate proceedings as it was in the defendants' own interest to ensure that the proceeds of any damages recovered from them as defendants be restored to JV Co (not the plaintiffs). The Court considered that this provided a "safeguard" against the plaintiffs misusing their authority to bring proceedings on behalf of JV Co.

(E) DIRECTOR/CHAIRMAN'S DUTIES RELATING TO PROXY VOTES: THE WHITLAM DECISION  
(By Leanne Edwards, [Freehills](http://www.freehills.com.au))

Australian Securities and Investments Commission v Whitlam [2002] NSWSC 591, New South Wales Supreme Court, Gzell J, 19 July 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/july/2002nswsc591.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Overview

On 19 July 2002, Justice Gzell in the New South Wales Supreme Court, held that Mr Nicholas Whitlam, a director of NRMA Limited, had breached his director's duties, as well as breached his duty as a proxy, by deliberately failing to vote on a poll in accordance with the instructions of those who had appointed him.

The breaches occurred at the 1998 Annual General Meeting of NRMA, where Whitlam as chairman of the meeting, failed to vote proxy votes against a resolution seeking to increase the remuneration of the directors of NRMA.

On the facts, Gzell J found that Whitlam had deliberately failed to sign the poll paper and was seeking deliberately to over-ride the intent of the members of NRMA. Accordingly, Gzell J held that Whitlam breached his duty as a director to act honestly (former section 232(2) of the Corporations Law (Cth)) and his duty not improperly to gain an advantage or cause a detriment to the company (former section 232(6) of the Corporations Law (Cth)).

Section 250A(4)(c) requires a proxy, who is the chair, to vote on a poll, and to vote in a way directed by the member. Gzell J found that by deliberately failing to sign the poll paper in respect of the votes directed against, Whitlam had contravened that section.

On 15 August 2002, Gzell J made orders banning Whitlam from acting as a director of any company for a period of five years and requiring him to pay pecuniary penalties of $20,000. [See Australian Securities and Investments Commission v Whitlam [2002] NSWSC 718.] Whitlam has announced his intention to appeal.

The court also found that Whitlam breached section 180(1) of the Corporations Act 2001 (Cth) for failure to exercise due care and diligence when amending certain minutes of directors' meeting. Gzell J exercised his discretion to relieve Whitlam of liability under section 180(1) because Whitlam's actions with respect to the proffering of the amended minutes were not dishonest.

(2) The case

(a) Proxies

ASIC bought an action that the defendant as a proxy failed to vote in accordance with the directed votes and thereby contravened section 232 of the Corporations Law (Cth) as it then stood.

At the Annual General Meeting of NRMA held on 28 October 1998, Whitlam had been directed to act as proxy in his capacity as chairman of the annual general meeting. Whitlam had requested that the poll papers with respect to votes directed to him as proxy be divided so that he had separate poll papers for votes to be exercised in favour of the resolution, against the resolution and for undirected votes. The rules applicable to the meeting required a poll paper to be signed to constitute a valid vote.

Resolution 6 sought to increase directors' remuneration. A special resolution of members was required to pass that resolution. In excess of 29% of members of the 15,165 members who lodged a valid appointment of proxy, instructed their proxy to vote against resolution 6.

Whitlam filled out but did not sign the poll paper with respect to the 3,973 votes against resolution 6. Those proxy votes against the resolution were not counted, and the effect of their exclusion from counting resulted in resolution 6 being passed.

(b) Amendment to minutes of directors' meeting

ASIC brought action against Whitlam for a breach of the sections 180 (care and diligence), 181 (good faith) and 182 (use of position) of the Corporations Act 2001 (Cth).  
  
Whitlam had amended minutes of directors' meeting of NRMA Insurance Group (NIGL) dated 11 August 2000 and circulated the amended minutes to the directors for the following board meeting on 6 September 2000. The minutes contained a discussion of Whitlam's remuneration arrangements stating that four items had been noted. The amendments with respect to his remuneration replaced the words "noted" with the words "recommended by the Board Committee" and added the words "It was RESOLVED to accept these recommendations".

(3) Reasons for the decision

(a) Proxies

Gzell J found on the facts that Whitlam had deliberately failed to sign the relevant poll paper and had therefore breached sections 232(2), 232(6) and 250A(4)(c) of the Corporations Law.

Some of the findings on the facts included that Whitlam had inquired prior to the meeting about the circumstances proxy holders could fail to acquit their responsibilities, and had been informed that a proxy holder might fail to sign a proxy paper. Whitlam filled out the proxy papers at the annual general meeting when the meeting was quiet and had displayed no inconvenience in completing the task. Further, Whitlam's reaction when being confronted with the unsigned poll paper was not consistent with innocence.

In reaching his decision, Gzell J rejected a number of submissions.

Gzell J rejected the submission that the powers and conduct of the chairman were not within the scope of Whitlam's office as a director for the purposes of section 232. Whilst a chairman of a meeting might have duties which are distinct from those of a director, that does not mean the duties are mutually exclusive. A director does not cease to be a director because he or she chairs a meeting. In this case, the NRMA constitution provided that the president of the Board of directors would take the chair. Accordingly, the power of the chairman was a power qua director. Whitlam was therefore obliged to exercise the power honestly (former section 232(2)) and not to make improper use of that position to gain an advantage for himself or any other person (former section 232(6)).

Gzell J also rejected the argument that importing the concept of duties of a director into the duties of a chairman might place a chairman who is also a director in a conflict of interest, because the director may not agree with the direction in which the votes are being cast. Gzell J held that in voting in accordance with the instruction of a member appointing him proxy, Whitlam would not infringe any duties cast upon him as a director.

The submission that the defendant had signed the poll paper by filling in his name and initials was also rejected. The rules for valid voting at the annual general meeting required a poll paper to have the name and initials filled out and also the personal signature of the proxy.

Gzell J rejected the submission that the failure "to sign" the poll paper did not amount to a failure "to vote". Whitlam was aware that a failure to sign would cause those specific votes to be excluded from the count. Accordingly, Gzell J found that the failure to sign did amount to a failure to vote.

Gzell J rejected the argument that the opportunity to vote continued until after the result was declared. The failure to vote had occurred when Whitlam had failed to sign the poll paper. Therefore, the failure to vote had occurred prior to the result being declared.

On 15 August 2002, Gzell J made orders banning Whitlam from acting as a director of any company for a period of five years and requiring him to pay pecuniary penalties of $20,000.

(b) Amendment to minutes of directors' meeting

Gzell J found that by revising and circulating the amended draft board minutes, Whitlam did not exercise the degree of care and diligence that a reasonable person in the position of the defendant would exercise and was in breach of section 180(1) of the Corporations Act. Gzell J exercised his discretion under section 1317S(2) of the Corporations Act to excuse Whitlam wholly of liability as he had not acted dishonestly with respect to the proffering of the amended minutes. The minutes were merely a draft which had been submitted to the board of directors for its confirmation. There was no guarantee the draft minutes would be confirmed.

Justice Gzell was not satisfied that Whitlam was in breach of sections 181(1) or s182(1) of the Corporations Act. It was not up to Whitlam to determine the accuracy of the minutes of board meetings. That was a function of the board. Whitlam did not gain any additional remuneration to which he was not entitled or cause detriment to NRMA. Whitlam did not cause to be recorded in a company document his entitlement to such remuneration, nor was the board hoodwinked by Whitlam's actions. The proffering of minutes for consideration of the board was not an improper purpose. The position would have been different if the defendant had hoodwinked his fellow directors into confirming a false set of minutes.

(F) MORTGAGEE RECEIVER EXERCISING POWER OF SALE IN FAVOUR OF APPOINTOR  
(By Tom Webb, Solicitor, [Mallesons Stephen Jaques](http://www.mallesons.com))

In the matter of Actwane Pty Ltd [2002] NSWSC 572, Supreme Court of New South Wales, 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/2002nswsc572.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

In what circumstances can a receiver, acting in the capacity of mortgagee, exercise a power of sale in favour of a company controlled by the receiver's appointor?

This recent decision of the Supreme Court of New South Wales deals with the circumstances in which such a transaction can occur, the extent of reasonable precautions the receiver is obliged to take in such circumstances and the relevance of the traditional equitable principle that a mortgagee cannot exercise a power of sale in favour of itself.

The case is also interesting in that the receiver applied for an order, in similar terms to that granted in Re One.Tel Networks Holdings Pty Ltd (2001) 40 ACSR 83, that he would be justified in making his decision as to entry into the agreement for sale on the basis of information obtained and enquiries made by him up to the date of the application.

(1) Facts

The receiver had been appointed as receiver of the property of Actwane Pty Ltd ("Actwane") and manager of its business pursuant to two deeds of charge. Actwane had granted two debenture charges to St George Bank Limited, which secured Actwane's indebtedness to the Bank. Actwane's debt was guaranteed by Moss. Actwane defaulted on its debt to the Bank and the guarantee was called upon. Moss discharged Actwane's indebtedness to the Bank in full and was discharged from his liability under the guarantee. The Bank then assigned the charges to Moss and he exercised his rights under those charges to appoint a receiver and manager to Actwane.

The receiver entered into possession of certain property of Actwane, including two of the three issued shares in Hotel Redfern Pty Ltd ("Hotel Redfern"), which owned the leasehold to the Skybar Hotel in Redfern.

The receiver was in receipt of an offer from Temujin Securities Pty Ltd ("Temujin") to purchase the two-thirds interest in Hotel Redfern. Temujin already owned the remaining one-third share in Hotel Redfern. The sole director and shareholder of Temujin was Moss.  
  
The receiver had formed the opinion that the offer represented fair market value for the two shares, and was for a higher price than could be expected if the two shares were offered for public sale. He obtained a valuation of the interest for the purpose of making this assessment. He also took into account that, by purchasing Actwane's shares, Temujin would acquire a 100% interest in Hotel Redfern, and any other purchaser besides Temujin would be unlikely to pay full value for the shares as it would not be acquiring 100% control.  
  
The receiver applied to the Court for the following orders pursuant to section 424 of the Corporations Act 2001 (Cth):

"Two directions, to the effect that:

(a) it would not be unlawful for him to accept a certain offer by Temujin and thereby enter into an agreement with Temujin solely by reason of the fact that the appointor of the receiver and manager under the Deed of Appointment … is also the director and sole shareholder of Temujin;  
  
(b) he would be justified in making his decision as to the entry into the agreement on the basis of information obtained and inquiries made up to the present time."

Actwane was also in liquidation at the time of the application. The liquidator appeared by leave at the hearing. He neither supported nor opposed the making of order (a) above. However, he opposed order (b) on the basis that the receiver ought to make a commercial decision on the sale offer on what the receiver judged to be sufficient information and inquiries. The liquidator submitted this was not a proper case in which to give the receiver the comfort of such an order.

(2) Whether lawful for receiver to exercise power of sale

Austin J was prepared to make order (a) that it would not be unlawful for the receiver to accept the offer by Temujin notwithstanding that its sole director and shareholder was also the receiver's appointor (subject to a clarification of the wording of the order). On the basis of Re Vartex Petroleum Industries Pty Ltd (unreported, Supreme Court of New South Wales, Equity Division, Hodgson J, 17 August 1989) and Re North City Developments Pty Ltd; ex parte Walker (1990) 20 NSWLR 286, Austin J decided this was an appropriate case in which to make an order under section 424 of the Corporations Act as to the lawfulness of the receiver's proposed course of action. The proposed order (as clarified) was similar to that granted in One.Tel (supra) in that it did not involve the Court expressing opinions on matters of fact as to which there might have been some contest, nor did it embody a view as to whether the receiver had acted properly under the law concerning exercise of the mortgagee's power of sale on the basis of good faith, proper procedure and fair price. Rather, order (a) dealt solely with whether the proposed sale would be unlawful strictly on the basis of the equitable principles concerning the exercise by a mortgagee of a power of sale in favour of itself. In order to make clear that he was not expressing any view on the broader principles applicable to a proper exercise of the mortgagee's power of sale, Austin J added the words "notwithstanding the principle of mortgage law that the mortgagee cannot exercise a power of sale in favour of itself" at the end of order (a).

The traditional equitable principle against a mortgagee exercising a power of sale in favour of itself derives from Farrar v Farrars Ltd (1888) 40 Ch D 395. In that case, Lindley LJ said at 409:

"It is perfectly well settled that a mortgagee with a power of sale cannot sell to himself either alone or with others, nor to a trustee for himself … nor to anyone employed by him to conduct the sale … A sale by a person to himself is no sale at all, and a power of sale does not authorise the donee of the power to take the property subject to it at a price fixed by himself, even although such price be the full value of the property. Such a transaction is not an exercise of the power, and the interposition of a trustee, although it gets over the difficulty so far as form is concerned, does not affect the substance of the transaction."

Austin J discerned two limbs to the rule in Farrar v Farrars Ltd, which the receiver was required to overcome.

There is a "logical difficulty" in a mortgagee exercising a power of sale in favour of itself on the simple basis that it is not logical to speak in terms of selling anything to oneself. This was quickly dismissed on the basis that, in this case, the proposed sale was to a different legal entity (Temujin) from the mortgagee (Moss).

Austin J also identified an "absolute equitable principle" against a mortgagee exercising a power of sale in favour of itself. The fact that the prohibition also extends to a sale to a trustee or agent of the mortgagee suggests a wider equitable principle must be at stake, beyond the mere "logical difficulty" referred to above (see One.Tel (2001) 40 ACSR 83 at [51]).

Although sale to the trustee of a mortgagee does not overcome the principle in Farrar v Farrars Ltd, it was confirmed by the Privy Council in Tse Kwong Lam v Wong Chit Sen [1983] 3 All ER 54 that sale by a mortgagee to a company in which the mortgagee is interested does not offend the wider equitable principle in Farrar v Farrars Ltd. The Privy Council was dealing with a purchaser company in which the only shareholders were the mortgagee, his wife and children. Lord Templeman, giving the opinion of the Privy Council, said at 59:

"In the view of the Board on authority and on principle there is no hard and fast rule that a mortgagee may not sell to a company in which he is interested. The mortgagee and the company seeking to uphold the transaction must show that the sale was in good faith and that the mortgagee took reasonable precautions to obtain the best price reasonably obtainable at the time. The mortgagee is not however bound to postpone the sale in the hope of obtaining a better price or to adopt a piecemeal method of sale which could only be carried out over a substantial period or at some risk of loss."

In reliance on Tse Kwong Lam, Austin J concluded that it was not unlawful according to the both limbs of the rule in Farrar v Farrars Ltd for the receiver to accept the offer of sale by Temujin, by reason of the fact that Temujin's sole shareholder and director was Moss. Although the facts differed slightly in that the Privy Council was dealing with a purchaser company with shares owned by the mortgagee, his wife and children, rather than the mortgagee alone, it appeared that the mortgagee in Tse Kwong Lam was in effective control of the purchaser company and was entirely responsible for its financing. Austin J concluded, at [14], there was "no obvious basis for not applying the Privy Council's reasoning where the mortgagee is the sole director and shareholder of the purchaser company".

Austin J also appeared to express some doubt at [15] as to whether the equitable principle in Farrar v Farrars Ltd "has survived into the 21st century". It may seem anomalous that a mortgagee's power of sale can be exercised in favour of a company wholly controlled by the mortgagee, but not in favour of a trustee of the mortgagee. There also seems to be little utility in the rule, given the ease with which it may be subverted by exercising a power of sale in favour of a legally separate, but wholly related, corporate entity. Nevertheless, this triumph for form over substance persists in the absence of an appropriate case in which to consider the continued operation of the rule in Farrar v Farrars Ltd.

(3) Whether receiver justified in making decision on information obtained and inquiries made

Austin J was not prepared to make order (b) sought. In general, he concluded, the Court should avoid taking a view of the commercial desirability of an agreement proposed by a receiver: Deputy Commissioner of Taxation v Best & Less (Wollongong) Pty Ltd (1992) 7 ACSR 255. The form of the order sought was in similar terms to that granted in the One.Tel case, also by Austin J. However, the factual circumstances of that case justified a departure from the general rule, which was not justified in the present case. His Honour said at [17]:

"In that case [One.Tel], the proposed agreement was the result of difficult and complex negotiations, necessarily conducted over a very short period of time. Additionally, the receiver was in dispute with the joint liquidators of the One.Tel companies as to the ownership of certain assets and as to access to documents and information. The evidence indicated that in all those circumstances, it had not been possible for the One.Tel receiver to carry out the usual investigations and assessments that a receiver and manager would normally carry out, including investigations as to the true ownership of assets and their value and as to his prospects of success in litigation against the joint liquidators or the companies in liquidation (see at 93). It was also relevant to take into account that the obtaining of an appropriate direction from the Court was a condition precedent to the operation of the complex, negotiated agreement."

In concluding there were no such pressing circumstances in the present case, Austin J said there was no evidence of any constraint upon the receiver to prevent him from making proper investigations and assessments as to the proposed sale. Temujin's offer was fairly straightforward in its terms.

Austin J was clearly reluctant to make section 424 of the Corporations Act an avenue for receivers to have the Court sanction their commercial judgment in routine cases. His Honour said at [18]:

"There is therefore no particular need for the receiver to act otherwise than on his own commercial judgment, and no legitimate basis for him to receive the special protection that such a direction would provide. The application for the second direction has the flavour of an attempt by the receiver to obtain such protection for his commercial decision as the Court is prepared to give him, without any particular regard to the circumstances of the case."

A more comprehensive discussion of when the Court will be justified in making orders that a receiver is justified in entering into commercial agreements, and the form of order appropriate in such cases, can be found in One.Tel (2001) 40 ACSR 83 at [27]-[41].

(G) RELIANCE ON INFORMATION PROVIDED AS A DEFENCE TO DIRECTOR'S LIABILITY FOR VOIDABLE TAXATION PAYMENTS  
(By Tom Webb, Solicitor, [Mallesons Stephen Jaques](http://www.mallesons.com))

Iso Lilodw' Aliphumeleli Pty Limited (in liq) v Commissioner of Taxation [2002] NSWSC 644, Supreme Court of New South Wales, Davies AJ, 2 August 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/august/2002nswsc644.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

Where an insolvent company has made payments of taxation which are later found to be voidable payments and set aside, the directors of the company are liable under section 588FGA of the Corporations Act 2001 (Cth) to indemnify the Commissioner of Taxation in respect of any loss or damage resulting from the taxation payments being set aside. A director of a corporation who is liable under section 588FGA has a defence under section 588FGB of the Corporations Act that he or she had reasonable grounds to expect, and did expect, that the company was solvent at the time of the voidable payment and would remain solvent even if it made the payment. In particular, section 588FGB(4) provides that it will be a good defence under the section if the director relied on information provided by another person as to the company's solvency, and it was the other person's responsibility to provide such information to the director.

This case provides an example of an unsuccessful attempt to rely on the defence in section 588FGB. The case also contains some observations by the Court as to the purpose of the defence and the elements for establishing it. The companies concerned are involved in mineral exploration, and the Court analyses the extent to which the financial volatility commonly experienced by such companies can be considered in the context of the defence in section 588FGB.

(1) Facts

Iso Lilodw' Aliphumeleli Pty Limited (in liquidation) ("ALI") provided clerical, managerial and administrative services and expertise to two companies involved in mineral exploration, Copper Mines and Metals Limited ("CMML") and Danae Resources Limited ("Danae"). CMML and Danae were the only shareholders in ILA. As ILA only existed for the limited purpose of providing services to CMML and Danae, it was provided with no capital; each of CMML and Danae owned one $1 share. It was not intended that ILA would build up substantial assets of its own or that it would derive any substantial profits. ILA was funded by CMML and Danae each agreeing to pay to it a minimum of $40,000 monthly in exchange for services. CMML ceased making monthly payments to ILA in accordance with this arrangement from late 1997, due to CMML being starved of funds after an agreement for CMML to acquire a copper mine was cancelled. Acquisition of the copper mine would have provided a source of ongoing funds to CMML. Once CMML ceased funding ILA, ILA fell into its own financial troubles. During much of 1998, ILA was insolvent. In the first half of 1998, ILA was in arrears to its creditors, some of whom had engaged collection agencies, and the lease of ILA's premises was terminated for non-payment of rent. ILA's secretary wrote to its directors expressing his doubts about the company's solvency and warning of exposure to the insolvent trading provisions of the Corporations Act.

In July 1998, ILA came into some additional funds when it received a one-off payment from Danae after Danae entered into a mining venture under which loan finance was advanced to it. ILA was able to pay some of its long-standing creditors at this time.

Against that background, ILA made four payments of group tax totalling $261,938.70 in June, July, August and December 1998 respectively. These payments were the subject of earlier proceedings as to whether they were voidable payments, and if so, should be set aside. The result of the earlier proceedings was that a Master held that the four relevant payments of group tax were made at a time when ILA was insolvent, and that each payment should be set aside.

In the present proceedings, the Commissioner of Taxation applied for an order that the directors of ILA, Mr Prentice and Mr Getley, were liable under section 588FGA of the Corporations Act for the payments of group tax set aside by the earlier orders.  
Davies AJ concluded that the payments of group tax were made at times when ILA was insolvent, and the directors of ILA had no reasonable grounds to expect otherwise (see at [73]). This had the consequence that the directors Prentice and Getley were liable to indemnify the Commissioner for the loss caused by the payments being set aside unless they could establish a defence under section 588FGB. Both Prentice and Getley sought to avoid liability by this defence.

(2) The defence in section 588FGB

Section 588FGB of the Corporations Act provides, inter alia:

"(3) It is a defence [to liability under section 588FGA] if it is proved that, at the payment time, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it made the payment.

(4) Without limiting the generality of subsection (3), it is a defence if it is proved that, at the payment time, the person:

(a) had reasonable grounds to believe, and did believe:

(i) that a competent and reliable person (the other person) was responsible for providing to the first-mentioned person adequate information about whether the company was solvent; and  
(ii) that the other person was fulfilling that responsibility; and

(b) expected, on the basis of information provided to the first-mentioned person by the other person, that the company was solvent at that time and would remain solvent even if it made the payment."

(3) Directors' expectations of solvency

Prentice and Getley each claimed that they expected, and had reasonable grounds to expect, that the company was solvent and would remain so following the payments. Although Prentice and Getley were aware that ILA was starved of funds at most of the relevant times, they nonetheless expected that ILA would eventually be able to call on funds from its shareholders, CMML and Danae, as a result of various prospective mining projects each shareholder was pursuing. The expectation that funds from an external source will be forthcoming is a relevant consideration in establishing the defence in section 588FGB. In this regard, Davies AJ, at [65], relied on his judgment in Taylor v Powell (1993) 113 ALR 374, where he said at 382:

"The expectation that funds may be available from a source external to the company was held to be sufficient to protect a director from personal liability in Deputy Commissioner for Corporate Affairs v Caratti (1980) 5 ACLR 119. In that case, a director in control of a group of related companies was absolved of personal liability for a contract made by one company which had historically relied upon the injection of loan funds from the other companies as required, notwithstanding that the financial support was subsequently withdrawn. Likewise, Foster J in Kemish at 188 and 193, and Mahoney JA in Dunn v Shapowloff at 244, gave consideration to a company's capacity to borrow or realise a promise to make funds available to the company. In Flavel v Day (1984) 9 ACLR 502, Prior J similarly took account of a promise to lend money to a company where the director had periodically injected funds into the company to enable it to meet its obligations."

On the facts of the present case, Davies AJ was not satisfied as to the availability of funds from ILA's shareholders. By early 1998, it was clear that CMML would not be in a position to provide ILA with funds until its own position improved. Danae, however, was able to provide funds in July and August 1998. Prentice claimed that he expected this flow of funds from Danae would continue. However, Davies AJ held there was no basis to reach such a conclusion. In mid-1998, Danae had entered into a mining venture with Golden Valley Mines NL ("Golden Valley"), under which Golden Valley assumed control of half the Board of Danae. While Danae's financial position improved as a result of the Golden Valley venture, now that Danae was at least partially controlled by Golden Valley, it was unwilling to fund ILA's debts, many of which related to work ILA had done for CMML, rather than Danae.

In any event, Davies AJ concluded that, even allowing for its brief period of improved fortunes in mid-1998, it was obvious to Prentice and Getley that ILA had been in serious financial trouble since late 1997. The mid-1998 improvement did not affect ILA's underlying solvency problems. Davies AJ said at [70]-[71]:

"[70] Had July 1998 been the first month in which ILA encountered liquidity problems, I would have been inclined to conclude that the amounts outstanding were so small as merely to represent a temporary liquidity problem. However, by the end of 1997, ILA was unable to pay its debts as they fell due. The company entered a period of long-standing insolvency from which it never recovered.

[71] It is worth noting that all three companies [ILA, CMML and Danae] incurred expenses at a rate far beyond any existing ability to meet them. Their concern was with mineral exploration and mining ventures, not financial control … CMML continued to use ILA to investigate new projects but it could not pay for the costs and expenses incurred."

After noting that Danae's Chairman had written to Prentice in June 1998 to say Danae was "operating at cost levels which are unsustainable", the consequences of this for ILA's financial outlook should have been obvious. Davies AJ said at [72]:

"In Sandell v Porter…Barwick CJ said that "It is the debtor's inability, utilizing such cash resources as he can command through the use of his assets, to meet his debts as they fall due which indicates insolvency." From late 1997 onwards, ILA could not meet its obligations as they fell due. ILA did not have any asset resources of its own on which it could call for the payment of debts. ILA had to rely upon its shareholders CMML and Danae. But CMML was not in a position to support it. Danae may have been in a position to extinguish the outstanding liabilities of ILA had it decided to do so. However, the only funds which Danae had available were borrowed funds. The lender of the funds [Golden Valley] was represented by directors on the Board. Mr Prentice was not in a position to do whatever he wished with those monies. ILA, which continued to incur debts by reason of its work for CMML, was not in a position to expect Danae to meet all its obligations."

On this basis, both Prentice and Getley failed to convince Davies AJ that they had reasonable grounds to expect ILA was solvent at the time any of the relevant payments of group tax were made.

Prentice was intimately involved in the affairs of ILA. Davies AJ concluded at [78] that he failed to establish either the subjective or the objective elements of the defence in section 588FGB(3).

Getley was less involved than Prentice in the day-to-day operations of ILA. He was, however, a director of CMML and would have been aware of that company's financial troubles and its default in its obligations to ILA. He was aware that ILA was continuing to provide services to CMML even after CMML was no longer able to pay for them. Any future expectations of profitable projects for CMML were too remote to be taken seriously as a source of funds for ILA (see at [78]).

(4) Reliance on information provided

Getley also sought to rely on section 588FGB(4). He said that he relied on Prentice to inform him about ILA's solvency. His association with Prentice over several years led him to place faith in Prentice's judgment in such matters. Getley said Prentice's past ability to secure funds for ILA led him to feel sure he would do so again. Getley was a non-executive director based in Perth, whereas ILA operated from Sydney. His contact with Prentice and other officers of ILA occurred mostly by telephone. None of this appears to have been disputed, but the defence nonetheless failed in the circumstances.

Davies AJ noted the following at [83]-[92]:

- Getley was unable to point to any particular "information" which he received (from Prentice or anyone else) on which to base his view as to ILA's solvency;  
- Getley never asked anyone at ILA whether ILA was solvent;  
- Getley was in constant receipt of information that both CMML and ILA were paying urgent amounts only and were "juggling creditors";  
- Getley was aware of the failure of CMML's copper mine project; and  
- Getley was aware that ILA could not pay its employees, and even called a meeting of employees to explain this position to them.

Far from being satisfied that Getley was provided with information that would have satisfied him ILA was solvent, Davies AJ concluded at [91] that the information Getley received was sufficient for him to conclude it was insolvent.

Davies AJ also noted the comments of Young CJ in Eq in Manpac Industries Pty Ltd v Ceccattini [2002] NSWSC 330, where his Honour said the prime thrust of the defence in 588FGB(4) is to deal with the situation of large corporations with bulky accounts where there is an established system of reporting to the Board by a large staff of financial controllers and accountants. In such circumstances, it can be expected that these officers will raise any problems with the Board.

(5) Approach to solvency of mining companies

Davies AJ was unimpressed with Getley's assertion that he believed ILA's liquidity problems were temporary and merely symptomatic of the mining industry's cyclical nature. The obligations of directors to avoid insolvent trading remain. His Honour said at [88]:

"Mr Getley contended that he believed that everything would turn out satisfactorily in the long run and that the shortage of money which ILA encountered was simply the regular shortage of money which mineral exploration companies tend to encounter. Such an attitude, which was in substance a view that, with a successful project, the company would be able to trade out of its problems, does not satisfy either of the defences provided by s588FGB(3) and (4)."

That is not to say that the financial volatility commonly experienced by mining companies will not be taken into account in making the threshold judgment as to whether the company is insolvent. Davies AJ said at [64]:

"I accept that CMML and Danae were mineral exploration companies whose financial position fluctuated markedly from time to time and that that fact is a factor which ought to be taken into account. People dealing with mineral exploration companies would understand the problems of the industry. However, to say that the nature of the industry is a factor to be taken into account is not to say that mineral exploration companies are exempt from the solvency provisions of the Act. Directors of companies which trade when the companies are unable to pay their debts as and when they fell due are liable to encounter the personal obligations imposed by the Corporations Act."

(H) THEME BASED MUSIC COLLABORATIONS AS MANAGED INVESTMENT SCHEMES  
(By Emma Bloomer, [Phillips Fox](http://www.phillipsfox.com))

Australian Securities and Investments Commission v IP Product Management Group Pty Ltd (ACN 085 083 834) [2002] VSC 255, Victorian Supreme Court, Byrne J, 28 June 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/vic/2002/june/2002vsc255.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

During 1999, a series of 26 music schemes were promoted and marketed by IP Product Management Group Pty Ltd (IPP) as project manager and its director and secretary Peter Ambrosy. Also involved in these schemes was Donald MacGregor, a previous director of Berimah International Pty Ltd (BI). These schemes involved the compilation of a theme based CD from works by different musical artists, with these CDs to be marketed using television and film. Potential investors were invited to contribute money on the expectation of earning a profit on their investment. A further incentive in the schemes was a potential tax deduction of up to 4.5 times the initial investment in the scheme. A total of $8,787,424 was invested in these schemes.

Each of the schemes required capital of $5,505,375, which was to be provided by two sources. The first was from private investors contributing $1,150,000 (which comprised 95% of the 'ordinary project capital'), while the project manager was to provide $4,355,375 towards each scheme (of this amount $60,375 was the remaining 5% of the 'ordinary project capital' while $4,295,000 was the 'preferred project capital'). Most of the schemes were established as unincorporated joint ventures or partnerships between the project manager and investors. In each scheme for which documentation was available, IPP was the project manager.

For each scheme, $7,895 was to be paid to the licensor under the licence agreement, with the remaining $5,497,480 to be paid to Melke Entertainment under a marketing agreement for the production and marketing of the product and the administration and management of the project. Further, the project manager's contribution to each scheme would be paid only for the balance of the budget and would be paid to or at the direction of Melke Entertainment. The music schemes also detailed how profits and losses were to be distributed between the project manager and private investors.

(2) Proceedings

ASIC instituted proceedings against IPP, Peter Ambrosy, BI and Donald MacGregor, claiming that the defendants had breached the Corporations Law ('the Law') on three grounds:

(a) the defendants had promoted and implemented unregistered managed investments in contravention of section 601ED(5) of the Law;

(b) the defendants had acted as unlicensed dealers of 'securities' in breach of section 780; and

(c) the defendants had engaged in misleading and deceptive conduct contrary to section 995.

ASIC sought injunctions to prevent further breaches of the law, declaratory relief, and orders winding up the music schemes, IPP and BI.

The trial proceeded as an undefended matter and was conducted upon affidavit. Peter Ambrosy, IPP and BI had previously filed affidavits in defence. Donald MacGregor did not enter an appearance, and took no part in the proceeding.

(3) Managed investment schemes

The court began by considering whether the music schemes constituted managed investment schemes, in light of the broad definition contained in section 9 of the Law. Justice Byrne found that each of the music schemes clearly met the first two requirements of a managed investment scheme, as investors had contributed money to acquire rights to benefits produced by the scheme, and that money had been pooled to produce benefits for those scheme members.

In relation to the third feature, namely that the members do not have day-to-day control over the scheme's operations, his Honour noted that a greater involvement on the part of the members than merely having the right to be consulted was required before an arrangement would fall outside the definition of a managed investment scheme. Under the music schemes the members had no choice as to the identity of the project manager, and agreed that the whole of the management and control of the operation would be vested in the project manager as specified in the management agreement and would be exercisable by the project manager. Further, the evidence showed that the members in fact exercised no control over the schemes. Byrne J concluded that the music schemes were therefore managed investment schemes for the purposes of the Law.

His Honour then considered whether the interests acquired by investors in these schemes constituted 'securities' under the Law. At the relevant time, section 92(1)(e) defined securities to include 'interests in a managed investment scheme'. The interests in the music schemes were therefore found to be 'securities'.

(4) Breaches of the Law

ASIC alleged that the defendants operated managed investment schemes in contravention of section 601ED(5) which prohibits a person from operating an unregistered managed investment scheme that is required to be registered under section 601EB of the Law.

Byrne J considered whether these schemes were required to be so registered. Under section 601ED1, subsections (a) and (b), a managed investment scheme must be registered under section 601EB if it has more than 20 members, or it was promoted by a person, or an associate of a person, who was, when the scheme was promoted, in the business of promoting managed investment schemes. Byrne J found that all of the music schemes required registration. Considering the 26 schemes independently of one another, his Honour held that the promoters of these schemes were in the business of promoting such schemes. Similarly, if the schemes were considered to be component parts of one over-riding scheme, this scheme had more than 20 members and so registration was still required. The court concluded that IPP, as the project manager, along with Peter Ambrosy and Donald MacGregor (who acted to promote and implement these schemes), were operators of the schemes and therefore each had contravened section 601ED(5). In contrast, Byrne J concluded that the involvement of BI in the music schemes was insufficient to lead to the conclusion that BI operated the schemes.

Byrne J also found that each of these parties had contravened section 1018(1) of the Law in respect of each of the schemes. This was because the interests involved in the schemes were securities, and no prospectus had been lodged or registered prior to the securities being offered for subscription.

ASIC also alleged that Peter Ambrosy and Donald MacGregor breached section 780 of the Law by acting as unlicensed dealers of securities. Byrne J agreed, finding that the interests in the schemes were considered to be securities, and the promotion and marketing of these securities fell within the definition of 'dealing' under the Corporations Law. As neither individual held a dealer's licence, they had both contravened this section.

(5) Misleading and deceptive conduct

ASIC alleged that all of the defendants had engaged in misleading and deceptive conduct in the promotion and implementation of the music schemes contrary to section 995 of the Law, and further that IPP and BI had breached section 52 of the Trade Practices Act 1974. His Honour noted that section 765 of the Law placed the onus on the defendants to prove that they had reasonable grounds for making representations as to future matters, which was significant as this was an undefended proceeding.

Regarding the alleged breach of section 995, both Peter Ambrosy and Donald MacGregor were considered to have made the representations below, as these statements were included in the explanatory memorandum they relied upon to attract investors to the scheme. However, the court found that neither BI nor IPP were guilty of misleading and deceptive conduct. There were four relevant statements:

(a) The project manager would provide venture capital for each music scheme as outlined in the explanatory memorandum;

(b) The project manager would in the case of each scheme provide 100% of the preferred project capital, namely, $4,295,000;

(c) The project manager would in the case of each scheme provide 5% of the ordinary project capital, being $60,375; and

(d) The venture capital for each scheme, namely $5,497,480, would be paid to Melke Entertainment Pty Ltd 'for an approved marketing and media plan which includes provision for product evaluation and refinement, any market testing, distribution and initial project administration service fee.'

The court found all representations to be misleading and deceptive, as the evidence indicated that the promoters did not at the time have the resources or the expectation of having the resources to fulfil the first three representations. The final statement was misleading and deceptive because only $300,000 was in fact paid to Melke Entertainment, with the balance of the investor contributions being sent offshore to companies associated with Peter Ambrosy and Donald MacGregor - there had been no intention to fulfil this representation.

(6) Unlawful implementation of the schemes

ASIC alleged that the defendants implemented this scheme unlawfully by applying investors' contributions through foreign corporations and offshore banking entities otherwise than as provided in the music scheme documentation. After analysing the records of the defendants, his Honour accepted the following:

(a) The investors' contributions were not paid to IPP, but were deposited in a trust account in the name of International Advisory Services Pty Ltd (IAS) in Melbourne. Most of the deposits for these schemes were reconciled, with a total of $8,620,355.88 deposited during the life of the scheme. The total investors' contributions over this period was $8,787,424, and of this amount $8,609,544 was transferred to an IAS account in Hong Kong.

(b) None of the project manager's ordinary or preferred capital contributions was paid into the IAS account.

(c) No amount of money approximating the sums specified in the explanatory memorandum was paid to Melke Entertainment.

Byrne J concluded that although some CDs were made and promotional concerts held, the scheme was managed in a way that provided no real prospect of earning profit for investors, and as such the music schemes were an elaborate sham and fraud on investors, if not the Australian Taxation Office.

(7) Relief

Byrne J made orders for the winding up of both the music schemes and IPP. He also made the declarations requested by ASIC against Peter Ambrosy, IPP and Donald MacGregor as to contraventions of sections 601ED, 780, 995, and 1018 of the Law.

The court however declined to grant an injunction against IPP restraining it from committing further contraventions of section 601ED, finding that it could hardly be supposed that the company would offend this provision again when in liquidation, or if released from liquidation into the direction of other persons. Similarly, Byrne J felt that to grant the requested injunctions against Peter Ambrosy and Donald MacGregor would serve no purpose, as if these persons were to promote another scheme, it would be unlikely to resemble the music schemes, and would thus probably fall outside the scope of the injunction sought by ASIC.

(I) COURT APPROVAL FOR SCHEME OF ARRANGEMENT  
(By Mark Stevens, [Phillips Fox](http://www.phillipsfox.com))

Hibernian Friendly Society (NSW) Limited [2002] FCA 913, Federal Court of Australia, Conti J, 22 July 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/federal/2002/july/2002fca913.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

The Hibernian Friendly Society (NSW) Pty Ltd ("Hibernian") was registered in New South Wales as a Friendly Society on 7 September 1880. Hibernian provides medical, dental, hospital, funeral and other social security benefits for its members with membership contributions pooled for the payment of claims by members. Hibernian is also involved in the establishment and operation of retirement villages.

Hibernian's directors and management wished to convert the mutual structure of the society into a demutualised structure taking the form of a publicly listed company, so that members could realise the value of their membership, yet maintain their policies or fund memberships relating to the traditional provision of medical benefits etc.

On 1 July 1999, the Society converted to corporate status under the Corporations Law as a public company limited by shares and guarantee. On 15 September 1999, Hibernian registered as a life insurance company under the Life Insurance Act 1995 (C'th), by virtue of Item 11 of Schedule 8 to the Financial Sector Reform (Amendments and Transitional Provisions) Act (No 1) 1999 (C'th).

By an Originating Process filed on behalf of Hibernian, orders under section 411(1) of the Corporations Act 2001 were sought to convene a meeting of Hibernian for the purpose of considering, and if thought fit, approving the scheme of arrangement between Hibernian and its members and an order of the court approving the scheme of arrangement.

(1) Conti J's decision

Conti J ordered that a meeting of members be held for each class of members for the purpose of considering and if thought fit, agreeing to the scheme of arrangement. Conti J's orders included the time and place of each meeting, the chairperson of each meeting, the quorum of each meeting and the service of the notice of meeting, explanatory memorandum, disclosure statement and associated documentation.

Conti J ordered that proxy forms for each meeting be lodged within a specified time and that each meeting be convened and conducted as if it were a general meeting of Hibernian, regulated by its constitution and the Corporations Act, except for certain provisions which were inconsistent in the circumstances. Conti J approved the explanatory memorandum prepared by Hibernian and ordered that the notice of meeting be advertised in a national Australian newspaper.

The application was stood over until 11 September 2002 to be heard before Conti J.

(2) Reasons for judgment

Conti J made his orders in light of the following matters:

(a) The existing structure of Hibernian did not permit the distribution of any substantial retained profits except to the extent applied to meet members' benefits.

(b) Substantially more value would be delivered to members in a more comprehensive and modern structure.

(c) Substantial care and consideration was given by Hibernian to the quantification of shares attributable to members.

(d) The existing schemes for members' benefits would be maintained.

In arriving at his decision, Conti J considered the 3 expert reports which were to be sent to members, being an actuarial report of the NSW Government Actuary's Office relating to the ongoing security of Benefit Fund entitlements, a report regarding the fairness and reasonableness of the basis for allocating shares amongst members and a third report regarding whether the policy rights of members would be affected by the scheme of arrangement, and if so in what respect.

Conti J followed the principles summarised by Emmett J in Pacific Minerals NL [2002] FCA 239, in particular:

(a) The Court will not convene a meeting unless the arrangement proposed is of such a nature and in such terms that, if the arrangement receives approval by a majority of members, the Court will be likely to approve the arrangement on the hearing of any application that is unopposed.

(b) The Court should ensure that there will be sufficient disclosure (of its details and effect) to those effected by the arrangement and there has been reasonable opportunity for ASIC to examine the terms of the arrangement.

(c) The Court will have regard to the acceptability of the documentation of the proposed arrangement, the commercial viability and morality of the arrangement, the likely acceptability of the arrangement, the bona fides of the proposals, whether the proposals can be achieved by another method and any objections or submissions by ASIC.

(d) The Court will examine whether the arrangement complies with the substantive requirements of the law and ensure that the arrangement will not involve any unfair or oppressive results.

(e) The Court will take into account questions of public policy as well as commercial morality, having regard to the interests of parties who will be bound by the arrangement. In doing so the court acknowledges that members are better judges of what is to their own commercial advantage. However, the Court will consider the technical or mechanical aspects of the arrangement to ensure that the Court's approval is a sufficient safeguard against defects at the technical or mechanical level and to ensure that the scheme of arrangement is a reasonable one.

(f) The Court will seek to ensure that the terms of the arrangement will be enforceable by all persons bound by it against those who are seeking to implement it or obtain benefits from it.

(g) In considering whether to approve a scheme of arrangement, the Court must first be satisfied that the resolutions have been passed in accordance with statutory requirements. The Court has a further duty of satisfying itself that the arrangement is fair and equitable between different classes of security holders.

(h) The Court must be satisfied that the proposal is at least so fair and reasonable that an intelligent and honest person, who is to be bound by the arrangement, when acting alone in respect of his or her interests might approve the scheme.

Conti J found that the proposed arrangement for de-mutualisation was of such a nature, and cast in such terms, that if the arrangement was to receive the approval of the requisite majority at the meeting of members, the Court would be likely to approve the scheme on the hearing of any subsequent application which is unopposed.

(J) MORTGAGES: UNCONSCIONABLE ADVANTAGE AND THE DUTY TO DISCLOSE  
(By Robert Armstrong, [Corrs Chambers Westgarth](http://www.corrs.com.au))

State Bank of New South Wales Limited t/as State Bank of New South Wales v Allan James Watt and Fay Elizabeth Watt [2002] ACTSC 74, Supreme Court of the Australian Capital Territory, Gray J, 2 August 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/act/2002/august/2002actsc74.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

This recent decision of Gray J in the Supreme Court of the Australian Capital Territory provides a discussion of the duty of a creditor to disclose to an intending surety anything in the transaction as between the creditor and the debtor that the surety could reasonably expect not to exist if they were to enter the transaction. The decision also provides a useful analysis of the circumstances in which unconscionable advantage might be taken by a creditor of a party in a position of special disadvantage with respect to entering a financial transaction.

(2) Facts

(a) The claim

The plaintiff (State Bank of New South Wales) claimed possession of a residential property in the Australian Capital Territory. The defendants, Allan James Watt and Fay Elizabeth Watt, were the registered proprietors.

The plaintiff claimed that the defendants were in default under a registered memorandum of Mortgage of Crown Lease dated 30 August 1992 ("Mortgage") and that, as at 18 December 2001, the amount outstanding secured by the mortgage was $1,263,020.89.

(b) Background

In 1989, the defendants became directors and shareholders with their son-in-law, Graham Dyer, and daughter, Gayle, in Dyspurrs Pty Ltd ("Dyspurrs"). Dyspurrs was the corporate vehicle used by Mr Dyer for a newsagency business and a subsidiary business involving selling imported classic motor cars.

In late 1989, Mr Dyer requested his parents-in-law to assist the business by providing security to the Commonwealth Bank for a loan to Dyspurrs. The security proposed was a mortgage over the defendants' matrimonial home and principal asset.

According to Mr Watt, his wife was against giving the mortgage requested because she did not think her son-in-law a good manager. However, Mrs Watt said that she left all business arrangements to her husband and "reluctantly" agreed to the mortgage but did not know exactly what it entailed. The mortgage was therefore given over the defendants' property to the Commonwealth Bank to secure advances to Dyspurrs.

The defendants left for an overseas vacation in early 1991 whereupon Mr Dyer, on the advice of the business' accountant, negotiated with the State Bank of New South Wales to change banks in order to take advantage of a competitive offer.

The plaintiff approved the loan in June 1991. The mortgage documents included a first mortgage on the defendants' residential property predicated on a discharge of the existing mortgage to the Commonwealth Bank as well as a second mortgage on the son-in-law's and daughter's residential property. An estimated borrowing requirement was made of $550,000 but this was to be reduced by $100,000 through the divestment by Dyspurrs of its stock of classic motor vehicles.

The loan facility documents were taken overseas by Mr Dyer to where the defendants were holidaying in order to obtain their signatures. They were told that the business was going over to the State Bank of NSW for better terms. No specific discussion of the documents themselves took place and both defendants claimed that they were unaware that the documents contained a mortgage over their property.

In late 1991 the plaintiff became aware that the Commonwealth Bank also held a second mortgage in respect of the Dyer's residential property. Accordingly, the plaintiff arranged that a personal loan be given to Mr and Mrs Dyer to cover the amount outstanding. Rather than delay settlement, the monies owing ($16,728.23) were provided by drawing down the Dyspurrs facility and the account credited with the amount. No advice was ever given to the defendants concerning this matter.

Dyspurrs began to have financial difficulties and in 1994 the defendants were party to and signed an offer by the bank to extend the loan facilities to $682,000. The defendants resigned as directors in late 1994 whereupon they raised with the bank the matter of the Mortgage.

(3) The defendants' claim

The defendants claimed that the Mortgage should not be enforced and that it should be set aside. It was maintained that the plaintiff failed in its duty to disclose certain of the circumstances material for the surety to know before executing a guarantee. The defendants also claimed that they were in a position of special disadvantage which made the plaintiff's conduct in obtaining the mortgage from them unconscionable.

(4) Decision

(a) Duty of disclosure

It was put that in taking the guarantee and securing it by the Mortgage the plaintiff had a duty to disclose that which the surety would not normally expect (see Commercial Bank of Australia Ltd v Amadio (1983) 151 CLR 447 at 457), and that the arrangement entered into whereby the second mortgage on the Dyers' residential property was discharged was such a matter that required disclosure, as was the proposal to reduce the debt level by divesting the stock of classic motor vehicles.

Gray J asserted that the matter is best tested by the effect of non-disclosure on the nature or degree of the surety's responsibility. His Honour considered the temporary use of the company's overdraft facility to discharge the Dyers' second mortgage before repayment by personal loan did not affect that responsibility. Gray J reasoned that the extension of the facility to the Dyers was not significantly different from not disclosing the extension of credit to a principal debtor outside the ambit of a surety arrangement (cf Bank of Nova Scotia v Neil (1968) 68 DLR (2d) 357), or the principal debtor personally guaranteeing to the creditor the account of another party, thereby exposing the surety to an additional contingent liability (cf Goodwin v National Australia Bank Ltd (1968) 117 CLR 173). These situations did not give rise to a duty to disclose and it was held that in the present case the circumstances were sufficiently similar such that the plaintiff was not under any duty to disclose this aspect of the transaction to the defendants.

In considering whether the proposal that the business divest itself of the stock of vehicles should have been disclosed by the plaintiff, Gray J noted that its purpose was to achieve a reduction in the overall debt by some $100,000 over 12 months. It was found that the sale of these assets would have only been of benefit to the defendants by reducing their exposure. His Honour held that the plaintiff was under no duty to disclose this aspect of the transaction to the defendants. Gray J reasoned that it did not materially extend the surety's responsibility, and could not be thought to affect any decision to enter into the guarantee, particularly in the context which was to give effect to the transfer of the company's banking business.

(b) Unconscionable conduct

In considering whether the defendants were to be granted equitable relief on the basis that the plaintiff took unconscionable advantage of the defendants, Gray J cited Mason J in Amadio (at 461) who referred to the class of case in which a party makes unconscientious use of that party's superior position or bargaining power to the detriment of a party who suffers from some special disability or is placed in some special situation of disadvantage.

In Amadio, the word "disadvantage" was qualified by the adjective "special" so as to disavow any suggestion that the principle applies wherever there is a difference in bargaining power of the parties and the disabling circumstance is to be one which seriously affects the ability of the innocent party to make a judgment as to his own best interests, when the other party knows or ought to know of the existence of that circumstance and of its effect on the innocent party.

In this case, Gray J took into account all the circumstances surrounding the transaction to consider whether the defendants were in a position of special disadvantage vis-à-vis the plaintiff. His Honour noted that in Blomley v Ryan (1956) 99 CLR 362 at 405, circumstances adversely affecting a party to negotiations were taken to include age, sex, and lack of assistance or explanation. The defendants pointed to their age, inexperience in commercial loans, and lack of legal or financial advice concerning the transaction as disadvantaging them.

Gray J intimated that something more was necessary for the above to specially disadvantage the defendants. Inexperience was dismissed to the extent that Gray J was not satisfied that the defendants entered the transaction without understanding the broader proposition that they were executing documents in order to benefit their business. His Honour stated that the matters of which they were not advised concerning the transaction were to form part of the background to be assessed, but those matters were also required to in some way put the defendants at a disadvantage. The defendants reliance on the alleged disadvantage of an increase in their borrowing commitment due to the payment of the Dyers' second mortgage was held to be inconsequential given the reduction of the commitment by the divestment of the stock of classic motor vehicles.

Moreover, the fact that the defendants were overseas at the time and the circumstances under which they signed the documents could not be relied on as contributing to the defendants' disadvantage. There was no "manufactured" urgency in signing and there was ample opportunity for discussion of the documents. The fact that little or no discussion of the documents took place was held to be a matter of choice for the defendants and did not go towards constituting any misrepresentation by Mr Dyer or indeed creating any situation in which the defendants were disadvantaged.

Gray J also considered that the defendants' arguments that there existed a situation of emotional dependence on their part as sureties toward Mr Dyer as debtor, and on Mrs Watt as surety for her husband were unfounded (see Garcia v National Australia Bank (1998) 194 CLR 395). Simply, the circumstances giving rise to the execution of the documents by the defendants did not constitute any "undue influence, misrepresentation or other legal wrong" that was referred to in Garcia's case.

It was concluded by Gray J that any special disadvantage must be "sufficiently evident" to the creditor to make it unconscientious for the creditor to accept the guarantor's consent to the transaction. There was nothing to indicate that the defendants were not in a position to make an informed choice as to their participation.

For the above reasons, Gray J found for the plaintiff and dismissed the defendants' cross-claim.

(K) THE COURT'S POWER TO AWARD COSTS IN RELATION TO AN APPLICATION FOR APPROVAL OF A COMPULSORY ACQUISITION  
(By Martin Argente, Legal Advisor, [Corrs Chambers Westgarth](http://www.corrs.com.au))

Austrim Nylex Limited v Irene Juliana Kroll (No 3) [2002] VSC 290, Supreme Court of Victoria, Warren J, 25 July 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/vic/2002/july/2002vsc290.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

In this case, the plaintiff sought Court approval of the proposed compulsory acquisition of the remaining minority interests in National Consolidated Limited pursuant to sections 664(3) and 664F(1) of the Corporations Act 2001.

The defendants, as remaining minority shareholders, opposed the granting of the approval.

The compulsory acquisition was approved and final orders were made pursuant to section 664F of the Corporations Act 2001.

The issue to be determined was the defendants' costs of the proceedings. Section 664F(4) of the Corporations Act 2001 provides:

"664F(4) The 90% holder must bear the costs that a person incurs on legal proceedings in relation to the application unless the Court is satisfied that the person acted improperly, vexatiously or otherwise unreasonably. The 90% holder must bear their own costs."

The plaintiff submitted that the defendants acted "improperly, vexatiously or otherwise unreasonably" and, therefore, were not entitled to all their costs.

The defendants filed a summons seeking orders that the proceeding be stayed pending the hearing and determination of appeals in two proceedings to the Court of Appeal of Queensland (being, Pauls Limited v Dwyer (2001) 19 ACLC 959 and Pauls Limited v Elkington (2001) QCA 414) which were said to raise similar or identical issues to the present proceeding. The application by the defendants was dismissed and all arguments on behalf of the defendants were rejected entirely.

Shortly before this case started another similar proceeding concerned with compulsory acquisition of minority shareholdings was fixed for trial (being, Capricorn Diamonds Investments Pty Ltd v Catto and Ors (2002) VSC 105). The Capricorn case was extensively referred to in this case.

In this case, Dr Elkington, a defendant, sought his costs of attending hearings (fares and accommodation). He did not claim any costs with respect to the preparation of his affidavit or written submissions. The other defendants claimed all their costs on a solicitor-client basis.

The plaintiff submitted that the defendants were entitled to the costs of the proceeding on a party-party basis except for:

(a) any costs incurred personally by Dr Elkington;

(b) the costs of and incidental to the preparation of the affidavits of Dr Elkington and Mr Catto;

(c) the costs of and incidental to the stay application because the application failed; and

(d) the costs incurred by the defendants after 14 October 2001 due to the fact that the expert evidence of Lonergan was rejected in Capricorn and the defendants had 14 days to consider that the proposed evidence of Lonergan was incorrect and misconceived.

If costs after 14 October 2001 were allowed the plaintiff submitted that the defendants should not be allowed their costs associated with the constitutional issues they had raised or the allegation of material non-disclosure.

It was held that the defendants were entitled to certain of their costs of the proceeding as follows:

(a) in relation to the stay application, on the basis that it was entirely misconceived and lacked sufficient evidence to invoke the discretion to stay, it was held that the defendants acted unreasonably in bringing the stay application and accordingly they were not allowed to receive their costs of that application;

(b) in relation to the attack as to lack of material disclosure by the plaintiff, it was held that the attack brought by the defendants on procedural matters particularly concerned with lack of material disclosure was misconceived, and by ventilating these matters at trial and thereby prompting the plaintiff to respond to the complaints, the defendants acted unreasonably and, therefore, were not entitled to any costs associated with those matters;

(c) in respect of the costs associated with the constitutional arguments, as there was no criticism made of the way in which the defendants conducted the constitutional arguments and the attitude of the Court was not known in the Capricorn judgment at the time the arguments were made in this case, it was held that the defendants did not act improperly, vexatiously or unreasonably and they should be allowed the costs of the constitutional arguments;

(d) in relation to the costs incurred by Dr Elkington personally in attending court, it was held that in seeking to represent himself, for the purposes of section 664F(4) of the Corporations Act 2001, he acted unreasonably and therefore costs were not allowed. Dr Elkington could have allowed his representation to be encompassed with that of the other defendants and, by doing so, avoided unnecessary costs duplication.

The remaining matter that was considered was the nature of costs to which the defendants were entitled. The plaintiff submitted that the costs to be awarded should be the usual costs namely costs on a party-party basis. The defendants argued that the costs should be on a solicitor and client basis. It was noted that there is nothing in the legislation to indicate the type of costs contemplated by the legislature to be allowed.

It was held that considering that:

(a) section 664F(4) contemplates costs in the ordinary event and, ordinarily, such costs in proceedings are costs on a party-party basis; and

(b) there is no command in the legislation to indicate any contemplation by the legislature that the acquiring party should pay other than the usual costs,

there was no reason why the defendants should receive their costs other than on a party-party basis.

6. RECENT CORPORATE LAW JOURNAL ARTICLES

J Martin, 'Distribution Complexities in the Winding Up of an Insurance Company in Australia' (2002) 10 Insolvency Law Journal 80

Recent collapses of Australian insurance and reinsurance companies will bring into focus two statutory provisions that require a departure, in the liquidation of an insurance company in Australia, from the pari passu principle of equal treatment of all creditors. The nature and extent of the departure represented by the two provisions is far from clear, and several of the more important interpretation issues that will require resolution in the courts are addressed in this article.

M Caulfield and A Baxter, 'Recovery of Company Assets from the Spouses or Associates of Delinquent Directors' (2002) 10 Insolvency Law Journal 95

Liquidators attempting to enlarge a company's estate to allow the payment of creditors are often frustrated by directors who have misappropriated company property. Company directors who misappropriate company assets can attempt to avoid detection or liability by transferring legal ownership of the assets to spouses or associates with the intention that they will still be able to enjoy the beneficial use of the assets. This article seeks to review the legal options available to enable recovery of misapplied company property. It is concluded that directors of smaller companies and their spouses and associates probably can be brought to account. By contrast, wealthy directors may still be able to avoid disgorging their ill-gotten gains by transferring them to spouses or associates. Equitable remedies (rather than statutory remedies) may provide fruitful avenues for those seeking to recover company property when wealthy directors employ their resources to delay the initiation of proceedings beyond the statutory limitation periods. This seems to be the case with the liquidator of the former Bond empire. However, those seeking to recover assets from directors involved in the more recent high-profile corporate collapses have been able to make effective use of recently-introduced statutory provisions.

M Broderick and C McKenzie, 'Insolvency Practice Under the Corporations Law Rules' (2002) 10 Insolvency Law Journal 104

This article reviews the changes to court practice and procedure in applications made pursuant to the Corporations Act which have been invoked by the introduction of the Corporations Law Rules, and examines the bases upon which some of the substantive changes to the former rules are predicated. It also suggests areas for proposed amendment. The article considers, in detail, the winding up procedure and the topical subject of court approval of remuneration of corporate insolvency practitioners, and the payment of legal fees.

Note, 'The Rule Against Double Proofs' (Lumley General Insurance Ltd v Oceanfast Marine Pty Ltd) (2002) 10 Insolvency Law Journal 116

Note, 'Legal Costs and Priority Claims' (In the matter of Pasminco Limited (Administrators Appointed); McLuskey and Spark v Pasminco Limited (Administrator Appointed)) (2002) 10 Insolvency Law Journal 118

Note, 'Bonus Payments and Priority Claims' (Walker v Andrew) (2002) 10 Insolvency Law Journal 120

Note, 'A Pot-Pourri of Personal Insolvency Cases' (2002) 10 Insolvency Law Journal 122

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