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1. RECENT CORPORATE LAW AND CORPORATE GOVERNANCE DEVELOPMENTS

(A) US SENATE BANKING COMMITTEE APROVES AUDIT IMPROVEMENT MEASURES

On 19 June 2002, the US Senate Banking Committee voted 17-4 to adopt legislation to improve the quality of audits. The measures create an independent oversight board to oversee the conduct of auditors of public companies; establish guidelines and procedures to assure that auditors of public companies do not engage in activities that could undermine the integrity of the audit; set standards for audit committees and for corporate executives, and impose penalties when standards are violated; establish additional criteria for financial statements and require enhanced disclosures regarding conflicts of interest; and provide a substantial increase in funding for the Securities and Exchange Commission.

The bill now goes before the full Senate for consideration at a time to be determined.

(B) SEC PROPOSES FRAMEWORK OF A PUBLIC ACCOUNTABILITY BOARD

On 20 June 2002, the United States Securities and Exchange Commission voted unanimously to propose rules to reform oversight and improve accountability of auditors of public companies.

The proposed rules establish the framework for a Public Accountability Board (PAB). The Commission describes it as a system of "private sector" (but not "self") regulation that would not be under the control of the accounting profession. The structure is intended to supplement the SEC's oversight and enforcement efforts by expanding the opportunities to detect and remedy ethical lapses or deficiencies in competence, thereby complementing the Commission's enforcement efforts.

The rule will be open to comment for 60 days after publication in the Federal Register.

Key provisions of the proposed rules include:

- Membership. To assure that the benefits of the new regulatory regime extend to investors in all public companies, the financial statements of SEC-registered companies would not be deemed to comply with Commission requirements unless the company's outside auditors were members of a PAB. To ensure that a PAB has access to diverse, non-discretionary, funding and full information about audits, an SEC-registered company's financial statements also would not comply with Commission requirements unless the company was an adjunct member of, and thereby bound to cooperate in any review or proceeding commenced by, the same PAB as its accountants.

- SEC Oversight. The Commission would recognize a PAB after reviewing, and being satisfied with, among other things, the entity's proposed structure, charter, by-laws, rules, stated practices, proposed budget, proposed board members, membership requirements, systems, and procedures. The SEC would also oversee selection or termination of PAB board members, and the authority to review, alter, modify or abrogate any PAB rule or disciplinary sanction.

- Independent PAB Board. To ensure independence from the accounting profession, a PAB would be dominated by persons not associated with the accounting profession. This requirement likely would be met by a board with nine members - no fewer than six of whom are independent public members, and no more than three of whom are practicing or retired members of the public accounting profession. The latter members would provide needed current expertise, but possible accounting profession members would expressly not have any vote in, or say about, a PAB's determinations regarding disciplinary actions or findings about, and sanctions to be imposed on, members.

- Independent PAB Funding. A PAB will have a dependable, uninterrupted, non-discretionary funding source, from both its accounting firm members and public company adjunct members, to ensure that its funding is not based on discretionary payments or on funding exclusively by the accounting profession.

- Strong Oversight by PAB. Accounting firms, individual accountants, public companies and their management would be required and obligated to cooperate with PAB quality control reviews and disciplinary proceedings, and a PAB would determine appropriate document retention guidelines for its member firms. Failure to cooperate could result in suspension of the right to conduct public audits. A PAB's efforts would be directed at enforcing ethical and competency standards respecting accounting firms and individual accountants. A PAB would not conduct any roving investigations of public companies.

- PAB Quality Control Reviews. A PAB will directly perform quality control reviews of audit procedures and practices, at least annually for large firms (those that audit approximately 80% of SEC-registered US public companies) and at least triennially for all other firms. Such reviews will be designed to ensure that audit firms have quality control policies and procedures regarding, among other things: (i) independence, integrity and objectivity of audits; (ii) personnel management; (iii) acceptance and continuation of audit clients; (iv) audit performance; (v) audit methodology; and (vi) consultation and resolution of differences of professional opinion during audits.

In addition to the above items, quality control reviews would address, among other things: (i) rotation of audit personnel; (ii) independent partner reviews of audits; (iii) consulting services; (iv) reporting termination of auditor engagements to the Commission; (v) assisting in audits by foreign associated firms; (vi) reporting litigation alleging violations of the securities laws; and (vii) partners and employees of auditors joining clients.

- PAB Disciplinary Powers. A PAB will be responsible for conducting public disciplinary proceedings and imposing a broad range of disciplinary sanctions against its accounting firm and individual accountant members, including fines, censures, removal from client engagements, limitations on activities and suspension from auditing either specific SEC clients, or all SEC clients for a time certain, or an unlimited time. A PAB may discipline individual accountants for unethical or incompetent conduct or other violations of professional standards. A PAB may discipline accounting firms for not having quality control systems that meet the highest professional standards or for not complying with such systems in a way that provides reasonable assurance that the firm meets or exceeds professional standards in its audit, review or attest engagements.

- Audit Standard Setting. A PAB will have the responsibility for assuring high ethics, auditing, and quality control standards, either by setting them directly or by relying on and overseeing designated private sector bodies as authoritative sources of such standards. (A PAB will not, however, establish GAAP, which would continue to be established by the FASB, subject to revitalized and revamped SEC oversight).

(C) ARTHUR ANDERSEN CONVICTION

On 15 June 2002, a jury in Houston, Texas, found accounting firm Arthur Andersen LLP guilty of obstruction of justice. The United States Securities and Exchange Commission issued the following statement regarding the conviction: "The Commission is deeply troubled by the underlying events that resulted in Andersen's conviction, especially insofar as the verdict reflects the jury's conclusion that Andersen engaged in conduct designed to obstruct SEC processes. In light of the jury verdict and the underlying events, Andersen has informed the Commission that it will cease practicing before the Commission by Aug. 31, 2002, unless the Commission determines another date is appropriate.

"In the interim, the orders and rules the Commission announced on March 14 and released on March 18, 2002, following the indictment of Andersen remain in effect, and Andersen may continue to make required filings on behalf of its clients in compliance with those rules and orders, which contain provisions ensuring continuing Andersen quality control procedures. The Commission hopes this action will minimize any potential disruption to the capital markets and the affected issuers while those issuers complete certain pending or future filings, offerings and other activities. This relief is procedural in nature, is of finite duration and is intended solely to address temporary disruptions that the affected issuers may face as a result of Andersen's conviction."

(D) SEC PROPOSES REQUIRING CERTIFICATION OF QUARTERLY AND ANNUAL REPORTS; PROPOSES NEW FORM 8-K DISCLOSURES AND FILING DEADLINES

On 12 June 2002 the United States Securities and Exchange Commission proposed rules that would require a company's principal executive officer and principal financial officer to certify the contents of the company's quarterly and annual reports. The proposed rules are intended to enhance investor confidence in the quality of companies' periodic reports.

The Commission also proposed that several new items or events be reported on Form 8-K in an effort to improve the quality, amount and timeliness of public disclosure of extraordinary corporate events. In addition, the Commission proposed that Form 8-K reports, also known as current reports, be filed within two business days instead of the current five to 15 days.

(1) Certification of quarterly and annual reports

The proposed certification rules are consistent with a key provision of US President George Bush's 10-point "Plan to Improve Corporate Responsibility and Protect America's Shareholders," announced on 7 March 2002. The plan states that CEOs should personally vouch for the veracity, timeliness and fairness of their companies' public disclosures, including financial statements.

As proposed, new Exchange Act Rule 13a-14 would require the principal executive officer and principal financial officer of a company each to certify, with respect to the company's quarterly and annual reports, that:

- he or she has read the report;   
- to his or her knowledge, the information in the report is true in all important respects as of the last day of the period covered by the report; and   
- the report contains all information about the company of which he or she is aware that he or she believes is important to a reasonable investor as of the last day of the period covered by the report.

For purposes of the proposed certification, information is considered "important to a reasonable investor" if:

- there is a substantial likelihood that a reasonable investor would view the information as significantly altering the total mix of information in the report; and   
- the report would be misleading to a reasonable investor if the information was omitted from the report.

In addition, proposed new Exchange Act Rule 13a-15 would require a company to maintain procedures to provide reasonable assurance that the company is able to collect, process and disclose the information required in the company's periodic and current reports pursuant to the Exchange Act, and also require a periodic review and evaluation of these procedures. This annual evaluation would need to be presented to the company's principal executive officer and principal financial officer, and these individuals would be required to certify in the company's annual report that they have reviewed the results of the evaluation.

The proposed rules would apply to any US domestic company that is subject to the reporting requirements of the Securities Exchange Act of 1934.

The Commission invites public comment on the proposed rules. Comments should be received within 60 days of publication of the proposed rules in the Federal Register.

(2) New Form 8-K Disclosure Requirements and Deadlines

The proposals would require current reports on Form 8-K of 11 new items or events:

- entry into a material agreement not made in the ordinary course of business;  
- termination of a material agreement not made in the ordinary course of business;  
- termination or reduction of a business relationship with a customer that constitutes a specified amount of the company's revenues;   
- creation of a direct or contingent financial obligation that is material to the company;  
- events triggering a direct or contingent financial obligation that is material to the company, including any default or acceleration of an obligation;   
- exit activities including any material write-off or restructuring;   
- any material impairment;   
- a change in a rating agency decision, issuance of a credit watch or change in a company outlook;   
- movement of the company's securities from one national securities exchange or inter-dealer quotation system of a registered national securities association to another, delisting of the company's securities from an exchange or quotation system, or a notice that a company does not comply with a listing standard;   
- notice to the company from its currently or previously engaged independent accountant that the independent accountant is withdrawing a previously issued audit report or that the company may not rely on a previously issued audit report; and   
- any material limitation, restriction or prohibition, including the beginning and end of lock-out periods, regarding the company's employee benefit, retirement and stock ownership plans.

The proposals would move two disclosure items that currently are required in companies' annual and quarterly reports to Form 8-K:

- unregistered sales of equity securities by the company;   
- material modifications to rights of holders of the company's securities.

The proposals would amend several existing Form 8-K disclosure items to include:

- disclosure regarding the departure of a director for reasons other than a disagreement or removal for cause;   
- the appointment or departure of a principal officer, and the election of new directors; and   
- disclosure regarding any material amendment to a company's certificate of incorporation or bylaws.

The proposals would also accelerate the current five business day deadline for disclosure about changes in a company's independent accountant and resignations of directors, and 15 calendar day deadline for other required disclosures, to two business days, so that there would be a uniform filing period for all of the mandated Form 8-K disclosure items.

The Commission invites public comment on the proposed rules. Comments should be received within 60 days of publication of the proposed rules in the Federal Register.

(E) UK REVIEW OF NON-EXECUTIVE DIRECTORS

On 7 June 2002 a consultation document was issued by Derek Higgs, who is leading the UK Review on the role and effectiveness of non-executive directors.

Mr Higgs, who was appointed to head the review into the role of non-executive directors by the Chancellor Gordon Brown and Trade and Industry Secretary Patricia Hewitt in April.

The key issues on which Derek Higgs is inviting views are:

- What role should non-executive directors perform and how does this compare to the present position?  
- What knowledge, skills and attributes are needed and what can be done to attract, recruit and appoint the best people to non-executive roles?  
- Do existing structures and procedures facilitate effective performance by non-executive directors?  
- Do existing relationships with shareholders or others need to be strengthened?  
- How can non-executive directors best be supported to perform their role?

and in relation to all of the above:

- In what ways is the position different for smaller listed companies?  
- What can we learn from international experience?

The consultation document can be obtained from <http://www.dti.gov.uk/cld/non_exec_review>. Responses to the consultation are requested by 6 September 2002. Derek Higgs will report to the Secretary of State for Trade and Industry and the Chancellor of the Exchequer by around the turn of the year.

The Review was launched on 15th April and is assessing:

- the population of non-executive directors in the UK - who they are, how they are appointed and how they can be drawn from a wider pool of talent;  
- the independence and effectiveness of non-executives;  
- the actual and potential relationship between non-executives and institutional investors; and   
- what could be done to strengthen the quality, independence and effectiveness of UK non-executive directors.

(F) NYSE BOARD RELEASES REPORT OF CORPORATE ACCOUNTABILITY AND LISTING STANDARDS COMMITTEE

On 6 June 2002 the New York Stock Exchange released recommendations from its Corporate Accountability and Listing Standards Committee, which proposes new standards and changes in corporate governance and disclosure practices of NYSE-listed companies. The committee report, presented to the NYSE Board of Directors, also makes recommendations to Congress and the Securities and Exchange Commission on various policy and regulatory matters.

Recommendations include:

- increasing the role and authority of independent directors;   
- tightening the definition of "independent" director and adding new audit committee qualification requirements;   
- encouraging a focus on good corporate governance;   
- giving shareholders more opportunity to monitor and participate in the governance of their companies;   
- establishing new control and enforcement mechanisms; and  
- improving the education and training of directors.

The committee will now solicit public comment on its recommendations, then seek approval of the report at the NYSE Board of Directors' 1 August meeting. Committee co-chairs are NYSE Board members Gerald M Levin, CEO (retired) of AOL Time Warner Inc; H Carl McCall, Comptroller of the State of New York and Sole Trustee, Common Retirement Fund of the State of New York; and Leon E Panetta, director of the Panetta Institute for Public Policy.

Central to the report is a provision that boards of NYSE-listed companies have a majority of independent directors; listed companies would have a two-year transition period to satisfy this requirement. In addition to an expanded role and greater authority of independent directors, the committee report calls for:

- increasing the responsibilities of board audit committees;   
- mandating that shareholders vote on all equity-based compensation plans, including stock option plans;   
- requiring audit, nominating and compensation committees to consist solely of independent directors, with a requirement that the chair of the audit committee have accounting or financial management experience;   
- tightening the definition of an independent director, including a five-year cooling-off period for former employees;   
- mandating that director compensation represent the sole remuneration from the listed company for audit-committee members;   
- granting the audit committee sole authority to hire and fire auditors and to approve any significant non-audit work by the auditors;   
- requiring the CEO of NYSE-listed companies to attest to the accuracy, completeness and understandability of information provided to investors;   
- mandating that listed companies adopt and publish corporate governance guidelines and a code of business conduct and ethics;   
- establishing a Directors' Education Institute to assist directors in their responsibilities;   
- allowing the NYSE to impose additional penalties, including public reprimand letters, in addition to suspension and delisting;   
- requiring non-US issuers to disclose how their practices differ from NYSE rules and procedures.

The committee's recommendations to Congress and the SEC include:

- establishing a new private-sector organization, funded separately from the accounting industry itself, to monitor and govern public accountants;   
- calling for the SEC to evaluate the impact of Regulation FD on earnings guidance and to consider reforms;   
- asking Congress to allocate additional resources to the SEC to increase the agency's monitoring and enforcement activities;   
- prohibiting relationships between auditors and their clients that would affect the fairness and objectivity of audits;   
- calling for Congress to establish a panel to study the concentration of employee 401(K) holdings in company stock;   
- giving the SEC the authority to permanently bar officers and directors from holding office again after violating their duties to shareholders;   
- calling on the SEC to require companies to report complete GAAP-based financial information before any reference to "pro forma" or "adjusted" financial information;   
- calling for the SEC to exercise more active oversight of the FASB to improve the quality of GAAP and the speed of FASB actions;   
- asking the SEC to improve management's discussion and analysis disclosure on critical accounting alternatives and assumptions;   
- requiring the prompt disclosure of insider transactions.

The committee urges policymakers to avoid imposing additional liability on directors, or reducing the protections currently available through director and officer liability insurance and state-law exculpation provisions. The report also urges them to avoid repealing or weakening the Private Securities Litigation Reform Act.

These recommendations follow the NYSE's implementation of a series of rule changes to address conflicts of interest between research analysts and the investment-banking units of its Member Firms. The new rules, which were approved by the SEC last month and are expected to be implemented in November, significantly alter the way NYSE Member Firms and their research analysts and investment banking departments manage and disclose conflicts of interest.

On 6 June 2002 the United States Securities and Exchange Commission Chairman Harvey L Pitt issued the following statement on the report issued by the NYSE's Corporate Accountability and Listing Standards Committee:

"The Commission strongly commends the NYSE Board's creative and far-reaching proposals to improve the level and quality of corporate governance in America. This was precisely the kind of effort we hoped would result when we asked the exchanges to rethink their listing agreements last February. This is a significant step in addressing major concerns raised by the investing public in light of recent events. It is more important than ever that decisive action be taken to restore investor confidence to the financial markets, and I commend the leadership shown by the NYSE.

"The steps proposed by the NYSE represent an important first step, but improvement of corporate governance is a work in progress, and we look forward to continuing to work with the NYSE and all other interested parties toward that end."

(G) GOLDMAN SACHS CHAIRMAN HANK PAULSON CALLS FOR ACTION TO RESTORE INVESTOR CONFIDENCE

On 5 June 2002 Henry M Paulson, Jr, Chairman and Chief Executive Officer of The Goldman Sachs Group, Inc called for reform within the US financial system to restore public confidence in business principles and practices, in a speech before the National Press Club, in Washington, DC.

Mr Paulson discussed an agenda of change in three principle areas: accounting policy, standards of corporate governance and conflict of interest.

(1) Accounting policy

Corporate Accountability: Accounting is the responsibility of corporate management and the Chief Executive Officer (CEO), at a minimum, should be required to certify that his or her company has established reasonable procedures for assessing the accuracy and completeness of its financial results and disclosures.

Auditor Independence: Board Audit Committees must develop policies and processes to ensure that there is no doubt that the company's auditors report to them and work for them. A major step in that direction would be for Audit Committees to perform a rigorous annual review that would include negotiation of audit fees and a real consideration of the factors that would cause a decision to replace the auditor.

Oversight: The Securities and Exchange Commission (SEC) must be responsible for setting and enforcing auditing standards, either by establishing an independent public regulatory organization, as the Commission has already suggested, or by taking more direct responsibility itself. In any event, current peer review process, which allows auditing firms to police themselves, should be replaced with an effective "audit of the auditors."

Reform of the US Rules-Based Accounting System: This is where the most change is needed, Mr Paulson said, with the focus on fundamental principles to ensure that all the risks and rewards of an entity are properly recorded and disclosed to shareholders. Today, US GAAP accounts for the vast majority of the worlds' economic activity. The "European system," which is less rule oriented and more judgment based, is clearly different and successful in its own right. The goal should be convergence of accounting systems, incorporating the best from both models. To do this, we need a new approach to standard setting.

A Long Hard Look: Mr Paulson encouraged the SEC to take a long, hard look at how accounting standards are set in the US, including governance of the Financial Standards Rule-making Board (FASB), selection of FASB members, the FASB standards-setting process with all of its time delays, and the overall resources at the FASB's disposal.

Fair Value Accounting: Mr Paulson urged the FASB to review "historic cost" accounting which, he said, is hopelessly antiquated for companies primarily engaged in financial services or, for companies heavily involved with financial instruments, such as Enron. Instead of requiring such companies to record the current, fair market value of all financial assets and liabilities, the historic cost model allows them to record certain financial assets and liabilities at their historic cost. And while the value of financial instruments can vary greatly with the fluctuations of the market, institutions that use historic cost methodology - primarily banks - are not required to account for those movements in their financial statements. The result is that investors, regulators and the media have no way of quantifying the real economic impact of these liabilities.

(2) Corporate governance

Mr Paulson added that much good work is being done in the area of corporate governance, and stressed that the key was to move quickly to implementation. He outlined a ten-point plan that reflects best practices:

First, public companies should describe to shareholders, either in the Annual Report or the Proxy Statement, how its system of corporate governance works to ensure their interests.

Second, all listed companies should have a majority of independent directors, both in substance and appearance.

Third, the Board of Directors should be required to determine that no "independent" director has any relationship that the Board believes may impair or appear to impair, the exercise of that director's independent judgment. Additionally, the nature of that director's relationships should be fully disclosed to shareholders.

Fourth, non-management, independent directors should be required to meet periodically without the "insiders", including the CEO, being present.

Fifth, both Audit Committees and Compensation Committees should consist entirely of independent directors.

Sixth, executive officer compensation should be aligned closely with shareholder interests by making equity a very material portion of such compensation, and compensation committees should be encouraged to develop guidelines that require that equity be held for significant periods of time.

Seventh, all compensation plans granting stock, options or other company securities to directors or executive officers should be approved by both the Compensation Committee and by shareholders.

Eighth, all "compensation" or other financial relationships with the company and its executive officers or directors should be fully, fairly and promptly disclosed.

Ninth, all transactions in company securities by executive officers or directors should be disclosed within 48-hours.

Tenth, while "insider" selling in advance of bad news is already illegal, in the case of CEOs, a one-year "claw back" should be mandated in the case of bankruptcy, regardless of the reason.

(3) Conflict of interest

The final area that Mr Paulson discussed was conflicts of interest.

"For an integrated investment bank such as Goldman Sachs, conflict management has always been a core competency because it is critical to our reputation and a key to our success. But, particularly in the context of the technology and telecom bubble of the late 1990s, we have not done as good a job as we might have in preserving and protecting the appearance of independence of our research analysts who play a vital role in the investing and capital allocation process."

To address this challenge, Mr Paulson said, the firm recently announced a number of important steps, beginning with the positive reaffirmation of the principles of integrity, independent thought, analytic rigor and transparency - which were codified into a statement of Investment Research Principles.

In addition, the firm appointed an Ombudsman who is available to promptly address any conflicts that may arise, and instituted new oversight responsibilities for the Audit and Compensation Committees of its Board of Directors.

(H) REFORM OF NEW ZEALAND SECURITIES TRADING LAW

On 31 May 2002 the New Zealand Government issued three discussion documents covering:

(1) Insider trading law. This looks at the definition of insider trading and examines various policy justifications for regulating against insider trading. It also explores how an insider trading regime can best meet and promote these policy objectives.

(2) Market manipulation law. This looks at whether the government should do more to prevent market manipulation and what forms of market manipulation should be banned.

(3) Which financial products and entities should be covered by New Zealand securities trading law and what penalties and remedies should apply. In particular, it considers what improvements could be made to civil and administrative remedies for breaches of the law and whether criminal and civil penalties regimes should be introduced.

Submissions close on Friday, 30 August 2002. The discussion documents are available at:

<http://www.med.govt.nz/buslt/bus_pol/bus_law/securities/>

(I) ACCOUNTING EXPOSURE DRAFT 106 - DIRECTOR, EXECUTIVE AND RELATED PARTY DISCLOSURES

On 31 May 2002 Mr Keith Alfredson, Chairman of the Australian Accounting Standards Board (AASB), announced the release of Exposure Draft ED 106, relating to Director, Executive and Related Party Disclosures. He noted that "the key disclosures in ED 106 have been developed from the requirements of section 300A of the Corporations Act and reflect current best practice in major capital markets overseas". There are two parts to ED 106, the first proposing a new standard dealing with director and executive disclosures by disclosing entities and the second part detailing consequential amendments to AASB 1017 "Related Party Disclosures". ED 106 is open for comment until 30 September 2002 and is available on the AASB's website - <http://www.aasb.com.au>.

The most significant disclosures proposed to be required in the financial reports of disclosing entities are listed below.

(1) Annual remuneration of each specified director and specified executive; specified directors being the directors of the parent entity and specified executives comprising at least five executives with the greatest authority for the management of the economic entity, irrespective of whether employed by the parent or a subsidiary.

(2) Components of each individual's remuneration for the year, classified under the headings of (1) primary, (2) post employment, (3) equity compensation and (4) other benefits.

(3) Measurement of equity-based compensation benefits based on the net fair value of the equity instruments at vesting date (when the employee becomes entitled to the beneficial interest); the amount so calculated disclosed as remuneration in the year vesting occurs.

(4) Information on the terms and conditions of grants of equity compensation and other bonuses; to be disclosed in the year granted and in subsequent years until fully vested, including high and low estimates of the value (at year end) that remains to be earned; high assuming all performance criteria are met and low assuming none are met.

(J) AUDIT & ASSURANCE ALERT ON AUDITOR INDEPENDENCE

On 27 May 2002 the Australian Auditing & Assurance Standards Board (AuASB) announced it had issued a new Audit & Assurance Alert (Audit & Assurance Alert 11 "Communication with Entities in Relation to Auditor Independence") which clarifies best practice in providing information on independence related matters.

This Audit & Assurance Alert directly addresses two recommendations included by Professor Ian Ramsay in his report 'Independence of Australian Company Auditors'. AuASB Chairman, Mr Bill Edge, said: "The Alert suggests formats for disclosures in relation to a declaration of independence by the auditor to the Audit Committee or Board, and for disclosures of non-audit services fees in financial reports."

Increasingly, as part of best practice corporate governance, audit committees and boards of directors are seeking assurance on the part of the auditor in relation to the independence of the external audit. This Alert will assist auditors choosing to make such representations.

Australia mandates disclosure in the financial reports of the remuneration of the auditor for both audit and non-audit services provided. This disclosure is required currently under Accounting Standard AASB 1034 "Financial Report Presentation and Disclosures". The Alert distinguishes between disclosures that are to be made under that Accounting Standard and provides suggested wording for additional detailed disclosure of the types of service provided. Entities may choose to include this additional information in their annual financial reports.

Mr Edge added, "The AuASB will seek to contribute to the deliberations of the Australian Accounting Standards Board to further develop the requirements of AASB 1034 in respect of disclosure of remuneration for audit and non-audit services."

(K) NASDAQ APPROVES RULE CHANGES TO MODIFY KEY CORPORATE GOVERNANCE STANDARDS

On 24 May 2002 the Nasdaq Stock Market, Inc announced that its board of directors had approved modifications to several important corporate governance standards. The rule changes would:

- require shareholder approval for stock option plans that include executive officers or directors;  
- tighten the definition of an independent director;   
- require that related-party transactions be approved by an issuer's audit committee or comparable body;   
- clarify that a company can be delisted for misrepresenting information to Nasdaq;  
- require that companies disclose the receipt of an audit opinion with a going concern qualification; and   
- permit companies to disseminate material information via Regulation FD-compliant methods of disclosure, instead of solely by a press release.

These rule changes grew out of a series of recommendations by the Nasdaq Listing and Hearing Review Council that were endorsed by the Nasdaq executive committee of the board of directors and submitted to SEC Chairman Harvey Pitt on 12 February 2002.

These rule changes were also approved by the National Association of Securities Dealers (NASD) board of governors, acting in its capacity as Nasdaq's self-regulatory organisation until the Securities and Exchange Commission (SEC) approves Nasdaq's exchange registration application.

(L) GREENPEACE POLICY ON CORPORATE ENVIRONMENTAL CHANGE

On 22 May, 2002 Greenpeace released a report outlining benchmarks for corporate environmental change. These benchmarks advocate a set of concrete operational changes built around Greenpeace's six international campaigns.

The report specifically outlines Greenpeace's assessment criteria for the Reputation Index published annually by the Sydney Morning Herald and the Age. The Index invites a number of environment, labour relations and human rights groups to score Australia's largest 100 companies for social and environmental performance.

Greenpeace's six international campaigns are climate change, oceans and fisheries, ancient forests, toxics, the nuclear threat and genetic engineering. Each campaign has a set of benchmarks for corporate action, including conducting an audit of energy use and eliminating GE products from supply chains.

The report is available on the Greenpeace website at <http://www.greenpeace.org.au>.

(M) CLARITY, CONSISTENCY NEEDED FOR AUSTRALIA'S REGULATORY WATCHDOGS: LAW REFORM COMMISSION

On 23 May 2002 the Australian Law Reform Commission (ALRC) said that Australia's regulators - such as the Australian Competition & Consumer Commission, Australian Securities and Investments Commission, and the Australian Taxation Office - were obliged to enforce compliance and impose penalties under regimes that are often "incoherent and incomplete".

The ALRC released a Discussion Paper, "Securing Compliance", as part of a major inquiry into the use of civil and administrative penalties in federal jurisdiction.

The ALRC's research shows there are now almost 2,400 federal regulatory penalty provisions, in areas such as aged care, aviation, banking, border control, customs, environmental protection, social security and trade practices.

The three main areas of reform being investigated by the ALRC are:

- regulatory consistency and transparency - the need for greater standardisation of the parameters within which regulators operate;   
- greater legislative clarity - the ALRC takes the view that the law should be clear on various aspects of the imposition and recovery of civil and administrative penalties where at present it is silent, incomplete or confused; and  
- greater legislative consistency - the ALRC is considering how best to structure new provisions to achieve the greatest standardisation and avoid dispersing them throughout the large body of federal regulatory legislation.

The ALRC will use the Discussion Paper as the basis for further consultations before formulating its final recommendations for reform in a report due to be delivered to the federal Attorney-General in November this year.

This Discussion Paper is available on the Law Reform Commission's website at <http://www.alrc.gov.au>.

(N) APPLYING PERFORMANCE CONDITIONS TO STOCK OPTIONS

On 20 May 2002 The Corporate Library published a research report dealing with stock options in the United States.

Do stock options tie pay to performance? Not at over 90% of American companies, where stock option awards are more tied to overall market returns than to the creation of shareholder value. Stock options awarded during the long bear market of the 1990's amount to the biggest windfall profits ever seen.

The Corporate Library's new report shows that options granted without specific, properly disclosed, performance goals have no credibility.

In contrast to the US, over 95 per cent of all executive stock option awards in the UK are granted with a performance condition.

Now that the bear market is over, and the number of companies repricing stock options grows, it would not be surprising if stockholders had lost faith in stock options. One way to restore this faith, suggests the report, would be to apply performance conditions to stock options. Conditions that can be used include premium or index-linked exercise prices, where the company's stock price must rise to meet the premium price or must rise in excess of an industry index in order for the option to be worth exercising. Or schemes can require that one of a range of other financial targets must be met before options can be exercised, for example earnings per share, stock price or total return to stockholders.

While market resistance is the main obstruction to introducing performance-based stock options, there are other barriers:

- accounting rule that forces companies to recognise the cost of stock options if they are subject to performance conditions, while allowing the cost of non-performance based options to be ignored;   
- tax rules that allow stock options without performance conditions to be recognised as performance-related pay.

The report urges regulatory and investment bodies to come together to break down these barriers, and force compensation committees of companies to reconsider their policies.

The contents of the report are:

- an account of the regulatory and accountancy background;   
- an assessment of the performance conditions in use;   
- the UK experience - how to introduce performance targets;   
- undermining market-priced stock options - the corporate view;   
- a detailed analysis of two company defences of market-priced options - 3M and Office Depot;   
- company practice - a full review of performance-based stock options in operation;   
- tables detailing practice in the 50 companies awarding performance-based options, plus a selection of other types of performance condition in use in the S&P 500.

The report is available at <http://www.thecorporatelibrary.com/company_research/reports/>.

(O) AUDITING: EUROPEAN COMMISSION ISSUES RECOMMENDATION ON INDEPENDENCE OF AUDITORS

In May 2002 the European Commission issued a Recommendation on "Statutory Auditors' Independence in the EU". The Recommendation features a set of high level principles and in particular recommends that auditors should be prohibited from carrying out a statutory audit required by law if the auditors have any relationship with their client that might compromise the auditor's independence. This may include any financial, business, employment or other link, or any situations where the auditors provide to the same client services additional to the audit. The Recommendation deals with two key independence issues raised by the collapse of Enron, namely "provision of additional services" by auditors and their "employment with the audit client". Although the Recommendation is not legally binding, it will serve as a clear benchmark of good practice that the Commission expects to be immediately applied throughout the EU audit industry. In three years time, the Commission will review how the Recommendation has been applied in practice and will consider whether binding EU legislation may then be required. However, the Commission may act earlier if it is not satisfied with Member States' application of the Recommendation.

(1) Dos

According to the Recommendation, statutory auditors should be required to consider and to document, for each individual audit engagement, any potential risks or threats to their independence, as well as the safeguards for mitigating those risks. The independence of auditors needs to be protected systematically. Threats to independence vary in nature and in seriousness and auditors need to put in place different safeguards depending on the circumstances. The ultimate safeguard ("prohibition") is not to enter into certain relationships or not to provide certain additional services to the audit client.

(2) Don'ts

The Recommendation also indicates clearly what is not acceptable. For example, auditors should not conduct a statutory audit:

- if they have any direct or significant indirect financial interest in the audit client;   
- if a close family member works in a management position in the audit client; or   
- if they receive an unduly high proportion of their revenue from one client.

Also, partners involved in performing audits should not join the audit client before the end of a two year cooling-off period. Key audit partners must also "rotate" within seven years (in other words, they must not be involved in auditing the same client for more than seven years in succession). Member States would remain free to establish stricter rules than those laid down in the Recommendation.

The principles-based approach to auditor independence is combined with other broader safeguards set out in the Recommendation. These include the full disclosure, at least annually, of fees for audit and non-audit services, and a written declaration confirming independence, which must be made by the auditor to the audit client's governance body, for example a board of non-executive directors or a supervisory board. Furthermore, all EU statutory audits should be subject to external quality assurance systems that require auditors to review compliance with ethical principles and rules, including independence rules, according to the Commission's existing Recommendation on "Quality Assurance for the Statutory Audit in the EU".

The Commission's initial response to the various aspects of the collapse of Enron is featured in a paper published recently on the Commission's website (see IP/02/584 and <http://europa.eu.int/>)

This paper indicates a series of measures to further improve the quality and credibility of the EU audit profession, including: the use of international standards on auditing, audit committees and improved oversight over the audit profession. The Commission Recommendation on Statutory Auditors' independence is an integral part of this strategy. EU Economic and Finance Ministers meeting informally in Oviedo in April called for rapid application of the Commission Recommendation.

The full text of the Recommendation is available on the Europa website: <http://europa.eu.int/>

(P) BRT CEOS ISSUE "BEST PRACTICES" ROADMAP FOR EXCELLENCE IN CORPORATE GOVERNANCE

In May 2002 the CEOs of approximately 150 of the largest corporations in America announced core principles to help American public companies meet their corporate governance responsibilities more effectively. In the wake of the Enron bankruptcy, the public, investors, and shareholders are demanding to know more about the workings of Corporate America. The Business Roundtable (BRT) issued best practices in corporate governance, and the Roundtable's member CEOs strongly encourage all US public companies to adhere to these guidelines, which would help restore public trust in American business.

The Business Roundtable's 2002 Principles of Corporate Governance call on companies to adopt a number of best practices in corporate governance, including:

- require stockholder approval of stock options and restricted stock plans in which directors or executive officers participate;   
- create and publish corporate governance principles so that everyone from employees to potential investors understand the rules under which the company is operating;   
- provide employees with a way to alert management and the board to potential misconduct without fear of retribution;   
- require that only independent directors may sit on the board committees that oversee the three functions central to effective governance- audit, corporate governance and compensation;   
- ensure that a substantial majority of the board of directors comprises independent directors both in fact and appearance;   
- ensure prompt disclosure of significant developments;   
- establish a management compensation structure that directly links the interests of management to the long-term interests of stockholders, which includes a mix of long- and short-term incentives;   
- require the audit committee to recommend the selection and tenure of the outside auditor and consider what policies should be adopted by the company with respect to changing the outside auditor, rotating the audit engagement team personnel or limiting the hiring of such personnel.

A copy of the BRT's 2002 Principles of Corporate Governance can be obtained by visiting the BRT web site at <http://www.brt.org>.

(Q) US STUDY ON STOCK EXCHANGE LISTING STANDARDS AND CORPORATE GOVERNANCE

In May 2002 the Committee on Federal Regulation of Securities of the American Bar Assocation published a report titled "Special Study on Market Structure, Listing Standards and Corporate Governance". The study examines the effectiveness of the governance and disclosure systems applicable to public companies in the United States. In particular, the study examines the role of the Securities and Exchange Commission (SEC) and US stock exchanges in matters pertaining to corporate governance.

The study recommends a proposal involving the development of best practice guidelines and the implementation of a "complier explain" approach. Under this proposal, the New York Stock Exchange and the Nasdaq Stock Market would act jointly, subject to SEC authorisation, to establish a protocol for the development of non-binding best practice guidelines limited to those corporate governance matters necessarily for and directly relevant to, the integrity of the securities markets and fundamental fairness to investors. It is recommended that the SEC adopt a rule requiring public disclosure by each listed company as to whether it complies with the exchange-established best practice guidelines or explaining the reasons for any areas of non-compliance.

The structure of the study is as follows. Section 1 addresses the history and role of corporate governance listing standards in the US markets. Section 2 examines issues relating to stock exchange and SEC authority over corporate governance listing standards. Section 3 addresses the recent evolutions of the securities marketplace, including market fragmentation caused by the proliferation of alternative trading systems and internationalisation and its effect on corporate governance listing standards. Also considered is demutualisation. Section 4 examines corporate governance regulation and practices outside the US and a sample of seven jurisdictions for comparative purposes. Section 5 includes an analysis of and various alternatives to the present US system and outlines the proposal for the development of best practice guidelines.

The study is available on the website of the Committee on Federal Regulation of Securities at <http://www.abanet.org/buslaw/fedsec/>.

2. RECENT ASIC DEVELOPMENTS

(A) INTERNATIONAL COLD CALLING INVESTMENT SCAMS REPORT

On 19 June 2002 Mr David Knott, Chairman of ASIC, released "International Cold Calling Investment Scams", an ASIC report into the international telemarketing scams that cheated many thousands of Australians.

Between 1999-2001, more than 82 unlicensed overseas telemarketing firms systematically cheated Australian investors of an estimated $400 million. More than 7,300 people contacted ASIC directly, of whom 80% lost money. Global losses could run into billions.

'ASIC's report shows how international investment scams are becoming more sophisticated, both in conning consumers and exploiting the difficulties in cross-border law enforcement', Mr Knott said. 'The report provides important lessons for dealing with future scams and proposes ways for regulators and consumers to combat those scams', said Mr Knott. 'As consumer interest in investing grows, it is important for the community to understand the risks posed by such scams. ASIC's report aims to raise awareness about these scams and thereby improve investor protection', said Mr Knott.

ASIC's report documents the extraordinary lengths to which the cold callers went to establish  
trust and to convert that trust into a 'sale'.

'Cold calling operators, typically based in Asia, made false promises about investments, using fake 'props', such as expensive documentation and websites, to convince investors of their legitimacy. Investors received near worthless shares that could not be sold, or no shares at all. Cold callers created complicated international set-ups to make it harder for consumers to check investments or to recover money. For example, an English operator cold called Australian investors from Bangkok, claiming to be in Japan, selling shares in a company operating in China, but traded through a US over-the-counter market. Payment for the shares was routed through a Hong Kong bank account. Although the cold calling operations lay outside the reach of Australian laws, ASIC made sustained and persistent efforts to prosecute offenders, warn investors, and obtain international action. In particular, cooperation with overseas regulators has been vital and will become increasingly important in dealing with this type of fraud', said Mr Knott.

Action taken by ASIC includes:

- prosecuting any offenders known to have entered Australian jurisdiction;  
- using our international relationships to urge overseas authorities and overseas police to close down these operations. Prosecutions, arrests and other action was taken by Thai, Singaporean, Philippine, Indonesian and Hong Kong authorities during 2001;  
- creating an Internet blacklist of known cold calling organisations, which has been visited 32,000 times by people logging on from <http://www.fido.asic.gov.au>;  
- publishing regular warnings to investors through radio and TV appearances and 18 media releases; and  
- conducting in-depth research to understand these scams better.

'While complaints about this scam have declined, they have not disappeared. In the report ASIC puts forward 11 proposals for tackling such scams including:

- targeted education and warnings;  
- international action, including enforcement action, in cooperation with overseas regulators, particularly in Asia and the USA;  
- domestic regulatory action in cooperation with financial institutions and law enforcement agencies; and  
- improvements to ASIC's capacity to obtain compensation, freeze accounts and take action against those involved in cold calling.'

This report, a list of cold calling organisations, information and true stories can all be found  
on ASIC s consumer website FIDO at <http://www.fido.asic.gov.au>.

(B) ASIC FINDINGS SUPPORT REVISION OF ACCOUNTING STANDARD

On 7 June 2002 ASIC announced that a survey of financial statements to 31 December 2001 had reconfirmed the need for urgent revisions to accounting standard AASB 1018 'Statement of Financial Performance'.

(1) Statements of Financial Performance

ASIC conducted a follow-up of its 30 June 2001 survey with a review of the financial reports of 30 listed companies. This confirmed that inappropriate and undesirable practices identified in its previous review were continuing.

'These practices included: giving undue prominence to non-statutory "profit" lines; showing large amounts as "other revenue" and "other expenses"; and showing some expenses on a nature classification and others on function', said Ian Mackintosh, ASIC's Chief Accountant. 'The continuing examples of sub-standard practices reinforced the need for the AASB's recent exposure draft ED 105, which suggests a number of amendments to clarify and strengthen the operation and intent of the current AASB 1018. ASIC supports the AASB's intention that the revised AASB 1018 apply for financial years ending on or after 30 June 2002 and congratulates them for finalising a standard so quickly', he said.

(2) Half-year reports

ASIC also reviewed compliance with the new accounting standard AASB 1029 'Interim Financial Reporting'.

'While compliance with AASB 1029 was generally satisfactory, some companies using the ASX Appendix 4B as the basis for their statutory half-year reports failed to make required additional disclosures. Appendix 4B is in the process of being revised and this should resolve the problems for the 30 June 2002 reporting', Mr Mackintosh said.

(3) 30 June 2002 reviews

ASIC intends to focus on compliance with the new accounting standard AASB 1005 'Segment Reporting' in its review of full-year financial reports of selected listed companies balancing at 30 June 2002. It is intended that the ASIC review will obtain information on selected companies' internal reporting of segments as a part of this review.

(C) ASIC STREAMLINES REPORTING FOR LIQUIDATORS, RECEIVERS AND ADMINISTRATORS

On 6 June 2002 ASIC announced that it is introducing electronic lodgment for liquidators, receivers and administrators, so that they can quickly and accurately lodge documents with ASIC for companies under external administration. The 'EXAD' project will improve the accuracy and consistency of data available on corporate insolvency. More accurate data will also assist in the better education of company officers and consumers.

Another benefit of electronic lodgment is that data will be received in a structured, consistent and timely manner, which will allow the earlier review of that information by ASIC.

Development of ASIC's EXAD project has been undertaken in close consultation with the Insolvency Practitioners Association of Australia (IPAA) and individual practitioners.

The first stage of the EXAD project commenced on 3 June 2002. Receivers, administrators and liquidators can now electronically lodge reports about a company under external administration with ASIC, including reporting suspected offences by company officers. By completion of the project all forms lodged with ASIC by liquidators, receivers and administrators will be able to be lodged electronically.

(D) COURT IMPOSES PENALTIES ON FORMER HIH DIRECTORS ADLER, WILLIAMS AND FODERA

On 30 May 2002 Mr David Knott, Chairman of ASIC, said that orders made by the Supreme Court of New South Wales against certain former directors of HIH Insurance Limited (HIH) highlighted the serious consequences that can flow from a failure of good corporate governance.

The three defendants, former HIH director Mr Rodney Adler, former HIH Chief Executive Officer Mr Ray Williams and former HIH Chief Financial Officer Mr Dominic Fodera, were found by Mr Justice Santow to have breached their duties under the Corporations Act. Orders were also made against Adler Corporation Pty Ltd.

The breaches related to a payment of $10 million by an HIH subsidiary (HIH Casualty and General Insurance Ltd) to Pacific Eagle Equities Pty Ltd, a company of which Mr Adler was a director.

His Honour made the following orders against the respondents:

- Mr Adler was banned from acting as a director of any company for a period of 20 years;   
- Mr Adler and Adler Corporation were each ordered to pay pecuniary penalties of $450,000 (totalling $900,000);   
- Mr Williams was banned from acting as a director of any company for a period of 10 years and was ordered to pay pecuniary penalties of $250,000; and   
- Mr Fodera was ordered to pay pecuniary penalties of $5,000.

In addition, Messrs Adler and Williams and Adler Corporation were ordered to pay aggregate compensation of $7,958,112 to HIH Casualty and General Insurance Limited (subject to verification of the calculation of interest).

Costs have been ordered equally against all four defendants (Messrs Adler, Williams and Fodera and Adler Corporation), subject to submissions.

This judgment is discussed in more detail later in this Bulletin - see [Item 5(A)](http://www.law.unimelb.edu.au/bulletins/archive/Bulletin0058.htm#5.recentcorporatelawdecisions).

3. RECENT ASX DEVELOPMENTS

(A) ASX AND IWL SIGN HEADS OF AGREEMENT

On 27 May 2002 Australian Stock Exchange Limited (ASX) and IWL Limited (IWL) signed Heads of Agreement relating to the use of IWL's FundLink software as core technology for ASX FundConnect, the unlisted managed funds transaction processing service ASX will roll out in early 2003.

The Heads of Agreement provides for a Confirmation Stage under which IWL will assist ASX to assess FundLink's fit with ASX FundConnect's business requirements. While the Confirmation Stage is progressing, the parties intend finalising the terms of their commercial agreement and agreeing on an implementation project plan for the evolution of the complete ASX FundConnect service technology.

The agreement between ASX and IWL provides significant advantages in three main areas. Firstly, it is expected that ASX FundConnect will be able to offer greater functionality at the point of initial roll-out. Secondly, the Agreement will allow for a more cost effective development path for ASX FundConnect compared to the alternative of building the core functionality in its entirety. Thirdly, IWL will facilitate connectivity to ASX FundConnect through its existing financial planning software applications, potentially delivering a critical mass of financial planner distributors to the service.

4. RECENT TAKEOVERS PANEL MATTERS

(A) APPLICATION FROM ASIC CONCERNING AUSDOC

On 14 June 2002 the Takeovers Panel advised that it had received an application from the  
Australian Securities and Investments Commission (ASIC) for a declaration of unacceptable circumstances in relation to the affairs of Ausdoc Group Limited (Ausdoc).

The application relates to a break fee and other lock-up provisions that Ausdoc entered into with ABN AMRO which has announced a bid for Ausdoc.

ASIC's concerns relate to:

- the size of the break fees reported by Ausdoc (the maximum fee payable is $3.5 million), and  
- the fact that a break fee is also payable in the event that the bidder does not reach the 90% compulsory acquisition threshold (subject to certain other conditions).

ASIC said that it was concerned that the break fee arrangements may have an adverse effect on competition for control of Ausdoc, and adversely affect shareholders in Ausdoc.

The Panel for the application is Mr Michael Tilley (sitting President), Professor Ian Ramsay (sitting Deputy President) and Ms Luise Elsing.

(B) PANEL RELEASES DRAFT GUIDANCE NOTE ON CONFLICTS OF INTEREST

On 7 June 2002 the Takeovers Panel advised that it had released for public comment a draft Guidance Note on Conflicts of Interest as they relate to Panel members sitting on individual matters.

The draft Guidance Note sets out the principles which the Panel and its members will apply when assessing whether their interests may give rise to a conflict or a reasonable apprehension of bias in relation to an application to the Panel. It also sets out the procedures that the Panel has in place to assist members in identifying potential conflicts of interest, notifying these to the President of the Panel, and to parties, in order to facilitate a speedy appointment of a sitting Panel to deal with an application.

The draft Guidance Note sets out the types of interest (both professional and personal in nature) which potential members of the sitting Panel are asked to consider and to disclose. It addresses the relevance of particular interests or relationships, including the relationship of a member's firm with a party or a person who is connected with a party, and the fact that a member is a consultant to a firm which is acting for a party.

The Panel noted that its policy is that if the President decides that a particular interest of a member is not sufficiently significant to cause any apprehension of bias, the Panel will nonetheless disclose that interest to the parties. This is to further the aim of transparency of process, and to ensure that parties are provided with as much information as practicable when they are considering the interests of members.

Sometimes a conflict may arise or be discovered after proceedings have commenced. The draft Guidance Note sets out the factors which will be relevant to the President's decision as to whether or not the sitting Panel should be reconstituted, and the process to be followed if a new sitting Panel member is appointed.

The draft Guidance Note is available on the Panel's website at <http://www.takeovers.gov.au/Content/guidance/guidance.asp>.

The Panel invites comments on the draft Guidance Note by Friday, 19 July 2002. Comments may be provided to Kristen Jung, a legal secondee to the Panel, by post at the address shown below, by fax on 03 9655 3511 or by email to kristen.jung@takeovers.gov.au. Consistent with the Panel's policy on its consultation procedures, parties providing comments should indicate whether or not their comments are provided in confidence.

(C) PANEL RELEASES DRAFT GUIDANCE NOTE ON FRUSTRATING ACTION

On 31 May 2002 the Takeovers Panel advised that it had released for public comment a draft Guidance Note on Frustrating Action.

The Guidance Note follows from decisions by the Panel in the Pinnacle 5 and Pinnacle 8 matters (the decisions are published on the Panel's website). In both those matters the Panel advised that it would publish guidance as to what actions that directors of a target company might take during a bid may be unacceptable.

Frustrating action is generally described as corporate action that could effectively prevent a proposal concerning control or ownership of a company. For example, a target company might initiate the sale or acquisition of major assets after the announcement of a takeover where the bid is subject to a defeating condition triggered by such a sale or acquisition.

In such cases, the decision on the success or failure of the takeover bid is taken by the board of the target company, rather than the shareholders. The Panel's primary concern is to ensure that it is shareholders who make decisions concerning the ownership and major direction of their companies.

The principles of the Panel's frustrating action Guidance Note mean that where a proposed action by directors would conflict with an external proposal which relates to the control or ownership of a company, directors' freedom of choice becomes restricted. Therefore, there will be things which a board may properly decide and do in the absence of an external control proposal (indeed may even be required by their directors' duties to do) which those directors will need to seek shareholder approval for when directors are aware of an external control proposal.

The Guidance Note relates to control proposals, not the everyday run of company business. Therefore, the Panel does not consider that its Guidance Note will impose any material chilling effect on the abilities of directors and management to run companies. The Panel's guidance emphasises that not every frustrating action will constitute unacceptable circumstances.

Unacceptable circumstances relate to material changes that adversely affect the objectives of a bid, after the bid is announced.

The Panel noted that there may be some very few occasions where the cost to the target company of foregoing a corporate opportunity is so great that target directors consider that undertaking the frustrating action, without shareholder approval, is in the best interests of their shareholders. Where they are faced with such a decision the Panel advises that directors should first look to whatever alternatives are available to put the decision into shareholders' hands before choosing any action which would deny shareholder choice. The Panel noted that there are different ways of achieving shareholder choice, shareholder meetings are but one way. The Panel noted that its Guidance Note provides no safe harbour for directors who choose such a route.

The Panel noted that it does not intend to facilitate bidders abusing the Panel's Guidance Note by making bids subject to laundry lists of conditions that are intended to force target companies into submission.

The draft Guidance Note is available on the Panel's website at : <http://www.takeovers.gov.au/Content/guidance/guidance.asp>.

Comments on the draft Guidance Note are invited by Friday 12 July 2002. Comments may be sent by post, fax or email to:

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5. RECENT CORPORATE LAW DECISIONS

(A) ORDERS FOR RELIEF IN THE ADLER CASE  
(By Giselle McHugh, [Mallesons Stephen Jaques](http://www.mallesons.com))

ASIC v Adler [2002] NSWSC 483, Supreme Court of New South Wales, Santow J, 30 May 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/may/2002nswsc483.html> or <http://www.cclsr.law.unimelb.edu.au/judgments/>

(1) Background

This judgment determines orders for relief following the decision of Santow J in ASIC v Adler ([2002] NSWSC 171) ("the Judgment"), an action commenced by ASIC following the collapse of HIH Insurance Limited ("HIH").

The Judgment is discussed in Corporate Law Bulletin No 55 (March 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, Rodney Adler, Ray 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 Limited ("PEE"), a company controlled by Adler and the trustee of the Australian Equities Unit Trust ("AEUT"), and part of that amount was subsequently 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, the trust'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.

(2) Relief sought by ASIC

Following publication of the Judgment, declarations were made pursuant to section 1317E(1) of the Act. In addition, ASIC sought disqualification orders, compensation orders and pecuniary penalties against Adler, Williams and Fodera pursuant to sections 206C, 1317H and 1317G, as well as compensation orders and pecuniary penalties against the Third Defendant, Adler Corporation Pty Ltd. Compensation provisionally totalling $7,958,112 (plus interest from May 2002) was sought, representing the loss suffered by HIH, HIHC and PEE in respect of the $10 million payment.

(3) Disqualification from managing corporations

The relevant provisions of the Corporations Act applicable to disqualification are primarily found in section 206C, which operate when a declaration has been made under the Act's civil penalty provisions (or, alternatively, under section 206E where there have been repeated contraventions of the Act). In both cases, the Court must be satisfied that the disqualification is justified taking into account the matters in each respective subsection.

Santow J identifies the guiding principles derived from cases dealing with these provisions or their predecessors. It is well settled that the primary purpose of the disqualification power is protection of the public. Although there is a corollary of personal deterrence, the aim of disqualification should not be punitive. In considering disqualification, the discretion of the Court is directed to the nature of the relevant person's conduct in relation to the management, business or property of a corporation and, once the Court is satisfied that disqualification is justified, to any other matters the Court considers appropriate.

In Rodney Adler's case, there had been a repeated series of contraventions of the Act. In considering whether to make a disqualification order, the relevant transactions are to be judged individually as well as for their cumulative effect (and not be treated as a single transaction with a single penalty, as Adler had contended). Highly relevant was the number of companies (three) that had suffered because of Adler's dereliction of duty, and that Adler had repeated instances of misconduct, pointing to a greater risk to the public if he were allowed to continue to manage companies. The gravity of the contraventions as well as their repetition in nine distinct transactions made a powerful case for the lengthiest disqualification period.

A wide range of disqualification periods have been imposed by the courts, taking into account an almost infinite variety of facts and discretionary considerations. Against very substantial disqualification orders pressed by ASIC, Adler advanced a number of private interest considerations, primarily regarding his ability to earn an income by managing Adler Corporation, a private company, and submitted that any disqualification order should be limited either in time, or to the management of public companies or to the management of companies other than Adler Corporation and its wholly-owned subsidiaries.

Santow J dismissed Adler's submissions: the public protective purpose of disqualification is paramount and precludes a simple balancing exercise. Without being punitive, it would subvert the public purpose if private interest considerations were to prevail or preclude an order that went no further than necessary to serve the public purpose. In addition, the language of section 206G of the Act expressly permits an application to a Court by a disqualified person for leave to manage a particular corporation or a particular class of corporations. That there is no similar distinction in the associated disqualification provisions strongly suggests that they are not to be read as permitting a qualified order.

There is no justification for a distinction between the management of public companies and private companies. Protection of the public envisages protection of individuals that deal with public and private companies, including consumers and creditors as well as shareholders and investors. Arguably the public needs even greater protection dealing with private companies, which are not subject to the heavier regulation imposed on public companies.

In determining a disqualification order, a lack of contrition is highly relevant to the issue of whether a director or officer is likely to contravene again. In circumstances where Adler continued to vigorously deny any wrongdoing, there was nothing to suggest that in the future he would act any differently. As to Adler's contention that the scope and extent of disqualification should be referenced to the standard of conduct of the other (non-defendant) directors of HIH, Santow J concluded that the question as to what the board would have done, had it known of the transactions which constituted the various contraventions, was irrelevant. As ASIC contended, any approval of the transactions (whether with or without full disclosure of the material facts) would have involved a breach of their own duties as directors.

In the absence of fraud, but taking into account the essentially applicable factors which led Austin J to impose a banning order of 25 years in ASIC v Parkes [2001] 38 ACSR 355 (at 386), Santow J imposed on Adler a period of disqualification from managing a corporation of 20 years. A disqualification period of 10 years was also imposed on Adler's fellow director Ray Williams. Williams' conduct, though involving serious breaches, fell short of the level of seriousness applicable to Adler. Santow J did not consider disqualification to be warranted in Dominic Fodera's case. Having considered all the circumstances, and taking into account the protective purpose of the disqualification provisions, it was unlikely that Fodera would again fail to appreciate the importance of ensuring that proper corporate approval processes are not bypassed.

(4) Compensation

Santow J did not consider it appropriate to attempt to differentiate between the Defendants as to proportional shares of a compensation order. It was not open to any of the Defendants to argue that their contribution to the damage was smaller than that of others or that they were only partly responsible, for such arguments can only be put in contribution proceedings between the Defendants. In addition, section 1317H(1) of the Act requires that the Court must specify the amount of the compensation. There is a strong argument that differentiation between defendants (whether based on some kind of formula or otherwise) is not in conformity with the statutory requirement for specification, nor with the well settled principles of joint and several liability.

However the Court can conclude, in relation to any particular defendant, that in all the circumstances no compensation order should be made. The Court's discretion is denoted by the word "may" in section 1317H(1). Santow J held that no compensation order should be made against Fodera, given the very different character of Fodera's conduct (the nature of his failure was essentially omission) and Fodera's substantially lesser role in occasioning the loss. Santow J concluded that compensation orders would be made against Adler, Adler Corporation and Williams, with each jointly and severally liable in respect of the final sum of $7,958,112.

(5) Pecuniary penalty

As with determining the period of a disqualification order, there is no simple mechanical process for quantifying an appropriate pecuniary penalty. The penalty has a punitive character, but it is principally a personal and general deterrent to prevent the corporate structure from being used in a manner contrary to commercial standards. The penalty should be no greater than is necessary to achieve this object. The capacity of a person to pay is a relevant consideration.

A court may order a person to pay a pecuniary penalty of up to $200,000 under section 1317G of the Corporations Act where, inter alia, a declaration of contravention has been made, the contravention materially prejudices the interests of the corporation and is "serious". Santow J had concluded that the various transactions which contravened the Act were not to be treated as a single transaction. Thus the discretion arose to order a pecuniary penalty order for each of the nine contraventions of up to $200,000, against both Adler and Adler Corporation. Adler Corporation is not to be taken as simply the alter-ego of Adler, although he is in effective control of it.

Santow J referred to the difficulty in articulating how the total figure of the Court's pecuniary orders, in the amount of $450,000 against each of Adler and Adler Corporation, was arrived at. Each of the transactions gave rise to multiple contraventions. Santow J sought to apply the "totality" principle in a way that would act as a personal and general deterrent without being oppressive, an "instinctive synthesis" of relevant factors leading to an appropriate outcome which reflects the gravity of the contraventions, the material loss suffered and the importance of both personal and general deterrence. There was no contrition of any kind that would warrant mitigation of the pecuniary penalty orders. Pecuniary penalty orders were also made against Williams in the amount of $250,000 and Fodera for $5,000.

(B) FAIR VALUE AND THE COMPULSORY ACQUISITION OF MINORITY SHARES - PART 1  
(By Cindy McGrath, [Blake Dawson Waldron](http://www.bdw.com.au))

Austrim Nylex Limited v Kroll (No 2) [2002] VSC 193, Supreme Court of Victoria, Warren J, 24 May 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/vic/2002/may/2002vsc193.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Facts

The plaintiff (Austrim Nylex Limited) offered to compulsorily acquire the remaining minority units in National Consolidated Limited (NCL), a company in which the plaintiff held over 90% of the issued shares. The plaintiff sought court approval of the proposed compulsory acquisition by relying on sections 664(3) and 664F(1) of the Corporations Act 2001 (Cth).

The defendants (Kroll) were minority preference shareholders and opposed the plaintiff's application on two grounds:

(i) the offer made by the plaintiff for the minority shareholding did not give fair value; and

(ii) the statutory provisions relied on by the plaintiff were unconstitutional and therefore invalid.

(2) Background

In April 2000, the plaintiff engaged an expert (DMR) nominated by the Australian Securities and Investments Commission to prepare a report in accordance with section 667A of the Corporations Law as to the fair value of the remaining preference shares.

DMR considered the maximum value of each of the remaining preference shares was $1.71. The plaintiffs offered the minority shareholders $2.00 for each remaining preference share.   
In January 2001, under section 644C(2)(b) of the Corporations Law, the plaintiffs forwarded to each minority shareholder a notice of compulsory acquisition, the initial report of DMR and an objection form. The defendants objected on the grounds that the price offered was not fair and that the initial report of DMR failed to take into account "special benefits" that the plaintiff would receive if it acquired 100% interest in NCL.

The defendants provided expert reports which valued the shares at $11.00 (being within a valuation range of $6.12 to $87.46). The major contributing factor for the difference between the plaintiff's and defendant's price was the value attached by the defendants to "special benefits" of 100% ownership of NCL.

(3) Part 6A.2 of Division 1 of the Corporations Act

Warren J provided a background to Part 6A.2 of Division 1 of the Corporations Act. Her Honour referred to her judgment in Capricorn Diamonds Investments Pty Ltd v Catto and stated:

"…the legislature was seeking to balance the interests of two groups of parties that is, the interests of facilitating changes in corporate ownership with the need to protect the rights of the minority shareholders. Part of the process was the discouragement of minority shareholders from demanding a price for their securities that is above fair value, the practice of greenmailing...The objective of the legislature was to remove the matters that would otherwise operate to force a price above fair value were there to be the ordinary commercial bargaining context in which consent of both parties is required before a transaction can be concluded. Furthermore, in the explanatory memorandum the provisions of 667C are explicitly addressed and it was stated that it is proposed that experts would not account for premiums .... The memorandum refers to premiums on account of the special value of outstanding securities to the acquirer, that is, the extent to which the acquirer may be prepared to pay a sum above fair value in order to secure its objective."

(4) The issues

There were three main issues in the proceeding, namely:

(i) Did the terms proposed by the plaintiff in its compulsory acquisition notice give fair value for the shares covered by the notice?

(ii) Is Part 6A.2 of the Corporations Act constitutionally valid?

(iii) Was there compliance with the requirements of section 664C(2) in relation to disclosure by the plaintiff in its compulsory acquisition notice?

(5) Fair value

Warren J held that there are eight principles to be applied in determining fair value:

- fair value of an asset is its fair equivalent in money ascertained by a supposed sale by voluntary bargaining between vendor and purchaser;  
- the fact that the units must be disposed of at a fair value should not be a factor leading to a discount or lower valuation than would otherwise be obtained;  
- fair value does not require that any amount should be included in respect of ransom value or a power of veto;  
- the value of the special benefits to the acquirer is not properly to be included in the calculation of the value of the company as a whole;  
- apart from under section 667C, fairness requires that the value of any special benefits should be allocated pro rata amongst securities in the same class;  
- if the value of special benefits is to be included under section 667C, the value should be allocated pro rata;  
- fairness requires consideration of whether the value is fair to all the shareholders, rather than whether it is fair to a particular shareholder or class of shareholders in the peculiar circumstances of the case; and  
- fair value may require a more liberal estimate of value within a range of possible values where there is compulsory acquisition of property. However, it does not permit a premium for forcible taking.

(6) Special Benefits

In addition Warren J held that expert reporting in accordance with section 667C is not required to take into account any special benefits that 100% ownership may achieve and the associated factors as they do not reside in and are not embodied in the company as a whole. Special benefits are characterised as external to the asset as they do not exist at the time when the valuation occurs and will only ever exist after the transaction has taken place. Furthermore any attribution of special benefits would be contrary to the intentions of Parliament - to preclude synergies or special benefits from the determination of fair value.

Nevertheless Warren J stated that if special benefits were to be calculated in the share price, then the value of the special benefits should be distributed pro rata. That is, the value must be fair to all shareholders and not just the minority shareholders. The minority shareholders claimed that the value of special benefits should be divided equally between the two classes of shareholders - ordinary and preference shareholders. The defendants were the only preference shareholders in the company.

(7) Constitutional validity

The defendants argued that Part 2A.2 of the Law was invalid because it was not in force at the time of the commencement of the Corporations (Victoria) Act 1990 (Vic). They argued that it was an impermissible delegation of legislative power by the state of Victoria to the Commonwealth (by virtue of section 51(xxxvii) of the Constitution) for a Victorian Act to purport to incorporate future Commonwealth legislation (ie, the Law as amended from time to time).

It was held that the need to consider this argument was largely removed by the introduction of the Corporations Act in 2001. Section 1384 of the Corporations Act deals with proceedings commenced under the old legislation. Under section 1384, the "continued proceedings" continue as if they had always arisen under the equivalent section of the Corporations Act.

The plaintiff was required to demonstrate that this action was a continued proceeding under section 1384. Warren J held that it was the defendant's constitutional argument which resulted in the proceedings being classified as a "Federal corporations proceeding" under section 1382(1)(b)(c) and satisfying section 1384(1)(b).

(8) Compliance with section 664C(2)

The defendants argued that the compulsory acquisition notice served by the plaintiff did not disclose all information that was material within the meaning of section 664C. Justice Warren held that there was no evidence or insufficient evidence of the matters complained about by the defendants with respect to material disclosures. Moreover, there was no evidence that any of the matters relied on by the defendants were material to a minority shareholder's decision to object. If in any event there had been failure by the plaintiff to provide material information known to it, her Honour considered that such failure would constitute a procedural irregularity that could be remedied under section 1322(4).

(9) Findings

Warren J held that the compulsory acquisition notice gave fair value for the shares in NCL. Therefore, in accordance with the statutory directive in sections 664(3) and 664F(1) of the Corporations Act the compulsory acquisition was approved.

(C) FAIR VALUE AND THE COMPULSORY ACQUISITION OF MINORITY SHARES - PART 2  
(Elizabeth Sahhar, [Blake Dawson Waldron](http://www.bdw.com.au))

Teh v Ramsay [2002] NSWSC 456, Supreme Court of New South Wales, Barrett J, 24 May 2002.

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2002/may/2002nswsc456.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Introduction

Lip Ten Teh (the plaintiff) sought an order under section 661E(2) of the Corporations Act 2001 (Cth) (the "Act") that 552,000 shares in the capital of Alpha Healthcare Limited ("Alpha") held by him not be compulsorily acquired by Ramsay Centauri Pty Limited (the defendant) under section 661A(1). The compulsory acquisition followed in the wake of a takeover bid made by the defendant in respect of shares in Alpha. The conditions laid down by section 661A in relation to the compulsory acquisition power following a takeover bid had been satisfied. The consideration offered by the defendant bidder was 40 cents per share, so that the aggregate price for all shares was $18,084,104. The main issue in this case was whether the consideration offered was fair value. Section 661E(2) of the Act provides:

"The Court may order that the securities not be compulsorily acquired under subsection 661A(1) only if the Court is satisfied that the consideration is not fair value for the securities."

Barrett J considered the words "only if the Court is satisfied" to be significant, as "they delineate the sole issue in these proceedings". His Honour stated that the discretion to make an order under section 661E(2) does not arise unless it is established to the court's satisfaction that the "consideration is not fair value for the securities". In this case, the consideration was clearly 40 cents. Barrett J thought that the question to which section 661E(2) directs attention as the sole basis of the court's jurisdiction is therefore whether 40 cents multiplied by the number of the plaintiff's shares (i.e. $0.40 x 552,000 = $220,800) is "fair value for the securities". Accordingly, the answer will be in the negative only if "the fair value for the securities" is greater than $220,800. Barrett J stressed that there is no scope for the court to inquire into the fairness of the takeover bid or of the proposed compulsory acquisition - there is only a single avenue of attack, namely the question of adequacy of consideration posed by section 661E(2). That question is to be answered solely by reference to the statutory concept of "fair value for securities" defined by section 667C.

(2) "Fair value for securities" - section 667C

Section 667C lays down the method of determining what is "fair value for securities". Barrett J commented that section 667C rules out all other possible methods of valuation and excludes from consideration all matters other than those to which it directs attention. "Fair value" is a statutory label and the use of "fair" does not mean that there is to be something intrinsically fair according to general notions of fairness.

(3) "Value of the company as a whole" - section 667C(1)(a)

Barrett J stated that the directions in section 667C(1) are to be followed sequentially. The first step is to "assess the value of the company as a whole". As the statute provides no direction for assessing the value of this construct, His Honour went back to the basic valuation approach "long recognised by the law" and explained by Griffith CJ in terms of a hypothetical sale and purchase in Spencer v The Commonwealth (1906) 5 CLR 418. Barrett J concluded that "determination of the 'value of the company as a whole' looks solely to the stand-alone worth of the particular collection of benefits and detriments represented by the enterprise, viewed through the eyes of the hypothetical buyer and seller".

Further, section 667C(1)(a) is not concerned with the "value of the company as a whole" to any particular person. It is concerned only with valuing the overall enterprise. A by-product of section 667C(1)(a) using the words "the company as a whole" is to ensure that the total enterprise is viewed as a distinct commodity in its own right. This means that the "premium for control" is inherent in the enterprise value from which "fair value for securities" is to be derived per section 667C. Barrett J cited Santow J's obiter dictum in Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd (2000) 34 ACSR 737 that section 667C is "a clear legislative indication" that "the collective value of the company as a whole, including any special value derived from 100% ownership is to be allocated without attributing a premium or discount to particular securities". This paragraph of Santow J's judgment was accepted by Douglas J in Pauls Ltd v Dwyer (2001) 19 ACLC 959 and not disturbed on appeal (Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd (2001) 40 ASCR 221). Barrett J concluded that a special value component extractable by a shareholder who struggles hard not to be dislodged ("a premium for forcible taking") plays no part in the section 667C(1)(a) determination of "the value of the company as a whole".

Accepted methods of company or enterprise valuation then come to the fore. One or all of several basic approaches would be adopted: (1) a discounted cash flow approach; (2) an approach having regard to the assets and liabilities and, in a nominal sense, to the surplus which might be expected to eventuate if the assets were realised and the liabilities discharged; and/or (3) an approach looking to an estimate of future maintainable earnings and the application of a capitalisation factor with all recognisable risk factors reflected in the capitalisation factor. However, these are not the only available approaches.

(4) The other elements of section 667C

His Honour did not need to deal with other aspects of section 667C(1)(b) and (c) which have been the subject of analysis in recent decisions. As Alpha had on issue only one class of shares, the only apportionment called for by section 667C(1) is apportionment among members who hold shares carrying identical rights and ranking in all respects pari passu.

Section 667C (2) identifies a matter which must be "taken into account" in determining "fair value for securities" and is expressed not to limit section 667C(1). Barrett J took the view that the process in section 667C(1) is to be undertaken in the first instance and the result is to be reviewed (and adjusted if necessary) in the light of the material to which section 667C(2) directs attention.

(5) The relevant date

The other matter of construction is the identification of the date as at which it is necessary for "fair value for securities" to be determined. Barrett J held that the relevant date is that date on which the compulsory acquisition is initiated; namely the point at which the bidder lodges its compulsory acquisition notice with ASIC under section 661B(1)(b). This event marks the start of the new relationship between the bidder and the non-accepting shareholders, in which challenges mounted by dissenting shareholders arise.

(6) The plaintiff's onus in this case

Barrett J held that it is for the party seeking exercise of the jurisdiction (i.e. the plaintiff non-assenting shareholder) to show, by admissible evidence properly adduced, that the consideration falls short of "fair value for the securities." Here, the plaintiff bore the onus of showing what the "fair value" was and that the consideration of $220,800 fell short of it. The court must be satisfied that the consideration is not "fair value", thus some discrepancy must be affirmatively shown. Barrett J referred to case law under predecessor legislation which accords with his view of the present section 661E(2).

(7) The plaintiff's and defendant's evidence

The plaintiff's evidence contained in three sworn affidavits revealed that the directors of Alpha (bar one) recommended that shareholders accept the defendant's takeover bid in the absence of a higher offer. The plaintiff's documentary evidence included extracts from Alpha's annual reports and accounts, Alpha's announcements to the Australian Stock Exchange and a decision of the Corporations and Securities Panel (the Takeovers Panel). Much material sought to be adduced was ruled inadmissible under sections 76(1) and 56(2) of the Evidence Act 1995. The first category of rejected material included the views of stockbrokers and newspaper commentary. The second category, concerning takeovers of other companies and the conduct of parties in relation to those transactions, was inadmissible for lack of relevance. The defendant's evidence consisted of four affidavits and included the audited financial statements of Alpha and its controlled entities for the year ended 30 June 2001 and material supplied by the Australian Stock Exchange regarding share price history.

(8) The submissions

The plaintiff made ten submissions, only four of which were addressed by the defendant on the basis that they depended on rejected evidence. The plaintiff argued that the Takeovers Panel made a finding that Netcare (a potential bidder for Alpha) offered to acquire the debt from the Sun Group for $100,000 more than the defendant and to acquire the Company shares at 45 cents. Further, the acceptance of the defendant's offer by the receiver of the Sun group prevented Netcare from offering Alpha's other shareholders a consideration of 45 cents per share. The defendant argued that the lack of success of the Netcare proposal at 45 cents and the Sun Group's preference for the defendant's proposal at 40 cents were a product of rational market behaviour. The plaintiff also argued that the directors who owned shares in Alpha stated in the target's statement that they did not intend to accept the defendant's offer. The defendant retorted that the attitude of individual directors has no bearing on any question arising in relation to section 667C. Furthermore, the plaintiff argued that the financial and due diligence reports prepared by Ernst & Young did not qualify as independent expert reports on the fair value of Alpha, as Ernst & Young was the receiver who refused Netcare's higher offer and have been the auditor of the defendant's parent company for several years. The defendants argued that this evidence was tendered to show the financial position of Alpha and was not put forward as the work of an independent expert. The defendant's main submission was simply that the plaintiff had failed to discharge the onus cast upon him by the Act and therefore must fail. The defendant also relied upon the history of trading in Alpha shares obtained from the Australian Stock Exchange, highlighting that, until 7 March 2001, the highest sale price was never above 40 cents.

(9) Decision

Barrett J dismissed the plaintiff's application for an order under section 661E(2). The plaintiff "failed to appreciate the nature and scope of the task the legislation required him to undertake" to obtain the order sought. His Honour noted that it was unfortunate that the plaintiff proceeded without legal advice. Whilst the paper prepared for the board of the defendant before the takeover bid had some relevance in showing the "value of the company as a whole", the plaintiff "failed entirely to come to grips with the indispensable first step dictated by section 667C(1)(a)." The plaintiff failed to discharge the onus of showing that, so far as his shares were concerned, the compulsory acquisition consideration of $220,800 fell short of the "fair value for the securities" in the defined sense of section 667C. Additionally, Barrett J considered that the aforementioned paper provided scope for the view that $220,800 was not less than "fair value"; indeed it suggested that the value of the company as a whole fell substantially short of the total bid consideration. His Honour did not comment on the various matters by which the plaintiff sought to question the defendant's conduct in the course of the bid, as those matters were irrelevant to the litigation.

(10) Costs

The defendant argued that, if the plaintiff was unsuccessful in his claim under section 661E(2), it would expect to have an order for costs. The defendant drew attention to the absence of a similar provision to section 664F(3), which expressly says that the 90% holder is to pay the costs of an objector unless the court is satisfied that the objector acted improperly, vexatiously or otherwise unreasonably. Barrett J said that the absence of any similar provision is relevant but cannot be taken to mean that a similar outcome should or should not be ordered here. In contrast, the plaintiff argued that costs should not be awarded against him and cited Re Deans [1986] 2 NZLR 271, where Hardie Boys J held that it would be inappropriate to award costs in favour of the offeror, where the possibility of an objection was a distinct likelihood and the likely costs would surely have been taken into account in the cost of the takeover. However, Barrett J held that the proceedings were "actively initiated and pursued by the plaintiff" and resulted in his failing to obtain the order he sought against the defendant. His Honour ordered that the plaintiff pay the defendant's costs of the proceedings.

(D) SETTING ASIDE A DEED OF ARRANGEMENT  
(By Alex Vynokur, [Baker & McKenzie](http://www.bakernet.com))

Bamco Villa Pty Ltd v Montedeen Pty Ltd [2002] VSC 184, Supreme Court of Victoria, Pagone J, 17 May 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/vic/2002/may/2002vsc184.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Summary of application

The proceeding in this case arose in the context of previous disputes and proceedings between the parties.

The plaintiff ("Bamco") sought an order, under section 445D or section 447A of the Corporations Act 2001, that a deed of arrangement voted upon by the creditors, and entered into by the defendant ("Montedeen") be set aside. According to regulation 5.3A.07(1) of the Corporations Regulations 2001, a consequence of making an order under s445D is that Montedeen would be taken to have passed a special resolution under s491 that the company be wound up voluntarily.

(2) Background facts

On 18 October 2001 Mr Cauchi and Mr Lofthouse were appointed joint and several administrators of Montedeen. That appointment had been preceded by the service upon Montedeen of a creditor's demand by Bamco. On 7 December 2001 Mr Lofthouse prepared a report to creditors in which he informed them, among other things, that some important information regarding Montedeen had only been provided to him earlier on the day of the report and that he had little opportunity to review that information prior to completing the report.

The report further set out a proposal which had been received on 7 December 2001 (i.e. the day of the report) proposing that Montedeen enter into a deed of arrangement (in essence, the creditors would receive 50 cents in the dollar). In his report to the creditors, Mr Lofthouse included a recommendation that the "creditors should not accept the proposal as put". The report also contained some analysis of the affairs and transactions of Montedeen indicating matters that required further investigation before a fully informed recommendation (or a fully informed decision) could be made.

The meeting of the creditors of Montedeen took place on 14 December 2001. Two days before that date, the sole director of Montedeen provided a subsequent proposal to Mr Lofthouse for a deed of arrangement which varied significantly from that considered in the report of 7 December 2001 (in essence, the creditors would receive 25 cents in the dollar).

Mr Lofthouse prepared a supplementary report pursuant to section 439A for the purposes of the creditors' meeting, and made comments about it at the meeting. Specifically, he recommended that the meeting be adjourned to permit him properly to report to creditors pursuant to the provisions of the Corporations Act.

A proxy for Bamco moved that the meeting be adjourned in order to reconsider the amended proposal. Bamco accounted for about 25% of the voting value of creditors for the purposes of that meeting, but there was no seconder for the motion - the rest of the creditors, as His Honour noted, were disinterested in making an informed decision on this matter. The creditors resolved that the meeting should continue. At the meeting, all creditors but Bamco voted in favour of the deed of arrangement.

(3) The decision

His Honour decided the case on the following grounds:

(a) Section 445D(1)(e) - injustice

His Honour accepted the submission made on behalf of Bamco that effect cannot be given to the deed without injustice within the meaning of section 445D(1)(e). Applying the decision of Austin J in Cresvale Far East Ltd (in liq) v Cresvale Securities Ltd (2001) 37 ACSR 394, His Honour was of the opinion that to prefer a deed of company arrangement in this case was to remove "the possibility of proper investigation" of certain transactions.

Pagone J emphasised that there were many transactions that should be, but have not been, investigated which may potentially provide a better return to the creditors than under the deed of arrangement. It was held that it would be unfair if a significant creditor, such as Bamco, was not given the benefit of proper investigation recommended by an impartial administrator.

It was recognised by the Court that there are cases where the views of the majority of creditors should be preferred to those of the minority (however large in value or however great in percentage the minority creditors might be) but this was not considered to be such case.

One of the factors that His Honour took into account in arriving at his decision was the fact that on the evidence, there was an indication of a predisposition by some creditors against the adoption, or even consideration of, a measured and considered position that might be of greater benefit to all creditors.

His Honour noted that a different conclusion might have been reached if the creditors had, as between themselves, debated their competing interests and different views over a period of time and had thereby come to be informed about each others' interests and position.

(b) Section 445D(1)(f) - oppression or unfair prejudice

Pagone J also accepted the submissions on behalf of Bamco that the deed of arrangement would be oppressive or unfairly prejudicial to, or unfairly discriminatory against, Bamco, or contrary to the interests of the creditors of Montedeen as a whole.

The oppression, unfair prejudice, unfair discrimination, or the act or omission contrary to the interests of the creditors of Montedeen as a whole, was found to be not in the circumstance that Bamco may have received payment of only a fraction (25%) its debt. Rather, in this case, it was found to lie in the adoption of a deed of arrangement without a proper consideration by the creditors of all that should properly and fairly be considered both in their own interests and in the interests of each other.

(c) Section 445D(1)(g) - other reason

His Honour was of the opinion that the deed of arrangement was entered into to effect a purpose contrary to the purposes which the statutory provisions are designed to achieve through deeds of arrangement.

It was held that the deed of arrangement should be terminated because its soundness and reasonableness is fundamentally impaired and flawed by poorly considered decisions in disregard of the reasonable and sound recommendations from the impartial administrator.

His Honour thought that it may be undesirable for him to express concluded views about some of the matters because not all matters were fully explored in the evidence and, in any event, were matters for the administrator or liquidator to consider after full and proper investigation. These matters included contentions that Montedeen was insolvent and the arguments concerning the debts due.

(d) Section 447A - orders

Montedeen argued that the deed of arrangement should not be terminated because Bamco is not in a position to fund a liquidator to conduct investigations into potentially voidable transactions. Pagone J thought that this fact, and the course of litigation between the parties, were both matters which were relevant to whether the deed of arrangement should be terminated. Against them, however, were such facts as the commercial determination by Bamco to pursue its entitlements and the existence of a large debt payable to Montedeen in 2004 and 2005.

Therefore, it was ordered that the deed of arrangement be terminated.

(E) MATERIALLY PREJUDICING CREDITORS BY CHANGE OF COMPANY TYPE  
(By Simon Rear, [Corrs Chambers Westgarth](http://www.corrs.com.au))

Neato Employment Services v Australian Securities and Investments Commission [2002] AAT 429, Administrative Appeals Tribunal, the Hon C R Wright QC, 6 June 2002.

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/aata/2002/june/2002aata429.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

This case illustrates the factors that will be taken into account when determining whether a company's creditors are likely to be materially prejudiced when the company changes from a company limited by guarantee to a company limited by shares.

(1) The facts

On 9 April 2001 NEATO Employment Services Limited ("NEATO") lodged an application with the Australian Securities and Investments Commission ("ASIC") to change the company's type from a company limited by guarantee to a company limited by shares. The members of NEATO had passed a special resolution proposing that each of the members, who were all guarantors of the company, would be issued with shares if the company changed in status.

The Department of Employment, Workplace Relations and Small Business ("DEWRSB") (now the Department of Employment and Workplace Relations) is a creditor of NEATO pursuant to a long-term contract ("Contract"). Under the Contract NEATO provided training and securing of employment for unemployed people.

When DEWRSB became aware of NEATO's proposal to change company type, the Minister for Employment Services wrote a letter to ASIC objecting to the change because it may put NEATO's business at risk and alter the company's ability to meet its obligations under the Contract.

On 19 July 2001 ASIC refused to change the status of NEATO because ASIC was not satisfied that the company's creditors were not likely to be materially prejudiced.

NEATO applied to the Administrative Appeals Tribunal for a review of ASIC's decision.

(2) Section 164 Corporations Act 2001 - creditors not to be materially prejudiced

Section 164 of the Corporations Act 2001 provides that ASIC must give notice that it intends to alter the details of the company's registration, provided ASIC is satisfied that:

(a) the application complies with section 163; and

(b) the company's creditors are not likely to be materially prejudiced by the change.

(3) The decision

The Tribunal concluded, with ease, that NEATO's application for review should succeed and the application to change the company type be remitted to ASIC to give effect to the change. The change of status by NEATO to a company limited by shares was not likely to materially prejudice the company's creditors.

In determining whether the company's creditors are not likely to be materially prejudiced by the change, the Tribunal examined the financial status of the company. The evidence of NEATO's auditor and the Managing Director was almost undisputed and indicated that NEATO was in a strong financial position to pay all debts and to trade profitably in the future. The company had substantial cash reserves and had shown substantial profit increases in previous years.

The Tribunal stated that the phrase "material prejudice" must be prejudice which is "substantial and not trifling".

(F) SUMMARY JUDGMENT - ASSIGNMENT OF CONTRACT  
(By Simon Rear, [Corrs Chambers Westgarth](http://www.corrs.com.au))

Vangale Pty Ltd (in liq) v Kumagai Gumi Co Ltd [2002] QSC 137, Supreme Court of Queensland, Mullins J, 17 May 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/qld/2002/may/2002qsc137.html> or <http://cclsr.law.unimelb.edu.au/judgments/>

This is a decision of Mullins J relating to an interlocutory application by Kumagai Gumi Co Ltd ("Kumagai"), the defendant in proceedings between Starelec (Qld) Pty Ltd (in liquidation) ("Starelec"), as first plaintiff, Vangale Pty Ltd (in liquidation) ("Vangale"), as second plaintiff, and Kumagai. Kumagai sought to strike out Vangale's pleadings pursuant to Rule 171 of the Uniform Civil Procedure Rules ("UCPR") of Queensland and applied to have summary judgment entered in its favour pursuant to Rule 293 UCPR.

(1) The facts

Kumagai was engaged as project manager for the development of the Royal Pines Resort situated at Ashmore on the Gold Coast. Kumagai engaged Thiess Watkins White ("TWW") as the head contractor. A written subcontract dated 23 November 1989 ("the Subcontract") was entered into by TWW and Starelec which provided for TWW to engage Starelec as subcontractor to carry out electrical service works for the development. On 14 May 1990 Starelec gave a fixed and floating charge to Natwest Australia Bank Ltd ("Natwest") over all of its undertaking and assets both present and future. In May 1990 a receiver was appointed to TWW.

On 30 May 1990 Starelec and Kumagai entered into an agreement in relation to the completion of the electrical services which were subject to the Subcontract between TWW and Starelec. By letter dated 28 June 1990 the applicant gave notice to Starelec that the receiver of TWW had executed a formal assignment of the benefit of the Subcontract between TWW and Starelec to Kumagai. Starelec completed the electrical service works in November 1990.

By 24 April 1991 Natwest had crystallised the floating charge over Starelec's assets. Starelec was ordered to be wound up on 31 May 1991. Vangale was registered as a company on 3 June 1993. Natwest assigned its rights under the charge to the respondent in consideration of the payment of $20,000.00 by deed dated 14 September 1993. Notice of the assignment of the charge to Vangale was given to Kumagai in or around 1995.

The proceedings were commenced on 12 April 1996. On 1 April 1999 Vangale went into voluntary liquidation pursuant to resolution of its directors. A statement of claim was filed in the main proceedings on 1 October 1999. Starelec's claim against Kumagai was dismissed by the consent of Starelec and Kumagai on 27 July 2000.

(2) The application

In the proceedings, Vangale claimed against Kumagai as the assignee of Natwest. The application by Kumagai raised the issue of whether the charge, upon crystallisation, conferred rights on Natwest to pursue Starelec's rights of action in contract, tort and a quantum meruit against Kumagai by bringing proceedings in its own name. Kumagai's primary argument is that under clause 32 of the Subcontract, which requires the subcontractor to receive written consent from the builder before assigning the contract, the assignment by Starelec of the benefit of the Subcontract to Natwest was ineffective because it was prohibited by clause 32.  
Clause 4.1 of the charge provided that Starelec charged to Natwest all its estate and interest in the mortgaged property which was all its undertaking and assets, both present and future. Prior to crystallisation of the charge, Starelec's interests under any rights of action accruing from the Subcontract were the subject of the floating charge. Mullins J, in his judgment, provides a brief summary of the nature and interests of a charge prior to and after crystallisation. He states that "although it is clear that the equitable proprietary interest of the chargee takes effect on crystallisation, what is not clear is the true nature of the equitable proprietary interest which arises upon crystallisation".

Mullins J found it unnecessary to determine the true construction of the charge and resolve this issue as he found against Kumagai upon different reasons, which are stated below. For Kumagai's argument based on clause 32 of the Subcontract to succeed, it is imperative that the charge operate as an equitable assignment of the property charge.

It is also noted that the copy of the charge that was exhibited in evidence contained many   
illegible parts and it was not possible for the court, if it had been required, to reach a conclusion about the nature of the rights conferred by the charge on Natwest.

(3) Incorporation of Clause 32 of the subcontract

For Kumagai's application to enter judgment in its favour to succeed, there would need to be no issue at trial as to whether or not clause 32 of the Subcontract was incorporated into the contract between Starelec and Kumagai. Kumagai argued that on the construction of the contents of its letter dated 30 May 1990, Kumagai contracted with Starelec on the basis of the Subcontract which would necessarily incorporate clause 32. Vangale asserted that this contract between Starelec and Kumagai was of limited terms and only incorporated those terms of the Subcontract that were expressly provided for in the letter dated 30 May 1990. Mullins J found that although the construction of the letter proffered by Vangale was not appealing, it was not untenable and could be affected by any admissible extrinsic evidence relating to the making of the contract. The onus on showing that there was no evidence relevant to determining the basis of the contract was on Kumagai.

Mullins J found that Kumagai had not satisfied the onus of showing that clause 32 of the Subcontract had been incorporated into the Subcontract. Due to this finding, it was unnecessary for the Court to decide Kumagai's primary argument that clause 32 of the Subcontract prohibited the assignment of the benefit of the Subcontract to the assignee of Natwest, Vangale.

Mullins J, however, provided some brief observations on the matter. He referred to the decision of the House of Lords in Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd [1994] 1 AC 85 ("Linden Gardens"). Lord Browne-Wilkinson provided the leading judgment in Linden Gardens and concluded that the clause in the building contract which required consent in order to assign the contract prohibited the assignment of the benefit of the contract.

Even if clause 32 of the Subcontract did apply to the contract between Starelec and Kumagai in terms that required Kumagai to consent to an assignment of the Subcontract by Starelec, there are timing issues in relation to granting of the charge and the making of the contract. The charge was granted with effect from 14 May 1990 prior to the making of the contract between Starelec and Kumagai on 30 May 1990. An issue that would also require resolution is whether the charge amounted to an assignment for the purpose of clause 32 of the Subcontract.

(4) Assignability of claim for damages and negligence

Kumagai argued that Vangale could not sue in negligence as the right to sue for damages in tort is always regarded as a bare right of action, not property, and therefore not assignable. A qualification to this rule is that the action may be assigned in circumstances where the assignee has a genuine substantial interest or a genuine commercial interest in maintaining the cause of action. Vangale was a shelf company used for the purpose of acquiring from Natwest the rights of action of Starelec against Kumagai. Vangale acquired the charge as trustee of a family trust, where the intention of that family was to recover any moneys payable by Kumagai and ultimately distribute the benefit of those moneys to the family. Therefore, the court concluded that there was factual material relevant to showing a genuine commercial interest on the part of Vangale in pursuing Starelec's claims against the applicant.

(5) Conclusion

Mullins J dismissed Kumagai's application as the issues confronted by the case could not be disposed of on a summary basis as against Vangale.

This decision illustrates that there must be no need for a trial of the issues in order to have summary judgment entered in favour of the defendant. The case is riddled with unresolved issues that would require further investigation and finding by the court.

(G) PAYMENTS MADE BY AN INSOLVENT COMPANY TO THE COMMISSIONER OF TAXATION HELD TO BE AN UNFAIR PREFERENCE  
(By Nghi Tran, [Phillips Fox](http://www.phillipsfox.com))

Schmierer v The Commissioner of Taxation [2002] QSC 133, Supreme Court of Queensland, Chesterman J, 29 April 2002.

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/qld/2002/may/2002qsc133.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

The plaintiff was the liquidator (and formerly the administrator) of Gonund Pty Ltd (in liquidation) ('the company'). The company carried on the business of hiring out cranes to building contractors. The liquidator sought to recover from the defendant ('the Commissioner') certain payments made to the Commissioner by the company on the basis that each payment was an unfair preference.

(1) What was the debt owing to the Commissioner?

From 1 April 1998 until liquidation the company was registered as a group employer under Division 2 of Part VI of the Income Tax Assessment Act 1936 and as an eligible paying authority pursuant to Division 3A of the same Act. Consequently, the company was obliged to make deductions from salaries and wages paid to employees and from prescribed payments made to subcontractors and to remit the total of the deductions to the Commissioner within 21 days after the end of the month in which the deductions were made.

The company had difficulties meeting its obligations to the Commissioner. It did, however, make 4 payments which were the subject of the present application. The liquidator sought to recover from the Commissioner the total of the payments pursuant to section 588FF of the Corporations Act ('the Act') on the ground that each payment was an unfair preference as defined by section 588FA.

(2) Was the company insolvent when the payments were made?

For the purposes of the liquidation the relation-back day was 1 May 1999. Chesterman J outlined the evidence that supported the conclusion that the company was insolvent from at least 1 May 1999. First, the ratio of its current assets to current liabilities stood at 0.35 in January and decreased during the year. This meant that its liabilities were three times greater than its assets. Secondly, it had a deficiency of working capital on 31 January 1999 of just over $100,000 and by 31 October the deficiency stood at $491,668. Over the same period the deficiency of assets over liabilities increased from ($72,155) to ($471,393). From April 1999 the company neither had income nor capital with which to pay its debts. The four payments in question were made to the Commissioner in May and June 1999.

(3) Could the Commissioner come within the defence provided by section 588FG?

Broadly speaking, section 588FG(2) of the Act ensures that a transaction will not be voidable against a person if (a) the person entered the transaction in good faith, and (b) at the time when the person became such a party, the person had no reasonable grounds for suspecting that the company was insolvent, and a reasonable person in the circumstances would have had no such grounds for so suspecting, and (c) the person has provided valuable consideration. Sections 588FG(3) to (5) provide, in essence, that where payments said to be unfair preferences were made to the Commissioner to reduce a liability to pay tax the reduction is deemed to be valuable consideration.

A key issue was therefore whether the Commissioner had no reasonable grounds for suspecting that the company was insolvent. To determine the meaning of 'suspect', Chesterman J referred to the much cited passage of Kitto J in Queensland Bacon Pty Ltd v Rees (1965-1966) 115 CLR 266 at 303: 'A suspicion that something exists is more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to 'a slight opinion, but without sufficient evidence'.'

On the basis of the evidence, Chesterman J concluded that the Commissioner must have had an apprehension or fear that the company could not pay its debts as they fell due. In February and March an officer of the Commissioner was told expressly that the company could not pay it debts because it did not have the money and that it would not be able to pay unless it could borrow a sufficient sum from its bank.

In late March 1999, the company informed the Commissioner that the negotiations with the bank were continuing, which obviously meant that no facility had been obtained. In April, the Commissioner was told that the company would not know until mid-June whether it had succeeded in 'refinancing' and in the mean time the company requested an arrangement by which, for 2 months, the company would pay debts which fell due in that period.

Chesterman J noted that the 4 payments in question were made in May and June, possibly pursuant to that proposed arrangement. Also, by the end of June the Commissioner knew that the bank advance had not materialised. Chesterman J held that the Commissioner therefore had reasonable grounds for suspecting that the company was insolvent and a reasonable person in its circumstances would certainly have entertained the suspicion.

(4) Did the Commissioner obtain a preference as a result of the payments?

The Commissioner sought to assimilate his position to that of a trade creditor who conducts a 'running account' with a customer who ultimately becomes insolvent. The Commissioner submitted that the impugned payments were of the same character as payments made on a running account in return for the supply of further goods or services and therefore could not be regarded as preferences.

The Commissioner relied heavily upon the decision in Airservices Australia v Ferrier (1996) 185 CLR 483. Chesterman J, upon consideration of the majority judgment in that case, concluded that the Commissioner's submission was misconceived. His Honour stated that the reason why payments on a running account are not ordinarily preferences is that they are made in return for the supply of further goods and services which are of value to the payer. There is no net benefit to the payee by reason of the payment - it has parted with goods or services to the value of the payment.

Chesterman J quoted from the majority judgement in Airservices Australia v Ferrier as follows: 'If the sole purpose of the payment is to discharge existing debt, the effect of the payment is to give the creditor a preference over others ... if the purpose of the payment is to induce the creditor to provide further goods or services as well as to discharge an existing indebtedness, the payment will not be a preference unless the payment exceeds the value of the goods or services acquired ... Thus, a debtor does not prefer a creditor to other creditors if he or she pays a debt, or part of it, to induce the creditor to supply goods of equal or greater value than the amount of the payment.'

Chesterman J stated that where there is an ongoing relationship between traders and payments are made and goods are supplied then it may be appropriate to conclude that the payment was made in return for something of equal value. His Honour held that the immediate problem for the Commissioner was that it was not a provider of goods or services and that by no stretch of the imagination could it be said that the company made the payment to obtain goods or services essential to the conduct of its business. Nor did sections 588FG(3) to (5) assist the Commissioner. Chesterman J stated that those sections merely overcome the difficulty that otherwise the defence provided by section 588FG could not apply to the Commissioner. The sections did not convert the Commissioner into a supplier of goods and services.

Chesterman J held that the payments were unfair preferences. The Commissioner was ordered to pay the liquidator an amount equal to the 4 payments in question together with simple interest at 10 per cent from the date of each preference payment until the date of judgment.

In anticipation of the result the Commissioner had already issued third party notices against the directors of the company pursuant to section 588FGA of the Act. Under that section, where the Commissioner is ordered to disgorge to the liquidator, any director in office when the Commissioner was paid may be ordered to indemnify the Commissioner.

(H) EXTERNAL ADMINISTRATION: SCOPE OF COURT'S POWER TO SUMMON FOR EXAMINATION  
(By Tammy Kingsley, [Phillips Fox](http://www.phillipsfox.com))

Boys v Peter Raymond Quigley (as receiver and manager of Geneva Finance Ltd) [2002] WASCA 99, Supreme Court of Western Australia, Full Court, Wallwork, Murray and Anderson JJ, 8 April 2002

The full text of the judgment is available at:

<http://cclsr.law.unimelb.edu.au/judgments/states/wa/2002/april/2002wasca99.htm> or <http://cclsr.law.unimelb.edu.au/judgments/>

(1) Background

Under section 586A (mandatory examination) of the Corporations Act 2001 ('the Act'), the Court is to summon a person for examination about a corporation's 'examinable affairs' if an 'eligible applicant' (as defined) applies for the summons and the Court is satisfied that the person is an 'examinable officer' of the corporation or was such an officer during the relevant period.

Further, under section 596B of the Act (discretionary examination) the Court may summon a person for examination about a corporation's examinable affairs if an eligible applicant makes the summons and the Court is satisfied that the person has taken part or been concerned in the corporation's examinable affairs and has or may have been guilty of misconduct in relation to the corporation, or may be able to give information about the corporation's examinable affairs.

This case was an appeal from a decision by Master Sanderson refusing to discharge 6 summonses for the appellants to be examined about the affairs of Geneva Finance Ltd ('Geneva'), pursuant to section 596B of the Act. The appellants were former partners of an accounting firm who were the auditors of Geneva. Geneva had instituted proceedings against the appellants claiming damages for negligence in the discharge of their auditor's duties.

The application for the issue of the examination summonses was made by the respondent in this appeal, Mr Quigley. Mr Quigley, the receiver and manager of Geneva, was appointed by the trustee of a debenture deed under which the company had issued $30,000,000 worth of debenture stock. Mr Quigley applied for the issue of the examination summonses because he suspected that the appellant's insurers were 'involved' with the HIH group, raising the risk that that the appellant's insurance arrangements and own financial resources might be insufficient to justify continuation of the damages claim.

(2) Subject-matter of order for examination

Broadly speaking, the summonses ordered each appellant to produce at the examination the following, (in many cases the key date being 26 July 1990, which was the date that Mr Quigley was appointed):

(a) all relevant professional indemnity insurance policies and any related endorsements,

(b) all correspondence between each appellant and their professional insurer or broker;

(c) all documents relating to each asset including land, house, contents, motor vehicles, shares or other property in each appellant's possession, custody or power or which they own, owned or have an interest in ('Assets');

(d) certain valuations or appraisals, and related correspondence in any way relating to the Assets;

(e) any agreements, correspondence and/or notes of any communication to any bank, financier or other lender evidencing any pledging, charging, granting of any form of security over any of the Assets or evidence of the terms upon which an appellant had granted a personal guarantee or indemnity to any third person or entity;

(f) all tax returns prepared and/or lodged by each appellant or on their behalf;

(g) all statements of financial position prepared by each appellant or on their behalf;

(h) all documents evidencing the nature and extent of the legal or beneficial interest held by each appellant in each and every company or trust which they have or have had any legal or beneficial interest; and

(i) all bank statements recording the balance of any account maintained by each appellant and/or any relevant company or trust.

The appellants applied for an order discharging the examination summonses. Master Sanderson refused to discharge the summonses, but reduced the scope of documents to be produced. The appellants appealed against Master Sanderson's order, and argued in the alternative that the scope of examination remained too wide. The respondent cross-appealed, arguing that Master Sanderson's order unduly reduced the range of documents.  
In this case, Anderson J provided the leading judgement with which Wallwork J concurred. Murray J also agreed with Anderson J, but made some additional comments on the information put before Master Sanderson as well as the scope of sections 596A and 596B of the Act.

(3) Grounds for a court to summons a party for examination under Part 5.9, Division 1 (sections 596A-597B)

Anderson J observed that as auditors do not fall within the definition of 'examinable officer' in section 596A of the Act, the application for their examination comes under the Court's discretion to summon for examination under section 596B. Mr Quigley was an 'eligible applicant for the purposes of sections 9 and 596B(1)(a) of the Act as he was authorised in writing by ASIC to make the application.

His Honour also noted that there is no provision in the Act to set aside an examination summons which has been issued pursuant to an order made under sections 596A or 596B. However, the Supreme Court is authorised by section 1337T(1) of the Act to make rules of court with respect to proceedings. One such rule is O81G r69, which allows a person served with an examination summons to apply to the Court within 3 days of service for an order to discharge the summons.

(4) Discharge of an examination summons

It is within the purposes of section 596B to conduct an examination to determine the amount likely to be recovered in actions by the company for breach of duty.

Anderson J observed that although initially it might seem strange that the personal financial resources and insurance arrangement of auditors are 'examinable affairs', it is of benefit to the receiver and manager to know what amount is likely to be recovered in an action for the auditor's breach of duty. The appellants did not dispute this construction of section 596B, but rather argued that the public interest considerations which may compel the exercise of the Court's discretion to order examination under that section are more pressing in the case of liquidators acting in the 'public interest', as opposed to receivers and managers who are privately appointed to realise the company's assets for the benefit of a specific group.

Anderson J disagreed that the Court, in exercising a discretion under section 596B, should take a different approach to applications made by privately appointed receivers and managers, except to the extent that the Court should ensure that receivers and managers, who are not completely independent (as opposed to liquidators) do not make an application under s.596B that is oppressive, vexatious or for an improper purpose.

Anderson J held that there may be just as significant public interest considerations in the effective enforcement of securities issued by corporations as in the winding up of corporations. Debenture holders may exceed unsecured creditors, both in number and value, and will not necessarily be better able to withstand a loss than unsecured creditors of the same corporation. His Honour also noted that there is a public interest in protecting the interests of creditors who provide finance to corporations even if the receiver or manager in question pursues the company's choses in action primarily for the benefit of only one group of creditors.

Anderson J stated that the Court must ensure that the purposes intended to be secured by the legislation must be complied with when it exercises its discretion when considering powers of examination sought by the respondent. His Honour quoted Hayne J in New Zealand Steel (Australia) Pty Ltd v Burton (1994) 13 ACSR 610 stating that if the Court saw that the process was being used vexatiously, oppressively or for a private purpose it may decline to make an order or discharge the summons. Seeking information to enable a receiver or manager to decide whether to continue to attempt to realise an asset, however, would be a legitimate purpose providing the scope of examination is scrutinised by the Court.

Murray J concurred with Anderson J, also quoting Hayne J in New Zealand Steel (Australia) Pty Ltd v Burton. Providing the process of the examination is not used for a purpose foreign to which it was conferred by the legislation, examination should be allowed. This test overrides any 'vague notion of fairness' and would allow, for example, a creditor that has applied for an order for examination to obtain an 'unfair advantage' by gaining access to documents he or she would not otherwise be able to obtain from the interlocutory process, as long as the power was not being used for a purpose foreign to the purpose conferred by the legislation.

(5) Amending the scope of examination

Master Sanderson had discharged the summonses insofar as they required the appellants to produce documents relating to their personal financial capacity and limited the production of insurance-related correspondence by reference to a commencing date of 1 January 2001.

The order still allowed the respondent to question the appellants on their financial affairs and the existence and contents of documents concerning their financial affairs, even though they did not have to produce those documents. Anderson J held that the personal financial condition of the appellants was a legitimate field of inquiry in light of the intended purpose of the examination. His Honour therefore disallowed the appeal on that point.

In addition Anderson J partially upheld the respondent's cross-appeal, namely that Master Sanderson had unduly circumscribed the scope of the examination. His Honour reinstated the order relating to the production of the appellant's insurance correspondence, and extended the relevant time period back to 26 July 1990. However, in keeping with the appellants' submission, the scope of such documents was restricted to written communications from an insurer or broker to an appellant concerning limits to policy cover, policy conditions and denials of liability under such policies, including grounds for such denial.

Anderson J observed that it was not oppressive or inappropriate for the respondent to seek personal financial information from the appellants to enable him to assess the appellants' capacity to satisfy a judgment for damages. However, His Honour concurred with Master Sanderson that the production of personal financial information for examination was framed too widely and therefore discharged the summonses to the extent they contained points (2)(c) to (i) outlined above.

The respondent had prepared an amended form of order which Anderson J found to be uncertain and oppressive on its face and dismissed the cross-appeal insofar as it related to those paragraphs of the summonses. However, Anderson J permitted the respondent to make submissions to the Court so as to settle the form of the orders which would enable the respondent to fairly examine the appellants as to their personal means.

Anderson J proposed a draft example of such a non-oppressive requirement, which Murray J approved. Although Murray J would have also sought to limit the breadth of the general requirement in point (2)(a) regarding the 'examinable affairs of Geneva', His Honour accepted that Anderson J's order would provide guidance to the Registrar as to the appropriateness of questions to be asked, and that that was the most convenient way of limiting the scope of inquiry into the examinable affairs of the corporation. His Honour also noted that he would prefer points (2)(c) to (i) to be defined more particularly.

Given the private nature of the information being sought, Anderson J ordered the examination to be conducted in private under section 597(4) of the Act and that the respondent provide appropriate undertakings as to confidentiality. Murray J concurred with Anderson J on the making of these orders.

(I) POISON PILLS ARE TOO HARD TO SWALLOW  
(By Jon Skene, Solicitor, [Clayton Utz Lawyers](http://www.claytonutz.com))

Criterion Properties Plc v Stratford UK Properties LLC [2002] EWHC 496, High Court (Chancery Division) (England), Hart J, 27 March 2002

The full text of the judgment is available at:

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This decision deals with the issue of Poison Pills as a takeover defence strategy.

(1) Background

Criterion Properties Plc ("Criterion") was a property investment manager which had entered into a Limited Partnership with Stratford UK Properties LLC ("Oaktree"), a subsidiary of Oaktree Capital Management LLC. The companies entered into an Investment and Shareholders Agreement (the "ISA"), which established and regulated the activities of Criterion-Stratford Umbrella GP Limited (the "General Partner"). At the date of the ISA, 150 of the General Partners' issued shares were registered in the name of Criterion and the remaining 850 shares were issued and allotted to Oaktree. The ISA was made on 26 January 1998.

By March 2000, Criterion had learned that certain parties were acquiring a substantial number of Criterion shares, and was thus concerned at the possibility of a hostile takeover. Oaktree was also concerned about the possibility of a change in control of Criterion jeopardising the close personal working relationship of Oaktree with the management of Criterion.

By agreement dated 30 March 2000, the parties agreed to vary the ISA to the effect that if either:

- there was a change of control of Criterion; or  
- the managing director or the chairman of Criterion ceased to be either directors or employees or involved in the management of Criterion,

then Oaktree would have the right to be bought out of the partnership at the new price of Oaktree's investment in the partnership plus 25% per annum on that investment compounded monthly. The variation of the ISA was agreed to in order to put in place a strong disincentive to any person seeking to take control of Criterion.

However, the takeover bid never eventuated, and in late 2000 Criterion unsuccessfully sought Oaktree's agreement to a rescission of the variation of the ISA. In April 2001 Criterion's Managing Director was dismissed. In June 2001 Oaktree served a Put Notice on Criterion under the terms of the ISA (as varied), requiring Criterion to buy all the Oaktree shares at the amended Sale Price, relying on the dismissal of the managing director as the triggering event for the Put Notice.

Criterion commenced proceedings to set aside the variation of the ISA. Both Oaktree and Criterion subsequently applied for summary judgment.

(2) The arguments

Hart J held that the critical issue to be determined before the matter was allowed to go to trial was whether Oaktree had any realistic prospect of succeeding at trial, in view of Criterion's claim that the purpose of the variation of the ISA was an improper one on the part of Criterion's board, that Oaktree was on notice of the improper purpose, and that the agreement was in excess of the actual and ostensible authority of the members of Criterion's board.

The evidence accepted by the court was that, at the time the variation to the ISA was agreed to, Criterion's managing director held the view that:

- behind the potential bidder were disreputable persons with whom it would not be in the interests of Criterion to become closely associated;  
- the potential bidder's objective would be to wind up Criterion's business and liquidate the company (a suggestion supported by the potential bidder's past record);  
- Criterion ought to adopt a device (such as a rights issue or the creation of a "poison pill") to thwart the potential bidder's attempt to obtain control of Criterion;  
- the first limb of the trigger for the poison pill (change of control) would be the primary deterrent whilst the second limb (removal of chairman or managing director) would reinforce the first limb and also provide a rationale for the variation, namely to ensure continuity and stability in the ownership and management of the company with whom Oaktree had entered into partnership;  
- the poison pill was in the best interests of Criterion because it would act as a deterrent to the potential bidder (given the concerns about the potential bidder mentioned above) and, although it subjected Criterion to an additional financial obligation, the obligation would never be triggered in practice because the whole purpose and effect of the poison pill was to prevent the occurrence of the triggering event (ie change of control of Criterion or removal of the managing director or chairman);  
- the poison pill might also assist the chairman to acquire the shareholding of the potential bidder and thereby acquire a majority shareholding in Criterion, but this would also be in the interests of Criterion as it would eliminate any further threat from the potential bidder; and  
- the poison pill did not have as any part of its purpose the objective of keeping either the managing director or the chairman in office.

It was thus submitted that the motivation revealed by this evidence meant that the variation of the ISA was at least capable of being regarded as a proper exercise by the Criterion board of its powers (a final conclusion not being possible without a trial).

(3) The purpose of the pill

The Court did not agree. It drew a distinction between case law that gave a wide latitude to directors to defeat hostile takeover offers by means of the issue of shares (eg. Howard Smith Ltd v Ampol Petroleum Limited [1974] AC 821) and attempts to deter a takeover offer by a contingent transfer of value away from the target company, as would occur were the variation to the ISA to be enforced.

Hart J felt himself left with the bare question of whether the granting of the put option with the revised Sale Price could in any circumstances be justified by the desire to deter a predator whom the Criterion directors bona fide believed to be unsavoury. If the matter was simply one of degree then the matter would have to go to trial. However, Hart J held that the logic of the variation to the ISA must be that the result of the poison pill was that its effect on Criterion would in fact have been more damaging than the effect on Criterion of the acquisition of control by an unwanted predator. If that was not the effect of the poison pill, it would fail to have the deterrent effect on the predator which it was professedly designed to have. As a result, entry into the poison pill agreement could not possibly be justified as a proper exercise by the Criterion board of its powers. (Hart J noted that his decision said nothing about the validity of such a clause were it to have been originally included as one of the negotiated terms of the ISA.)

(4) Oaktree's knowledge

The question that followed from this conclusion was whether Oaktree knew or should be taken to have known that the board of Criterion was acting in excess of its authority.

It was suggested that Oaktree's ability to rely on the apparent authority of the Criterion board depended, not on a test of whether or not it had notice of the facts which constituted the breach of duty, but on whether it was unconscionable in all the circumstances for Criterion to have relied on that authority.

Drawing upon the "knowing receipt" constructive trust cases, it was held that the recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt. Therefore actual knowledge of circumstances which make the payment a misapplication is sufficient to bind the conscience of the recipient. According to the decision, it was plain for all to see that the variation to the ISA was motivated, not by a desire to advance or protect the commercial interests of Criterion, but by a desire contingently to cripple those interests so as to deter an unwanted predator. As there could be no circumstances in which that was a legitimate exercise by the Criterion board of its powers, the question of Oaktree being faced with the dilemma of not knowing whether or not the board's powers were exercised for a proper motive could not arise. As Oaktree knew what the motives were, it was irrelevant that neither it nor its lawyers perceived those motives to be a vitiating factor.

Thus summary judgment was granted in favour of Criterion and the poison pill was set aside.

(5) Comment

This case provides an interesting development in the common law as to defensive takeover strategies, which is nowadays something of a rarity given that these issues would usually be dealt with by the takeovers panel in either Australia or the UK.

It is interesting that summary judgment was given based upon the principle that, as a matter of law, the detriment caused by a poison pill designed to deter a takeover predator by contingently transferring value away from the target company cannot in any circumstances be outweighed by any potential benefit gained by deterring the predator. Hence it cannot be in the interests of the company and will thus be an improper exercise of the powers of the board of directors.

The submission that the poison pill was in the interests of the company (and hence enforceable as a proper exercise of the directors' powers) as it would deter predators and hence would never be triggered, was always a rather circular argument, effectively asking the court to enforce a poison pill because the directors reasonably believed that the poison pill would never be enforced.

However, the weakness of the decision is its treatment of a contingent transfer of value as being the same as an actual transfer of value, when there was only a chance (perhaps quite small) that the contingency would occur. Applying a different analysis, it seems arguable that directors are entitled to take risks with company property in the interests of the company, and that the business judgment for the Criterion directors was to calculate and weigh the detrimental value of the poison pill (perhaps by multiplying the cost of the poison pill being enforced with the perceived low chance of that contingency occurring) against the beneficial value of the poison pill (perhaps by multiplying the value of deterring the predator with the perceived high chance of the contingency not occurring). On this analysis there would seem to have been at least a triable issue as to whether the poison pill was a proper exercise of power.

Regardless of the correctness of the analysis, however, the decision is pleasing for providing a clear guideline as to the validity of these types of poison pills, in comparison to the rather obscure distinctions drawn at common law when considering the purposes of directors who issue shares as a defensive takeover strategy.

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7. RECENT CORPORATE LAW JOURNAL ARTICLES

S Haddy, 'A Comparative Analysis of Directors' Duties in a Range of Corporate Group Structures' (2002) 20 Company and Securities Law Journal 138

The scope and nature of directors' duties is a central aspect of the regulation of corporate groups, yet it is an area where regulation is surprisingly vague and piecemeal. This article analyses the law of directors' duties in corporate groups by firstly focusing on the "pure" scenario of the wholly-owned subsidiary, before going on to apply these core principles to a range of other group structures - namely, the partly-owned subsidiary, the targeted share company, and the dual listed company. The article concludes that, while the application of the principles of directors' duties to corporate groups may be somewhat unsatisfactory in the wholly-owned subsidiary scenario, the application of these principles to other group structures can be even more problematic, given the deficiencies in both clarity and consistency that are encountered.

G Williams, 'Cooperative Federalism and the Revival of the Corporations Law: Wakim and Beyond' (2002) 20 Company and Securities Law Journal 160

The decisions of the High Court in Re Wakim and R v Hughes undermined the viability of the Corporations Law. They also had a wider impact in re-asserting a more fragmented vision of Australia's federal system. The referral of power by the States to the Commonwealth was effective in "fixing" the Corporations Law by replacing it with the Corporations Act. However, it was no more than a stop-gap measure. It did nothing to remedy the fact that the Constitution, as interpreted by the High Court, no longer provides an adequate framework for federal-State cooperation on national legislative schemes. This article proposes a long-term constitutional solution to both the Corporations Law and wider problems.

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