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1. RECENT CORPORATE LAW AND CORPORATE GOVERNANCE DEVELOPMENTS

(A) UK CORPORATE GOVERNANCE COMBINED CODE

At its meeting on 23 July 2003, the UK Financial Reporting Council (FRC) agreed the final text of a new Combined Code. The new Code will come into effect for reporting years beginning on or after 1 November 2003.

The new Code is based on the draft revision of the existing Code that Derek Higgs suggested in his report on non-executive directors published in January 2003, which also incorporated the recommendations of Sir Robert Smith’s report on audit committees. The agreed final text reflects extensive consultation by the FRC since January.

The Code’s overall aim is to enhance board effectiveness and to improve investor confidence by raising standards of corporate governance. Its main features are:

- new definitions of the role of the board, the chairman and the non-executive directors;   
- more open and rigorous procedures for the appointment of directors and from a wider pool of candidates;   
- formal evaluation of the performance of boards, committees and individual directors, enhanced induction and more professional development of non-executive directors;   
- at least half the board in larger listed companies to be independent non-executive directors, with a definition of independence of non-executive directors;   
- the separation of the roles of the chairman and the chief executive to be reinforced;   
- a chief executive should not go on to become chairman of the same company;   
- closer relationships between the chairman, the senior independent director, non-executive directors and major shareholders; and   
- a strengthened role for the audit committee in monitoring the integrity of the company’s financial reporting, reinforcing the independence of the external auditor and reviewing the management of financial and other risks.

As with the existing Code, in order to meet their obligations under the Listing Rules, listed companies will have to describe how they apply the Code’s main and supporting principles and either confirm that they comply with the Code’s provisions or provide an explanation to shareholders. The new Code emphasises that companies and institutional investors should enter into dialogue based on trust and mutual understanding. Companies should give helpful and informative explanations, and institutional investors should take a considered approach when evaluating them.

The Code published on 23 July incorporates the substance of Derek Higgs’ and Sir Robert Smith’s proposals. The detailed drafting reflects the consultation process. The main areas of difference are:

- modification of the Code’s structure to include not only main ‘principles’ and ‘provisions’ but also ‘supporting principles’, allowing companies greater flexibility in how they implement the Code;   
- the board chairman to be able to chair the nomination committee;   
- clarification of the roles of the chairman and the senior independent director (SID), emphasising the chairman’s role in providing leadership to the non-executive directors and in the communication of shareholders’ views to the board;   
- for smaller listed companies below the FTSE 350, relaxation of the rule on the number of independent non-executives to 'at least two' instead of 'at least 50%'; and   
- particularly rigorous review rather than special explanation when non-executive directors are re-elected beyond six years.

The intention is that provisions should be as clearly defined and verifiable as possible, so that companies can report unambiguously whether or not they have followed them. The supporting principles are cast in more general terms and leave the detailed method of implementation for companies to decide. Companies will be required, as at present, to make a statement on how they have applied the main principles, and this requirement will extend to the supporting principles as well.

The new Combined Code is available on the FRC website at <http://www.frc.org.uk/combined.cfm>

(B) IFAC BOARD PROPOSES CHANGES TO CODE OF ETHICS IMPACTING ACCOUNTANTS WORLDWIDE

On 21 July 2003 the International Federation of Accountants (IFAC) recommended significant changes to its Code of Ethics for Professional Accountants, expanding both the guidance and authority of the Code, which is applicable to all member bodies and to accountants worldwide.

An exposure draft of the revised Code, posted on IFAC’s website at <http://www.ifac.org/EDs>, proposes that the Code be elevated from a “model code” on which to base national requirements to a “standard,” requiring IFAC member body compliance. This change is part of IFAC’s overall efforts to work with its member bodies to raise the quality of practice by accountants worldwide.

The proposed revised Code specifically expands guidance for all individual accountants addressing integrity, objectivity, professional competence, confidentiality, and professional behaviour. Clearer identification of threats and safeguards are set out for professional accountants in public practice in the areas of second opinions, fees and remuneration, and custody of client assets.

The revised Code also provides new and in-depth guidance for professional accountants in business by addressing issues such as potential conflicts, preparing and reporting information, financial interests, inducements, and disclosing of information.

The exposure draft extends the principles-based approach, consistent with that used in Section 8 on Independence issued in November 2001, to the entire Code, addressing accountants both in practice and in business.

Because these proposals call for significant changes for member bodies and individual accountants, the exposure period has been extended to 120 days. Comments are requested by 30 November 2003. They may be submitted to Edcomments@ifac.org or faxed (+1-212-286-9570) to the attention of the IAASB Technical Director.

Comments may also be mailed to the Technical Director’s attention at IFAC, 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA.

IFAC is the worldwide organization for the accountancy profession. Its 155 member bodies are located in 113 countries and represent over 2.4 million accountants employed in public practice, the private sector, education, and academia.

(C) SEC PUBLISHES STAFF REPORT ON PROXY PROCESS REVIEW

On 15 July 2003 the United States Securities and Exchange Commission published a report prepared by its Division of Corporation Finance concerning the Division's review of the Commission's rules and regulations regarding the nomination and election of directors. The staff report notes the need to improve the existing proxy process and recommends action in two areas: improved disclosure and improved shareholder access to the director nomination process. The report recommends the following actions:

- Require more robust disclosure of the nominating committee processes of public companies, including the consideration of candidates recommended by shareholders.  
- Require specific disclosure of the processes by which shareholders may communicate with the directors of the companies in which they invest.  
- Require that major, long-term shareholders (or groups of long-term shareholders) be provided access to company proxy materials to nominate directors, where there are objective criteria that indicate that shareholders may not have had adequate access to an effective proxy process. Examples of events that would trigger this access could include situations where the results of the proxy process are not acted on by companies or where there is substantial shareholder dissatisfaction with the operation of the proxy process.

SEC Chairman William H Donaldson said, "An effective proxy process has never been more important to restoring investor confidence. We have worked and continue to work with the markets to put in place listing standards and rules that increase both the role of independent directors and the voice of shareholders. The next step is to assure that the proxy process reinforces these important advances. The staff is to be commended for its work in gathering the views of the public and preparing timely and responsible recommendations. I have asked them to prepare rule proposals that would effect each of the recommendations in the report. I hope that the Commission will be able to consider such proposals as early as August with regard to the disclosure recommendations and as early as September with regard to the proxy access recommendation. I look forward to the Commission's deliberations and to public discussion regarding those proposals."

The staff report may be found on the Commission's website at <http://www.sec.gov>

(D) MICROSOFT TO EXPENSE STOCK OPTIONS

On 8 July 2003 Microsoft Corp announced changes in employee compensation. Starting in September 2003, employees will be granted Stock Awards instead of stock options. The Stock Award program offers employees the opportunity to earn actual shares of Microsoft stock over time, rather than options that give employees the right to purchase stock at a set price.

While many companies provide stock awards, commonly known as restricted stock units, to executives, Microsoft is one of the first major corporations in which every employee will be eligible to become a direct owner of the company through Stock Awards.

As a result of the changes in its compensation approach, Microsoft indicated that starting with its 2004 fiscal year, the company will begin expensing all equity-based compensation, including previously granted stock options.

"Because Stock Awards must be expensed as they vest, we will include the cost of all equity-based compensation in both future and prior years' financial statements to preserve year-over-year comparability," said John Connors, senior vice president, finance and administration, and chief financial officer at Microsoft. "We agree with others in our industry that there's no one-size-fits-all approach when it comes to equity compensation programs and the resultant accounting for them. Every company has a unique set of circumstances, and this is the appropriate accounting treatment for our new compensation plan."

(E) THE WORLD'S LARGEST COMPANIES

In its 14 July 2003 issue Business Week published its list of the top 1,000 companies based on the share price of these companies as at 31 May 2003. The list excludes companies from what Business Week refers to as emerging markets. About 100 companies from emerging markets (such as China, Korea, Russia, Taiwan, South Africa, Brazil and Mexico) would have made the list based on their market capitalization.

Companies from the following countries make up the top 1,000 list (2002 figures are in brackets):

Australia - 27 (19); Austria - 2 (1); Belgium - 9 (10); Britain - 77 (85); Canada - 41 (39); Denmark - 6 (6); Finland - 5 (6); France - 48 (51); Germany - 35 (35); Greece - 7 (3); Hong Kong - 18 (15); Ireland - 4 (5); Italy - 24 (24); Japan - 129 (142); Netherlands - 19 (19); New Zealand - 1 (1); Norway - 5 (5); Portugal - 4 (3); Singapore - 6 (6); Spain - 18 (15); Sweden -17 (17); Switzerland - 17 (20); and United States - 488 (473).

(F) SETTLEMENT OF SEC'S CLAIM FOR A CIVIL PENALTY AGAINST WORLDCOM

On 7 July 2003 the United States Securities and Exchange Commission announced that the United States District Court Judge Jed Rakoff issued an Opinion and Order approving the SEC's settlement with WorldCom, Inc.

In its Opinion and Order, the Court concluded that "the proposed settlement is not only fair and reasonable but as good an outcome as anyone could reasonably expect in these difficult circumstances." The Court noted that the civil penalty to be paid by WorldCom, would be "75 times greater than any prior such penalty." The Court wrote that "the Court is satisfied that the Commission has carefully reviewed all relevant considerations and has arrived at a penalty that, while taking adequate account of the magnitude of the fraud and the need for punishment and deterrence, fairly and reasonably reflects the realities of this complex situation."

In its Opinion and Order, the Court stated that the Court will enter the Final Judgment as to Monetary Relief in the form submitted by the parties. That Final Judgment provides that WorldCom is liable for a civil penalty in the amount of $2.25 billion. The Final Judgment also provides that in the event of confirmation of a plan of reorganization of WorldCom by the Bankruptcy Court, WorldCom's obligations under the Commission's judgment shall be deemed to be satisfied by the company's payment of $500 million in cash and by its transfer of common stock in the reorganized company having a value of $250 million to a distribution agent to be appointed by the District Court. Under the terms of the settlement, the funds paid and the common stock transferred by WorldCom to satisfy the Commission's judgment will be distributed to victims of the company's fraud, pursuant to Section 308 (Fair Funds For Investors) of the Sarbanes-Oxley Act of 2002. The proposed settlement remains subject to review and approval of the United States Bankruptcy Court for the Southern District of New York.

The Commission has alleged that WorldCom misled investors by overstating its income from at least as early as 1999 through the first quarter of 2002, as a result of undisclosed and improper accounting (Litigation Release No 17829).

The Commission filed its case against WorldCom on 26 June 2002, the day after WorldCom announced that it intended to restate its financial results for five quarters-all quarters in 2001 and the first quarter of 2002 (Litigation Release No 17588). The Commission also sought the appointment of a corporate monitor for WorldCom, and on 3 July, US District Judge Jed S Rakoff appointed former SEC Chairman Richard Breeden to that position.

On 26 November 2002, the Commission obtained a judgment against WorldCom through which the Commission obtained the full injunctive relief it sought against WorldCom. In addition, the judgment ordered WorldCom to undertake extensive reviews of its corporate governance and internal controls, as well as required the WorldCom to establish a training and education program for WorldCom officers and employees to minimize the possibility of future violations of the federal securities laws. The 26 November 2002 judgment explicitly left open the determination of monetary penalties to be imposed on WorldCom (Litigation Release No 17866).

Since the Commission filed its action against WorldCom, the company has made a series of announcements expanding its anticipated financial restatement due to the fraud, both in dollar amount and in time. In addition, the Commission has brought civil actions against four former employees of WorldCom. The Commission filed civil actions against former WorldCom Controller David F Myers on 26 September 2002 (Litigation Release No 17753); former WorldCom Director of General Accounting Buford "Buddy" Yates, Jr, on 7 October 2002 (Litigation Release No 17771); and Betty L Vinson and Troy M Normand, former accountants in the WorldCom's General Accounting Department, on 10 October 2002 (Litigation Release No 17783). All of these actions are pending.

In determining to enter into the settlement, the Commission considered remedial acts promptly undertaken by WorldCom and cooperation afforded the Commission staff.

The Commission acknowledges the assistance and cooperation of the US Attorney's Office for the Southern District of New York and the Federal Bureau of Investigation.

(G) ACCC ISSUES DISCUSSION PAPER ON LONGER-TERM ACCOUNTING SEPARATION RULES FOR TELSTRA

On 4 July 2003 the Australian Competition and Consumer Commission (ACCC) issued a Discussion Paper on new record keeping rules to implement a longer term accounting separation regime for Telstra. The paper raises a number of issues which need to be resolved in order to ensure a more transparent, accountable and informed regulatory market by improving the provision and disclosure of information on Telstra's operations to the ACCC, industry, the public and the Government.

The paper seeks comment on issues relating to the development of the current cost accounting and imputation testing frameworks which will apply to Telstra's longer term (post-2003) reporting under the new accounting separation regime.

The paper is available from the ACCC website at <http://www.accc.gov.au> under Telecommunications or from John Bahsevanoglou on (03) 9290 1949 or Carl Toohey on (03) 9290 1872.

(1) Background

On 24 September 2002 the Minister for Communications, Information Technology and the Arts, detailed a range of measures aimed at increasing the level of competition and investment in the telecommunications market to benefit consumers and business.

One of the key measures announced was the encouragement of a more transparent regulatory market by requiring an augmented system of Accounting Separation (AS) of Telstra's wholesale and retail operations. AS was seen as a means of addressing competition concerns arising from the level of vertical integration between Telstra's wholesale and retail services and improving the provision of costing and price information to the ACCC, access seekers and the public.

The Telecommunications Competition Act allows the Minister to give a Ministerial Direction to the ACCC about Telstra's wholesale and retail operations. It also provides the Minister with a power to direct the ACCC to prepare or publish reports using its existing broad record-keeping rule powers under Part XIB of the Trade Practices Act 1874.

On 10 June 2003, the Minister issued a Ministerial Direction instructing the ACCC to use its existing powers under Part XIB of the Trade Practices Act 1874 to ensure that:

- Telstra prepares current cost accounts, as well as existing historical cost accounts to provide more transparency to the ACCC about Telstra's cost as an ongoing sustainable business;  
- Telstra prepares reports for the ACCC on current cost and historic cost key financial statements in respect of 'core' interconnect services;  
- Telstra's reports be disclosed by the ACCC with an accompanying assessment statement by the ACCC;  
- the ACCC publishes an ‘imputation’ analysis (based on information provided by Telstra, which assumes that Telstra purchases the ‘core’ interconnect services at the price that it charges external access seekers);  
- Telstra prepares reports for the ACCC comparing its actual performance in supplying ‘core’ services to itself and to external access seekers in terms of key non-price terms and conditions;  
- the ACCC prepares and publishes a six-monthly report on competition in the corporate segment of the market.

The discussion paper deals with the first four points noted above. A separate discussion paper on key performance indicators (KPIs) for non-price terms and conditions (fifth point) was issued in April and a more comprehensive monitoring system for KPIs will be implemented over a similar time-frame to that being proposed for CCA and imputation testing.

A discussion paper competition on the corporate market report is currently being prepared and will be issued in due course.

(H) COMMONWEALTH DPP TO UNDERTAKE HIH CRIMINAL PROSECUTIONS

On 3 July 2003 the Australian Treasurer, Peter Costello and the Australian Attorney General, Daryl Williams announced the Government's decision that the Commonwealth Director of Public Prosecutions (CDPP) will undertake criminal prosecutions relating to the financial collapse of the HIH Insurance Group. This will include criminal prosecutions under the Corporations Act and the Crimes Act (NSW).

A key task of the HIH Royal Commission was to inquire into the possibility of breaches of law and whether possible criminal or other legal proceedings should be referred to the relevant agency. In releasing the Commissioner's report on 16 April 2003 the Government immediately referred all possible breaches of the Corporations Act to the Australian Securities and Investment Commission (ASIC) and breaches of the NSW Crimes Act to the NSW Director of Public Prosecutions.

The Government sought the advice of the CDPP and ASIC and has accepted their recommendation that the CDPP is the most appropriate and effective body to undertake HIH criminal prosecutions.

The powers of the CDPP are extensive and provide the best opportunity for the efficient prosecution of HIH cases. The CDPP has the power to prosecute offences against the Corporations Act, to grant indemnities to witnesses, to appeal against sentences and other matters following completion of the prosecution and, under arrangements with the States, to prosecute State offences.

A specialised unit will be established within the CDPP and will be staffed by people experienced in the prosecution of complex commercial cases. The unit will be dedicated solely to the pursuit of HIH matters. The specialised unit will be assisted by two Senior Counsel and two Junior Counsel retained from the bar who will advise on matters referred to the CDPP by ASIC. A taskforce has already been established within ASIC to examine prosecutions and prepare briefs for possible proceedings. The Government expects these two agencies to work closely on investigating and prosecuting possible breaches arising from the failure of the HIH Insurance Group.

The Government intends to allocate additional funding of $14 million over three years to the CDPP to undertake criminal prosecutions. ASIC has already been provided with additional funding of $17.5 million in 2003-04 and $10.7 million in 2004-05 to undertake this task.

The Government has also ensured that ASIC is able to efficiently and expeditiously investigate possible breaches of the law by legislating to transfer the records of the HIH Royal Commission to ASIC. The legislation maintains key protections that currently attach to the Royal Commission records, such as the protection of individuals against self-incrimination and rights to claim legal professional privilege.

(I) STANDARDS AUSTRALIA BLUEPRINT FOR GOOD CORPORATE GOVERNANCE

On 3 July 2003 Standards Australia published a series of five new Australian Standards to help organizations develop and implement effective corporate governance practices.

The Chief Executive of Standards Australia, Mr Ross Wraight, said: “Unlike other governance guidelines these Australian Standards are non-prescriptive and have been designed as an easy to understand framework for small, large, public, private and not-for-profits. As a national framework they also pull together a number of the key elements in the corporate governance including the OECD Principles of Corporate Governance and guidelines produced by IFSA, ASX Corporate Governance Council.”

According to Standards Australia’s Director of Business Standards, Mr Mark Bezzina: “These Standards are the first national consensus based guidelines for corporate governance in the world and were developed with the involvement of all major Stakeholders.”

“During the public comment process in January the draft Australian Standards were reviewed by an extensive cross section of the Australian business community and the business governance committee incorporated the extensive feedback before the publication of the full Standards today.”

The Australian Standards in the corporate governance series include:

- AS 8000 Good Governance Principles  
- AS 8001 Fraud and corruption control   
- AS 8002 Organizational codes of conduct  
- AS 8003 Corporate and social responsibility   
- AS 8004 Whistleblower protection programs for entities

The first Standard in the series, AS 8000 Good Governance Principles, defines key aspects of good governance, provides an outline of the major objectives and gives guidance on how to apply the principles. It also gives advice on:

- Developing a governance policy   
- Education and training for the Board and senior management  
- Strategies for continuous improvement of governance performance  
- Dealing with governance breaches – detecting, recording and dealing with governance breaches and complaints  
- Record keeping  
- Internal reporting – process of identifying, evaluating and managing key risks  
- Board Directors induction programs

The Standard outlines the role and responsibilities of the Board including the development of a remuneration policy, development of measurable performance indicators and adherence to a code of conduct.

It provides advice on disclosure and transparency obligations including information on financial and operating results, organizational objectives, shareholder ownership and voting rights, Board and executive remuneration, major organizational risks and annual reporting on governance systems.

It states that the rights and equitable treatment of shareholders should be protected and the rights to vote in general shareholder meetings, the transfer of shares, elect members of the Board and share the profits of the entity. Shareholders should also have the right to participate in decisions concerning fundamental corporate changes and have the opportunity to obtain effective redress for violation of their rights.

The responsibilities of shareholders are also outlined in the Standard and are crucial for effective governance. Shareholders should have a willingness to exercise their right of ownership and express their views to Boards of Directors. As owners of the entity shareholders elect the Directors to run the entity on their behalf and hold them accountable for its progress.

The Standard also defines the term independent director and outlines what is expected of an individual in their capacity as Chairperson, CEO, Director and Company Secretary and has a special informative appendix covering issues for consideration in the governance of not-for-profits.

Copies of the Standards can be downloaded from Standards Australia’s website at <http://www.standards.com.au> or purchased through the Customer Service Centre on 1300 65 46 46.

(J) UK SURVEY OF COMPANY DIRECTORS’ RESPONSIBILITIES

Shareholders and directors should work together to ensure the system of voluntary codes are effective or run the risk of coming under further pressure, according to the results of a new survey, published on 3 July 2003.

The survey found that although directors recognise their responsibilities, they spend less time determining the strategy and structure of the business or talking to shareholders than they believe they should because of the time spent on complying with regulation and red tape.

Only 3% of all respondents thought that institutional investors looked to generate long-term shareholder value rather than short-term goals

Following from Derek Higgs’ report, the survey also found that:

- Directors continue to prefer voluntary regulation rather than legislation of boardroom activity.  
- Only 30% of the FTSE 350 are likely to recruit non-executive directors in the next 12 months and 80% of these will be recruited from the traditional pool of senior management from other companies.  
- Nearly half of the FTSE 350 respondents felt that Non-Executive Directors should never be paid in shares, even though both the Association of British Insurers and the Hermes principles on corporate governance recommend this as an appropriate method.  
- Although there has been much dissent from shareholders and the Government is consulting over executive pay, less than a fifth of listed company respondents thought their companies would discuss directors’ packages with institutions before they are agreed.

More than 200 directors took part in the joint CMS Cameron McKenna and Institute of Directors survey in April and May 2003. Executive and non-executive directors were asked how they spend their time, what they are worried about and where they turn to for advice. Directors were also asked about levels of remuneration and the implications of recent reports affecting corporate governance and proposed reforms for non-executive directors and audit committees.

The full results of the survey are available at <http://www.law-now.com>; or [http//www.iod.com/underpressure](http://www.law.unimelb.edu.au/bulletins/archive/http//www.iod.com/underpressure) or by emailing samantha.beams@cmck.com or katherine.danby@iod.com

(K) NEW GUIDANCE ON AUDIT REPORTS ISSUED BY AuASB

On 30 June 2003 the Australian Auditing and Assurance Standards Board (AuASB) issued a Guidance Note “Improving Communication between Auditors and Shareholders”, which provides additional guidance for use by auditors for the 30 June 2003 year-end reporting period.

Mr Bill Edge, Chairman of the AuASB said, “There is demand for an alternative form of audit report by users of audited financial reports in the Australian marketplace. This Guidance Note represents a step towards improving the quality of communication between auditors and shareholders, particularly in light of the recent reform proposals within the CLERP 9 Discussion Paper and the HIH Royal Commission Report.”

The Guidance Note is available on the website of the AuASB at <http://www.aarf.asn.au/>

For further information, please contact:

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(L) FSA FINALISES NEW REGIME FOR ALTERNATIVE TRADING SYSTEMS

On 30 June 2003 the United Kingdom Financial Services Authority (FSA) issued its final rules for alternative trading systems (ATS) which will increase the level of transparency available to market participants and improve market monitoring of trading platforms. Currently, the rules for ATSs are the same as those for ordinary securities firms, an anomaly which is addressed by the proposals. Both market participants and consumers will benefit from the improved standards which will limit the scope for market abuse and provide greater price information to the market.

The proposals in the policy statement include:

- Enhanced transparency provisions for ATSs will lead to improved visibility of prices for investors. This will enable them to make informed investment decisions.  
- A requirement that ATS operators introduce arrangements to monitor trading undertaken on their systems and report potentially abusive trading to the FSA. This will help prevent abusive trades at the expense of ATS users or other consumers.   
- Enhanced information about systems to be given to retail and intermediate customers who sign up to use them. This will mean that clients are aware of the way in which their deals will be handled.   
- ATSs to ensure that markets are properly informed about the instruments traded, where there are retail or intermediate customers using their systems.

The European Union is currently considering proposals revising the Investment Services Directives. This includes transparency and market monitoring rules for ATSs. The standards which the FSA has proposed are in line with the provisions currently under discussion.

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

(M) FSA REFINES PLANS FOR REGULATING GENERAL INSURANCE

On 30 June 2003 the United Kingdom Financial Services Authority (FSA) published its revised proposals for regulating the sale of general insurance, which begins on 14 January 2005. In response to feedback on CP160 and separately commissioned independent research on costs, the FSA has amended its plans to ensure that regulation properly reflects the risks in the general insurance sector.

This consultation paper (CP187) contains draft rules which will raise the standard of advice consumers receive, reduce the likelihood of consumers buying inappropriate cover and improve service standards for handling claims and complaints. The main policy changes are:

- Critical illness, private medical insurance and income protection insurance will not be subject to a specifically tailored regime for higher risk products, as proposed in CP160. Instead, there will be requirements aimed at addressing particular risks, which can arise across all types of insurance products. For example, all firms will be required to disclose significant and unusual exclusions to their customers. So, for medical insurance, consumers must be told up-front what medical conditions and types of illness will be excluded from a policy.  
- Small businesses will be classified as commercial customers, rather than private customers as proposed in CP160. Only private individuals will be classified as retail customers.  
- Long-term care insurance will be regulated as an investment product. A separate consultation paper will follow in the autumn.

As part of CP187, the FSA is also putting forward proposals for some changes to the regime for exempt professional firms which covers solicitors, accountants and actuaries in connection with insurance and mortgage business.

The FSA welcomes feedback to this consultation by 30 September 2003. Final rules are expected to be published in January 2004.

The consultation paper is available on the FSA website at <http://www.fsa.gov.uk>

(N) NEW US RULES REQUIRE SHAREHOLDER APPROVAL OF EQUITY COMPENSATION

On 30 June 2003 the United States Securities and Exchange Commission approved new rules proposed and adopted by the New York Stock Exchange and the Nasdaq Stock Market requiring shareholder approval of equity compensation plans, including stock option plans. The new rules will also require approval for repricings and material plan changes.

The new rules will provide for the first time comprehensive shareholder approval requirements for these plans for companies subject to the listing standards of the NYSE and Nasdaq. The NYSE's new rules will replace its current pilot program, which exempted "broad-based" equity compensation plans from a shareholder approval requirement.

The Commission also approved a change in the NYSE rules for voting shares held in "street name" on equity compensation plans. The change will permit a broker that is a member of the Exchange to vote for or against those plans only when the broker receives instructions from the beneficial owner of the voting securities.

The release approving the new rules may be found on the Commission's website at <http://www.sec.gov>

(O) EXPANDING THE SCOPE OF AUDIT

On 26 June 2003 The Institute of Chartered Accountants in Australia (ICAA) identified a need for Australian businesses to work with the auditing profession to improve investor confidence by expanding the scope of audit, following the release of the paper “Financial Report Audit: Meeting the Market Expectations”.

Chief Executive of the ICAA Stephen Harrison said: “The Institute is challenging the business community to improve the financial information they provide to investors. Financial audits are a key component of this information.”

Stephen Harrison said: “The profession has failed to close the so-called ‘expectation gap’ of what an audit does. The audit expectation gap has not significantly narrowed and the Institute’s Financial Report Audit is proposing a different approach – changing the scope of audit so it better lines up with community expectations.”

The ICAA’s Financial Report Audit paper provides a series of short-term steps to improve the audit product, while looking at what is needed for longer term change to take place.

The report is available on the ICAA website at <http://www.icaa.org.au/index.cfm>

Following is a summary of the proposal contained in the paper.

(1) Proposals for expanding the scope of audit

The paper presents opportunities that exist to expand the scope of services currently being provided by audits as well as additional areas that could be undertaken as part of an extended audit.

The options presented raise implementation issues that will need to be addressed, such as:

- Format of the expanded report   
- Criteria and measurement of extended services   
- Determination of who the report is prepared for   
- Determination of presentation as plain english vs legally worded   
- Education of the profession – current and future   
- Education of the community   
- Legislative requirements – auditing standards and indemnity issues

There are a number of areas of the audit that need to be reviewed for systemic change:

(a) Core audit services

Extensions could be made to existing core audit services to add further value to the financial report audit.

This would create an opportunity to further reduce the expectation gap by redesigning the audit report to clarify what the audit does and does not cover.

(i) Internal control

Current: There has been a trend to ‘unbundle’ audit of internal controls from the standard audit of financial statements.

Proposal: Management should report on internal control process and the auditor should report on those assertions.

Challenges: Should it only cover financial reporting internal controls? Should it be broadened to other internal controls eg risk management and corporate governance?

(ii) Fraud detection

Current: Greater public education needed regarding financial report audit – currently it only reviews financial statement fraud.

Proposal: Audit should thoroughly investigate fraudulent financial reporting

Challenges: Need to develop tests for forms of fraud other than financial statement eg defalcation. Need to develop methods of reporting on the finding of those tests and the controls in place to prevent such frauds.

(iii) ‘Going concern’

Current: Expectation that the audit opinion provides assurance of the ongoing viability of an entity via verification of financial statements.

Proposals: Auditors prepare an assurance report with respect to going concern.

Challenges: Management identifying a set of performance indicators pointing to the health of the so the auditor can offer commentary. The auditor identifying and reporting on key non-financial indicators that can impact corporate failure. Auditors providing commentary on the company’s financial health.

(b) Extended audit services

These would be valid extensions given the substantial knowledge auditors already have.

(i) Business risks

Proposal: Board of Directors report on the risks an entity faces and the controls in place to handle those risks and auditors should provide assurance on that report.

Challenges: There will be a need to have a Framework in place for identifying typical business risks across Industries so that there is consistent and comparable reporting.

(ii) Management Discussion and Analysis (MD&A)

Proposal: MDA should disclose information on a company’s performance according to core businesses, strategy, critical success factors and key performance indicators.

Challenges: Need to determine the form of the subsequent audit report and the level of assurance.

(iii) Quality of accounting policies

Proposal: Management should reveal accounting policy choices that disclosure should be audited. The auditor should attest to the key accounting policy choice options, the impact of the choice on financial statements and their views on the appropriate choice.

Challenges: This is a dual reporting function with the auditor attesting to management’s assertions on where accounting policy choices have been made.

(iv) Corporate governance

Proposal: Provide assurance on compliance with the ASX Corporate Governance Council recommendations.

Challenges: Developing performance criteria. Maintaining auditor independence when considering some of the recommendations.

(v) Continuous disclosure

Proposal: Provide assurance on company’s disclosures to the ASX under continuous disclosure requirements.

Challenges: What level of assurance is required? Should reports be to shareholders, board of directors or the audit committee?

(vi) Performance audits

Proposal: Expanding scope of audit to incorporate performance audits

Challenges: Developing appropriate criteria and ensuring criteria remain current and can be measured. Determine the appropriate instances where a performance audit is required

(vii) Continuous audits

Proposal: Use XBRL technology to facilitate easier application of continuous audits on continuous financial reporting.

Challenges: Commitment from Boards that a continuous financial reporting framework is required. Development of continuous auditing tools allowing the Auditor to report on the Board’s Financial Information, made assessable on the Company’s website.

(P) FSA IMPLEMENTS REFORMS ON GOVERNANCE OF LIFE INSURANCE FIRMS

On 26 June 2003 the United Kingdom Financial Services Authority (FSA) announced it is pressing ahead to implement its far-reaching plans to improve the governance of life insurance firms. These include making the use of discretion in with-profits funds more transparent and making directors and senior management of life insurers explicitly responsible for all decisions of their business, including those taken on actuarial advice.

The Policy Statement sets out the timetable for implementing the new arrangements as follows:

- firms to define and make available to with-profits policyholders their "Principles and Practices of Financial Management" (PPFM) by end March 2004 - the PPFM documents how firms exercise their discretion in managing with-profits funds;  
- firms to put in place any changes in governance arrangements and reporting to with-profits policyholders by end March 2004; and  
- following the decision to discontinue the Appointed Actuary regime, the actuarial function and with-profits actuary will assume their roles by the date when the Integrated Prudential Sourcebook (PSB) takes effect for life insurers during 2004.

The policy statement is available on the FSA website at <http://www.fsa.gov.uk>

(Q) CaLPERS APPROVES PLAN TO CRACK DOWN ON EXECUTIVE COMPENSATION SYSTEM

In June 2003 the California Public Employees’ Retirement System’s (CalPERS) Board of Administration approved a comprehensive action plan to crack down on what it refers to as abusive executive compensation plans in corporate America and hold compensation committees more accountable for their actions.

The plan calls for CalPERS to publicly scrutinize companies with the worst and best trends in executive compensation, and outlines a model executive compensation policy statement for companies to use as a blueprint to develop their own policy. It also unveils specific areas where CalPERS will vote its shares against compensation issues.

Under the plan, CalPERS will identify 10-15 companies with bad and good compensation practices using an analysis tool that compares CEO compensation to its corporate peers and the performance of the company versus its peers. The analysis takes into account total CEO compensation as well as base salary, incentive plans, restricted stock, options, and other compensation factors.

CalPERS analysis will be used to decide how CalPERS will vote its proxies on compensation issues and to highlight poor and good compensation practices on the pension fund’s web site.

In addition to the analysis, CalPERS will vote against any compensation plan that does not prohibit repricing, include a significant portion of performance-based components and vesting periods of at least four years for a significant portion of overall grants.

CalPERS also plans to vote against compensation plans that contain evergreen provisions that automatically increase the shares available for grants on an annual basis, and those that provide reload options allowing an optionee who exercises a stock option using stock already owned to receive new options for the same number of shares used.

CalPERS model executive compensation policy encourages companies to design programs that provide alignment of interests with shareowners and include a combination of cash and equity-based compensation. The pension fund also wants programs to be transparent and fully disclosed. Plans should include the parameters of the employment contract provisions, severance packages, and the overall compensation philosophy.

CalPERS expects to fully implement its plan by Fall 2003 and will use it to vote its shares in the 2004 proxy season.

A copy of CalPERS Executive Compensation Plan can be found on its website at http://www.calpers.ca.gov, click CalPERS Board Meeting Information, then Investment Committee, then item 7C.

CalPERS is the United States’ largest public pension fund with assets of $138 billion. It provides retirement and health benefits to 1.3 million State and local public employees and their families.

(R) STUDY OF CEO PAY IN EUROPE

Europe's highest paid CEOs are in France according to a study of pay practices among FTSE Euro top 300 companies published in June 2003 by the European Corporate Governance Institute. French CEOs earn on average EUR1.85 million. This is 16% more than the average EUR1.55 million in pay and performance-based bonuses of UK CEOs, and much more than Dutch CEOs (EUR1.37 million), German Executive Board members (EUR1.18 million), Italian CEOs (EUR1.05 million) and Swiss CEOs (EUR0.98 million). The study found that 47% of CEO pay in France is variable or performance related, 47% in Germany as well, 41% in the Netherlands, 38% in Italy and 33% Sweden. The UK's 31% of performance related pay jumps to 70% if long-term incentives and pension benefits are included.

The study is available at <http://www.ecgi.org/remuneration/index.htm>

(S) CANADIAN CORPORATE LAW REFORM REPORT

In June 2003, the Canadian Senate Standing Committee on Banking, Trade and Commerce published a report recommending measures to restore investor confidence following recent corporate collapses. The report is titled "Navigating Through 'The Perfect Storm': Safeguards to Restore Investor Confidence". Following are the recommendations of the Committee.

(1) Legislation be introduced that would require a majority of the members of the board of directors to be independent, recognizing the special circumstances that may be faced by closely held corporations and small and medium-sized businesses. As well, the independent directors should be required to meet in camera on a periodic basis. Moreover, legislation should require the development of a code of ethics to be followed by all members of the board of directors. Finally, the federal government should encourage provincial/territorial governments and private sector stakeholders to develop specifically tailored education and training initiatives that would enhance the knowledge of members of the board of directors in areas that are outside their expertise.

(2) Legislation be introduced that would require all audit committee members to be independent and financially literate; moreover, at least one member should be a financial expert. The audit committee should also have the ability to select and take advice from an independent audit advisor. As well, legislation should require in camera meetings between the audit committee and the auditor. Finally, the federal government should encourage provincial/territorial governments and private sector stakeholders to develop specifically tailored education and training initiatives that would enhance the level of financial literacy among boards of directors in Canada, particularly among audit committee members.

(3) Legislation be introduced that would prohibit compensation committee members from being a member of management and would require them to have a level of expertise in the areas of compensation and human resource management. The compensation committee should also have the ability to select and take advice from an independent compensation consultant.

Moreover, legislation should require in camera meetings between the compensation committee and the company's compensation consultant.

(4) Legislation be introduced that would limit the non-audit services that auditors can provide to their audit-clients. These restrictions should not necessarily apply to small and medium-sized businesses. The rules developed by the Canadian Public Accountability Board should be used as a guideline.

(5) Legislation be introduced that would require the audit committee to oversee the auditor selected by the company's shareholders.

(6) Legislation be introduced that would require rotation of the lead audit partner every seven consecutive years.

(7) Relevant laws and regulations be reviewed with a view to ensuring that the accounting profession benefits from modified proportionate, rather than joint and several, liability.

(8) Legislation be introduced that would obviate real or perceived conflicts of interest by financial analysts.

(9) The federal government review current legislative and regulatory provisions regarding fraud, insider trading and other offences, including the adequacy of any penalties, with a view to implementing any needed changes as expeditiously as possible. It should also examine the extent to which existing procedures and resources are adequate to ensure that instances of corporate corruption are properly prosecuted.

(10) Legislation be introduced that would establish whistleblower protection for employees with respect to the reporting of financial irregularities and failed corporate governance.

(11) The role of Chief Executive Officer and Chair of the Board of Directors be split, bearing in mind the special circumstances that may exist with closely held companies and small and medium sized businesses.

(12) The federal government take a leadership role and work with Canadian stakeholders in undertaking discussions with the US Financial Accounting Standards Board, the International Accounting Standards Board and others that will result in all relevant parties working expeditiously toward the development of global uniform accounting standards.

(13) The federal government convene a meeting of all stakeholders to discuss the entity that should have responsibility for the setting of - and, importantly, revisions to - accounting standards and rules. The government must take a leadership role in ensuring that the entity to which responsibility is given has the necessary independence, accountability and transparency to safeguard investor confidence.

(14) Legislation be introduced that would require an organization's Chief Executive Officer and its Chief Financial Officer to certify that the annual financial statements fairly present, in all material respects, both the results of the organization's operations and its financial condition.

The report is available at: <http://www.parl.gc.ca/common/committee_Senhome.asp?Language=E&parl=37&Ses=2&comm_id=3>

(T) SURVEY OF INVESTMENT MANAGERS

In June 2003 KPMG published a report titled "Revolutionary Shifts, Evolutionary Responses: Global Investment Management in the 2000s". The report presents the results of a survey of 185 investment managers in 20 countries (with a total of Euro 19 trillion under management) as well as interviews with 60 CEOs and CIOs from these firms. The report aims to:

(a) identify the nature and scale of changes that have occurred in the global investment management industry;

(b) highlight the responses of individual firms to massive falls in business volume and profits; and

(c) underline further actions that can help executives of these firm manage their businesses.

The report is available at <http://www.kpmg.com/>

(U) LEVELS OF SHARE OWNERSHIP

The Australian Stock Exchange has released a report on levels of share ownership in 2002 in 10 countries. Of the 10 counties, those with the highest levels of share ownership among the adult populations are:

Australia - 50%  
USA - 50%  
Canada - 46%.

Other countries included in the report are Germany (18%) and Switzerland (25%). The share ownership percentages for these countries includes both direct and indirect share ownership. Indirect share ownership refers to ownership of shares through managed funds. In terms of direct share ownership, 37% of adult Australians own shares directly.

Although absolute comparisons are difficult (due to different data collection periods, sources, methodologies, weighting treatment, etc), the findings show that total share ownership in Australia has grown by 47% since 1997. Only Germany among the 10 sample countries has grown faster, increasing, from a low base, by 100% over the same period.

The report also provides details on the profile and behaviour of the shareowners from the featured countries. It found that share ownership increases with rises in education, and household income and assets, and that financial planners and the media are among the most popular sources for share information and advice for Australians.

The International Share Ownership report can be viewed at:   
<http://www.asx.com.au/about/pdf/ASXInternationalShareOwnershipSummary03.pdf>

(V) UK PARLIAMENTARY COMMITTEE RELEASES REPORT ON THE UK GOVERNMENT’S MAJOR REVIEW OF COMPANY LAW

The UK House of Commons Trade and Industry Committee has released its report on the UK Government's major review of company law in that country. The Government White paper was published July 2002 and titled "Modernising Company Law'" (see the July 2002 issue of this Bulletin for a summary of the White Paper). Since the publication of the White Paper, the Higgs Report on the Role and Effectiveness of Non-Executive Directors was published (see the February 2003 issue of this Bulletin for a summary of the Higgs Report) and this report was also considered by the Trade and Industry Committee. Following are the conclusions and recommendations of the Committee. The report is available at:

<http://www.parliament.uk/commons/selcom/t&ihome.htm>

(1) Directors' duties

We consider that the aim of the law should be to provide a framework to promote the long term health of companies, taking into account both the interests of shareholders and broader corporate social and environmental responsibilities. The specific duties of care required of companies to their employees and society at large will normally best be set out in other legislation, covering areas such as health and safety, environmental and employment law. However, the proposed statement of directors' duties in the White Paper does represent a step forward as, for the first time, it explicitly recognises that good managers will have regard to a broader range of considerations than value to shareholders, which on its own may lead to short-termism. The White Papers' formulation leaves the responsibility to make decisions about the company's future where it should be—on the directors, not on the courts (Paragraph 22).

We see no need to include a duty to creditors in the statement of directors' duties. This statement is intended to lay out a broad, generic set of obligations and not a detailed list of the legislation which directors might be required to adhere to under certain circumstances (Paragraph 25).

(2) Higgs Review

We welcome the Higgs Review. The proposals are modest but can contribute to good corporate governance standards in the UK, whilst the 'comply or explain' principle ensures that they should be flexible enough to avoid being seen as overly prescriptive. Interpretation is important, however, and the boards of companies must approach the proposals in an objective and sensible fashion in order to adopt those suitable to them and adapt those that need to be 'tweaked'. Similarly, though, failure to comply should not be taken as a negative sign by investors, providing it is accompanied by an adequate explanation that shows how governance standards are not compromised by the decision. It is important that the proposals are not interpreted so flexibly that they lack substance, nor so rigidly that they become a straitjacket (Paragraph 49).

(3) Non-Executive Directors: multiple directorships

The emphasis on fulfilling the duties of NEDs rather than setting down mandatory limits on their commitments is in keeping with the general approach adopted throughout the Higgs Review and we broadly support this approach. But, it is important that the flexibility built into the Higgs proposals is not abused and this will need to be monitored carefully by the Financial Services Authority as guardian of the Combined Code, and by the Department of Trade and Industry. We are confident that such monitoring will take place, given the concerns about multiple directorships expressed to us by key interest groups (such as the IMA) and the welcome given to the Higgs proposals by bodies such as the ABI and the National Association for Pension Funds (Paragraph 49).

It has been suggested that the Higgs proposals will result in NEDs having to commit more time to their work and that remuneration will need to increase accordingly. The Higgs Review suggestions for increasing the supply of NEDs would help to alleviate the problem. But for the most part Higgs is not proposing much that is not already adopted as best practice by many companies. Given this, it is hard to see how the time commitment of those NEDs who have already been doing their jobs thoroughly will increase significantly. There must be concerns about whether those who feel they cannot meet the time commitments were fulfilling the duties required of them (Paragraph 48).

(4) Non-Executive Directors: recruitment

We believe that there is scope for recruiting NEDs from outside the usual, narrow pool. Some could be found among younger business people with direct commercial experience, others among those with still relevant but broader experience. In fact, it might be that the introduction of those with backgrounds different from those of the existing, thoroughly homogeneous pool of NEDs could introduce fresh thinking and an element of dynamism to company boards (Paragraph 35).

(5) Directors: training

It is important that attitudes towards training of directors change. Relevant experience is clearly fundamental for directors but their professional development should not stop merely because they have reached board level. However, this attitudinal change can only be realised if training provision is available. The Institute of Directors now runs a chartered directors programme, but this is the exception and directors' training (as opposed to training in management, for instance) remains scarce. We hope that the Higgs Review can act as a stimulus to both the provision and take-up of training for all directors (Paragraph 38).

(6) Effect of Higgs proposals on company boards

We recognise that the Higgs proposals could have different implications for larger and smaller fully listed companies. In order to comply with the provision that boards should have a majority of NEDs, smaller listed companies may not be so willing to appoint senior managers to the board. We consider the wider representation of the Executive Directors on the Board to be a particular benefit to companies and therefore suggest that the situation is kept closely under review by the Government. We would be concerned if the effect of the Higgs proposals was to encourage smaller listed companies to relist on the AIM where overall it would be shareholders' protections that would be diminished (Paragraph 47).

(7) Reporting by companies

(a) Environmental and social reporting

The proposed Operating and Financial Review (OFR) would be a marked improvement on current minimum reporting standards. It would help to give a much more rounded, clearer view of both past operations and future prospects of companies. It would be of benefit not only to shareholders and potential investors in companies, but also to all those concerned with wider aspects of company behaviour, whether as employees, local residents, or as interest groups involved in environmental/social issues or general corporate governance (Paragraph 69).

We believe that in practice directors will not be able to get away with assuming that environmental and social concerns are not relevant to their company and can be passed over without comment; we think that, in this area too, companies will be expected by investors and monitoring groups to "comply or explain". We would also be concerned if the effect of these proposals concerning the production of an OFR were to support a 'box ticking' attitude amongst companies. We recognise the concerns expressed by some witnesses over whether the division into "core" and "other" matters would in effect downgrade the latter, but we consider that there will be pressure (from investors and others) for companies to raise their standards of reporting to those set by the pioneers in this area. In this context, we agree with the view expressed by the TUC that company law alone cannot be expected to change corporate culture: without active shareholders and other interest groups, unwilling or incapable directors would be able to nullify the effects even of statutory obligations (Paragraph 70).

There seems to be a discrepancy between what the advocates of greater Corporate Social Responsibility want from the auditing of OFRs and what auditors—and the Government—expect. Given the limitations on auditor responsibility even in respect of financial information, it would be unrealistic to expect auditors to assume greater responsibility for information that is qualitative and even less easy to verify than financial reports (Paragraph 68).

(b) Which companies should be required to produce OFRs?

To date there has been little private sector experience of the production of OFRs in the UK, and a number of companies are clearly anxious about what an OFR will be expected to contain, and the cost and difficulty of producing one. So on balance we prefer a gradualist approach, so that the details of what is required can be worked out with the largest companies and then the key aspects extended to smaller companies. We are therefore content with the thresholds for production of OFRs proposed in the White Paper (Paragraph 75).

(c) Penalties for failure to comply with reporting requirements

We agree that the effect of the law should be to encourage companies to make the proper disclosure in their annual report and accounts rather than merely to punish directors for failing to do this. We note that the current—criminal—sanctions have been little used. We therefore concur with the Government that administrative measures should be more effective in achieving disclosure. We also support the proposal to introduce a clear criminal offence of intent to mislead or deceive the auditors (Paragraph 79).

(8) Audit by the 'Big Four' accountancy firms

We believe that such an audit for many companies was always a status symbol rather than a sign of extra quality, as a number of accountancy firms are equally well qualified to audit most companies. We also think that greater competition in the market for accounting services would promote auditor independence and give a good basis for investor confidence. We therefore hope that institutional investors will not revert to putting pressure on smaller companies to use only one of the 'Big Four' companies on the basis of mere prestige; such an action would contradict many of their efforts in other areas to increase transparency, accountability and effective corporate governance overall (Paragraph 86).

(9) Provision of non-audit services by auditors

Although the evidence is necessarily anecdotal, it seems to us that there is a danger of audit services being used as a loss leader, not least because the lack of competition for auditing big and especially multinational companies must make it very difficult for even the most conscientious audit committee to determine a true market rate for the job. It therefore seems appropriate to limit the types of non-audit services provided by auditors (Paragraph 90).

We do not think there should be a ban on all types of non-audit work by auditors: some tasks could be carried out by auditors without undermining their independence, and potentially more efficiently than by bodies without the inside knowledge of company operations gained by auditors. We consider that the two principles described by the ICAEW are the key tests to determine whether or not non-audit work should be banned (Paragraph 91).

However, particular concerns have been expressed about the supply of expensive IT systems, especially financial control systems; and it seems to us obvious on first principles that external auditors should not also be involved in the provision of internal audit systems. We would therefore recommend a strengthening of the requirements in these areas. Beyond this, we are content that the details of the requirements should be filled in by experts (Paragraph 92).

(10) Regulation of auditors

For reasons of flexibility and maintaining a light-handed approach to regulation, we conclude that it should be the responsibility of an independent body to set standards to uphold the independence of auditors. If such regulation seems to be failing, however, we believe that the Government should re-consider whether it is necessary to impose statutory restrictions on certain types of non-audit work by auditors (Paragraph 94).

(11) Rotation of auditors

We welcome the recent changes to the rules on rotation of audit personnel and on the two year "cooling off" period for auditors. However, we are not confident that by themselves they will be sufficient to restore confidence in the independence of auditors (Paragraph 100).

We agree with the Co-ordinating Group that compulsory re-tendering could simply be an expensive but unproductive exercise. This option depends on the vigilance and independence of the company's audit committee to be effective; but, with a vigilant and independent audit committee, it is not necessary (Paragraph 101).

We are less inclined than some of our witnesses to worry about an increased likelihood of audit failure in the first two years of a new company's tenure. More convincing to us are the arguments about the difficulty of finding a new audit firm that does not have a conflict of interest over the provision of non-audit services, especially in the present uncompetitive state of the market. We therefore do not recommend mandatory rotation of audit firms. However, we do not think that it should be ruled out altogether: if the other measures taken both to increase the scrutiny of auditors by independent directors, and to encourage greater competition among audit firms, prove insufficient to restore confidence in the objectivity of external auditors, then compulsory circulation of audit firms should be re-considered (Paragraph 102).

(12) Audit committees

We agree that audit committees have a vital role to play in corporate governance, and that they should be the main channel of communication between auditors and shareholders via the full board. In order to be "the best practical proxy to the shareholders" for the auditors, such committees should be composed of non-executive directors who are not compromised by having had too close a relationship with the management of the company in the past, who are highly analytical, tough-minded and at least some of whom have had recent financial experience. So that the shareholders are kept as fully informed as possible, such committees should also make a full report to both board and shareholders on how they have exercised their function of scrutinising the auditors. In this context, it also makes sense for the chairman of the audit committee to attend the AGM to answer questions from the shareholders, as already provided for in the Combined Code. Finally, it is important for the members of the audit committee to be fully briefed about their special role, and companies should, where necessary, provide specific training for members of the audit committee to enable them properly to scrutinise external audit and internal control and risk management (Paragraph 107).

(13) Institutional investors

Ultimately, the primary concern of institutional investors is to maximise the returns on their investments. Whilst this may bring with it some pressure on companies hoping to attract funds from institutional investors to ensure that they have adequate corporate governance systems in place, there is a limit to the extent to which the institutional investors are willing or able to police the probity of the UK's companies (Paragraph 120).

(14) Revising Company Law in future

We recommend that, when the Companies Bill is eventually drafted in full, particular attention be paid to whether powers are being delegated appropriately, whether to Ministers or to other bodies; and we consider that, to assist in this, all proposed secondary legislation should be published at the same time as the primary legislation. We also recommend that any changes in the exercise of the most significant powers be subject to the Regulatory Reform Order procedure, which ensures both wide publication and more detailed parliamentary scrutiny than other forms of secondary legislation (Paragraph 126).

(15) Public availability of directors' home addresses

We sympathise with those who fear that directors' families may be made the target of extremist campaigning groups; but we are also aware that many people have concerns about unscrupulous company directors who operate on the edge of legality, and the fact that home addresses are on a public register provides some extra assistance in tracking down these people. We hesitate to recommend a further breach of the principle of transparency, not least because it is not yet clear whether the recent legislation to protect 'at risk' directors will be effective. We therefore agree with the Government that the situation should be kept under review (Paragraph 131).

(16) Misuse of registers of shareholders

There are valid reasons for maintaining public access to registers of shareholders; and we agree with the Government that it would be more effective to allow companies to refuse to provide copies of the register than to give them the right to try to recover any financial gain from illegitimate use of the information. We consider that, with the general background of data protection and human rights legislation, the courts will be able in practice to distinguish between appropriate and inappropriate use of information. We are concerned that it should be as cheap and easy as possible for companies to apply to the courts in such cases, and urge the Government to bear cost in mind when drafting these provisions (Paragraph 133).

(17) Disclosure of convictions by companies

We consider that it would be in harmony with the other proposed alterations to company law to increase transparency by requiring disclosure of convictions for breach of company law. We agree that, to ensure fairness, there should be a central register, but we see no reason why in addition companies should not be required to disclose such breaches themselves. Under the proposals on the provision of information in company reports and accounts, any failure by companies to make such disclosure would not be a further criminal offence but could be corrected by administrative measures (Paragraph 138).

2. RECENT ASIC DEVELOPMENTS

(A) ASIC ACTS ON CONFLICTS OF INTEREST

On 22 July 2003 ASIC announced the results of its program of reviewing related party disclosure documents sent to shareholders by public companies.

Under the Corporations Act (the Act), public companies need shareholder approval in order to give related parties a financial benefit that is not ‘at arms length’. The Act requires that a company must dispatch sufficient material to shareholders to enable them decide if it is in the interests of the company to pass the proposed resolution. The documents must also be lodged with ASIC before they are sent to shareholders.

In the 2002/2003 financial year ASIC conducted detailed surveillance on over 52 sets of documents and required amendments to be made in 39 cases.

Related party documents most commonly fail to place a value on options being issued to directors or other related parties. ASIC considers that shareholders must know the value of the proposed benefit in order to make an informed decision about whether or not to approve the related party transaction.

ASIC believes that it is best practice to calculate the value of the options in accordance with the valuation model contained in the International Accounting Standards Board’s Exposure Draft ED 2 ‘Share-Based Payment’. All material assumptions used in the model should be clearly disclosed.

Use of this methodology was recommended in ASIC media release 03-202, issued 30 June, (Valuing Options for Directors and Executives) in the context of disclosure in the directors report of the company.

Other information which is material to shareholders’ decisions about whether to approve a proposed grant of options or issue of shares to a related party will often include:

- details of other remuneration already being received by the related party,  
- the extent to which shareholders’ interests will be diluted if shares are being issued or when options are exercised;  
- the basis used for valuing any shares to be issued under the transaction;  
- shares or options currently held by the related party; and  
- the company’s share price history over the last year.

This information enables a shareholder to see the proposed benefit in full context.

It may also be appropriate to include an independent expert’s report on the proposed transaction. Directors should ensure that the expert is adequately qualified to provide the type of report being presented.

Additionally, ASIC has found that disclosure is often inadequate in situations where a company proposes to acquire a business from a related party. In such cases, ASIC considers that the law requires prospectus type comprehensive disclosure to be made to shareholders. This includes disclosure of the risks, the business’ track record, and any assumptions underpinning forecasts or valuations.

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(B) GUIDE TO ORGANISATIONAL COMPETENCY OBLIGATIONS: RESPONSIBLE OFFICERS

On 22 July 2003 ASIC released a new licensing guide “Responsible officers: Demonstrating compliance with organisational competency obligations”.

The guide explains how applicants for an Australian financial services (AFS) licence can demonstrate that they comply with ASIC’s organisational competency obligations in Policy Statement 164 Licensing: Organisational capacities [PS 164]. The guide also explains how ASIC will assess the competency of nominated responsible officers, on whose experience licensees rely to meet these requirements.

PS 164 outlines five alternatives that applicants may use to demonstrate the competency of their responsible officers. This new guide, prepared by ASIC’s licensing analysts, addresses questions raised by different industry groups about how each of these alternatives is applied during assessment of licence applications.

The guide also clarifies that responsible officers for managed investment schemes do not need to meet the requirements of PS 164 unless they are providing financial product advice or financial services unconnected with operating the scheme. These responsible officers are instead required to comply with ASIC Policy Statement 130 “Managed investments: Licensing”.

A copy of the guide is available from the ASIC website at <http://www.asic.gov.au> or by calling Infoline on 1300 300 630.

(C) DEFECTIVE PROSPECTUSES

On 21 July 2003 ASIC provided an overview of its actions in relation to public fundraisings for the 2002/03 financial year. Since July 2002, ASIC has placed a total of 89 stop orders on defective prospectuses seeking to raise over $383 million from the public by the issue of securities.

ASIC intends that publication of the various defects identified in fundraising documents will assist issuers and the advisers who prepare these documents to adequately discharge their duties.

The most common defect was a failure by companies to clarify how the funds would be applied in the event that the company failed to raise the amount originally sought in the raising where it was not underwritten, nor subject to a minimum subscription condition.

Other common defects related to the adequacy of financial information disclosed in the fundraising document, and a lack of disclosure in relation to other material information, usually, the risks associated with the company’s current activities or the proposed venture. Defects relating to the use of financial forecasts in prospectuses were much lower than in previous years suggesting that most prospectus issuers are now familiar with ASIC’s policy statement on forecasts (Policy Statement 170: Prospective financial information).

ASIC considers inadequate financial information to include a failure to meet the specific disclosure requirements in offer information statements (see Policy Statement 157: Financial reports for offer information statements), and the adequacy of details about intangible assets.

Since ASIC last provided an update on its prospectus actions in April this year, ASIC has issued six final stop orders and revoked a further nine interim orders on fundraising documents that contained insufficient information for investors. Three other companies lodged replacement or supplementary documents, which addressed ASIC’s concerns, prior to the issue of an interim stop order.

Most final stop orders were issued with the consent of the relevant company, after they made the decision not to proceed with the particular prospectus, rather than to address the disclosure deficiencies.

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(D) LATE DISCLOSURE OF FINANCIAL STATEMENTS

On 17 July 2003 ASIC announced the results of its campaign against listed companies that failed to lodge their financial statements on time.

The project was designed to detect and take action against listed companies which failed to lodge their half-year financial statements on time, or companies which failed to lodge their full-year financial statements on time, where they had a December 31 balance date.

ASIC issued 22 orders under section 713(6) of the Corporations Act against companies which were late, or failed to lodge their December half-year financial statements. A further five determinations under section 713(6) of the Act were issued against companies which were late, or failed to lodge their December full-year financial statements.

Orders under section 713(6) have two major effects. The first is that they require the companies to use a full prospectus, rather than allowing them the opportunity to rely on the shorter form of prospectus usually available for a listed company that has been complying with its disclosure obligations to the market.

The second is that companies are unable to avail themselves of some ASIC class orders which would otherwise assist in cheaper and quicker fundraising. Examples of these class orders are CO 02/1276, which allows placement of securities in the listed class to be on-sold within 12 months of the placement, and CO 02/831, which allows companies to offer up to $5,000 worth of securities in the listed class to existing members without a prospectus.

ASIC is considering additional enforcement action against those listed companies which have still not lodged their financial statements. The companies have a right of appeal against the orders to the Administrative Appeals Tribunal.

(E) ASIC’s INTERIM APPROACH FOR REGULATION OF MUTUAL RISK PRODUCTS

On 15 July 2003 ASIC announced its interim position in relation to the regulation of mutual risk products (MRPs).

MRPs are risk products that provide an alternative to conventional general insurance products. Generally, MRPs involve participation in a ‘mutual’ scheme based around particular professions, small business associations, franchise operations or community groups (MRP scheme). MRP schemes may cover a range of risks, such as professional indemnity and public liability risks.

‘In general, ASIC considers MRPs to be financial products for the purposes of the Corporations Act because they represent both facilities for managing financial risk and interests in a managed investment scheme. As such, ASIC generally expects MRP providers to comply with the managed investment scheme and licensing provisions of the Act’, ASIC Executive Director Financial Services Regulation, Mr lan Johnston said.

‘In specific, limited circumstances, ASIC will consider granting relief from the managed investment and licensing provisions of the Act’, he said.

The approach outlined in the information release is intended to provide guidance to industry about:

- the application of the managed investment and licensing provisions of the Act;  
- the circumstances in which ASIC will consider granting relief from these provisions, and  
- ASIC’s general approach to licensing people who provide financial services in relation to MRPs.

In the event that the law is amended, or its current position changes, ASIC will provide further guidance to industry.

(1) MRPs and MRP schemes

In general, there are two types of MRP schemes - mutual discretionary funds (MDFs) and mutual non-discretionary funds (MNDFs). Both these schemes involve members contributing money, which is then pooled and held by the person operating the scheme (the MRP provider).

The MRP provider uses the pool of money for purposes such as acquiring general insurance products (eg group insurance) to cover specified risks of the members and for paying claims by members up to a certain limit (such as the excess on the general insurance product(s), eg the first $200,000 of any claim).

The two types of schemes differ in that generally, MDFs only provide members with a right to have their claim properly considered - the payment of claims or provision of financial assistance is at the discretion of the MRP provider. MNDFs provide members with a right to have their claim paid, and the MRP provider has a legal obligation to pay members claims.

The approach outlined in the information release will apply in relation to all MRPs, regardless of whether the scheme involved is a MDF or a MNDF.

(2) Application of the managed investment provisions of the Act

In general, ASIC considers that MRPs are financial products because they represent interests in a managed investment scheme. As such, ASIC generally requires that MRP providers comply with the managed investment provisions in Chapter 5C of the Act.

ASIC has adopted the interim position that it will consider granting conditional relief from the managed investment scheme registration requirement in section 601ED of the Act, on a case-by-case basis, where:

- the MRP provider holds an AFSL with the necessary licence authorisations; and  
- any money received as contributions for a MRP or assets held by the MRP provider as a result of these contributions are held on trust for the members by the MRP provider, only invested in an account held with an Australian authorised deposit-taking institution (AD1) or a cash management trust, or otherwise used to acquire general insurance policies on behalf of the members, pay claims by members or pay any remuneration of the MRP provider in accordance with its agreement with the members.

To qualify for conditional relief, applicants must apply to ASIC in accordance with Policy Statement 51: Applications for relief.

(3) Application of the licensing provisions

ASIC considers that MRPs are financial products because they represent facilities for managing financial risk.

In general, ASIC requires any person who carries on a business of providing financial services in relation to MRPs (such as MRP providers) to hold an Australian financial services licence (AFSL). The AFSL licence authorisations required will depend on the activities of the particular financial service provider.

For example, where ASIC has granted conditional relief from the managed investment scheme registration requirements (as described above), a MRP provider may require authorisations to:

- issue interests in a managed investment scheme;  
- apply for general insurance products, deposit taking facilities of an ADI or managed investment products on behalf of members; and  
- depending on the particular circumstances, provide custodial services by holding general insurance products, deposit taking facilities of an ADI or managed investment products on trust for, or on behalf of, members.

Applicants for AFSL's will need to consider which authorisations are appropriate for their particular circumstances and, where necessary, seek their own professional advice.

AFSL holders who provide financial services in relation to MRPs will be subject to the standard licence conditions set out in Pro Forma 209 Australian Financial Services Licence [PF209].

MRP providers will also be subject to an additional AFSL licence condition aimed at providing enhanced disclosure for consumers. This licence condition will require MRP providers to warn consumers of any risks related to MRP providers (and MRPs) not being prudentially regulated.

Specifically, this licence condition will require MRP providers, when issuing or offering to’ issue MRPS, to inform consumers:

- that the MRP provider is neither authorised under, nor subject to the provisions of, the Insurance Act 1973;  
- that the MRP is not a product regulated by APRA; and  
- of the extent to which the MRP provider will ensure that it has adequate financial resources to pay future claims by members.

MRP providers must provide this warning to all retail and wholesale clients.

When applying for an AFSL, applicants should clearly state whether they provide financial services in relation to MRPs and, if so, describe the nature of the ‘financial services and scheme(s) involved. This information will assist ASIC in considering licence applications.

ASIC will only consider granting relief from the licensing provisions in Chapter 7 of the Act to address atypical or unforeseen circumstances and unintended consequences of those provisions.

The criteria that ASIC will apply in considering applications for relief are those set out in Policy Statement 167 Licensing: Discretionary powers and transition [PS 167.3-167.12]. Applications for relief should also comply with Policy Statement 51: Applications for relief.

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(F) ASIC REGULATION OF PROMISSORY NOTES

On 14 July 2003 ASIC announced the release of an FAQ to assist issuers of promissory notes in understanding their obligations under the Corporations Act. The FAQ provides guidance on the circumstances when promissory notes are likely to be regulated as financial products.

A promissory note is an unconditional promise by an issuer to pay an agreed sum of money at a fixed or determinable future time to, or at the order of, a specified person.

Generally, where an offer involves just a promissory note with a face value of at least $50,000 and no other special features, it will not be regulated under the Corporations  
Act. However, ASIC notes that some issuers are seeking to rely on the promissory note exemptions under the Act by offering complex investment arrangements involving promissory notes to retail investors. In some cases, although an offer involves the issue of a promissory note, the rate of return and the financial risk to retail investors varies or is dependent on the performance of certain investments.

ASIC believes that these arrangements are likely to be financial products and therefore regulated under the Corporations Act, requiring licensing and disclosure. In particular ASIC is concerned about complex arrangements involving promissory notes that:

- are accompanied by other promises about how the money loaned may or will be repaid;  
- may reasonably be considered to express or contain a representation or agreement that the investment returns will be produced by an underlying specific investment or the performance of some specific commercial activity;  
- are not liquid, cannot be easily traded and are not designed to raise short term finance to manage day to day liquidity issues; and  
- are directed primarily at the retail clients.

For example, an arrangement is likely to involve the offer of financial products if investors’ money (raised through the offer of promissory notes) is used to partly fund the purchase and development of property and investors are led to understand that repayment is dependant on the success of the development.

(1) Promissory notes

(a) Is a promissory note arrangement where each note has a face value of more than $50,000 a financial product?

Generally, a simple promissory note with a face value of more than $50,000 would not be a financial product. Other promissory notes may either be a debenture or another sort of financial product, as set out below.

(b) Is a promissory note with a face value of more than $50,000 a debenture?

A financial product that is just a promissory note with a face value of more than $50,000 is not a debenture.

However, ASIC considers the exclusion of promissory notes from the definition of debenture only includes those instruments that are simple promissory notes or similar debt instruments (such as Negotiable Certificates of Deposit), which do not have any other significant obligations or undertakings arising from the note or other instrument. These types of instruments meet the definition of promissory note contained in the Bills of Exchange Act 1909.

(c) Is a promissory note with a face value of more than $50,000 another sort of financial product?

Even if not a debenture, if the person who is issued the note has been led to understand that the payment under the note will be produced by the use of the proceeds of the note issue in a common enterprise or from a pool to produce those benefits, the note may be an interest in a managed investment scheme. If the managed investment scheme has more than 20 members or the promoter is in the business of promoting managed investment schemes, the interest will be a financial product.

Also if the person who is issued the note, or the issuer intends that the proceeds from the note issue be used to enable the payment under the notes, then the notes could also be a facility for making a financial investment. Generally such a facility will also be a financial product.

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(G) COURT UPHOLDS APPEAL BY NICHOLAS WHITLAM

On 10 July 2003 the New South Wales Court of Appeal upheld the appeal by former NRMA Limited President Mr Nicholas Whitlam, in relation to findings made against him by Justice Gzell of the Supreme Court of New South Wales in July 2002.

ASIC commenced its action against Mr Whitlam believing that his failure to vote proxies in accordance with members’ directions did not result from mistake or inadvertence.

After hearing the evidence at the trial, Justice Gzell concluded that Mr Whitlam deliberately sought to override the intent of NRMA members and that he had acted dishonestly. These findings, together with His Honour's view that Mr Whitlam posed a risk of repeated misconduct, were factors considered when he imposed the five-year ban and pecuniary penalty last year.

The Court of Appeal overturned the orders made against Mr Whitlam.

‘We are naturally disappointed by [the] result’, ASIC Chairman, Mr David Knott said.

‘The decision appears to hinge primarily on legal questions directed to the capacity in which Mr Whitlam acted when he dealt with the proxies. The Court of Appeal was not satisfied that ASIC adequately established that Mr Whitlam’s conduct constituted a breach of his duties as a director of NRMA. The Court considered that ASIC’s pleadings did not adequately deal with this legal issue’, he said.

‘On the other hand, it is clear that the Court did not rule out the possibility that Mr Whitlam’s failure to sign the poll paper was deliberate’, Mr Knott said.

‘In the circumstances, ASIC will need to carefully review the judgement before determining our future position on this case. Over the next three weeks we will be considering with Counsel whether an application for special leave to appeal to the High Court should be made’, Mr Knott said.

The decision of the Court of Appeal is reviewed in Item 4(B) of this Bulletin.

(H) COURT UPHOLDS PENALTIES AGAINST HIH DIRECTORS

On 8 July 2003 the New South Wales Court of Appeal (Justices Mason, Giles and Beazley handed down its decision on the appeals by former HIH Insurance Limited director, Mr Rodney Adler, and former HIH Chief Executive Officer Mr Ray Williams, against the findings of Justice Santow of the Supreme Court, that Messrs Adler and Williams had breached their duties as directors of HIH Casualty and General Insurance Ltd. The Court upheld Mr Adler’s appeal against the finding that he had breached section 183 of the Corporations Act (wrongly using information obtained as it company officer) but confirmed all other breaches decided by Justice Santow against Mr Adler and Mr Williams.

The Court also upheld the bans, pecuniary penalties and compensation ordered against the defendants, subject to a recalculation of the interest component of the compensation. The Court awarded costs of the appeal to ASIC (which are additional to the approximately $600,000 costs payable to ASIC in relation to the original proceedings).

(1) Background

In March 2002, Justice Santow found that Mr Adler, Mr Williams and former HIH Chief Financial Officer, Mr Dominic Fodera, had breached their duties as directors under the Corporations Act, in relation to a payment of $10 million by an HIH subsidiary (HIH Casualty and General Insurance Limited) to Pacific Eagle Equities Pty Ltd, a company of which Mr Adler was a director.

As a result of the decision, Mr Adler was banned from acting as a director of any Company for 20 years. Mr Williams was banned for ten years.

Mr Adler and Adler Corporation were each ordered to pay pecuniary penalties of $450,000 (totalling $900,000). Mr Williams was ordered to pay pecuniary penalties of $250,000 and Mr Fodera was ordered to pay pecuniary penal ties of $5,000.

In addition, Messrs Adler and Williams were ordered to pay compensation of $7,986,402 to HIH Casualty and General Insurance Limited. The Court of Appeal has ordered that the interest component of that sum be recalculated.

The decision of the Court of Appeal is reviewed in Item 4(C) of this Bulletin.

(I) TOWER AUSTRALIA TO REPAY INVESTORS

On 4 July 2003 the Federal Court of Australia gave judgment and made orders in proceedings brought by ASIC against Tower Australia Limited (Tower). Tower consented to the orders and will reimburse investors who have been underpaid for their investments in Tower’s Blue Ribbon Products.

The Court declared that Tower had engaged in misleading and deceptive conduct since early 1993, by sending:

- annual statements of account to some investors that recorded incorrect redemption or withdrawal benefits; and  
- letters (either attaching a cheque or confirming a direct deposit into a nominated account) to some investors incorrectly stating that the amount of the cheque or the deposit represented the sum total of the investors’ redemption or withdrawal benefit.

Tower estimated that the cost of repaying policyholders is about $600,000, and has made provision in its accounts for that amount.

The Court has ordered Tower to send notices (if it has not already done so) to affected investors advising them that, as a result of computer error, they may have received incorrect surrender values and/or withdrawal amounts.

The Court also noted ASIC’s acceptance of an enforceable undertaking on 19 June 2003 from Tower stating that Tower will:

- repay any shortfall (plus interest) to investors who have fully redeemed their investments;  
- correct the entitlements of investors who have partially redeemed their investments;  
- take all reasonable steps to ensure that all redemption advices, and redemption and withdrawal amounts are correct;  
- use its best endeavours to rectify the computer error; and  
- not take any action against investors who may have been overpaid.

Tower has also undertaken to conduct an internal review to ensure that financial products similar to the Blue Ribbon Products are not similarly affected by computer error.

The orders follow an ASIC investigation into complaints alleging that surrender values shown in annual statements for the Blue Ribbon Products were incorrect. Tower has cooperated with ASIC throughout the investigation, and took steps to address ASIC’s concerns.

(J) ASIC GUIDELINES: USING PAST PERFORMANCE FIGURES IN INVESTMENT ADVERTISEMENTS

On 3 July 2003 ASIC released final guidelines on the use of past performance information in investment advertisements.

Key guidelines include that:

- advertisements using past performance information should include a five-year return figure (or the longest period available for newer funds);  
- information about returns should be balanced with information about risks;  
- all past performance figures are up-to-date; and  
- important information should not be buried in fine print.

Other key guidelines include that:

- promoters should not give undue prominence to past performance information;  
- promoters are encouraged to show performance compared to a benchmark or their peers;  
- returns should be calculated after all on-going fees have been deducted; and 'simulated' past performance figures should only be used in very limited cases.

Research on the use of past performance information shows that:

- it is used in advertising for many products in the financial services industry, especially when recent returns look good;  
- promoters choose varying methods for showing past performance, resulting in poor comparability;  
- advertisements rarely include information about the risk or volatility of the promoted investment; and  
- academic research commissioned by ASIC indicates past performance is a weak and unreliable predictor of future performance over the medium to long term.

Copies of the guidelines are available from the ASIC website at <http://www.asic.gov.au>

(K) VALUING OPTIONS FOR DIRECTORS AND EXECUTIVES

On 30 June 2003 ASIC issued final guidelines about the way Australian listed companies should include values of options in the disclosure of directors’ and executive officers’ emoluments in their annual directors’ reports for reporting years ending on or after 30 June 2003.

All listed companies are required to comply with their obligations under section 300A (1)(c) of the Corporations Act.

The final guidelines take account of the comments ASIC received in response to its draft guidelines, which were issued for comment on 7 May 2003.

The guidelines cover the valuation methods to be applied, as well as when to include option values for the purpose of emolument disclosures. ASIC has drawn on the International Accounting Standards Board’s Exposure Draft ED 2 Share Based Payment (ED 2), which provides an appropriate basis for valuing options and allocating their value over time.

The Australian Accounting Standards Board issued ED 2 as an Australian exposure draft (ED 108) and recently announced its intention to issue an accounting standard requiring remuneration disclosures in financial reports to include amounts relating to option values on the same basis as outlined in ED 2.

The ASIC guidelines require the options to be valued at the time they are granted and then to have that value apportioned over the period from grant date to vesting date. The options must be valued at market if they are listed, or by a valuation method that meets the requirements of ED 2 and ED 108 and the method chosen should be disclosed in the directors’ report.

The guidelines do not deal with the expensing of options or other share based-payments in the financial statements. This matter will be resolved by the issue of a final accounting standard by the Australian Accounting Standards Board. The disclosure in the directors’ report is a Corporations Act disclosure requirement that is not covered by Accounting Standards.

The option valuation principles in ED 2 and ED 108 have been applied to facilitate a more consistent approach to option valuations for meeting disclosure requirements under the Act. However, all entities preparing financial reports under the Act are also encouraged to apply the guidelines, in determining the amounts shown as remuneration of directors and executive officers, in their annual financial reports for the purposes of current accounting standards.

The guidelines are available on ASIC’s website at <http://www.asic.gov.au>

(1) Guidelines to valuing options in annual directors’ reports

These guidelines outline how listed Australian companies should include values of options in disclosures of directors’ and executive officers’ emoluments in their annual directors’ reports for years ending on or after 30 June 2003. They do not deal with the recognition in the financial statements of an expense in relation to options or other share-based payments.

(a) Directors’ report disclosure

All listed companies are required to comply with their obligations under section 300A(1)(c) by disclosing the value of emoluments relating to options in their directors’ reports.

Companies are not relieved of their statutory obligation merely because they regard the calculation or disclosure as being too difficult or onerous. Disclosure ensures that shareholders are properly informed as to the full value of the remuneration of individual directors and executive officers.

These guidelines have been issued to assist companies and directors in discharging their existing statutory disclosure obligations. If companies do not disclose the full remuneration, including option values, ASIC will consider action against the directors pursuant to section 344 of the Act.

Paragraph 60 of ASIC Practice Note 68 New financial reporting and procedural requirements (PN 68) states that listed companies must include options issued to directors and executive officers in the disclosure of emoluments of each director and each of the five executive officers receiving the highest emoluments under section 300A(1)(c) of the Corporations Act 2001 (the Act). Issued in 1998, PN 68 indicated that ASIC did not intend to prescribe methods for dealing with the accounting or valuation methods for options.

The International Accounting Standards Board’s Exposure Draft ED 2 Share-Based Payment (ED 2), released on 7 November 2002, now provides a basis for valuing options and allocating those values over time. It is appropriate to draw on ED 2 for the purposes of the disclosure of emoluments of directors and executive officers under section 300A(1)(c).

The Australian Accounting Standards Board (AASB) is committed to adopting International Financial Reporting Standards (IFRSs) and has issued ED 2 as Exposure Draft ED 108. The AASB proposes that a standard be operative for years beginning on or after 1 January 2004, the same time as proposed for the corresponding IFRS. The AASB has also recently announced it proposes that its forthcoming Accounting Standard ‘Director and Executive Disclosures by Disclosing Entities’ requires the disclosure of an individual’s remuneration for a reporting period include the amount recognised as an expense for that year in accordance with the accounting standard based on ED 108.

(b) Value of options

ED 2 and ED 108 provide clear guidelines on the types of option valuation models that can be applied and ASIC considers that these models can be applied to value all types of options granted to directors and executive officers.

For the purposes of s 300A(1)(c), listed companies should now value exchange-traded options at their market price at grant date, consistent with ED 2/ED 108. Other options should be valued as at their grant date using an option-pricing model that takes into account all of the six factors specified in ED 2/ED 108 and the other guidance on valuing options contained in ED 2/ED 108. The six factors are:

(i) the exercise price of the option;  
(ii) the life of the option;  
(iii) the current price of the underlying securities;  
(iv) the expected volatility of the share price;  
(v) the dividends expected on the shares, and  
(vi) the risk-free interest rate for the life of the option.

ED 108 says that the expected life, rather than the contracted life, shall be used for non-transferable options.

In determining the amount to be disclosed as remuneration over time, where appropriate, allowance should be made for amounts payable by the director or officer for the option.

It is expected that companies will already know the value of options previously granted. Any decision by directors in relation to the granting of options and the level amount of emoluments provided to directors and executive officers must have been made having regard to some measure of the amount of the emoluments being provided and assessed as appropriate for the level and performance of the services provided by the individuals concerned. Directors should therefore have determined option values at grant date in order to discharge their fiduciary obligations in granting those options. Where Part 2E.1 of the Act requires member approval of the issue of options, ASIC already insists that explanatory material sent to members pursuant to section 218(1) include the value of the options, the terms of the options, the basis of valuation, key assumptions affecting the value and the total remuneration package of the individuals concerned. Where that information is not included, ASIC will issue written comments that it considers the information essential to a decision by members. The company is required to send those comments to the members.

Currently, the valuation methodologies applied for determining emoluments are likely to reflect a range of diverse valuation approaches. To determine whether they need to change their approach, individual companies should benchmark their current valuation models against those in ED 2 and ED 108 to ensure that they reflect these valuation principles. These guidelines, by addressing when options are to be valued, the periods in which the values are disclosed, and referring to the limited range of models that cover the factors identified in ED 2 and ED 108, will result in greater consistency in including option values in emoluments under section 300A.

(c) When to disclose amounts as remuneration

ED 2 and ED 108 propose that an expense be recognised in relation to options over the period from grant date to the vesting date. For options that vest immediately, the value is recognised as an expense at grant date.

ED 2 and ED 108 recognise that some employees in a group of employees participating in an option scheme may not be expected to complete the full period of service required for options to vest. They also recognise that actual service may differ from that originally expected. As a result, certain adjustments are required to the amounts allocated to each financial year from grant date to vesting date using the units of service approach. That approach may be appropriate in the context of the cost of services of a group of employees where differences in the expected service lengths of individual employees may not materially affect the amount expensed in any period.

However, section 300A deals with the remuneration of individuals, and it is usually difficult to estimate when a single individual will cease to be a director or executive officer with any accuracy. Hence, for the purposes of measuring the remuneration of an individual for disclosure in the directors’ report, it should be assumed that the individual directors and executive officers will continue to provide service until the vesting date, unless it is probable that the particular individual will cease at an earlier date.

That is, for the purposes of section 300A disclosures, the value of an option at grant date is to be allocated equally over the period from grant date to vesting date (the vesting period) unless it is probable that the individual will cease service at an earlier date in which case the value is to be spread over the period from grant date to that earlier date. For options that vest at grant date, the value is disclosed as remuneration immediately.

Consistent with ED 2 and ED 108, changes in the value of options after grant date are only required to be included as emoluments when they result from changes to the contracted terms and conditions of the options made by the issuing entity. In that case, emoluments should include the change in the value of the options.

Remuneration should not be reversed if the options are forfeited before vesting or not exercised after vesting.

(d) Other disclosures

Subsection 300(1)(d) of the Act requires directors’ reports of all entities reporting under Chapter 2M of the Act to disclose details of options granted to directors and executive officers as a part of their remuneration and specifies the details to be disclosed.

In addition, listed companies are encouraged to disclose information as to how option values have been determined (including the model used, inputs to the model, historical and expected volatility, the risk-free interest rate, expected dividends, assumptions on vesting, how performance conditions have been taken into account and other significant assumptions affecting the value), a description of the basis of recognising the options over time, and the grant and vesting dates of the options.

(e) Transitional arrangements

These guidelines do not provide any transitional adjustments to amounts to be disclosed as remuneration under section 300A in the first year that the guidelines are applied. Such transitional adjustments would be inappropriate as section 300A is a pre-existing requirement intended to provide information as to the full annual remuneration of directors and executives.

Hence, these guidelines apply to all options, whether granted before or after the guidelines are issued, that had not vested prior to the commencement of the first financial year to which the guidelines apply.

No adjustment should be made to emoluments reported in the first financial year that the guidelines apply:

(i) to exclude amounts reported as emoluments in prior financial years that are required by the guidelines to be reported as emoluments in the current year, or

(ii) to include amounts that would have been reported as emoluments in prior financial years had the guidelines been applied in those prior years but which were not previously reported.

In adopting the guidelines, companies may include option values as emoluments at different amounts or in different financial years compared to their previous approach. This approach may result in some companies reporting amounts as emoluments in more than one year or some amounts not being reported as emoluments at all. In these circumstances, companies should briefly explain the change in basis and are encouraged to disclose the financial effect on the amounts of emoluments shown in the directors’ report.

Unlike ED 2 and ED 108, the guidelines do not provide any exclusion for options granted before 7 November 2002. ED 2 and ED 108 are a proposal for a new accounting standard dealing with the expensing of options issued as compensation to any party, whereas section 300A is a pre-existing disclosure requirement of the Act, requiring disclosure of the full remuneration of directors and executives to shareholders. ASIC does not accept that there would be an unreasonable burden in valuing options granted in previous years, particularly as directors should have obtained values at grant date in order to discharge their fiduciary obligations in granting those options.

(f) Possible changes to ED 2/ED 108

These guidelines should be applied on the basis of ED 2 and ED 108 as originally issued. ASIC will consider any decisions of the IASB to make changes the approach in ED 2 or issue a final standard and will issue a further information release if it considers such changes should be taken into account for the purposes of section 300A disclosures. Any further release would specify when such changes must be taken into account.

ASIC does not consider it appropriate to require tentative or final decisions of the IASB to be immediately taken into account for the purposes of section 300A disclosures. This would create uncertainty for companies in the process of finalising their financial report.

(g) IASB May 2003 meeting

At its meeting in May 2003, the IASB made a tentative decision to replace the units of service method with the method in the US standard FAS 123 Accounting for Stock Based Compensation of recognising option values over the service period (i.e. the vesting period or such shorter period estimated in valuing the options where performance conditions affect exercise price or exercisability date).

In addition, the IASB tentatively decided that the number of options originally expected at grant date to ultimately vest should be revised during the vesting period if it is expected that actual forfeitures will differ from initial estimates, consistent with one alternative approach in FAS 123.

These tentative decisions have no effect on the methodology outlined earlier in the guidelines. Given that section 300A deals with the disclosure of values of remuneration of individuals rather than the value of services received from groups of employees, the release:

(i) Does not apply the units of service approach but requires values to be spread equally over the vesting period, unless it is probable that the individual concerned will cease service at an earlier date.

(ii) Requires an assumption that a director or executive will meet the service requirement in relation to the full number and value of options at all times, unless it is probable that a director or executive will cease service. From that time values would cease to be included in remuneration disclosed for that individual, with no adjustment in respect of amounts disclosed, or to be disclosed, up to that time.

(iii) Does not allow for subsequent re-estimation of the number of options expected to vest as a result of a re-assessment of the outcome of existing performance conditions affecting some or all of the maximum number of options that might vest. The overall value of remuneration is the value of the options at grant date.

The IASB also tentatively decided that market-price-based performance conditions should be incorporated into the option pricing model applied at grant date. That valuation approach is consistent with paragraph 24 of ED 2. ASIC expects that such conditions will be taken into account in pricing options.

(h) Further guidance on applying section 300A(1)(c)

Directors of listed companies should refer to ASIC PN 68 for further guidance on the application of section 300A(1)(c).

(i) Disclosures in financial report

All entities preparing financial reports under the Act are encouraged to apply the guidelines in disclosing the remuneration of directors and executive officers in their annual financial reports for the purposes of AASB 1017 Related Party Disclosures and AASB 1034 Financial Report Presentation and Disclosures.

(j) Surveillance of reports

ASIC will review compliance with the guidelines in its surveillance of financial reports and directors’ reports of listed companies for the year ending 30 June 2003. Enforcement action may be considered where companies fail to disclose the value of emoluments relating to options granted.

(k) Interim guidelines

It is ASIC’s intention to withdraw the guidelines in the release should the Act be amended to specify a method of valuing and accounting for options issued as remuneration of directors and executive officers.

(L) COURT HANDS DOWN WATER WHEEL PENALTIES

On 30 June 2003 Mr David Knott, Chairman of ASIC, welcomed the judgment in ASlC’s civil penalty action against Messrs Bernard Plymin, John Elliott and William Harrison, the directors of Water Wheel Holdings Limited and Water Wheel Mills Pty Ltd (the companies).

The Court made formal declarations that each of the directors had contravened the insolvent trading provisions of the Corporations Law.

‘The outcome reinforces the need for directors to exercise reasonable care that their companies will be able to pay for goods and services contracted in the normal course of business. Failure to do so can cause serious financial hardship to families and small businesses supplying those goods and services’, Mr Knott said.

In relation to Mr Plymin, the Court ordered that he:

- be banned for 10 years from managing a corporation;  
- pay compensation of $1,428,000 to the companies (jointly with Mr Elliott);  
- pay pecuniary penalties of $25,000, and  
- pay ASIC’s taxed costs (jointly with Mr Elliott, but neither is obliged to pay more than 80 per cent of the total).

In relation to Mr Elliott, the Court ordered that he:

- be banned for four years from managing a corporation;  
- pay compensation of $1,428,000 to the companies (jointly with Mr Plymin);  
- pay pecuniary penalties of $15,000, and  
- pay ASIC’s taxed costs (jointly with Mr Plymin, but neither is obliged to pay more than 80 per cent of the total).

In relation to Mr Harrison, the Court ordered that he:

- be banned for seven years from managing a corporation; and  
- pay compensation of $300,000 to the companies.

The orders against Mr Harrison for compensation reflected a settlement reached with ASIC early in the litigation. In recognition of Mr Harrison’s cooperation and contrition, ASIC did not seek compensation and financial penalties from him exceeding $300,000. However, Justice Mandie viewed Mr Harrison’s ‘serious dereliction of duty’ as requiring a more lengthy banning period than had been recommended by ASIC. As part of the settlement with ASIC, Mr Harrison paid the agreed compensation amount to ASIC during the trial, pending a final decision by the Court. The amount paid represents a large portion of Mr Harrison’s available means, which will now benefit creditors.

‘ASIC is satisfied that the penalties imposed in this Case have underlined the importance of the insolvent trading laws and highlighted the serious consequences that may result when directors exercise inadequate care and diligence’, Mr Knott said.

‘The victims of insolvent trading failures are usually individuals and small businesses who have supplied goods and services to a company in good faith. In this case, many such parties in rural Victoria and New South Wales suffered as a result of the failure by Water Wheel’s directors to exercise due care and diligence.

‘The compensation ordered takes account of the revised distribution to creditors expected by the Administrator, and it will further benefit those creditors’, he said.

The Court’s decision is reviewed in Item 4(A) of this Bulletin.

(M) ASIC CALLS FOR FINANCIAL LITERACY EDUCATION IN SCHOOLS

On 30 June 2003 Mr David Knott, Chairman of ASIC, released Financial Literacy in Schools, a discussion paper that examines the existing levels of financial literacy teaching in Australian secondary schools and presents options for improving those levels.

Financial literacy is the ability to make informed judgments and to take effective decisions regarding the use and management of money.

The discussion paper draws on research undertaken by Erebus Consulting Partners, an independent education consultant. ASIC is grateful to the Financial Planning Association for their co-sponsorship of this research and for their commitment to enhancing financial literacy in schools.

The research found that while there are opportunities for teaching financial literacy in all jurisdictions, not all students will be exposed to such teaching and no students will be exposed to the full range of issues associated with financial literacy.

Financial Literacy in Schools looks at how we can improve this situation through:

- strengthening the emphasis given to financial literacy in the curriculum;   
- providing teachers with appropriate training; and  
- providing stimulating educational resources that deal with issues of interest to students and are linked to the curriculum.

Given the already crowded curricula, Financial Literacy in Schools proposes strengthening the position of financial literacy teaching within existing curricula and key learning areas (eg studies of society and environment or maths, as part of life skills cross-curricula outcomes, or as part of the transition from school agenda).

ASIC is seeking feedback on the issues raised in the Financial Literacy in Schools discussion paper by 26 September 2003. Copies are available from ASIC’s consumer website at <http://fido.asic.gov.au/> or by calling ‘ASIC’s Infoline on 1300 300 630.

For further information contact:

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3. RECENT TAKEOVERS PANEL MATTERS

(A) PANEL DECIDES SECOND POWERTEL APPLICATION

On 25 July 2003 the Takeovers Panel advised that it had made its decision on the application made on 10 July by the Roslyndale Syndicate (Roslyndale), seeking a declaration of unacceptable circumstances and certain orders in relation to the takeover bid by TVG Consolidation Holdings SPRL (TVG) for all of the shares in PowerTel Limited (PowerTel). The application was dealt with as follows.

Roslyndale submitted that TVG’s takeover bid should be subject to approval by a resolution of non-associated shareholders (or subject to a non-waiveable 50.1% minimum acceptance condition) because, in Roslyndale's view, the bid price is so low that the bid will be attractive only to WilTel Communications Group (WilTel), PowerTel’s largest shareholder.

The sitting Panel declined to conduct proceedings on this limb of the application, which it regarded as unfounded. Shareholder approval is not required for an acquisition of shares under a takeover bid, particularly where no contravention of the takeovers code and no manipulation of the market or comparable unusual circumstances was alleged or established.

Roslyndale requested an order that TVG should disclose in a supplementary bidder's statement certain forecast information concerning PowerTel, which it believed had been provided to TVG, and was material information which should be disclosed to shareholders, but which had not been included in TVG's bidder’s statement.

The Panel found that spreadsheets containing revenue budgets prepared by PowerTel management had been made available to TVG, Roslyndale, the major shareholders and the independent expert who provided reports in relation to the TVG bid and the Roslyndale proposal recently voted on at a general meeting of PowerTel. It decided that the contents of the spreadsheets are not in a form suitable for publication, but that the prospective financial information in them is material to a decision whether to accept the TVG bid or continue as a shareholder in PowerTel and that shareholders have not been provided with comparable information.

The Panel invited PowerTel to provide its shareholders with information comparable with the spreadsheets but better suited to publication, in the form of a reasoned discussion of the company's prospects, based on the latest information available to the Board. The information would not necessarily include quantitative forecasts, but should be presented in the context of an updated discussion of the choice now facing PowerTel shareholders, whether to accept the TVG bid or retain their shares.

PowerTel undertook to issue a supplementary target's statement updating the Board's recommendation concerning the TVG bid and containing a suitable discussion of the company's financial and other prospects. TVG has agreed to extend its bid so that it closes two weeks after the issue of PowerTel's supplementary target's statement, although that time period may need to be adjusted. The Panel has accepted those undertakings.

Roslyndale also noted that TVG proposed to cause PowerTel to conduct a rights issue and to underwrite the rights issue, should its bid be successful. Under the Listing Rules, the rights issue will need the approval of shareholders not associated with TVG. Roslyndale submitted that the statements in TVG's bidder's statement concerning the inter-relation of the bid and the rights issue were confusing, and that offerees might be misled into thinking that the rights issue was sure to proceed, if the bid succeeded. It submitted that the bid should be conditional on approval being obtained for the rights issue, that the bidder's statement should be clarified, or both.

The Panel rejected this submission. It has reviewed the references to the rights issue in the bidder's statement and does not regard them as misleading or confusing in the context of the bidder's statement. The proposal to make the bid conditional on approval of the rights issue has no basis in policy and appears to be unworkable.

On the basis of the undertakings mentioned above, the Panel dismissed Roslyndale's application.

The sitting Panel comprised Alison Lansley, Carol Buys and Chris Photakis.

(B) PANEL DECLARATION OF UNACCEPTABLE CIRCUMSTANCES IN RELATION TO THE AFFAIRS OF TRYSOFT CORPORATION LIMITED

On 3 July 2003 the Takeovers Panel made a declaration of unacceptable circumstances, and final orders, in relation the affairs of Trysoft Corporation Limited (Trysoft).

(1) The proceedings

The application was made by Mr Stephen Ioannides, a shareholder and former director of Trysoft. The application alleged that Trysoft's managing director, Mr Douglas Wong had entered into a voting agreement (the Robertson Agreement) with Mr Grahame Robertson and a company controlled by him, and that these parties together held approximately 44% of the shares in Trysoft. Mr Robertson is a former director of Trysoft.

The application alleged that the Robertson Agreement breached the 20% voting power threshold in section 606 of the Corporations Act (the Act) and had not been properly disclosed to the market or Trysoft shareholders.

During the course of the proceedings, the Panel also became aware of a second voting agreement to which Mr Wong, Trysoft and Mr Ioannides were parties (the Ioannides Agreement).

(2) The Agreements

Trysoft provided the Panel with a copy of both the Robertson Agreement and the Ioannides Agreement.

Among other things, the Robertson Agreement required Mr Robertson to vote his shares in support of an option scheme (the Wong Option Scheme) granting options to Mr Wong as part of his employment agreement. It also gave Mr Wong a right of first refusal over shares held by Mr Robertson.

The Ioannides Agreement also required Mr Ioannides (who at the time held approximately 19% of the voting power in Trysoft) to support the shareholder resolutions necessary to implement the Wong Option Scheme, among other things.

(3) The shareholder approval of the Wong Option Scheme

At the 2002 Trysoft annual general meeting, the shareholders of Trysoft voted under ASX Listing Rule 10.11 to allow Trysoft to issue the Wong options. Trysoft shareholders were not advised of the terms or the existence of the Agreements, although each of Trysoft, Mr Wong and Mr Robertson submitted to the Panel that they believed that Mr Wong had revoked the Agreements before the AGM.

At the AGM, both Mr Robertson and Mr Ioannides voted in favour of the Wong Option Scheme. If their votes had not been counted, the resolution to approve the scheme would have been defeated. Approximately 21.1% of Trysoft's shares were not voted at the AGM in relation to this resolution. It is possible that some of these additional votes may have been cast at the AGM if shareholders had been aware that Mr Robertson and Mr Ioannides were to be excluded from voting in relation to the resolution. However, it is impossible to know whether such votes would have been cast in favour of, or against, the resolution.

(4) The Panel's decision

The Panel decided that the Agreements resulted in Mr Wong acquiring a relevant interest in shares in Trysoft and in increases in the voting power of each of Mr Wong, Mr Robertson and Mr Ioannides in breach of section 606 of the Act. Despite submissions to the contrary from Mr Wong and Mr Robertson, the Panel did not accept that the Agreements had been terminated or that the breaches of section 606 had been remedied.

The Panel also decided that the Agreements required each of Mr Wong, Mr Robertson and Mr Ioannides to give a substantial holding notice under section 671B of the Act. Each of them failed, and continues to fail, to comply with these obligations.

The Panel declared that these breaches of the Act, and the failure to comply with the obligations under section 671B of the Act, constitute unacceptable circumstances.

The Panel also ordered that the Agreements be terminated with immediate effect, and that any options issued to Mr Wong under the Wong Option Scheme must not be exercised unless and until the Trysoft shareholders approve the Wong Option Scheme (subject to certain restrictions).

The Panel also accepted undertakings from each of Mr Wong, Mr Robertson and Mr Ioannides to the effect that they will obtain advice from their legal advisers concerning when parties will be associates for the purposes of Chapters 6 and 6C of the Act.

The sitting Panel comprised Robyn Pak-Poy (sitting President), Anthony Burgess and Marian Micalizzi.

The Panel will post its reasons for this decision on its website at <http://www.takeovers.gov.au/> when they have been settled.

(C) PANEL DECLINES TO COMMENCE PROCEEDINGS IN RELATION TO POWERTEL LIMITED

On 29 June 2003 the Takeovers Panel advised that it had declined to commence proceedings in relation to an application from TVG Consolidation Holdings SPRL (TVG). The Panel received the application on Thursday 26 June, seeking a declaration of unacceptable circumstances in relation to the affairs of PowerTel Limited (PowerTel).

The Panel decided on the basis of the information and circumstances currently before it, that additional disclosures made by both PowerTel and the Roslyndale Syndicate (Roslyndale) on Friday 27 June, following the application, mean that, on balance, the shareholders of PowerTel will have sufficient information on the Roslyndale Proposal to vote on the resolutions to approve the Roslyndale Proposal. The resolutions are currently proposed be put to PowerTel shareholders at a meeting under Item 7 of section 611 of the Corporations Act (Item 7 Meeting).

The Panel also considered that an undertaking offered by Roslyndale to accelerate the termination of its Share Sale Agreement with WilTel Communications Group (WilTel), PowerTel's largest shareholder, would resolve other issues raised by TVG.

TVG announced a takeover bid for all of PowerTel's shares on 10 June 2003. TVG's bid is a rival proposal to the Roslyndale Proposal. Under the Roslyndale Proposal, Roslyndale would, among other matters, acquire all of the PowerTel shares owned by WilTel, and WilTel would assign to Roslyndale various debts (somewhat more than $21.3 million) owed by PowerTel to WilTel.

(1) Panel considerations

The Panel considered the submissions which formed the TVG application, and the additional disclosures that were made on 27 June. It reached a preliminary view that the additional disclosures had addressed the disclosure issues raised by TVG, and Roslyndale had offered an undertaking which appeared to address TVG's concerns about the extended effect of the Roslyndale Share Sale Agreement. The Panel wrote to the parties on the evening of Friday 27 June, seeking responses by 5.30 p.m. Saturday 28 June to a number of questions the Panel considered appropriate to enable it to reassess its preliminary view. In light of the responses, the Panel decided on the evening of 28 June not to commence proceedings.

(2) Supplementary disclosure - 27 June 2003

PowerTel published a supplementary target's statement on ASX's companies' announcement platform (CAP) on the afternoon of 27 June. The supplementary target's statement included the following disclosure:

(a) a discussion of the changes that TVG had recently made to its bid (as set out in TVG's supplementary bidder's statement dated 25 June);

(b) an updated recommendation by the PowerTel directors on the Roslyndale Proposal in light of the changed TVG bid;

(c) an updated recommendation by the independent expert on the Roslyndale Proposal in light of the changed TVG bid;

(d) a discussion by the PowerTel directors as to why they make their updated recommendation; and

(e) notice of Roslyndale's further disclosure in the substantial shareholding notice published by Roslyndale on ASX's CAP on the afternoon of 27 June.

Roslyndale published a supplementary substantial shareholding notice on ASX's CAP on the afternoon of 27 June. Roslyndale's notice included the following documents, among others:

(a) copy of the notice of meeting and independent expert's report for the Item 7 Meeting (these two documents had already been posted on ASX's CAP, and posted to PowerTel shareholders on 3 June);

(b) a copy of the Share Sale Agreement between WilTel (the US parent and its Australian subsidiary which holds the PowerTel shares), Roslyndale and PowerTel (the copy which has been posted appears to be dated 15 May 2003, but is only partially signed). The copy includes as schedules to the agreement the following documents which had not been previously disclosed to PowerTel shareholders (although the terms of some had been described in the notice of meeting for the Item 7 Meeting):

(i) PowerTel financial statements at 31 December 2002;

(ii) a term sheet for Roslyndale's underwriting of a renounceable rights issue by PowerTel which forms part of the Roslyndale Proposal;

(iii) a list of documents to which Roslyndale had been provided access in its due diligence studies on PowerTel in January and February 2003; and

(iv) a deed of novation assigning from WilTel to Roslyndale the debt owed by PowerTel to WilTel; and

(c) copies of pro-forma letters from Roslyndale to potential sub-underwriters of the proposed PowerTel rights issue.

(3) Roslyndale undertaking to the Takeovers Panel

Roslyndale has, in the course of the Panel considering the TVG application, offered an undertaking to the Panel to waive all rights it may have under the Share Sale Agreement to restrict or prevent WilTel Communications Pty Ltd accepting the TVG offer after the Item 7 Meeting, if PowerTel shareholders vote against the Roslyndale Proposal. If they do reject the Roslyndale Proposal, the undertaking will have effect from the date of the Item 7 Meeting. Roslyndale's solicitors advised the Panel that Roslyndale had not intended the Share Sale Agreement to act as any form of lock up after the Item 7 Meeting. The Panel accepted Roslyndale's offered undertaking as a positive element in the resolution of the issues before it.

The terms of the Share Sale Agreement set a date of 31 July 2003 at which the Share Sale Agreement would terminate if the Roslyndale Proposal had not been approved by PowerTel shareholders. The Panel accepted Roslyndale's advice that that date had been set to ensure that negotiations and proceedings were not allowed to be unduly delayed, rather than as any device to affect the competitive market for PowerTel shares in any period after the Item 7 Meeting. The Panel also accepts that the date and the terms of the agreement were not drafted in contemplation of a rival takeover bid being announced and which might have been affected by the end date for the Roslyndale Proposal. The Panel notes that at the time the Share Sale Agreement was being drafted, Roslyndale and PowerTel did not know the dates of the TVG bid and did not know that the 31 July date would extend beyond the closing date of the TVG bid.

(4) Future conditional share sale agreements

The Panel considered that the events of the Roslyndale Proposal and TVG bid should be considered by companies and persons involved in drafting such agreements in future. In order to avoid the concerns expressed by TVG, which Roslyndale has resolved by its undertaking, parties to such conditional share sale agreements should preferably specify the share sale agreement to terminate, or become unconditional, at the earlier of the specified end date and the relevant shareholders' meeting to approve the acquisition by the purchaser.

The Panel considered that this is a matter which boards of target shareholders should consider in determining what would be in the best interests of shareholders. Ideally, target boards should try to ensure that their shareholders have maximum opportunities to consider different control alternatives, unimpeded by unnecessarily restrictive effects of the conditional share sale agreement to be put to shareholders for approval.

(5) Adequate time

TVG originally asked the Panel to consider whether or not the PowerTel shareholders would have adequate time to consider any additional information which it required to be disclosed if it had commenced proceedings and required further disclosure. In deciding not to commence proceedings, the Panel considered:

(a) the remaining time available until the Item 7 Meeting (and the cut-off time for lodging proxies for that meeting);

(b) the nature and availability of the information provided to PowerTel shareholders on 27 June, both in the supplementary target's statement and the Roslyndale further substantial shareholding notice (albeit that document contained 192 pages, that many PowerTel shareholders may have been deterred from downloading it by the size, and the fact that individual parts of it were not readily accessible as separate documents);

(c) the nature of the additional recommendations provided by the PowerTel directors and the independent expert;

(d) the nature, timing and content of information provided to PowerTel shareholders in the period leading up to the application by TVG (information provided by PowerTel, TVG and Roslyndale);

(e) the media coverage of the issues recently raised; and

(f) further steps which PowerTel and others may take in the future to advise PowerTel shareholders of the nature and existence of the additional information.

The Panel considered whether there appeared sufficient risk, on the face of the evidence put before it by parties and by TVG, concerning PowerTel shareholders' ability to assimilate the information to warrant the Panel commencing proceedings to consider postponing the Item 7 Meeting. However, on the basis of the further disclosures, the issues set out above, and the submissions of the parties, the Panel considered on balance that there was not a sufficient basis for commencing proceedings or postponing the meeting.

The Panel noted that both PowerTel and Roslyndale provided the supplementary information at a very early stage of the Panel's process following TVG's application. The Panel considered that while TVG's request for a postponement or adjournment of the meeting may have had materially more influence if the information had only been released following Panel proceedings, the very early disclosure by PowerTel and Roslyndale, well before TVG could have expected the Panel to have ordered it, had materially reduced the need for considering any delay of the PowerTel shareholders' decision.

The Panel considered that shareholders generally are inevitably required to assess and deal with changing circumstances in many types of transactions before voting or deciding whether or not to accept a takeover offer. In the context of takeovers, the legislation sets out supplementary bidder's statements and supplementary target's statements as the process for informing shareholders of new information and material changes. The Panel considers that the additional information provided prior to the Item 7 Meeting is equivalent to the disclosure that may have been provided if the Roslyndale Proposal had been a takeover bid.

On that basis, the Panel considers that on balance PowerTel shareholders have received sufficient information and will have sufficient time to be able to assess that additional information.

(6) Access to updated information via website

The Panel considers that PowerTel should, nevertheless, ensure that its website contains, as soon as possible, all of the recently disclosed information, in a prominent, and readily and conveniently accessible form, or links to other sites where the information is readily and conveniently accessible by PowerTel shareholders.

(7) Timing of TVG application

The Panel is not aware of whatever internal issues within TVG related to the timing of its application to the Panel. However, the Panel considers it would have been desirable, if it had been feasible for TVG, for the application to have been made earlier. In saying this, the Panel notes that the market has been aware of the existence of the Share Sale Agreement and the debt Assignment Agreement since their existence was disclosed in the 9 May announcement by PowerTel, and the fact of the agreements themselves not being disclosed was clear from 15 May when PowerTel announced that they had been signed, but did not include them in the announcement and Roslyndale did not include them in its initial substantial shareholding notice on 3 June. TVG has advised the Panel that it had been seeking disclosure of the relevant documents from WilTel and PowerTel but had been told that the documents would not be disclosed to TVG because the arrangements were subject to confidentiality obligations.

(8) TVG's application

TVG had asked the Panel to make a declaration of unacceptable circumstances in relation to the affairs of PowerTel and then to make orders that:

(a) PowerTel seek the consent of its shareholders to adjourn the Item 7 Meeting to enable supplementary disclosure to be made and considered by PowerTel shareholders.

(b) PowerTel issue a supplementary target's statement, by no later than 5 business days before the adjourned Item 7 Meeting, which:

(i) included all information regarding the Roslyndale Proposal that is material to PowerTel shareholders deciding on how to vote on the Roslyndale Proposal, in the context of the TVG Proposal, in terms approved by the Takeovers Panel; and

(ii) updated the recommendations made in the PowerTel target's statement, addressing the recent changes made by TVG to its bid conditions and intentions; and

(c) any agreement between WilTel and Roslyndale not restrict WilTel's capacity to accept the TVG bid subsequent to the PowerTel meeting (should PowerTel shareholders vote against the Roslyndale Proposal).

(9) Process

The President of the Panel appointed Carol Buys, Alison Lansley and Chris Photakis to constitute the Sitting Panel to consider the application.

The Panel will publish the reasons for its decision not to commence proceedings on its website at <http://www.takeovers.gov.au> when they are settled.

4. RECENT CORPORATE LAW DECISIONS

(A) WATER WHEEL NO 2 – IMPOSITION OF PENALTIES   
(By Polat Siva, [Clayton Utz](http://www.claytonutz.com))

Australian Securities and Investments Commission v Plymin, Elliott and Harrison (No 2) [2003] VSC 230, Supreme Court of Victoria, Mandie J, 30 June 2003

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/june/2003vsc230.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

On 5 May 2003, Mandie J found that Bernard Plymin and John Elliott had committed contraventions of section 588G (relating to insolvent trading) of the former Corporations Law (now the Corporations Act) (Australian Securities and Investments Commission v Plymin, Elliott and Harrison [2003] VSC 123). The third defendant to those proceedings, William Harrison, had admitted "liability" in the course of the proceedings.

Those proceedings were brought by ASIC and related to insolvent trading by two companies, Water Wheel Mills Pty Ltd ("Mills") and Water Wheel Holdings Limited ("Holdings") (collectively, "the Companies"). The Court found that the insolvent trading occurred between 14 September 1999 and 17 February 2000, the date the Companies were placed into administration. During the relevant period, Mr Plymin was the managing director of the Companies, Mr Harrison was the chairman of the Board of Directors and Mr Elliott was a non-executive director.

Submissions in relation to relief to be given were heard after the primary reasons for judgment were handed down, and this judgment was handed down on 30 June 2003. The substantive matters remaining to be considered were whether the Court should exercise the discretion under section 1317JA(2) to relieve Mr Plymin or Mr Elliott from liability, whether compensation orders should be made under section 588J(1), whether declarations as to contraventions should be made pursuant to section 1317EA(2), and whether management banning orders or pecuniary penalties should be imposed under section 1317EA(3). Submissions were also made in relation to Mr Harrison, and as to costs.

(2) Submissions

ASIC submitted that there was no basis for relieving either of the defendants from liability because, amongst other things, their conduct was unreasonable. It was submitted on behalf of both Mr Plymin and Mr Elliott that they should be relieved from liability.

ASIC was also seeking declarations as to contravention.

ASIC also submitted that there should be management banning orders made against both Mr Plymin and Mr Elliott, and that the greater culpability of Mr Plymin should be reflected in a longer period of disqualification. ASIC submitted that Mr Plymin should be prohibited from managing a company for a period in the range of 7 to 10 years, and that the appropriate period of prohibition for Mr Elliott would be in the range of 5 to 7 years. It was submitted on Mr Plymin's behalf that a prohibition order should not be made against him, but that a number of factors should be considered if such an order was made, so that "even in the lowest category of disqualification period the first defendant (Mr Plymin) should be at the lower end of the scale". It was also submitted on behalf of Mr Elliott that a prohibition order should not be made against him. In the alternative, it was submitted that if an order was to be made, it should be for a few months rather than years.

ASIC also submitted that pecuniary penalties should be imposed against both Mr Plymin and Mr Elliott, claiming that the appropriate level in the case of Mr Plymin was $120,000 and in the case of Mr Elliott, $100,000. On behalf of Mr Plymin, it was argued that a pecuniary penalty should not be imposed. It was also argued that in considering the amount of any penalty, any prohibition or compensation order should be taken into account, and that it was not appropriate to order a pecuniary penalty if compensation and disqualification were ordered. In relation to penalties, it was submitted that the Court should not impose any pecuniary penalty upon Mr Elliott, and that if the Court was minded to impose a penalty, it should not exceed in aggregate $20,000. Joint submissions were made by ASIC and Mr Harrison and it was submitted that the appropriate range for a pecuniary penalty against him was between $50,000 and $100,000, but that if a penalty was ordered, the amount of compensation should be reduced so that Mr Harrison's total liability would not be more than $300,000 (the amount he had previously provided to ASIC).

ASIC submitted that a compensation order should be made against each of Mr Plymin and Mr Elliott, jointly and severally, in the amount of the proven loss and damage, being the amount of the unpaid debts less the dividends received or likely to be received by those creditors. It was submitted by ASIC and Mr Harrison that the appropriate amount of compensation to be paid by him was $300,000, with this amount being divided pro rata between Mills and Holdings. Mr Plymin submitted that the Court was unable to order compensation because the extent of the loss was not known, and submitted that no compensation order should be made until the losses could be determined with certainty. Similar submissions were made on behalf of Mr Elliott.

ASIC submitted that there should be a costs order against both Mr Plymin and Mr Elliott.

Each of the defendants deposed as to their good character and expertise, with Mr Plymin and Mr Elliott also filing affidavits of other people in their support.

(3) Decision

(a) Mr Plymin

Mandie J found that Mr Plymin should not be excused pursuant to section 1317JA, accepting ASIC's submissions that his conduct was "unreasonable and inexcusable", "reckless and grossly negligent". His Honour stated that Mr Plymin's conduct showed no regard for the position of creditors, and the appointment of administrators came far too late. His Honour was not satisfied that Mr Plymin understood, even at the time of judgment, the nature of a director's duties or the seriousness of his contravention.  
  
Mandie J also stated that appropriate declarations as to contravention would be made in relation to Mr Plymin. Although there was a separate contravention each time a debt was incurred, it was common ground that the conduct would be treated as constituting one continuing contravention in relation to Mills, and one continuing contravention in relation to Holdings.

His Honour stated that he was not satisfied that Mr Plymin was a fit and proper person to manage a corporation, and banned Mr Plymin from managing a corporation for a period of ten years commencing on 28 July 2003, for the protection of the public.  
In relation to compensation orders against Mr Plymin, Mandie J stated that he was satisfied that the relevant amounts of loss and damage in relation to Mills and Holdings were $1.61M and $118,000 respectively. His Honour held that in all the circumstances, it was just and appropriate that orders should be made against Mr Plymin requiring him to pay compensation to Mills and Holdings. In deciding the amounts, Mandie J subtracted from the total loss and damage the amount of compensation to be paid to each of the Companies by Mr Harrison, and thus ordered Mr Plymin to pay approximately $1.428M in total to the Companies.

His Honour stated that he was satisfied that Mr Plymin's contraventions were serious contraventions, but stated that a relatively small pecuniary penalty should be sufficient to serve the interests of deterrence. This was due to the length of the prohibition order, the size of the compensation order and the order as to the costs of ASIC. His Honour ordered Mr Plymin to pay a pecuniary penalty of $25,000 ($20,000 in relation to Mills and $5,000 in relation to Holdings).

(b) Mr Elliott

Similarly, Mandie J held that Mr Elliott should not be relieved under section 1317JA. Although his Honour found that Mr Elliott was significantly less culpable than Mr Plymin, and less culpable than Mr Harrison, Mandie J described Mr Elliott's contraventions as serious and stated that they "represent a sustained and continuous course of inexcusable and unjustifiable neglect of important duties of a non executive director". Further, Mandie J found that Mr Elliott's conduct was not an isolated incident but rather showed "continuing disregard for the position of unsecured creditors".

Appropriate declarations were also made in relation to Mr Elliott.

In respect of a prohibition order, his Honour stated that he was not satisfied that Mr Elliott was a fit and proper person to manage a corporation, and found that an order should be made banning Mr Elliott from managing a corporation for four years commencing on 28 July 2003. In reaching this finding, Mandie J stated that the favourable evidence given about Mr Elliott by others stood "in stark contrast to the circumstances disclosed by the evidence in this proceeding". His Honour stated that Mr Elliott's conduct, his evidence concerning that conduct, including his explanations and attitude, did not engender any confidence in the Court as to his fitness to be a director of a company.

In respect of compensation, Mandie J stated that it was just and appropriate for Mr Elliott to pay compensation to the Companies in the same amounts as to be ordered against Mr Plymin ($1.428M, with the two defendants being jointly and severally liable for this amount).

His Honour also imposed a pecuniary penalty of $15,000 ($13,000 in relation to Mills and $2,000 in relation to Holdings) against Mr Elliott.

Mandie J ordered Mr Plymin and Mr Elliott to pay 80% of ASIC's costs in the proceeding, including reserved costs.

(c) Mr Harrison

Mandie J stated that appropriate declarations as to Mr Harrison's contraventions would be made, and stated that given $300,000 had been paid to ASIC by Mr Harrison, it was appropriate that Mr Harrison pay compensation totalling $300,000 to Mills and Holdings, and apportioned these amounts to the Companies.

His Honour was not satisfied that Mr Harrison was a fit and proper person to manage a corporation, and stated that the Court was not bound by any agreement between ASIC and Mr Harrison. His Honour went on to state that the 4-6 year period of disqualification (argued for by ASIC and Mr Harrison jointly) was not adequate having regard to the object of the protection of the public. Given Mr Harrison's "serious dereliction of duty" and his stated intention not to act again as a company director, Mandie J ordered that Mr Harrison be prohibited from managing a corporation for a period of seven years commencing on 28 July 2003.

His Honour stated that having regard to the admissions made by Mr Harrison, his co operation with ASIC and the payment of $300,000 compensation, no orders would be made against Mr Harrison as to a pecuniary penalty or costs.

(B) CHAIRMAN NOT EXERCISING DIRECTOR’S DUTIES WHEN VOTING PROXIES   
(By Bianca Achilles, [Freehills](http://www.freehills.com.au))

Whitlam v Australian Securities and Investment Commission [2003] NSWCA 183, New South Wales Court of Appeal, Hodgson, Ipp and Tobias JJ, 10 July 2003

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/july/2003nswca183.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Overview

On 10 July 2003, the NSW Court of Appeal overturned a decision of the NSW Supreme Court which had found Nick Whitlam breached his director’s duties as a NRMA Ltd (NRMA) and NRMA Insurance Group (NIGL) director.

ASIC brought proceedings claiming that Whitlam, when he was Chairman of the NRMA 1998 AGM, deliberately failed to sign 3,973 proxy votes directing him to vote against a resolution concerning the remuneration of the NRMA directors. ASIC alleged that this deliberate omission was a breach of the directors’ duties provisions of the former Corporations Law (specifically, sections 232(2), (4) and (6)) and further, a breach of section 250A(4) of the Corporations Law (the Law) which obliges a chairman, if appointed proxy by a member, to vote as directed (where the member so directs the proxy).

ASIC further claimed that Whitlam made certain revisions to draft minutes of a Board Meeting of NIGL, so that the minutes incorrectly indicated that the board had resolved to approve a recommendation relating to Whitlam’s remuneration package, whereas the meeting merely noted the topic for further consideration.

The Court of Appeal overturned the primary judge’s decision, determining that Justice Gzell’s finding that Whitlam’s omission to sign was deliberate was vitiated by certain errors of fact. The Court found that although ASIC had presented enough evidence to support a possible finding on the balance of probabilities that the failure to sign was deliberate, the evidence was insufficient to support such a finding beyond reasonable doubt.

The Court also held that by filling out and lodging the poll paper, albeit unsigned, Whitlam did vote and accordingly did not breach section 250A of the Law.

In acting as a proxy for members, the Court determined that a director is not necessarily exercising a director’s powers or discharging a director’s duties. Accordingly, upon the case pleaded and presented by ASIC, Whitlam was not found by the Court to have breached his director’s duties.

The Court further found that there was insufficient evidence to support the ASIC allegations that Whitlam had revised the board minutes.

(2) Facts - AGM

At the 1998 NRMA AGM, one of the resolutions before the shareholders was “Resolution 6” which proposed amendments to NRMA’s Articles of Association concerning the remuneration of directors. The resolution was supported by the Board, including the appellant.

Prior to the vote on each resolution, the NRMA’s Company Secretary and General Counsel instructed proxy holders that a failure to sign a poll paper would result in an invalid proxy vote.

As Chairman, Whitlam received proxy votes. He filled out, but did not sign, the poll paper with respect to 3,973 votes directed against Resolution 6. The NRMA, upon legal advice from its company solicitors, ruled that the unsigned poll paper was invalid and hence the resolution was approved.

ASIC brought a claim alleging that Whitlam’s failure to sign amounted to a failure to vote and therefore was a breach of section 250A(4) of the Law. ASIC also alleged that Whitlam failed to vote in accordance with members’ instructions, was intentional or recklessly indifferent to the rights of members and therefore breached his obligations under section 232(2) of the Law to act honestly.

ASIC alleged that Whitlam was aware, prior to the AGM, that the number of proxies directed against the resolution were such that Resolution 6 would not be approved at the AGM.

(3) The decision

The Court of Appeal, in the joint judgment of Justices Hodgson, Ipp and Tobias, found that the evidence called by ASIC was sufficient to support a conclusion, on the balance of probabilities, that Whitlam’s failure to sign was deliberate. However, the evidence was insufficient to support such a finding beyond a reasonable doubt.

The Court then considered whether Mr Whitlam had contravened section 250A of the Law. This section related to the appointment of a proxy. Subsection (4)(c) provided that an appointment may specify the way the proxy is to vote on a particular resolution and if it does, and the proxy is the chair, then the proxy must vote on the poll, and must vote as directed by the member.

The question was whether Whitlam, by filling out the form with the votes cast, his own initials, surname and address, and submitting the form in purported performance of the voting procedures, amounted in law to voting.

Despite non-compliance with the instructions as announced by the Company Secretary, the Court found that Whitlam’s unsigned poll papers constituted a valid vote. The Court determined that Whitlam’s actions were sufficient to manifest an intention to vote the proxies and that manifest intention was in fact given effect to. The Court therefore found that Whitlam did vote and thus could not be in breach of section 250A.

The Court found that Whitlam, in failing to sign the poll papers, did not breach his director’s duties. This was because when he was dealing with the poll paper and omitting to sign it, Whitlam was not exercising his powers as a director.

The Court ruled that a director who accepts appointment as a proxy will, as agent for the member who made the appointment, have the fiduciary duties of an agent towards the member as principal. The director will also be subject to statutory requirements (for example, section 250A) but only in the director’s capacity as proxy, not as a director, and these are duties owed to the member, not owed to the company. If the member directs the proxy/director to vote in a way that the director believes is not in the interests of the company, the director will generally, as the member’s fiduciary, be obliged to vote in that way.

If Whitlam was not exercising his duties as a director, the question was then whether he was discharging his duties as a director. The primary judge had held that because Whitlam became chairman and proxy through his office as director, he was a director subject to the duties he had as chairman and proxy, including the obligation to vote as directed.

However, the Court of Appeal determined that the mere circumstance that there was a causal connection between Whitlam’s position as a director and his appointment as proxy was not of itself sufficient to make his dealing with the poll paper a discharge of the duties of his office as director. Unless there was some further element involved, his duty in relation to the voting of proxy votes was to the proxy givers, not to the company, and it was not a director’s duty.

(4) Facts – Board minutes

The second factual scenario concerned a revision made by Whitlam to draft minutes of a Board Meeting of NIGL. On 11 August 2000, the board of directors of NIGL considered whether it should approve a remuneration package for Whitlam. Draft minutes of the meeting were prepared for circulation among the directors for board approval at its next meeting.

ASIC alleged Whitlam had caused certain revisions to be made to the draft, so that the minutes incorrectly indicated that the board had resolved to approve one recommendation relating to the appellant’s remuneration package, whereas the meeting merely noted the topic for further consideration.

The Court of Appeal found that, as a matter of fact, there was insufficient evidence to support ASIC’s case.

(C) HIH APPEAL BY ADLER AND WILLIAMS  
(By Giselle McHugh, [Mallesons](http://www.mallesons.com))

Adler v Australian Securities and Investments Commission; Williams v Australian Securities and Investments Commission [2003] NSWCA 131, New South Wales Court of Appeal, Mason P, Beazley and Giles JJA; 8 July 2003

The text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/july/2003nswca131.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

This decision largely dismisses the appeals lodged by Rodney Adler, Adler Corporation Pty Ltd and Ray Williams to the decision of Santow J in ASIC v Adler [2002] NSWSC 171 (“the Judgment”) in relation to actions commenced by ASIC following the collapse of HIH Insurance Ltd (“HIH”).

The Judgment is discussed in Corporate Law Bulletin No 55 (March 2002) and the subsequent orders are discussed in Corporate Law Bulletin No 58 (June 2002).

In the Judgment, Santow J held that HIH, its wholly owned subsidiary HIH Casualty and General Insurance Ltd ("HIHC") and, inter alia, certain directors of HIH (Adler, Williams and Dominic Fodera) had contravened the related party provisions of Chapter 2E of the Corporations Act (then the Corporations Law) ("the Act") and the financial assistance provisions of Part 2J.3 when HIHC advanced $10 million to Pacific Eagle Equity Pty Ltd ("PEE"), a company controlled by Adler and the trustee of the subsequently constituted Australian Equities Unit Trust ("AEUT"), and part of that amount was used to purchase shares in HIH.

Adler, Williams and Fodera were also found to have breached their duties as directors and officers of HIH and HIHC under Division 1 of Part 2D.1 of the Act in connection with their involvement in the above transactions, AEUT’s purchase of shares in certain unlisted technology and internet entities from entities associated with Adler, and loans from the trust to other entities associated with Adler.

Adler was disqualified from acting as a director of any company for 20 years and Williams for 10 years. In pecuniary penalties, Adler and Adler Corporation were each ordered to pay $450,000, Williams $250,000 and Fodera $5,000. Adler, Adler Corporation and Williams were also ordered to pay compensation of $7,986,402 to HIHC.

(2) Scope of the appeal

The appellants contended that Santow J fell into legal error in a number of respects and particularly that he had taken into account numerous matters outside ASIC's pleaded case and therefore those findings of fact were not open to be made. Much of the evidence at the trial was documentary with affidavit evidence given of actions, conversations, states of knowledge, reactions and opinions. Neither Adler nor Williams gave evidence. The Judgment included inferences and characterisations from facts which were beyond dispute and from facts which were arrived at upon assessment of the evidence. The appellants challenged many of these findings and much of the appeal judgment is concerned with dismissing those submissions. However, from a corporate law perspective, the key findings on appeal follow.

(3) Related party transactions (Chapter 2E)

Santow J had held that HIH and HIHC contravened section 208 of the Act because the payment of $10 million by HIHC to PEE on 15 June 2000 amounted to the giving of a "financial benefit" to each of PEE, Adler Corporation and Adler within the meaning of section 229 and the terms of that financial benefit were not "arms length" for the purposes of the exception in section 210. This followed regardless of whether the payment was by way of an interest-free unsecured loan (as ASIC contended) or a payment on trust, as Adler argued.

The appellants continued to argue that the $10 million payment should be correctly characterised as funds held by PEE on trust for HIHC as sole beneficiary and hence no one was given a financial benefit. The Court of Appeal disagreed, saying that the payment should be characterised as an interest-free unsecured loan but that, in any event, its character was not essential to whether a financial benefit had been given. At best for the appellants, even if a trust was imposed by law (as an interim measure resulting from the initial loan arrangement having fallen away in favour of investment in a unit trust to be constituted at some future date) a financial benefit was still given to PEE, Adler and Adler Corporation on the day the payment was made.

PEE had $10 million, which it had previously not had, for investment in joint venture capital and share trading, which was the giving of "finance or property" within section 229(3)(a) of the Act. PEE was entitled to 10% of any profits and, even if it were subject to the obligations of a trustee (which is neither an answer to the financial benefit in having the money nor an answer to unreasonableness), it had unfettered discretion, was controlled by one man known not to be risk adverse, and was in the position of an investment manager but outside HIH's normal criteria. The financial benefit was not given on terms which would be reasonable in an arms length transaction. Section 229(1) requires a broad interpretation of financial benefits being given, and to have regard to economic and commercial substance rather than legal form.

The Court dismissed the appellants’ submissions that, if the terms of the trust were those imposed by the general law of trusts, they were by definition reasonable in the circumstances or, alternatively, that because PEE was precluded from deriving any remuneration or other personal benefit from its role as trustee, the terms were less favourable to PEE than would ordinarily be negotiated in an arms length dealing. This would require an unduly limited view of the nature of the financial benefit and what constitutes the terms on which a financial benefit was given, including that the $10 million was paid to PEE in circumstances in which it was necessary that the law impose a trust because the payer and the payee had not concluded the arrangements for investment of the money. In an arms length dealing this would hardly be reasonable.

Adler’s “involvement” under section 209(2) was also upheld, despite Adler’s argument that ASIC had to establish his actual knowledge of all material ingredients of the contraventions by HIH and HIHC. But Adler knew all the facts which made the payment of the $10 million to PEE the giving of a financial benefit otherwise than on reasonable arms length terms. This was not knowledge of essential facts constituting contravention, but knowledge that the known facts satisfied the concept of giving a financial benefit otherwise than on reasonable arms length terms in the Act.

(4) Financial assistance (Part 2J.3)

The Court upheld the trial judge’s findings that, under section 260D(2), Adler and Williams were sufficiently “involved” in HIHC’s contravention of section 260A, whereby HIHC had suffered material prejudice as a result of financially assisting PEE to acquire shares in HIH. It confirmed that “involved” (as defined by section 79) only calls for the “more limited” requirement of proof of the person’s knowledge of the financial assistance, but does not extend to knowledge that the assistance did in fact materially prejudice the interests of the company.

(5) Duties of directors and officers (Part 2D.1)

The appellants’ submissions in relation to breaches of duty under sections 180 (care and diligence), 181 (good faith) and 182 (improper use of position) were not accepted. However Adler’s appeal was upheld in relation to section 183 and the finding that he had improperly used information gained as a director of HIH to gain an advantage.

At issue was whether disregard of HIH’s Investment Committee guidelines and procedures could be an improper use of information. Although the Court found in the negative in this case, it may be that information as to corporate procedures is improperly used if, from the knowledge of the procedures, a person is able to devise a way of using the procedures to gain an advantage or cause detriment, or to devise a way of evading protections against advantage or detriment. Similarly, disregard of whatever was known about the HIH investment portfolio did not amount to misuse of that information; nor did having a degree of knowledge as to Williams’ “susceptibility” to favouring a proposal of less conservative investment amount to “information” under section 183.

(6) Compensation

The first issue was whether the loss as a result of investing in AEUT was damage suffered by HIHC which “resulted from” the contraventions found (see section 1317H(1)(b)). The trial judge had concluded that, whether the more stringent test of causation applicable in equity to breaches of fiduciary duty or the common law test was applied, the loss had “resulted from” the identified contraventions, so as to satisfy the requirements of section 1317H for the making of compensation orders.

The Court of Appeal was unable to agree that analogy with equitable claims against fiduciaries influences the meaning and application of the section, referring to the observations of Spigelman CJ in O'Halloran v R T Thomas & Family Pty Ltd (1998) 45 NSWLR 262. The analogy is all the more difficult because some civil penalty provisions in the Act do not involve contravention by a person standing in a fiduciary capacity. The words “resulted from” in section 1317H are words by which, in their natural meaning, only the damage which as a matter of fact was caused by the contravention can be the subject of an order for compensation. The trial judge had considered that HIHC's loss resulted from the contraventions even on the common law test and the appeal judges found no reason to disturb that finding.

As to the calculation of the interest component, the trial judge’s analogy with the award of interest against a defaulting fiduciary (who is presumed to have made the most beneficial use of it) should not be adopted. The inquiry is into loss resulting from the contraventions, and the suffering of loss through loss of use of money is a matter of fact and is to be determined by evidence. On that basis, the estimation should take account of HIH's overall return on all of its investments, since it could not be concluded on the balance of probabilities that $10 million worth of HIH's assets would have been devoted to one form of investment rather than another.

(7) Jones v Dunkel inferences in civil penalty proceedings

The trial judge had repeatedly referred to the failure of Adler and Williams to give evidence at the trial and it was submitted on appeal that the penal nature of civil penalty proceedings meant that his findings were thus flawed by Jones v Dunkel inferences erroneously drawn. The appeal judges disagreed, saying that civil penalties can be regarded as punitive, with a resemblance to fines imposed on criminal offenders, but proceedings for civil penalties do not share the same fundamental features of a criminal trial.

It was also necessary to consider the Act, since its civil penalty provisions do not necessarily lead to imposition of pecuniary penalties, and may lead to a compensation order with the same effect as if the company had brought civil proceedings for breach of the directors’ duties or to a disqualification order made not punitively but protectively. They are not to be equated with provisions for criminal offences. Moreover, the civil penalty proceedings are expressly to be maintained by civil law processes. In ordinary civil proceedings the defendant cannot be forced to give evidence in his own case and civil penalty proceedings are no different in that respect. It was open for Jones v Dunkel inferences to be drawn against the appellants.

(8) Company directors

The appellants submitted that the practices of company directors “are too multifarious and individualated [sic] to constitute a field of ‘specialised knowledge’ within the meaning of section 79” of the Evidence Act 1995, and thus the trial judge erred in considering the opinions of a particular ASIC witness. The Court of Appeal’s view was that proper professional conduct in the sense of due care and obedience to customary practices and ethical rules is a field of specialised knowledge. That the common law and (now) the Act state directors’ duties of due care and proper conduct suggests that a company director should have specialised knowledge and be able to speak of the duties and their application.

(D) APPLICATION FOR SUMMARY DISMISSAL OF A CLAIM FOR INSOLVENT TRADING BECAUSE OF DELAY  
(By Sarah d’Oliveyra, [Phillips Fox](http://www.phillipsfox.com))

Geneva Finance Ltd (Receiver and Manager Appointed) v Howat [2003] WASC 119, Supreme Court of Western Australia, Master Newnes, 19 June 2003

The text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/wa/2003/june/2003wasc119.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background to the claim in respect of which the application was made

On 30 May 2003, Master Newnes of the Supreme Court of Western Australia heard an application in chambers for the dismissal of a claim for insolvent trading, under Order 33 rule 1(b) of the Supreme Court Rules, or alternatively, pursuant to the inherent jurisdiction of the court.

Russell John Hawkins (‘the Applicant’) is 1 of 5 defendants to a claim brought by Geneva Finance Ltd (Receiver and Manager Appointed) (‘the plaintiff’) in respect of loans which were made to the plaintiff’s holding company First Western Group Ltd (‘FWG’) while FWG was allegedly insolvent. At the time the loans were made, the Applicant was a director of FWG. On 20 August 1996, the plaintiff accordingly initiated proceedings against the Applicant and 4 other directors of FWG under section 556(1) of the Companies (Western Australia) Code. Notably, the plaintiff alleges that the Applicant and the first 2 defendants are personally liable to repay $4,931,639.24, forming part of the total amount of loans allegedly made by the plaintiff to FWG in the period between 1 January 1990 and 31 July 1990.

(2) Background to the application

On 24 January 2003, the Applicant applied for summary dismissal of the above claim on the basis that there had been inordinate and inexcusable delay by the plaintiff in the prosecution of the action, thereby causing prejudice to the Applicant.

The conduct giving rise to the claim allegedly occurred in the period between 1 January 1990 and 31 July 1990. Proceedings were commenced over 6 years later, on 20 August 1996, by the issuing of a writ. The writ was subsequently served on the Applicant on 14 February 1997. A memorandum of appearance was served on behalf of the Applicant on 17 February 1997. The plaintiff subsequently filed and served the statement of claim on 24 April 1997. On 9 October 1997, the Applicant filed and served his defence, effectively putting in issue every substantive fact necessary to establish the cause of action. Notably, the Applicant submitted in his defence that if the alleged loans were made, they were made without his authority or consent and that, at the time they were made, he did not have reasonable cause to expect that FWG was insolvent or, if it incurred the debt, it would be insolvent.

The plaintiff requested discovery of documents from the defendants on 17 March 1998. Failing compliance with the request by the first 4 defendants, the plaintiff applied for orders that they give discovery. On 26 August 1998, the plaintiff inspected the Applicant’s discovered documents. On 19 October 1998, the second defendant made an interlocutory application for security for costs. By consent, that application was adjourned to be heard at a special appointment.

Almost 2 years later, on 18 October 2000, the plaintiff filed a notice of intention to proceed. However, the plaintiff did not take steps to proceed with the action until 6 August 2001. On 18 December 2002, following further delay by the plaintiff, the Applicant’s solicitors requested reasons from the plaintiff for not applying to have the claim summarily dismissed for want of prosecution. The Applicant subsequently filed this application on 24 January 2003.

(3) Applicable principles

There was no dispute in relation to the principles to be applied in determining the outcome of the application. The House of Lords’ decision in Birkett v James [1978] AC 297 was treated as authority for the proposition that a claim should only be dismissed for want of prosecution if the plaintiff’s default has been intentional and contumelious. Further, and in the alternative, dismissal is warranted if there has been inordinate and inexcusable delay on the part of the plaintiff, thereby putting a fair trial at risk or causing serious prejudice to the defendant.

Master Newnes confirmed that the relevant factors for making a determination under this broad statement of principle are (a) the length of the delay, (b) the explanation for the delay, (c) the hardship to the plaintiff and (d) the prejudice to the defendant. As the Full Court emphasised in Sangora Holdings Ltd v Hodder [2003] WASCA 108, it is necessary to balance these factors and the interests of the parties to the application. Master Newnes confirmed that the public interest is also a relevant policy consideration in respect of claims for summary dismissal.

(4) Plaintiff’s explanation for the delay

At the outset, Master Newnes stated that there had been inordinate delay by the plaintiff in its prosecution of the action. However, that in and of itself is insufficient to warrant summary dismissal of a claim. The delay must also be ‘inexcusable’.

The plaintiff offered 3 reasons for its delay in prosecuting the action against the Applicant: (a) the relationship between the claim against the Applicant and other claims against the auditors of the plaintiff and another company, Resource & Industry Ltd; (b) the difficulties in assembling the necessary evidence in respect of the plaintiff’s claim against the Applicant and 4 other defendants; and (c) the plaintiff’s lack of funding for a trial. In respect of the plaintiff’s first submission, it was stated that the delay was directly associated with the need to first resolve other claims against the auditors (for approximately $21,414,629) and Resource & Industry Ltd. This, it was argued, was necessary to raise sufficient funding to take the plaintiff’s claim against the Applicant to trial.

In relation to the second submission, it was stated that the plaintiff had experienced considerable difficulty gathering evidence relevant to FWG’s financial position at the time the loans were made. The plaintiff relied further on the complexities and difficulties that arise in circumstances where a receiver is seeking to ‘unravel’ a substantial corporate collapse. Finally, the plaintiff submitted that funding issues contributed to the slow progress of the action. Upon the issuing of the writ on 20 August 1996, the plaintiff had at least 3 claims on foot and was a defendant to proceedings initiated by the auditors of the plaintiff company. The auditors’ claim against the plaintiff was ultimately unsuccessful. However, the plaintiff asserted that its financial position had worsened considerably as a result of defending the claim before the Federal Court.

(5) The Applicant’s submissions

In response to the plaintiff’s second and third submissions, the Applicant asserted that the complexity and cost associated with the claim against the Applicant and 4 other defendants would have been obvious to the plaintiff before it commenced proceedings. The Applicant therefore asserted that they were not a sufficient excuse for the delay. In relation to the plaintiff’s first submission, the Applicant stated that the plaintiff could not rely on its ‘deliberate strategic decision’ to commence a number of separate actions for the purpose of funding other litigation (including the claim against the Applicant and 4 other defendants) as an excuse for the delay.

(6) The public interest argument

The plaintiff relied on the decision of the English Court of Appeal in Re Manlon Trading (1995) 4 All ER 14 (‘Re Manlon Trading’) as a basis for asserting that, as a matter of policy, the court should have regard to the public interest in attributing liability to those responsible for corporate collapses or corporate misconduct. The Applicant replied that it was contrary to the public interest to allow actions to continue when there is no likelihood of success. In this regard, the Applicant relied on the Supreme Court’s dismissal of the plaintiff’s claim against Resource & Industry Ltd in 2002.

(7) Dismissal of the application

Master Newnes noted that the English Court of Appeal’s decision in Re Manlon Trading involved an application for summary dismissal in respect of a claim to disqualify a director. As Gibson and Staughton LJ confirmed in their determination of the appeal, disqualification proceedings are usually brought in the public interest rather than for the purpose of enforcing a personal right. In those circumstances, the public interest is an important factor in the court’s determination of whether a claim should be summarily dismissed for want of prosecution. Master Newnes was willing to concede that there might be a public interest in attributing liability to those responsible for corporate collapses, particularly in light of the fact that a number of small investors suffered loss as a result of the collapse of the plaintiff company. However, he was hesitant to treat public interest considerations as determinative in the present application. They were simply treated as a factor to be weighed in the overall balance of the factors relevant to determining the outcome of the application and the interests of the parties.

Ultimately, Master Newnes dismissed the application on the basis that the plaintiff’s delay was not inexcusable, and that it did not amount to contumelious conduct. Two additional considerations appear to have been influential in the outcome of this application: first, the applicant appeared to have suffered no specific prejudice as a result of the delay. The Applicant contended that his reputation was generally affected by the pending litigation, but did not make any submissions to the effect that he was suffering, or likely to suffer, adverse financial consequences as a result of the delay. In this regard, Master Newnes noted the Applicant’s apparent acquiescence in respect of the plaintiff’s delay until December 2002. The second consideration, which appears to have been determinative, was the fact that the limitation period for the plaintiff’s cause of action against the Applicant would not expire for a further 7 years. Even if the court ordered dismissal of the plaintiff’s claim for want of prosecution, Master Newnes noted that fresh proceedings could simply be initiated by the plaintiff the following day or at any time within the next 7 years. In light of this consideration, Master Newnes dismissed the application, subject to an undertaking that the plaintiff would make an application either to stay the proceeding or take the matter to trial by 30 June 2003.

(E) APPLICATION FOR LEAVE TO ENFORCE A GUARANTEE GIVEN BY A DIRECTOR OF A COMPANY IN ADMINISTRATION  
(By Michael Jackson, [Phillips Fox](http://www.phillipsfox.com))

National Australia Bank Limited v Anthony Patrick King [2003] NSWSC 525, Supreme Court of New South Wales, Barrett J, 18 June 2003

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/june/2003nswsc525.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

National Australia Bank Limited (“the Plaintiff”) is a creditor of seventeen different companies known collectively as “the King bus companies”. The directors of these companies are Anthony Patrick King and Peter James King (“the Defendants”). The Plaintiff claimed that the Defendants were guarantors of financial obligations owing to the Plaintiff that were created by a deed dated 3 October 2001. On 3 April 2003, the Plaintiff demanded payment from the Defendants of the total amount due under the guarantee of $146,999,741.96.

On 8 April 2003, five days after the Plaintiff demanded payment of the guaranteed amount, the Defendants placed the King bus companies under administration under Part 5.3A of the Corporations Act 2001 (Cth) (“the Act”). The Plaintiff subsequently appointed receivers and managers to the King bus companies.

(2) Application

The Plaintiff sought leave of the Court under section 440J(1) of the Act to enforce against the Defendants the guarantees said to have been given by them in respect of the indebtedness of the King bus companies. Section 440J(1) states:

“During the administration of a company:

(a) a guarantee of a liability of the company cannot be enforced, as against;

(i) a director of the company who is a natural person; or  
(ii) a spouse, de facto spouse or relative of such a director; and

(b) without limiting paragraph (a), a proceeding in relation to such a guarantee cannot be begun against a director, spouse, de facto spouse or relative; except with the leave of the Court in the accordance with such terms (if any) as the Court imposes.”

(3) Judgment

Justice Barrett began by distinguishing section 440J(1) from other provisions contained within Part 5.3A of the Act. His Honour stated that other provisions, namely sections 440B, 440C, 440D, 440F and 440G, aim to preserve the property and resources of the company so as to maintain its status quo unless the Court determines intervention by a creditor to be appropriate. His Honour continued by contrasting section 440J(1) as a section concerned with actions against directors of the company and not the company itself. An application brought under the section (and the subsequent enforcement) has no direct effect on the company’s ability to function as a going concern.

Counsel for the Plaintiff referred to two cases, BBC Hardware Ltd v GT Homes Pty Ltd [1997] 2 QdR 123 (“BBC Hardware”) and Wallabah Pty Ltd v Navillo Pty Ltd (1997) 23 ACSR 444 (“Wallabah”), both of which refer to the judgment of Hill J in Re Behan; Ex parte Pioneer Concrete (Qld) Pty Ltd (1995) 17 ACSR 725 (“Re Behan”).

Barrett J referred to the observations of Hill J in Re Behan on the operation and purpose of section 440J and noted his Honour’s reference to the Explanatory Memorandum accompanying the Bill from which section 440J was inserted. Hill J focused on the following extract of the Explanatory Memorandum:

‘It is anticipated that the directors of companies who have personally guaranteed the obligations of a company will be discouraged from appointing an administrator to the company if, immediately upon the appointment, that guarantee became enforceable. To remove this perceived impediment… proposed section 440J aims to impose a ‘stay’ on any enforcement action under a guarantee against a director… while a company is under administration, except with the leave of the Court.’

Further referring to the judgment of Hill J in Re Behan, Barrett J held that due to the use of the word ‘begun’ in section 440J, the section ‘is concerned only with the commencement of proceedings in relation to a guarantee or the enforcement of the guarantee itself’ and that it was not necessary to consider what steps may be characterised as steps involving enforcement of a guarantee.

Citing Wallabah, BBC Hardware, Mead Corporation v Carbonless Papers (Australia) Pty Ltd [2002] WASC 268, and Stegbar Pty Ltd v Mayfair (1993) 13 ACSR 354, Barrett J held that under section 440J the onus lies upon the creditor to positively show that there are good and cogent reasons to depart from the presumption underlying the section that the creditor ought not to be able to proceed.

In attempting to prove that the circumstances warranted such a departure, Counsel for the Plaintiff submitted to the Court 6 reasons for doing so:

(a) The Plaintiff had serious concerns regarding the inaccuracies in the materials provided to the Plaintiff and missing or non-existent assets held by the King bus companies. Evidence was served upon the Defendants 2 months before the application and there has been no attempt by the Defendant to explain or allay the Plaintiff’s concerns;

(b) The Defence had failed to co-operate with the receivers by:

(i) declining to answer questions or meet with the receivers; and  
(ii) refusing or failing to supply a report as to affairs under section 429A of the Act;

(c) A very large sum of money remained outstanding;

(d) No defences appeared likely;

(e) Any adjournment or postponement in enforcement proceedings would cause the Plaintiff unnecessary legal costs and increased interest on outstanding moneys; and

(f) The policy considerations demonstrated by the reported cases (as mentioned above) were not applicable in these circumstances.

In response to the sixth point, Barrett J reiterated the intentions of the legislature by explaining that the section aims to deal with the problem of directors shying away from appointing administrators when such appointments are needed because of a fear that doing so might precipitate claims under any guarantees which they have given in relation to the company’s debts. His Honour added that section 440J provides a legislative assurance that any repercussions of that kind could only occur during administration where the court has given appropriate leave.

Barrett J held that it would be incorrect to apply the section solely for the one purpose stated in the Explanatory Memorandum and that the section exists in a part of the legislation that is intended to ensure that administration undertakes an orderly course. His Honour stated that for this reason the ‘administrator has a clear and direct interest in the question whether leave should be granted under the section.’

This led Barrett J to dismiss the Plaintiff’s submission that as the guarantee was between the Defendant and the Plaintiff, only those 2 parties should have any bearing upon whether leave was granted. His Honour held that it would be dangerous and undesirable to attempt to deal with the question of leave under section 440J(1) without having heard the views of the administrator on whether granting leave would have any adverse impacts upon the due and orderly conduct of the administration.

Following the Queensland Court of Appeal case of Thomas v Bradnam’s Windows & Doors Pty Ltd [1999] QCA 487, Barrett J concluded by stating that the fact that the Plaintiff had taken steps towards enforcing the guarantees by serving the demands before the directors appointed an administrator was, in the view of the expressed legislative purpose, a very relevant consideration in favour of the Plaintiff’s case. Nonetheless, Barrett J held that the opinion of the administrator was also very relevant.

Barrett J therefore directed the Plaintiff to provide the administrators with a copy of the originating process and supporting affidavits and a copy of his Honour’s reasons by no later than Friday 20 June 2003. The Plaintiff’s application was stood over to 10am Friday 27 June 2003 before his Honour.

(F) PRIVILEGE AGAINST EXPOSURE TO A PENALTY  
(Bart Price, [Blake Dawson Waldron](http://www.bdw.com.au))

Australian Competition and Consumer Commission v FFE Building Services Limited [2003] FCAFC 132, Federal Court of Australia Full Court, Emmett, Hely and Jacobson JJ, 16 June 2003

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/june/2003fcafc132.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

This case concerned an action the Australian Competition and Consumer Commission ("ACCC") commenced against four corporations and seven individuals. The ACCC alleged the four corporations had made arrangements or arrived at understandings in contravention of sections 45(2)(a)(i), 45(2)(a)(ii), 45(2)(b)(i) and 45(2)(b)(ii) of the Trade Practices Act 1974 (Cth) ("TPA"). The ACCC also alleged that the individual respondents were knowingly concerned in or a party to the contraventions by the corporations. The ACCC claimed penalties against these individuals pursuant to sections 76 and 77 of the TPA.

The ACCC when bringing this action was directed by the court at first instance to file and serve evidence of all of its proposed witnesses. The ACCC requested that the court make similar orders in relation to the respondents. Two individual respondents contended that to provide statements in advance of the hearing would be inconsistent with their right to refuse to provide information that might tend to expose them to a penalty. The ACCC proffered an undertaking that if statements were provided by individual respondents the statements would not be tendered in the ACCC's case or used to support an argument that a particular individual respondent had a case to answer.

The court at first instance found a conflict of authorities between the Federal Court and Victorian Supreme Court in examining whether requiring a respondent to supply information prior to the close of their case contravened the principle that an individual should not be compelled to furnish information that may tend to expose that individual to a penalty. The court at first instance followed the precedent of the Federal Court, this decision was appealed and was the primary issue in the case.

(2) General principles of privilege against self-incrimination

The privilege against self-incrimination protects an individual from making a disclosure that may lead to an incrimination or to the discovery of real evidence of an incriminating nature. The rationale is that an applicant must prove their own case and not get any assistance from the respondent in proving its case.

(3) Decision in the Amcor case

Justice Sackville in Australian Competition and Consumer Commission v Amcor Printing Papers Group Ltd (1999) 163 ALR 465 concluded that to require individual respondents to file statements before the commencement of the trial was not consistent with the rationale underlying the privilege against exposure to penalties. Justice Sackville stated that requiring individual respondents to file statements of evidence would provide the ACCC with leads that would result in other adverse evidence being adduced in the proceeding in which the penalties were sought.

(4) Decision in the Sidebottom case

The Victorian Court of Appeal in Sidebottom v Federal Commissioner of Taxation (2003) 52 ATR 184 considered the question of directions for the filing and service of witness statements in a proceeding for pecuniary penalties under the Excise Act 1901 (Cth). The court in this case required individual respondents to file and serve witness statements prior to the trial.

The court held that the individual respondents would only be required to file and serve witness statements if they chose to give or adduce evidence, and only with respect to the evidence with which they sought to lead. The court argued that there was a fundamental distinction between a situation in which a person is required to produce documents and provide information, on the one hand, and a situation in which the person is left entitled to remain silent and unco-operative but is directed that, if he or she wishes to provide information, this must be done in a particular way or by a particular date. The court held whilst the former destroyed the privilege against self incrimination, the latter merely regulated the manner in which it was broken.

(5) Conclusion of the court

The court favoured the approach taken by the court in the Amcor case. The court held that although there was no direct compulsion on the individual respondents to file witness statements pursuant to the directions of the Commission, the practical consequence of the direction is that they will be compelled to file statements to preserve the option to which they are entitled, to decide after the ACCC's case is closed, to go into evidence. The court held that an undertaking given by the ACCC not to use the information is not determinative of the question as the privilege against self incrimination is either breached or not.

The court concluded that at some stage of proceedings, a respondent must elect whether or not to go into evidence. An election which is preserved until after the ACCC closes its case is very different from one which is brought forward to a time before the case of the ACCC is closed. Such pre-trial disclosure may assist the ACCC to improve its case against the respondent, which would so weaken the privilege against self incrimination that it was substantially undermined.

(G) THE AVAILABILITY OF THE PRIVILEGE AGAINST SELF INCRIMINATION   
(By Amelia Tooher, [Blake Dawson Waldron](http://www.bdw.com.au))

Australian Securities and Investment Commission v United Investment Funds Pty Ltd [2003] FCA 674, Federal Court of Australia, Finkelstein J, 4 July 2003

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/july/2003fca674.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

This case concerned whether the privilege against self-incrimination was available to respondents required to provide ASIC with information concerning the whereabouts of an amount allegedly obtained by fraud.

(2) Facts

The issue arose in relation to an investigation being conducted by ASIC into the affairs of United Investment Funds Pty Ltd and AMCO Insurance Management Group Pty Ltd (the “corporate respondents”). The corporate respondents, along with AMCO Group Pty Ltd, collected over $2.5 million in insurance premiums from approximately 1,000 policy holders. The collections were ostensibly on behalf of a Bosnian and Herzegovinan corporation, Grand Osiguranje AD Zvornik (“Grand”).

The corporate respondents claimed to have had authority to write insurance for Grand, although ASIC contended that they were not authorised to act as agents and no amount collected had been received by Grand. Further, examination of known bank accounts of the corporate respondents indicated that the money collected and deposited, had since been spent. ASIC also contended that the individual respondents, who were persons connected with the corporate respondents, were also prolific gamblers.

(3) ASIC’s application

ASIC applied to restrain the corporate respondents from writing insurance as Grand's agent and sought an order that they be wound up. It also sought and obtained an ex parte order for the appointment of a receiver over certain identified bank accounts. ASIC then moved on notice for the appointment of a provisional liquidator over the corporate respondents, however, the hearing was adjourned at the request of the respondents.

The respondents submitted to an order that each would make and file an affidavit disclosing, inter alia, any account that they had with a bank, building society or financial institution, the deposits and all withdrawals from those accounts and all facts within their knowledge as to the whereabouts of the premiums and the proceeds of those premiums. The order was made on the basis that “[i]f the deponent seeks to claim privilege with respect to any matter required…to be disclosed the claim must be made, and the grounds for it stated, in the affidavit to be made filed and served…which [affidavit] shall include the facts and matters upon which reliance is placed for such claim."

The affidavits contained no information as to the whereabouts of the premiums, as each deponent claimed that such information may tend to incriminate him.

As the respondents had failed to comply with the order, ASIC contended that each respondent was in breach of the order and sought that they be punished for contempt. ASIC argued that even if the privilege could apply, it had not been properly claimed, as no deponent had included the “facts and matters upon which” the claim for privilege was based.

(4) Finkelstein J’s decision

His Honour referred to the Full Court decision in Gamble v Jackson [1983] 2 VR 334, in which Starke J drew a distinction between two types of incriminating questions. At 336, “[t]he first is where the question itself reveals that the material sought is of a criminal and therefore incriminating nature….The second is where the question is innocent on its face but seeks after material which may form a link in a chain of incriminating material.” In the first case, Starke J held that it would not be necessary to produce any material to establish the privilege. However, in the second, an applicant must point to material which indicates the incriminating character of the material. For the purposes of this distinction, Finkelstein J divided the respondents into two groups.

(a) Individual respondents

The individual respondents were directors of and “effectively controlled” the corporate respondents. It was clearly ASIC’s view that the individuals were directly involved in the alleged wrongdoing. As any information required to be provided by the order would tend to incriminate the individual respondents, Finkelstein J considered that the individual respondents fell into the first category. Accordingly, they did not need to state “the facts and matters” which supported their objection to furnishing the information.

(b) Corporate respondents

As the privilege cannot be claimed by corporations (Environment Protection Authority v Caltex Refining Co Pty Ltd (1993) 178 CLR 477), the individuals selected to swear the affidavit on behalf of each corporation claimed the privilege. Accordingly, the corporation did not provide the information required by the order.

Finkelstein J did not accept this as a proper basis for the corporate respondents to withhold the information. The information could still be provided by the reasonable enquiries of a secretary, employee, agent or some other proper officer who was not implicated in the alleged wrong doing (Smith Kline & French Laboratories Ltd v Inter-Continental Pharmaceuticals (Australia) Pty Ltd (1969) 123 CLR 514, 519.

His Honour identified a further complication in the circumstances. Since the order was made, the corporate respondents had been placed into provisional liquidation and the liquidator was in effective control of the companies. Finkelstein J noted that it would be pointless to require the liquidator to comply with the order “for he knows nothing of the facts”. His Honour commented that the effectiveness of the order may require there to be limits placed on the powers of the provisional liquidator, so that the control of aspects of each corporate respondent’s affairs reverts to those who formerly controlled it. Therefore, it would be the former controllers, not the provisional liquidator, who may be called upon to ensure compliance with the order.

(H) OPPOSITION TO EXTENSION OF TIME FOR MEETING OF CREDITORS  
(By Scott Sharry and Ron Schaffer, [Clayton Utz](http://www.claytonutz.com))

In the matter of Pan Pharmaceuticals Limited [2003] FCA 598, Federal Court of Australia, Lindgren J, 6 June 2003

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/june/2003fca598.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

This decision deals with an administrators' application for an extension of time to convene a second meeting of creditors under section 439A of the Corporations Act 2001 (Cth) (the "Act") and a director's unsuccessful opposition to the application.

(1) Facts

The administrators of five companies which form part of the Pan Pharmaceuticals Limited Group (the "Pan Group") brought an application to extend the period within which they were required to convene a second meeting of creditors.

Leave was granted to a director and contributory of the Pan Group to appear and be heard in the proceedings without becoming a party to the proceedings.

(2) Legislation

Sub-section 439A(1) of the Act provides that the administrator of a company under administration must convene a meeting of its creditors within the convening period as fixed by sub-sections (5) or (6) of 439A. Sub-section 439A(2) provides that the meeting must be held within 5 business days after the end of the convening period. Sub-section 439A(5) provides that the convening period is, relevantly, the period of 21 days beginning on the day when the administration begins.

Under sub-section 439A(6) of the Act the Court may extend the convening period on an application made within the original 21 day period. The administrators sought to extend the convening period for a further 75 days.

(3) Administrators' position

The administrators submitted that they would not be in a position prior to the end of the convening period to prepare an adequate report to enable the creditors to make a decision whether or not to vote in favour of the resolution that:

(a) a deed of company arrangement be executed, if one were proposed; or

(b) the voluntary administration end; or

(c) there be a winding up of the companies.

The administrators provided substantial evidence regarding the issues which delayed the provision of an adequate report, which included the following:

- The Pan Group operated a highly complex business.  
- The administrators were negotiating with the Therapeutic Goods Administration ("TGA") to reinstate the manufacturing licence of the Pan Group (which had been suspended for a period of 6 months). Without the manufacturing licence the sale of the business of the Pan Group or any proposed deed of company arrangement would not be viable. Further, to prepare for a sale, the administrators would have to address a number of complex issues including the identification and valuation of the assets of the Pan Group. The administrators estimated that it would take approximately two months for the issues to be properly resolved before a tender could take place.  
- There were approximately 20 personal injury claims in relation to the Pan Group products. Most of these claims were not yet quantified. In order to advise the creditors properly in relation to these claims, the administrators had to ascertain the likelihood of their success and their estimated damages.  
- There were 30 claims made by and on behalf of "sponsors" (the entities supplied by the Pan Group who on-sold to distributors and retailers). The amounts claimed were generally unspecified. In order to properly advise the creditors the administrators needed to review each supply agreement and assess each claim.   
- Although required under the Act to provide reports to the administrators about the affairs and financial circumstances of the companies within 7 days, the directors of the Pan Group had requested and had been granted an extension of time to provide such reports which fell outside the period in which the administrators were required to convene the second meeting of creditors.  
- Creditors representing 62% in value did not object to the proposed extension of 75 days. If the application for an extension was not granted, the administrators would, at the second meeting, recommend that the meeting be adjourned for 60 days to enable the administrators to prepare an adequate report. If this was necessary the administrators estimated that the costs incurred in preparation would be in the order of $100,000.

(4) Director's position

Mr Selim, a director of the Pan Group, argued that the second meeting of creditors should be convened within the period set out in the Act for the following reasons:

(a) The creditors would be prejudiced by any further delay, which might cause some "sponsors" to collapse as they were not receiving a supply of goods. It was argued that the claims for compensation by the "sponsors" would increase for this reason and that the creditors were in a better position than the administrators or the Court to know where their best interests lie and how those interests are best protected.

(b) The administrators should present the information they had at the time of the second meeting and the creditors should be allowed to decide whether more information was needed before making a decision.

(c) The administrators' plan for a sale of the business of the Pan Group did not accord with the object of Part 5.3A which, according to paragraph 435A(a), is to "maximise the chances of the company, or as much as possible of its business, continuing in existence".

(d) It was argued that interest on the creditors' claims and the likely increases in those claims would be far greater than those costs thrown away by preparing for an earlier meeting of the creditors.

(5) Decision

Lindgren J referred to sections 439C and 439A(4) of the Act, and held that the application needed to be assessed by reference to whether an extension was necessary to enable the administrators to form an opinion (sub-section 439A(4)) and to adequately inform the creditors so that they would be in a position to vote on one of the options available to them at the creditors' meeting. After considering the evidence, Lindgren J granted a 75 day extension.

In obiter Lindgren J mentioned that if the second creditors' meeting could be held earlier, the administrators would be at liberty to apply (under section 447A of the Act) to have the meeting held prior to the end of the extended convening period. This was despite section 439A(2), which states that the meeting must be held within 5 business days after the end of the convening period.

(6) Comment

To be successful in obtaining an extension of time an administrator needs to show that the nature of the administration is of a size and complexity which require further information and assessment to be undertaken before he can adequately inform creditors.

It seems that the Court is prepared to be persuaded to agree with the evidence of an administrator as to whether more time is needed rather than to leave the decision wholly to the creditors of a company by way of an adjournment motion (although in this case it seems that the creditors would have voted in favour of an extension).

(I) ABUSE OF PROCESS IN AN EXAMINATION SUMMONS MADE UNDER SECTION 596A OF THE CORPORATIONS ACT  
(By Robert Trowbridge and Karen Perret, [Corrs Chambers Westgarth](http://www.corrs.com.au))

Carter v Gartner, in the matter of Gartner Wines Pty Limited and the Corporations Act 2001 [2003] FCA 653, Federal Court of Australia, Branson J, 30 June 2003

The text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/june/2003fca653.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

This application by Mr Gartner required the Court to give consideration to whether the issue of an examination summons has resulted in an abuse of process. Mr Gartner was summoned for examination, on the application of Mr Carter and Mr Hart (the “applicants”) under section 596A of the Corporations Act 2001 (Cth) (the “Act”) (“examination summons”). Mr Gartner asserted that, in the circumstances of this case, the relationship between the applicants and the National Australia Bank Limited (“NAB”) (ie, being represented by the same solicitors in separate Federal Court proceedings against the Gartner Family Group (“Federal Court proceedings”) rendered the purpose for which the examination summons was obtained an improper purpose.

In dismissing Mr Gartner’s application to (a) inspect the affidavits filed in support of the examination summons and (b) set aside the examination summons or alternatively, to stay the examination on the grounds of improper purpose, Branson J held the following:

(a) Rule 11.3(3)(a) (requiring an affidavit in support of an application under section 596A of the Act) and rule 11.3(7) (providing that the affidavit is not available for inspection) of the Federal Court (Corporations) Rules (“Rules”), “fills the gap” of section 596A of the Act which is silent as to both.

(b) There was insufficient material to demonstrate that Mr Gartner had an arguable case of improper purpose such that the Court could not dispose of the application fairly and properly unless Mr Gartner inspected the documents. In any case, Mr Gartner is not entitled to inspect the affidavits to “fish” for a case.

(c) The relationship between the applicants and a creditor (NAB) does not mean that there will be a breach of any duty of confidentiality when the solicitors, acting for both, inspect the documents produced at the examination summons.

(d) A receiver and manager, like a liquidator, owes a primary duty to debenture holders and not to the company despite being an officer of the company (section 82A of the Act). The mere fact that a creditor may acquire a collateral advantage by reason of information disclosed under an examination summons does not render the purpose of the examination summons improper.

(2) Facts

Mr Gartner and his wife (together “Mr & Mrs Gartner”) had for many years carried on a farming business under the partnership name “MJ & AW Gartner” on land owned by them in the Coonawarra district of South Australia. Mr & Mrs Gartner and the companies in which they, or Mr Gartner, hold shares will be together referred to as the “Gartner Family Group”.

On about 11 October 2001 NAB presented a document entitled “Corporate Letter of Offer” to the Gartner Family Group advising that it would agree to provide certain financial facilities to the Gartner Family Group to fund the construction of a winery. In November 2001 the Gartner Family Group accepted the NAB offer of financial facilities and members of the Gartner Family Group entered into mortgages and debentures and executed guarantees in favour of NAB.

On 20 February 2002, the applicants were appointed by NAB to investigate the affairs of Gartner Wines Pty Limited. On 8 August 2002 the Gartner Family Group purported to rescind the facilities, including the mortgages, debentures and guarantees entered into by the members of the Gartner Family Group. On 9 August 2002 NAB appointed the applicants as receivers and managers of the Gartner Family Group.

On 13 August 2002 the Gartner Family Group commenced the Federal Court proceedings against its accountants and NAB on the basis of, amongst other things, engaging in misleading and deceptive conduct, unconscionable conduct and breach of contract.

By letter dated 30 August 2002, the legal firm Finlaysons, acting for both the applicants and NAB in the Federal Court proceedings, requested ASIC to authorise the applicants to make applications for examination summons in relation to the companies in the Gartner Family Group. An authorisation as sought dated 25 September 2002 was issued to the applicants for the examination of Mr Gartner’s books and records. The applicants swore an affidavit in support of the application (“the supporting affidavits”).

(3) Decision

(a) On the application that the supporting affidavits be available for inspection by Mr Gartner

Mr Gartner claimed that his entitlement to inspect the supporting affidavits was (i) “a matter of right” or alternatively, (ii) because the Court will be unable fairly and properly to dispose of his application for an order setting aside or staying the examination summons unless Mr Gartner can inspect the supporting affidavits.  
It was argued that the right flowed from the failure of the Act to expressly provide that “an affidavit filed in support of an application made under section 596A is not available for inspection except so far as the Court orders”. This was compared to section 596C(2) which makes such provision in respect of an affidavit filed in support of an application made under section 596B.

Branson J held that whilst Division 1 of Part 5.9 of the Act does not require an application made under section 596A to be supported by an affidavit, rule 11.3(3)(a) of the Rules which requires it. Rule 11.3(7) further provides that, unless the Court otherwise orders, an affidavit in support of an application for an examination summons is not available for inspection by any person.

The court rejected that Mr Gartner was entitled to inspect the supporting affidavits “as a matter of right” holding that it was not necessary to read down rule 11.3(7) to made it consistent with the Act – the Rules being made in the exercise of a power to make rules for the Court (section 59 Federal Court of Australia Act 1976 (Cth)).

With regard to satisfying the Court that it would be unable fairly and properly to dispose of this application if Mr Gartner could not inspect the supporting affidavits, Mr Gartner placed reliance on the approach adopted by the Full Court in Re Excel Finance Corporation Ltd (Receiver and Manger Appointed; Worthley v England (1994) 52 FCR 69 (“Excel Finance”) where the court stated (at 93-94) that a court “has a discretion to order the disclosure, to a prospective examinee, of material lodged in support of the application for an examination order and should do so where the justice of the case so requires”.

Branson J noted however that the later passages of the same judgment provided that (at 94):

“An applicant will not be permitted access to such material to enable him or her to “fish” for a case. There must be material before the court from which it appears that the applicant has an arguable case, to which the material is relevant, before the discretion should be exercised in favour of that applicant. But once that appears the discretion will normally be exercised in favour of the application”.

Mr Gartner could not substantiate in evidence to the Court an arguable case that the examination summons was obtained for an improper purpose. In any event, Mr Gartner is not be entitled to “fish” through the material contained in the affidavits in order to ascertain material which would throw light upon the purpose of the applicants. To do so would be to undermine the intention disclosed by the Act and the Rules that inspection of affidavits filed pursuant to section 596A of the Act should be tightly controlled.

(b) The discharge of the summons or stay of examination on the basis of an abuse of process

Mr Gartner formally sought an order that the examination summons be set aside or stayed (until the applicants and NAB retained different lawyers) on the basis that (i) the election by the applicants to engage the same firm of solicitors that represents NAB in the Federal Court proceeding will render it impossible for the solicitors not to use documents obtained during the examination for an improper or ulterior purpose (ie, furthering the cause of NAB in the Federal Court proceeding) and (ii) the purpose of the examination summons was to further the interests of creditors (NAB) in the Federal Court proceedings and this constituted an improper purpose.

The argument was addressed by Selway J in D’Arrigo v Carter [2003] FCA 5. His Honour rejected the argument; concluding that in the absence of any court order to the contrary, the disclosure by a receiver (ie, the applicants) to the creditor (ie, NAB) by whom the receiver was appointed of information or documents obtained in an examination under section 596A of the Act is not a breach of any duty of confidentiality. Such disclosure is “clearly envisaged” by the Act.

Branson J rejected the argument that as a receiver is an officer of the company (section 82A of the Act), an “inevitable breach of duty” would arise from this position and the duty to creditors. Branson J held, approving the decision in Excel Finance, that the primary duty of the receiver is to the debenture holders and not to the company. He is receiver and manager of the property of the company for the debenture holders, not manager of the company.

In the circumstances of receivership, a receiver and manager would ordinarily have a similar need for information as a liquidator. It follows that there should be nothing to prevent a receiver from disclosing to creditors matters relevant to the receivership including legal proceedings conducted by the receiver.

Thus, the fact that the lawyers retained by a creditor would, by reason of their representation of the applicants who had successfully applied for the issue of an examination summons, gain access to documents produced at the examination was not a reason to set aside or stay the examination summons.

On the question of whether the examination summons is being used for the improper purpose to further the interests of a creditor, Excel Finance stated that two questions must be asked. First, what is the principal purpose for which the examination summons is being used? Secondly, if the principal purpose is that of furthering the cause of NAB in the Federal Court proceedings, is that litigation for the benefit of the receivership?

The stated purpose of the applicants here was to “investigate the circumstances in which certain assets of Gartner Family Group were moved beyond the control of NAB”.

Whether there will be a use or an abuse of process will depend upon the purpose rather than the result. For example, the consequence of the examination may be that the examiner has conducted a “dress-rehearsal” of cross-examination which may take place in a subsequent trial. The fact that the trial has commenced, or is contemplated, may throw light on the purpose but does not, of itself, constitute an abuse of process. The authorities reveal that the mere fact that a third party may acquire a collateral advantage by reason of an examination does render the purpose for which the examination summons was obtained improper.

Branson J dismissed Mr Gartner’s application having been satisfied that the purpose of the examination touched on the merits of the claims made by the applicants in the Federal Court proceeding.

(J) PARTNERSHIPS, JOINT VENTURES AND THE APPOINTMENT OF RECEIVERS  
(By Paul Lingard, [Mallesons Stephen Jaques](http://www.mallesons.com))

Guy Dominic D’Souza and Wilhelmina Maria D’Souza (as trustees for the D’Souza Family Trust) v Aaronisle Pty Ltd [2003] WASC 111, Supreme Court of Western Australia, Commissioner Johnson QC, 13 June 2003

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/wa/2003/june/2003wasc111.htm>  
or <http://cclsr.law.unimelb.edu.au/judgments>

(1) Summary

The plaintiffs (Guy and Wilhelmina D’Souza, as trustees for the D’Souza Family Trust) and the first defendant (Aaronisle Pty Ltd ), a company controlled by the second defendant (Clark Gray), were participants in a joint venture, formed for the purpose of developing land through the construction of residential units.

By a chamber summons filed in the Supreme Court of Western Australia, the plaintiffs (in their representative capacities), sought the appointment of a receiver over the assets of the joint venture. The assets included two residential units. One was the second defendant’s residence and the other was the residence of the second plaintiff’s brother, Gerardus Vile.

In a decision delivered on 13 June 2003, Commissioner Johnson QC ordered the appointment of a receiver over the assets of the joint venture pursuant to the power contained in section 25(9) of the Supreme Court Act 1935 (WA). The receiver was appointed to investigate the affairs of the joint venture and to collect and realise its assets, with the exception of the two residential units.

(2) Facts

In early 1999, the plaintiffs and the first defendant, a company controlled by the second defendant, entered into a joint venture for the express purpose of developing land through the construction of residential units.

In February 1999, a property in Scarborough was purchased, with a view to demolishing the existing building and constructing four residential units. The property was registered in the name of the second defendant and not in the name of the joint venture.

In order to finance the development of the Scarborough property, the plaintiffs’ residence, the residence of Gerardus Vile, and the Scarborough property were mortgaged as security.

Following completion of the development, two of the four units were sold to unrelated third parties in April 2002 for $520,000 and $590,000, respectively. At some later point in time, the second defendant and Gerardus Vile commenced living in the remaining units, purportedly as owners, each having purchased a unit for $500,000, respectively. However, both of these remaining units were registered in the name of the second defendant.

In mid-October 2002, the second defendant wrote to the first named plaintiff, informing him that the joint venture had made a loss of approximately $777,000. The letter went on to state that the second defendant intended to contribute $575,152.72 to the loss and that he expected the first named plaintiff to pay the balance.

On 17 January 2003, the plaintiffs purported to terminate the joint venture. The plaintiffs also placed a caveat over two units registered in the name of the second defendant.

By an interlocutory application brought in the primary proceedings commenced in the Supreme Court of Western Australia, the plaintiffs applied for interim orders for the appointment of a receiver over the assets of the joint venture and the extension of the caveat.

In affidavit evidence filed by the plaintiffs in support of that application, the plaintiffs alleged that the first and second defendants had engaged in serious misconduct and were in breach of their fiduciary obligations arising from the joint venture. Specifically, the plaintiffs relied upon the following:

(a) The registration of the Scarborough property in the second defendant’s name rather then in the name of the joint venture.

(b) The appropriation by the second defendant of the remaining two units.

(c) The failure by the second defendant to provide proper accounts for the joint venture despite repeated requests, including the failure of the second defendant to provide information in relation to vendor finance given to one of the unrelated third parties who had purchased a unit in April 2002.

(d) The drawing of a salary by the second defendant from joint venture funds without authorisation.

(e) The use of joint venture funds by the second defendant for other developments, unrelated to the joint venture.

(3) Orders sought

The plaintiffs, in their representative capacity, applied to the court for the appointment of a receiver over the assets of the joint venture with the power to manage and continue the business of the joint venture until the disposal of the remaining assets of the joint venture.

(4) Findings

Relevantly, section 25(9) of the Supreme Court Act 1935 (WA) provides as follows.

“A mandamus or an injunction may be granted, or a receiver appointed, by an interlocutory order of the Court or a Judge in all cases in which it shall appear to the Court or a Judge to be just or convenient that such order should be made; and any such order may be made either unconditionally or upon such terms and conditions as the Court or Judge shall think just ..”

Commissioner Johnson QC found that there was precedent for the appointment of receivers to partnerships. In reviewing the authorities, Commissioner Johnson QC found support for the appointment of a receiver in circumstances where:

(a) a partnership exists (or existed);

(b) that partnership will be dissolved (or has been dissolved) by court order or otherwise; and

(c) there are allegations of improper conduct.

On the facts, Commissioner Johnson QC found that:

(a) a partnership existed between the plaintiffs and first defendant;

(b) while the termination of the partnership was disputed, it was clear that, in any event, the partnership could not continue and that a final account was required; and

(c) a number of serious allegations of improper conduct had been raised by the plaintiffs.

Commissioner Johnson QC held that the appointment of a receiver to investigate the financial circumstances of the joint venture would both provide the plaintiffs with the accounting information they had requested and also assist the Court in determining the question of ownership of the two remaining units.

However, Commissioner Johnson QC limited the scope of the receiver’s powers, so as to not dispossess the second defendant and Gerardus Vile of the units in which they resided. As a consequence, Commissioner Johnson QC held that no undertaking as to damages was required as there was no damage to be apprehended by the defendants.

In summary, Commissioner Johnson QC ordered that a receiver be appointed to:

(a) take possession of the financial records of the joint venture;

(b) take possession of and realise the property of the joint venture, other than the two units resided in by the second defendant and Gerardus Vile;

(c) conduct investigations;

(d) demand and call up any debts due to the joint venture; and

(e) wind up the business affairs of the joint venture.

(K) APPLICATION FOR REMOVAL OF LIQUIDATOR, APPOINTMENT OF LIQUIDATOR AND POWER FOR LIQUIDATOR TO APPOINT HIMSELF AS ADMINISTRATOR  
(By Connie Chaird, [Corrs Chambers Westgarth](http://www.corrs.com.au))

Domino Hire Pty Ltd v Pioneer Park Pty Ltd [2003] NSWSC 496, New South Wales Supreme Court, Austin J, 10 June 2003

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/june/2003nswsc496.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Application

Clifford John Carpenter (“Mr Carpenter”) and Domino Hire Pty Limited (“Domino”) made an application to the New South Wales Supreme Court for:

(a) the removal of Gavin Frederick Crichton Thomas (“Mr Thomas”) as liquidator of Pioneer Park Pty Ltd (“Company”);

(b) the appointment of Christopher John Palmer (“Mr Palmer”) as liquidator of the Company; and

(c) the power for Mr Palmer to appoint himself as administrator of the Company; pursuant to section 436B(2) of the Corporations Act 2001 (Cth) (“Corporations Act”).

(2) Decision

Austin J dismissed the application with costs.

(3) Background

The Company, in consideration of financial accommodation provided by the Australia and New Zealand Banking Corporation Ltd (“Bank”), granted the Bank a charge over its assets. Mr Carpenter, as a director of the Company, guaranteed the Company’s performance of its obligations under the charge.

Subsequently, the Bank claimed that the Company was in default under the terms of the charge. In June 1999, the Bank appointed voluntary administrators under section 436C of the Corporations Act, and later those administrators became liquidators of the Company under section 446A. The Bank entered into possession of and sold assets of the Company to reduce the debt owed to it by the Company.

In October 1999, Mr Carpenter and Domino (a company controlled by Mr Carpenter) as creditors of the Company, sought Court orders for the removal of the liquidators of the Company. In December 1999, the Court granted such orders including that Mr Thomas, selected from the Court’s list of official liquidators, be appointed as liquidator of the Company.

In April 2001, Mr Carpenter and his solicitor, at a meeting of creditors, proposed a deed of company arrangement under which employee creditors would receive 50 cents in a dollar for long service leave and holiday pay entitlements, unsecured creditors would receive 10 cents in the dollar, proceedings would be commenced against the Bank for improperly exercising its power of sale of assets of the Company and a proportion of the proceeds would be distributed amongst the creditors. The creditors voted unanimously for this proposal and recommended that Mr Thomas appoint an administrator to commence the relevant process.

In May 2001, Mr Thomas issued a report to the creditors which provided that there was insufficient evidence that such litigation against the Bank would be successful, the party providing the funding for the deed of arrangement had not been identified and that, as a liquidator could commence proceedings against the Bank, he could not see any benefit to the creditors in entering into the deed. Additionally, Mr Thomas refused to appoint an administrator unless his outstanding fees were covered.

In May 2003, Mr Thomas and the Company commenced two proceedings against Mr Carpenter and Domino and Merlo Wholesale Pty Ltd (companies controlled by Mr Carpenter) for breach of directors’ duties and for entering into voidable transactions under Part 5.7B and section 588FB, respectively. The Bank agreed to fund the litigation.

(4) Applicants’ arguments

Mr Carpenter and Domino’s solicitor argued that Mr Thomas’ conduct, specifically, (amongst other things) improperly investigating the claims against Mr Carpenter and the companies controlled by him, failure to properly investigate the financial position of Mr Carpenter and the companies controlled by him, suppressing the potential claim against the Bank and acting to further his own interests, warranted his removal as liquidator of the Company.

(5) Test

The Court may remove a liquidator and appoint another liquidator in his place in a voluntary winding up under section 503 of the Corporations Act, which Austin provided that the Court will do upon “cause shown”. He explained that “It is open to the applicant for removal to point to any conduct or inactivity on the liquidator’s part that provides a basis for the conclusion that he or she should be removed, ranging from moral turpitude, to bias or partiality, lack of independence, incompetence or other unfitness for office”. Austin J further provided, with reference to case law, that courts have frequently emphasised that cause may be shown by establishing a mere perception of impartiality or bias.

However, the concept of “cause shown” is not limited to matters relating to the unfitness of a liquidator to hold office. Austin J also provided, with reference to case law that the role of a liquidator, the purpose of a liquidation and, in particular, whether the interested parties of the liquidation would benefit from the removal of the liquidator must be considered.

(6) Conclusion

Austin J concluded, on the evidence before him, that no cause had been shown by Mr Carpenter and Domino for the removal of Mr Thomas as liquidator of the Company and therefore, dismissed this application. As Mr Thomas would not be removed as liquidator of the Company, the applications to appoint Mr Palmer and to give Mr Palmer the power to appoint himself as administrator of the Company were too, accordingly, dismissed.

However, Austin J noted that if such cause had been shown, it seems highly unlikely to him that a Court would make an order granting a liquidator, who has not yet taken up office, the benefit of assessing his desirability to appoint himself as administrator under section 236(B), when such a benefit could not yet have been assessed by that liquidator.

Austin J also expressed doubt as to whether a person, other than the liquidator, may submit an application under section 236B(2). He noted that there was no authority on this point and stated that if Parliament’s intention was for such other persons to apply, one would expect to see provisions to that effect. Furthermore, he argued that it is sensible for only the liquidator to apply for an application, which if successful, would give him the discretion to accept another position.

5. RECENT BOOKS BY CENTRE FOR CORPORATE LAW MEMBERS

Following is a list of recent books co-authored by members of the Centre for Corporate Law and Securities Regulation at The University of Melbourne.

SECURITIES AND FINANCIAL SERVICES LAW  
Professor Robert Baxt, Ashley Black and Pamela Hanrahan, 6th edition, 2003, LexisNexis Butterworths (<http://www.lexisnexis.com.au>)

EXPERTS' REPORTS IN CORPORATE TRANSACTIONS  
Laurie McDonald, Grant Moodie, Professor Ian Ramsay and Jon Webster, 2003, Federation Press (<http://www.federationpress.com.au>)

FORD'S PRINCIPLES OF CORPORATIONS LAW  
Justice Robert Austin, Professor Harold Ford and Professor Ian Ramsay, 11th edition, 2003, LexisNexis Butterworths (<http://www.lexisnexis.com.au>)

CORPORATE GOVERNANCE AND INVESTMENT FIDUCIARIES  
Dr Paul Ali, Associate Professor Geof Stapledon and Martin Gold, 2003, Thomson/Lawbook Co (<http://www.lexisnexis.com.au>)

CORPORATIONS LAW IN PRINCIPLE  
Susan Woodward, Helen Bird and Sally Sievers, 6th edition, 2003, Thomson/Lawbook Co (<http://www.thomson.com.au/>)

COMMERCIAL APPLICATIONS OF COMPANY LAW  
Pamela Hanrahan, Professor Ian Ramsay and Associate Professor Geof Stapledon, 4th edition, 2003, CCH Australia (<http://www.cch.com.au/>)

THE OPEN CORPORATION: EFFECTIVE SELF-REGULATION AND DEMOCRACY  
Dr Christine Parker, 2002, Cambridge University Press (<http://uk.cambridge.org/>)

KEY DEVELOPMENTS IN CORPORATE LAW AND EQUITY: ESSAYS IN HONOUR OF PROFESSOR HAROLD FORD  
Professor Ian Ramsay (editor), 2002, LexisNexis Butterworths (<http://www.lexisnexis.com.au/>)

COMMERCIAL APPLICATIONS OF COMPANY LAW IN NEW ZEALAND  
Professor Gordon Walker, Terry Read, Pamela Hanrahan, Professor Ian Ramsay and Associate Professor Geof Stapledon, 2002, CCH New Zealand (<http://www.cch.co.nz>)

COMMERCIAL APPLICATIONS OF COMPANY LAW IN MALAYSIA  
Pamela Hanrahan, Professor Ian Ramsay, Associate Professor Geof Stapledon, Aiman Nariman Mohd Sulaiman and Aishah Bidin, 2002, CCH Asia (<http://www.cch.com.sg/>)

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