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| **1. Recent Corporate Law and Corporate Governance Developments** |
| **1.1 Costs of regulation** The amount and complexity of new regulation imposed on Australian business and the general community far outstripped the benefits and would damage the economy if left unchecked, according to a new report released on 23 May 2005 by the Business Council of Australia. Releasing its Business Regulation Action Plan, the BCA has found that the level of new laws and regulation is now growing at 10 per cent a year – three times as fast as Australia’s rate of economic growth. The BCA’s Regulation Action Plan quantifies the amount and cost of regulation on large and small business and outlines solutions to curtail the tide of Government red tape. It has found the problem of escalating regulation is occurring Australia-wide.This regulatory blow-out is also a major drain on public as well as business resources, with the costs to Governments of administering their own rules and regulations running into billions of dollars a year.For example:* The Commonwealth and State Parliaments added 33,000 pages in new laws, rules and regulations in 2003.
* Two thirds of all Acts passed by the Commonwealth last year affected business, large and small.
* The NSW Parliament produces on average 300 pages of new laws, rules, regulations and by-laws each week it sits.
* Queensland added 8,700 pages of new laws and rules in 2003 alone.
* In Victoria, there are 69 State business regulators controlling 26,000 pages of regulation.
* On average, the Commonwealth Parliament now passes 350 pages of new laws every week it sits. (Half of all legislation passed by the Commonwealth Parliament since Federation has been passed in just the last 14 years).
* The Commonwealth Government alone spends around $5 billion a year of taxpayer funds on administering business regulation.

To address the regulation problem, the BCA’s report recommends that Governments at the Federal, State and Local levels: * fix the systems that currently create regulation, making sure that all new regulation fully takes account of costs to business, avoids overlap and duplication with existing red tape and is subject to regular review;
* clean up the stock of existing regulation to improve or eliminate unnecessary, duplicate and outdated regulation; and
* tackle the overall problem of overlap and lack of coordination between the Commonwealth and States, and between States themselves.

The report is available on the Business Council [website](http://www.bca.com.au" \t "_new).**1.2 Performance-related departures of CEOs reached record levels in 2004** CEO dismissals and other forced departures reached record levels last year, according to the fourth annual survey of CEO turnover at the world's 2,500 largest publicly traded corporations. The study, by Booz Allen Hamilton, was released on 18 May 2005. The study also found that boards of directors in North America are the slowest to remove underperforming CEOs, while boards in Europe are the quickest.The study comprehensively examines the linkages between CEO tenure and corporate performance, comparing CEO turnover in major regions and in specific industry sectors. Among the findings:* Globally, performance-related successions increased 44% from 2003, and represented 31.4% of all CEO departures in 2004. Overall, 14.2% of chief executives at the world's 2,500 largest public companies left office in 2004, compared to 9.8% in 2003. The rate of CEO dismissals has increased by 300% from 1995 to 2004 and in 2004, 42% of CEO successions at European companies were related to performance, compared with 31% in the U.S.
* Overall, underperforming CEOs were removed after an average of 4.5 years in 2004. In Europe, CEOs removed for poor performance were in office for an astonishingly brief 2.5 years. Boards in North America were the slowest to remove underperforming CEOs, at 5.2 years.
* Regionally, the succession rate was highest in the Asia/Pacific region (excluding Japan), where 17.5% of the largest companies changed their CEO, a 230% increase over 2003. The next highest CEO succession rate was in Europe, at 16.8%, followed by Japan at 15.5% and North America, at 11.7%.

CEO turnover now matches the normal attrition rate for all employees. According to quarterly surveys by the research publisher BNA Inc., the typical employee turnover rate in the U.S. is about 12% per year, excluding layoffs and temporary employees. At 11.7%, the total rate of U.S. CEO departures in 2004 is equivalent to the overall rate of US employee turnover. The study reveals an unintended consequence of shareholder activism: an even greater likelihood that executives will focus on delivering short-term results at the expense of strategies that create long-term shareholder value. **(a) Key study findings**Underperformance not ethics, not illegality, not power struggles is the primary reason CEOs get fired. Forced turnovers are strongly correlated with poor shareholder returns. During the year before they left, dismissed CEOs had generated median regionally adjusted returns that were 7.7 percentage points lower than those who left office under normal conditions.New chief executives hired from the outside inherit companies in much worse shape than those inherited by insiders. For the CEO "class" of 2004, outsider CEOs joined companies whose shareholder returns averaged 5.2 percentage points lower during the preceding year than companies that promoted insiders.CEOs are retiring at ever-younger ages. An increasing proportion of successful chief executives age 55 or younger are choosing to retire. In North America, 17.5% of CEOs who stepped down as part of a planned transition in 2004 were 55 or younger, an increase of 61% over the prior year.The Sarbanes-Oxley Act (SOX) of 2002 did not force more CEO turnover in the US The upward shift in CEO firings occurred from 1995 to 2000; subsequent rates of overall turnover, dismissals, and tenure are all consistent with pre-SOX trends.Europe and Asia (excluding Japan) have become the most demanding environments for CEOs. These regions have the highest overall turnover, the most firings, the shortest tenures, and the most rapidly increasing rates of turnover. Europe's turnover rate of 16.8% is 425% higher than 1995, the first year Booz Allen tracked CEO successions. The Asia turnover rate of 17.5% (excluding Japan) is 256% higher than 1995 levels.A former CEO who stays as chairman creates a drag on performance. Companies in which a retired chief executive stayed on as chairman (46% of companies) underperformed other firms by a regionally adjusted 2.8 percentage points annually.Successful companies are more likely to fire a new CEO. Contrary to conventional wisdom, companies that performed well during the two years prior to their CEO's appointment have been one-third more likely to force that new CEO from office. Companies that struggled before their new CEOs came in were more likely to keep them longer.**(b) Industry specific findings****(i) Highest-risk industries:**In 2004, the industries that saw the highest rates of CEO turnover were industrials (19.5%), utilities (19.0%), healthcare (16.2%) and telecommunications (16.0%). Between 1995 and 2004, telecommunications companies had the highest CEO turnover rate (12.7%), followed by industrials (12.3%), energy (11.7%), and utilities (11.6%).**(ii) The safest industries:** The energy industry was the safest for CEOs in 2004, with an overall succession rate of 10.3% during the year. Other industries with low rates of CEO turnover in 2004 include materials (10.4%) and information technology (12.4%). Between 1995 and 2004, financial services companies had the lowest overall CEO turnover rate (8.6%), followed by consumer staples (10.2%) and information technology (11.0%).**(iii) Forced turnover:** Paradoxically, although recording one of the lowest overall succession rates, information technology had the highest rate of performance-related turnover in 2004 (44.8% of all CEO successions in the industry). Telecommunications (42.9% of total industry turnover), and consumer staples (36.8% of total industry turnover) rounded out the top three. **(c) Methodology**Booz Allen studied the 354 CEOs of the world's largest 2,500 publicly traded corporations who left office in 2004, and evaluated both the performance of their companies and the events surrounding their departures. To provide historical context, Booz Allen evaluated and the compared this data to information on CEO departures for 1995, 1998, 2000, 2001, 2002 and 2003. The data includes the financial performance of companies in the years before each CEO assumed office.For the purposes of the study, Booz Allen classified CEO departures as either:* Merger-driven, in which a CEO leaves after his or her company is acquired by or combined with another.
* Performance-related, in which the CEO was forced to resign, either because of poor performance or disagreements with the board.
* Regular transition, which includes all planned and long-scheduled retirements, as well as health-related departures or death in office.

**1.3 APRA proposes new prudential framework for governance** On 18 May 2005, the Australian Prudential Regulation Authority (APRA) released draft prudential standards and a discussion paper outlining proposed governance arrangements for authorised deposit taking institutions (ADIs), general insurers, life insurers and authorised non-operating holding companies (NOHCs).The package, which follows extensive industry consultation, outlines proposals for boards of APRA-regulated institutions to:* meet composition requirements regarding board size, independence of directors and shareholder representation;
* have a majority of independent non-executive directors, with exceptions for certain types of subsidiaries;
* have an independent non-executive director as chairperson of the board;
* establish a Board Audit Committee and a Board Risk Committee;
* have a policy on board renewal;
* ensure their institutions have a dedicated internal audit function; and
* apply independence provisions for external auditors, consistent with the CLERP 9 requirements in the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default).

APRA Chairman Dr John Laker said that the proposed prudential standards are intended to ensure that APRA-regulated institutions consider key governance principles, based on the ASX Principles of Good Corporate Governance for listed companies, and meet standards of governance that are generally considered good practice.The consultation package follows proposals outlined in APRA’s discussion paper Prudential Supervision of General Insurance Stage 2 Reforms, issued in November 2003.Comments on the discussion paper and draft prudential standards are invited by 12 August 2005.The APRA's discussion paper and draft prudential standards are available on the APRA's [website](http://www.apra.gov.au" \t "_new).**1.4 SEC report on pension/superannuation consultants**On 16 May 2005, the United States Securities and Exchange Commission’s (SEC) Office of Compliance Inspections and Examinations released the "Staff Report Concerning Examinations of Select Pension Consultants." The report follows an examination sweep into the practices of pension consultants, particularly focused on any conflicts of interest in their operations, and was initiated as part of the SEC´s program to identify and investigate risks in the securities industry.During its examination, SEC staff reviewed documents and information from a cross-section of 24 pension consultants who are registered with the SEC as investment advisers. The examinations reviewed: (i) the products and services provided by pension consultants; (ii) the method of payment for such services; and (iii) the disclosure provided to their clients. The Report details the findings, including:* more than half of the pension consultants or their affiliates provided products and services to both pension plan advisory clients and to money managers and mutual funds on an ongoing basis;
* a majority of the pension consultants have affiliated broker-dealers or relationships with unaffiliated broker-dealers which may provide a mechanism for money managers to compensate pension consultants, perhaps as a way to curry favour with the pension consultant;
* many pension consultants have affiliates that also provide services to pension plan clients; and
* many pension consultants do not adequately disclose material conflicts of interest arising from these practices to their clients.

Although investment advisers owe their clients a fiduciary obligation including to adequately disclose all material conflicts of interest some pension consultants appear to have erroneously concluded that they are not fiduciaries to their clients.The report contains recommendations to enhance pension consultants´ compliance programs to help ensure that the adviser is fulfilling it fiduciary obligations to its advisory clients. The report also raises important issues for plan fiduciaries who often rely on the advice and recommendations of pension consultants in operating their plans. Further information is available on the SEC [website](http://www.sec.gov/index.htm%22%20%5Ct%20%22_new).**1.5 APRA proposes improved prudential requirements for corporate groups** On 16 May 2005, the Australian Prudential Regulation Authority (APRA) released a discussion paper proposing a strengthening of the framework for the prudential supervision of corporate groups involving authorised general insurers. The consultation package outlines proposals to: * define a framework for the classification, calculation and management of capital adequacy at both the regulated entity and group levels;
* amend standards covering large exposures, intra-group dealings and asset concentration threshold to better encapsulate group dealings;
* ensure a group-wide approach to risk management that is supported by an annual report from the group’s auditor on the adequacy of the risk management environment and processes; and
* require groups to develop group-wide actuarial oversight for consolidated capital adequacy as well as the valuation of insurance liabilities.

The proposals mirror many of the current practices of the industry’s major players and have been developed in line with recommendations of the HIH Royal Commission on consolidated supervision. The discussion paper is available on APRA’s [website](http://www.apra.gov.au" \t "_new).**1.6 SEC statement on implementation of internal control reporting requirements**On 16 May 2005, the United States Securities and Exchange Commission (SEC) released the following statement on issues that arose during the first year of experience with the implementation of Section 404 of the Sarbanes-Oxley Act of 2002: "From the Commission's April 13th Roundtable on Implementation of Internal Control Reporting Provisions as well as from the extensive materials submitted in response to our request for feedback we believe two messages came through clearly: * First, compliance with Section 404 is producing benefits, including a heightened focus on internal controls at the top levels of public companies. We hope that this focus will produce better financial reporting.
* Second, implementation in the first year also resulted in significant costs. While a portion of the costs likely reflect start-up expenses from this new requirement, it also appears that some non-trivial costs may have been unnecessary, due to excessive, duplicative or misfocused efforts. As a result, we heard the implementation process needs to be improved going forward, so that it is more effective and efficient.

"In response to those concerns, we asked the SEC staff, at the end of the roundtable, to consider whether additional guidance and clarification of certain issues was appropriate. On 16 May 2005, the staff released a Staff Statement on Management's Report on Internal Control over Financial Reporting to provide such guidance. An overarching principle of this guidance is the responsibility of management to determine the form and level of controls appropriate for each company and to scope their assessment and the testing accordingly. Registered public accounting firms should recognize that there is a zone of reasonable conduct by companies that should be recognized as acceptable in the implementation of Section 404. The SEC staff guidance complements the guidance that the PCAOB will provide with respect to the application of its Auditing Standard No. 2, An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of the Financial Statements. "We wish to make clear that these actions are not the end of the process. The Commission staff will continue to monitor the implementation of the internal control reporting requirements, particularly for smaller public companies and foreign private issuers. In addition, because of the importance we place on effective and efficient implementation of Section 404, we believe the following broad concepts bear mention at this time: * Although it is not surprising that first-year implementation of Section 404 was challenging, almost all of the significant complaints we heard related not to the Sarbanes-Oxley Act or to the rules and auditing standards implementing Section 404, but rather to a mechanical, and even overly cautious, way in which those rules and standards apparently have been applied in many cases. Both management and external auditors must bring reasoned judgment and a top-down, risk-based approach to the 404 compliance process. A one-size fits all, bottom-up, check-the-box approach that treats all controls equally is less likely to improve internal controls and financial reporting than reasoned, good faith exercise of professional judgment focused on reasonable, as opposed to absolute, assurance.
* In future years we expect the internal control audit to be better integrated with the audit of a company's financial statements. If management and auditors can achieve the goal of integrating the two audits, we expect that both internal and external costs of Section 404 compliance will fall for most companies.
* Internal controls over financial reporting should reflect the nature and size of the company to which they relate. Particular attention should be paid to making sure that implementation of Section 404 is appropriately tailored to the operations of smaller companies. Again, this is an area where reasoned judgment and a risk-based approach must be brought to bear. We continue to be actively engaged in projects to evaluate and assess the effects of the internal control reporting rules on smaller companies. In addition to delaying the implementation of those rules for smaller companies, we have encouraged the Committee of Sponsoring Organizations (COSO) of the Treadway Commission to develop additional guidance in applying its internal control framework to smaller companies. We have established the Commission Advisory Committee on Smaller Public Companies to consider the impact of Commission rules including the internal control reporting rules on smaller companies.
* We encourage frequent and frank dialogue among management, auditors and audit committees with the goal of improving internal controls and the financial reports upon which investors rely. Management of all companies - large and small - should not fear that a discussion of internal controls with, or a request for assistance or clarification from, the auditor will, itself, be deemed a deficiency in internal control. Moreover, as long as management determines the accounting to be used and does not rely on the auditor to design or implement the controls, we do not believe that the auditor's providing advice or assistance, in itself, constitutes a violation of our independence rules. Both common sense and sound policy dictate that communications must be ongoing and open in order to create the best environment for producing high quality financial reporting and auditing; communications must not be so restricted or formalized that their value is lost.

"The entire financial reporting community, including investors, auditors, management, and regulators, shares the common goal of improving the reliability of financial reporting and the information available to the market. With the experience of the first round of Section 404 implementation, we should continue to focus on the lessons learned and ways to improve the process going forward. Section 404 is too important not to get right, but getting it right requires both effective and efficient implementation."**1.7 European Commission consults on minimum standards that should apply to shareholders rights** On 13 May 2005, the European Commission launched a public consultation on minimum standards that should apply to shareholders' rights in listed companies, particularly voting rights in order to remove certain practical and legal obstacles that currently hinder the exercise of these rights in a cross border context. Responses will be taken into account in a forthcoming proposal for a possible future directive, forming part of the Commission Action Plan on Corporate Governance. The deadline for responses is 15 July 2005.Respondents to an earlier consultation (IP/04/117) in this area, launched September 2004, supported the introduction of minimum standards at EU level for the organisation of General Meetings and the exercise of shareholders' rights. The main issues on which the Commission is seeking responses are:* the transparency of stock lending agreements and the status of depositary receipt holders
* the dissemination of relevant information before general meetings, notably to ensure that all shareholders, irrespective of their residence, obtain information in time and are able to cast an informed vote
* the removal of share blocking as a prerequisite to vote and its replacement by a record date
* the rights to ask questions and table resolutions, taking into account the fact that many shareholders are non-residents
* various methods of voting at a distance (by post, electronically, or by proxy)
* the availability to all shareholders of voting results following general meetings.

The Commissions' May 2003 Action Plan to modernise company law and enhance corporate governance (see IP/03/716 and MEMO/03/112) contains a set of initiatives aimed at strengthening shareholders' rights, reinforcing protection for employees and creditors, increasing the efficiency and competitiveness of European business and boosting confidence on capital markets. Public consultation on the Action Plan as a whole, which ended in mid-September 2003, showed a strong consensus behind the main measures. This exercise on minimum standards for shareholders rights is the sixth consultation arising from the Action Plan.The consultation paper is available on the Europa website at: [http://europa.eu.int/comm/internal\_market/company/shareholders/index\_en.htm](http://europa.eu.int/comm/internal_market/company/shareholders/index_en.htm%22%20%5Ct%20%22_new)**1.8 Corporate duties below board level** On 12 May 2005, the Corporations and Markets Advisory Committee (CAMAC) released a Discussion Paper titled Corporate Duties Below Board Level. The paper responds to a request from the Government for the Committee to consider a number of recommendations in the HIH Royal Commission Report on the failure of HIH Insurance (April 2003). In that report, the Commissioner, Justice Neville Owen, drew attention to possible gaps in the regulation of corporate behaviour below board level. He made the point that, without detracting from the overall responsibility of directors, the day to day management of companies, particularly larger ones, is often in the hands of managers below board level. The paper reviews the personal duties and liabilities under the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) of corporate officers, employees and other individuals below board level. It puts forward preliminary proposals to: * extend the duties in ss180 (care and diligence) and 181 (good faith and proper purpose) beyond directors and some corporate officers to "any other person who takes part, or is concerned, in the management of that corporation";
* extend the prohibitions in ss182 and 183 (dealing with improper use of corporate position or information) beyond directors, other officers and employees of a corporation to "any other person who performs functions, or otherwise acts, for or on behalf of that corporation"; and
* extend the prohibitions in ss1309(1) and 1307 (providing false information) beyond officers and employees of a corporation to "any other person who performs functions, or otherwise acts, for or on behalf of that corporation".

The paper also discusses whether there should be a general provision in the Corporations Act, as recommended in the Royal Commission report, prohibiting individuals from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a corporation by any statute. The Advisory Committee has called for submissions by 26 August 2005. The Committee will then prepare its final report, taking into account these submissions. The discussion paper is available on the CAMAC website at:[http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/$file/Corporate\_Duties\_DP\_May05.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion%2BPapers/%24file/Corporate_Duties_DP_May05.pdf%22%20%5Ct%20%22_new)**1.9 Director and executive remuneration information for shareholders**On 9 May 2005, the Parliamentary Secretary to the Australian Treasurer, the Hon Chris Pearce MP, released draft regulations which will give listed company shareholders the opportunity to receive less repetitive and more user friendly information about director and executive remuneration. The proposed regulations will modify the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) so that listed company shareholders will be able to receive audited information about the remuneration of executives and directors in a single place, in the annual directors' report. Currently, this information must be repeated in both listed companies’ annual financial reports and again in their annual directors’ reports as a result of the interaction of section 300A of the Corporations Act and Australian accounting standard AASB 1046 - Director and Executive Disclosures by Disclosing Entities. The draft regulations and commentary are available on the Treasury [website](http://www.treasury.gov.au" \t "_new).**1.10 World Bank governance indicators for 1996–2004**On 9 May 2005, the World Bank published its latest update of estimates of six dimensions of governance covering 209 countries and territories for five time periods: 1996, 1998, 2000, 2002 and 2004. These indicators are based on several hundred individual variables measuring perceptions of governance, drawn from 37 separate data sources constructed by 31 different organizations. The authors of the study analyse changes over time in their estimates of governance; provide a framework for assessing the statistical significance of changes in governance; and suggest a way of identifying statistically significant changes in country governance over time. While the authors find that the quality of governance in a number of countries has changed significantly (in both directions), they also provide evidence suggesting that there are no trends, for better or worse, in global averages of governance. Finally, the authors interpret the strong observed correlation between income and governance, and argue against recent efforts to apply a discount to governance performance in low income countries. The six governance indicators are:1. Voice and Accountability measuring political, civil and human rights.2. Political Instability and Violence – measuring the likelihood of violent threats to, or changes in, government, including terrorism.3. Government Effectiveness – measuring the competence of the bureaucracy and the quality of public service delivery.4. Regulatory Burden – measuring the incidence of market-unfriendly policies.5. Rule of Law – measuring the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence.6. Control of Corruption – measuring the exercise of public power for private gain, including both petty and grand corruption and state capture.The authors investigate whether there is an economic development dividend from better governance, or whether governance improvements are mostly the by product of higher incomes.There is by now a strong consensus among both academics and policymakers that good governance provides the fundamental basis for economic development.Academic research has focused on the effects of institutional quality on growth in the very long run, noting that there is a strong causal impact of institutional quality on per capital incomes worldwide. The research shows a representative set of estimates of this “development dividend” of good governance. These estimates suggest that a realistic one standard deviation improvement in governance would raise incomes in the long run by about two to three fold.The authors state that such an improvement in governance by one standard deviation is feasible and realistic, since it is only a fraction of the difference between the worst and best performers, and would correspond for instance, to an improvement in the current ratings of Voice and Accountability between the level of Myanmar to that of Kazakhstan, or from the level of Kazakhstan to that of Georgia, or from the level of Georgia to that of Botswana. For improvements in Rule of Law, a one standard deviation difference would for instance constitute the improvement from the levels of Somalia to those of Laos, or from Laos to Lebanon, or from that of Lebanon to Italy, or from Italy to Canada, while for Control of Corruption it is the improvement from the levels of Equatorial Guinea to those of Cuba, Honduras or Uganda, or from those of Uganda to those of Lithuania or Mauritius, or from those of Mauritius to those of Portugal, or from those of Portugal to the high standards of Finland, Iceland or New Zealand.Even over much shorter periods such as the past 10 years, countries with better institutional quality have grown faster. There is variation around these relationships, since governance is not the only thing that matters for development but it certainly is a very important factor deserving policymakers' attention.The authors investigate whether governance is improving. Over the eight-year period spanned by the governance indicators, the authors find that in about 10 percent of countries they can be highly confident (at the 90 percent significance level) that governance has changed substantially, while at a lower 75 percent significance level, roughly 20 percent of all observed changes stand out as significant. While in general institutional quality changes only gradually, there are also countries where one can point to sharp improvements or deteriorations over an eight-year period. This finding is of particular interest given the common perception that, while deterioration in a particular country can take place rather quickly, improvements are always very slow and incremental.For instance, since 1996 there has been significant improvement in Voice and Accountability in a number of countries, such as in Bosnia, Croatia, Serbia, Ghana, Indonesia, Sierra Leone, Slovak Republic and Peru, while a significant deterioration has taken place in countries such as the Ivory Coast, Zimbabwe, Kyrgyz Republic, Nepal, Haiti, and Israel. With these aggregate indicators it is also possible to ascertain that some countries have experienced significant changes in briefer time spans, such as the case of the major improvement in the Voice variable for Senegal, Turkey and Nigeria during 1998-2004, or its deterioration in Pakistan, Belarus, Russia, and Venezuela; or the deterioration in Rule of Law during that period in Ethiopia, Namibia, West Bank/Gaza and Argentina, or the improvements in Government Effectiveness in South Africa and Bulgaria.In general it is of concern that there is little evidence of systematic improvements in regional averages for governance in most regions including Africa. The authors also address the question of whether governance has been improving worldwide on average. They found that in fact there is no evidence of governance improving since 1996 (or any period thereafter). In fact, on average the quality of governance worldwide has remain stagnant, even though, as noted above, a number of countries have improved significantly, yet there are also countries exhibiting significant deterioration, and many where little change has taken place. Consequently, there is no significant difference in assessing relative or absolute changes in levels of governance since the mid-nineties.The report is available on the World Bank Group website at: [http://www.worldbank.org/wbi/governance/pubs/govmatters4.html](http://www.worldbank.org/wbi/governance/pubs/govmatters4.html%22%20%5Ct%20%22_new)**1.11 Personal liability for corporate fault** On 5 May 2005 the Corporations and Markets Advisory Committee (CAMAC), released a discussion paper on "Personal liability for corporate fault". The paper responds to a request from the Government to review aspects of directors' duties. The paper reviews the circumstances in which directors and corporate managers may be held criminally liable for corporate misconduct by reason of their formal position or function in a company and without the need to establish misconduct on their part. This form of liability is separate from that of the company itself or of an officer who has actually participated in a corporate breach. The paper looks at a range of Commonwealth, State and Territory environmental, occupational health and safety, hazardous goods and fair trading statutes, as they provide significant examples of this kind of derivative liability. In pursuit of their various public interest goals, there is a trend in statutes of this kind to treat directors and other officers as personally liable, including for criminal offences, for breaches of the law by their company without the need to show personal culpability. Questions of balance arise between the objective of adding to the onus on those individuals to do what they can to ensure corporate compliance, and the reasonableness in the varying practical circumstances of corporate business activities of such a presumption of personal fault. An unduly harsh approach may discourage people from becoming directors or undertaking other responsible corporate roles. The paper invites comments on the need to go beyond corporate and accessorial liability to impose liability on individuals by virtue of the position they hold in the company. The paper also draws attention to the broad range of differing statutory tests both within and between jurisdictions for imposing this form of liability. This lack of uniformity and resultant complexity may in itself: * detract from effective corporate governance by reducing the possibility of directors fully understanding their legal responsibilities in performing their corporate functions; and
* unduly increase compliance costs for businesses in attempting to identify and respond to that complex legal environment.

The paper puts forward for comment several versions of a provision that seeks to achieve a balance between the promotion of corporate compliance and the rights of corporate officers where a need is seen in legislation for the imposition of some element of derivative liability. Such a provision could be adopted as a model or template for use across the various jurisdictions in order to achieve a more harmonised approach. The possible provisions differ in relation to the classes of individuals potentially liable, the grounds of liability and whether the prosecution or the defence has the burden of proof. The Advisory Committee has called for submissions by 12 August 2005. The Committee will then prepare its final report, taking into account these submissions. The discussion paper is available on the CAMAC [website](http://www.camac.gov.au" \t "_new).**1.12 EU financial services policy for the next five years** On 3 May 2005, a new European Commission Green Paper was published with the objective of further integrating EU financial markets. The paper focuses primarily on implementing existing rules agreed under the Financial Services Action Plan (FSAP) and on cooperation, rather than proposing new laws. It explores ways of improving cross-border access to retail financial services and asset management. The Green Paper is open for public consultation until 1 August 2005. The final financial services policy programme will be presented in November 2005.The FSAP has over the last six years aimed to put integrated, efficient, deep and liquid financial markets at the service of European issuers, investors and financial service providers. Almost all of the measures in the FSAP have been agreed and EU decision making and regulatory structures have become more efficient.A short term need is to complete unfinished business and finalise legislation currently under negotiation in Parliament and Council. Furthermore, existing legislation must be implemented effectively, in three phases: effective transposition of EU rules into national law; more rigorous enforcement by supervisory authorities; continuous ex-post evaluation. At all stages of any future regulatory process, the Commission will apply the rigorous better regulation approach, with thorough impact assessment and extensive consultation.In a few areas, new initiatives may be proposed. A separate Green Paper on asset management will be published in July 2005. The investment fund industry currently manages almost 5 trillion euro and a small improvement in efficiency has huge immediate beneficial economic effects.EU's market in retail financial services remains fragmented. The Commission will look, for example, at ways to make cross-border use of bank accounts more consumer friendly and to break down barriers so that customers can shop around all over Europe for the best savings plans, mortgages, insurance and pensions, with clear information so that products can be compared. The Commission will propose legislation only if there is clear economic benefits.Other issues covered in the Green Paper include ensuring that supervisory practices and standards converge across Europe, encouraging cross-border investment and taking advantage of opportunities to influence the regulatory parameters of the emerging global financial market. The Green Paper is at available at: [http://europa.eu.int/comm/internal\_market/finances/actionplan/index\_en.htm](http://europa.eu.int/comm/internal_market/finances/actionplan/index_en.htm%22%20%5Ct%20%22_new)**1.13 APRA releases proposed general insurance risk and financial management reforms** On 3 May 2005, the Australian Prudential Regulation Authority (APRA) issued a discussion paper, draft prudential standards and guidance notes outlining a proposed strengthening of the prudential supervision of general insurance in the areas of risk and financial management. The consultation package outlines proposals to:* clarify and strengthen existing requirements in business planning, risk management, reinsurance management and outsourcing;
* ensure insurers adequately document reinsurance contracts;
* introduce strict requirements for the approval of limited risk transfer arrangements;
* require Approved Actuaries to complete an annual Financial Condition Report on each insurer and have a peer review undertaken of actuarial valuations of insurance liabilities; and
* require CEO and CFO attestation of the financial information provided to APRA, the Approved Auditor and the Approved Actuary.

The proposals follow comments received on APRA’s discussion paper, Prudential Supervision of General Insurance & No 8209; Stage 2 Reforms, issued in November 2003. Comments on the draft standards, guidance note and discussion paper Prudential Supervision of General Insurance Stage 2 Reforms–Risk and Financial Management released today are invited by 5 August 2005. APRA's discussion paper, draft prudential standards and guidance notes are available on APRA's web site at: [http://www.apra.gov.au/Policy/Draft-Prudential-Standards-General-Insurance-Risk-and-financial-management.cfm](http://www.apra.gov.au/Policy/Draft-Prudential-Standards-General-Insurance-Risk-and-financial-management.cfm%22%20%5Ct%20%22_new)**1.14 Interim report on the Associations Incorporations Act (VIC)** On 29 April 2005, the Minister for Consumer Affairs in the State Government of Victoria, Marsha Thomson, released the Interim Report of the Review of the [Associations Incorporation Act 1981](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=230" \t "default).The Interim Report proposes a range of measures that will ease the administrative burden on associations and limit the cost of compliance with the Act and the public is now invited to respond to the recommendations.The Minister stated when releasing the report: "While the review contains sensible recommendations in the main I wish to state that I will not proceed with recommendations 1 & 3 as described as I believe those could lead to a greater burden on associations".Following are the proposals contained in the report:* Proposal 1: Insert a purpose clause in the Act, which states that the Act is designed to serve not for profit organisations that are small, voluntary, non-trading and membership based. Consequent changes should be made to the Act to support the purpose clause.
* Proposal 2:The criteria for refusing applications or directing existing incorporated associations to apply for incorporation under other legislation should be amended to directly relate to the purpose clause.
* Proposal 3A transition period of five years should be put in place and in the first stage an assessment could be made of those organisations that have an annual income of $1 million or more.
* Proposal 4Retain the current two levels of reporting, but increase the asset level threshold for prescribed associations to $1 million and apply an appropriate method of indexation to the asset level threshold.
* Proposal 5It will no longer be a requirement that all associations have to lodge annual statements. This will be required of prescribed incorporated associations only.
* Proposal 6The Registrar will have a new power to make an application for a court order to enforce the rules of an association or enforce the rights and obligations of members where it is required in the public interest.
* Proposal 7Require all incorporated associations to maintain an asset register.
* Proposal 8Permit incorporated associations with surplus assets of less than $10,000 to apply to the Registrar for voluntary cancellation, thereby removing the need for these associations to appoint a liquidator.
* Proposal 9Prohibit the distribution of surplus assets to members or former members on winding up.
* Proposal 10Remove reference to the Public Officer from the Act and make the Secretary of the incorporated association responsible for these functions.
* Proposal 11Add to that part of the Schedule to the Act that lists rules that are not able to be deleted or altered the requirement that office holders of the association must return to the committee of the association any documents relating to the association that they have in their custody by virtue of their role in the association.
* Proposal 12Include in the Schedule to the Act that lists rules that are not able to be deleted or altered, the requirement that:
	+ an incorporated association must record and keep accurate minutes for general and committee meetings;
	+ the rights and conditions of access to the minutes of general meetings (including access to financial statements); and
	+ the right and conditions of access of committee members to the minutes of committee meetings.

The rights and conditions of access to the minutes of committee meetings by members should be included in an association’s rules but the rights and conditions are likely to vary between associations.* Proposal 13Develop a Model Code of Good Governance which may be voluntarily adopted by incorporated associations.
* Proposal 14The disciplinary procedures and the grievance procedures should be kept as separate processes. After an appeal of a disciplinary procedure is dismissed, it should not be then possible to use the grievance procedure processes to pursue the same issue.
* Proposal 15Clarify and strengthen the section of the Act requiring incorporated associations to set down a Grievance Procedure in their rules.
* Proposal 16Amend the Grievance Procedure in the Model Rules specifically with regard to the requirements for mediation.
* Proposal 17Examine whether or not the Magistrates’ Court is an appropriate forum for the hearing and determination of disputes, or whether another system of arbitration (including VCAT), would be a better system.
* Proposal 18Review the Model Rules to take account of the proposed changes to the Schedule to the Act.

The Interim Report is available for comment up until 10 June 2005 with copies accessed from the Consumer Affairs Victoria [website](http://www.consumer.vic.gov.au" \t "_new).**1.15 Refinements to financial services regulation** On 2 May 2005, the Parliamentary Secretary to the Australian Treasurer released a Proposals Paper titled Refinements to Financial Services Regulation. The proposals contained in the paper respond to concerns relating to aspects of the practical operation of the changes brought about by the [Financial Services Reform Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=58127" \t "default). The paper outlines a series of proposals aimed at addressing these concerns.The Government will consult with industry and consumer representatives on the proposed refinements to the regulatory framework put forward in the proposals paper, prior to preparing the necessary changes.The financial services regulatory framework was substantially amended by the introduction of the Financial Services Reform Act 2001 (now contained in Chapter 7 of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default)), which came into full effect on 11 March 2004.The introduction of harmonised financial services licensing, conduct and disclosure requirements has produced significant benefits for consumers through the promotion of consistent basic standards across the financial services industry.The Government has consulted with a broad cross section of the community to gauge the overall effectiveness of the new regulatory regime since its implementation, with particular consideration paid to whether the financial services reforms have achieved the Australian Government’s objectives. Overall, there is support for, and satisfaction with, the reforms.However, in light of stakeholders' day-to-day experience with the legislation, it has become clear that some aspects of the regulation of financial services would benefit from refinement to improve their practical operation.The intention underlying the refinement process is to:* ensure that consumers receive information that is relevant to their needs;
* reduce the compliance burden on industry; and
* clarify the intent of the legislative and regulatory framework that applies to the financial services industry.

A main area of concern relates to the amount and detail of information provided to consumers through financial services disclosure. In particular, it is felt that the content requirements for the various disclosure documents are resulting in the production of excessively lengthy and complex documents (or, in the case of oral disclosure, excessively lengthy verbal ‘scripts’), which are difficult to reconcile with the legislation’s requirement that information be presented to consumers in a "clear, concise and effective" manner.As a result, the purpose behind the disclosure requirements, that is, to assist consumers to make informed investment decisions, is potentially being undermined. In addition, the expense of producing lengthy disclosure documents is seen as an unreasonable burden on service providers and, in many instances, the increased cost is passed through to consumers.The proposals are therefore designed to achieve more effective written and oral disclosure. However, disclosure is not the only issue that is addressed by the proposals. Others include:* retail / wholesale client distinction;
* provision of secondary services;
* general advice definition;
* jurisdictional issues;
* authorised representatives;
* staff training; and
* non-cash payment facilities.

The proposals are intended to achieve the following broad outcomes:* Facilitate the provision of more specific and concise information to consumers by encouraging the production of disclosure documents that have less duplicated information and are more directly relevant to their needs.
* Provide oral disclosure that is simpler and more easily understood by consumers.
* Simplify General Advice Warnings and make them more meaningful for consumers.
* Streamline product disclosure requirements in relation to Basic Deposit Products and general insurance products.
* Improve aspects of the tests which determine whether a client is 'retail' or 'wholesale'.
* Reduce excessive disclosure where services are provided through intermediaries.
* More clearly delineate the distinction between ‘general’ and ‘personal’ advice.
* Clarify the jurisdictional extent of the law.
* Modify authorisation procedures for representatives, certain staff training requirements and the coverage of non-cash payment facilities.

The Australian Securities and Investments Commission (ASIC) has welcomed the Federal Government's proposals paper. ASIC has agreed to take the lead on eight projects arising out of the 25 refinement proposals in the paper. ASIC's eight refinement projects are to: * issue further guidance on Statements of Advice (SOAs), including releasing a model SOA (refinement proposal 2.2 in the Government's proposal paper);
* issue guidance and/or relief about compliance with the general advice warning requirements where there is an ongoing relationship between the adviser and the retail client (refinement proposal 5.1);
* issue guidance and/or relief to deal with inconsistencies in the general advice warning requirements applying to product issuers in their advertisements (refinement proposal 5.2);
* issue guidance and/or relief to clarify that advisers do not necessarily provide personal advice merely because they have some personal information about a retail client (refinement proposal 10.2);
* issue further guidance and/or relief to promote the provision of basic online calculators (refinement proposal 10.3);
* issue guidance and/or relief on the authorisation requirements for product arranging agents of Australian general insurance issuers (refinement proposal 12.2);
* undertake a discrete review of ASIC Policy Statement 146 Licensing: Training of financial product advisers on adviser minimum qualifications as it applies to advice about basic deposit products and related non-cash payment facilities (refinement proposal 13), and
* issue guidance and/or relief to deal with the unintended application of the non-cash payment facility definition to certain kinds of facilities (refinement proposal 14).

Further information on the paper is available at the Treasury [website](http://www.treasury.gov.au" \t "_new).**1.16 Basel Committee issues guidance on the compliance function in banks** On 29 April 2005, the Basel Committee on Banking Supervision released "Compliance and the compliance function in Banks". This paper provides basic guidance for banks and sets out banking supervisors' views on compliance in banking organisations.Using a framework of principles, the paper illustrates how compliance with the laws, rules and standards that govern banking activities helps to maintain a bank's reputation with its shareholders, customers, employees and the markets. At the same time, the paper incorporates sound practice guidance to assist banks in designing, implementing and operating an effective compliance function. To optimise its usefulness to all banks, the paper stresses that a single framework of principles for effective compliance risk management does not restrict individual banks to a single organisational or operational approach. However, each bank must be prepared to demonstrate that the approach adopted is effective in dealing with the bank’s unique compliance risk challenges.The Basel Committee on Banking Supervision was established by the central bank Governors of the G10 countries in 1975. It consists of senior representatives from banking supervisory authorities and the central banks of Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. Currently, the Committee reports to the central bank Governors and heads of supervision of the G10 countries. This paper is available at: [http://www.bis.org/publ/bcbs113.htm](http://www.bis.org/publ/bcbs113.htm%22%20%5Ct%20%22_new)**1.17 Major US investors critical of CEO pay disclosure** They say chief executives of major US companies are overpaid. They think golden parachutes serve no useful corporate purpose. They want directors held personally liable for the worst financial scandals on their watch. So say 88 major US institutional investors in a recent survey on executive pay and corporate governance issues conducted by executive compensation consultants Pearl Meyer & Partners. The investment managers also expressed widespread dissatisfaction with both the state of governance in corporate America and the cost to shareholders of compliance with Sarbanes-Oxley and other recent reforms.Among the specific opinions expressed by respondents to a March survey sent to selected investors with median assets under management of US$36 billion: * 75% say average CEO pay of US$10.5 million at major companies is too high.
* 59% are opposed to golden parachute arrangements.
* 98% say directors should be accountable for certain financial irregularities that occur on their watch.
* 60% rate earnings per share - one of the most widely used criterion for determining executive bonuses - among the least useful barometers of company and CEO performance.

Echoing the views of many governance critics, the size of chief executive pay packages drew the most fire. Three-quarters of respondents said current compensation for chief executives is too high and not one thought CEOs are underpaid.Investors also were dismissive of the widespread use of golden parachutes, or contractual arrangements that provide executives with financial protection in the event of a takeover. Viewed by the majority of fund managers as "an inappropriate personal incentive to management to take financial risks," more than one investor dubbed such payments "a reward for failure."In line with their own interests, 65% rated shareholder return as the first or second most important factor in setting CEO bonus and long-term incentive payments, followed by return on capital at 53%. An earnings per share, a frequently-used performance yardstick, was ranked last in importance.Investors are largely unimpressed by recent regulations, with one respondent calling Sarbanes-Oxley "an outrageous overreaction to some bad apples." Of six key SOX provisions, only two were rated worth the cost of compliance by a majority of respondents: real-time disclosure of insider trading and the certification of financial reports by CEO/CFO, at 58% and 53% respectively.Board pay drew less criticism, with respondents about evenly split whether current average director pay of US$177,000 at major companies is too high or about right. There was more consensuses about the need for Board accountability, with all but a handful of respondents saying directors should be personally liable for at least some serious financial or compensation irregularities on their watch. The majority thought personal accountability should be limited to "gross lack of oversight," while another 23% favoured a standard of "malfeasance" and 17% said directors should always be held personally liable.In related questions, investors by a two-to one-margin favoured proposals to allow easier shareholder nomination of directors. When it comes to casting their proxy ballots, fully 97% of respondents rely on their firm's voting guidelines, with three-quarters applying them strictly or with only rare exceptions.Significantly, dilution proved to be a most popular investment criterion - as well as the area most often cited for insufficient disclosure. Nearly 80% of respondents regularly consider dilution in making their buy/sell decisions, followed by executive stock ownership and corporate governance, both cited by about 65%. Better disclosure of dilution was called for by 69% of respondents, followed by 64% who wanted more information on equity pay practices and about half who would like improved reporting of executive pay levels and of executive stock ownership.Investors strongly approve of mandatory option expensing, with 73% saying the cost of option use will be a "significant" factor in their investment decisions. A total of 58% predicted that accounting for option use will result in improved profit-loss statements, which was similar to the proportion of respondents who expressed satisfaction with existing valuation methodologies.**1.18 FPA proposes principles for managing conflicts of interest**On 28 April 2005, the Financial Planning Association (FPA) released draft principles designed to assist members in managing potential or perceived conflicts of interest. A six month consultation period has begun, with FPA members invited to comment by Friday 28 October 2005.The FPA is engaged in a three phase process to improve the clarity and transparency of payment and remuneration practices in financial planning and to improve client understanding. Phase 1 was completed 1 August 2004 with adoption of the Code of Practice on Alternative Remuneration in the Wealth Management Industry. Phase 2 is complete with the announced adoption of the Industry Guide on Rebates & Related Payments from 1 January 2005. Work is well developed on Phase 3, the establishment of principles to help members manage areas where potential or perceived conflicts of interest may exist. It is recognised that financial planners have obligations under the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) to address conflicts of interest so that they can serve the interests of the clients. Policy Statement 181 sets out ASIC’s guidance as to best practice in managing, disclosing and where necessary, avoiding conflicts of interest. As well, the purpose of many of the disclosure provisions in the FSR regime is to resolve conflicts of interest. FPA’s intention is not to add another layer of regulation but to still existing obligations into a number of principles which members could use to better help clients build and manage their wealth. The FPA has adopted as the Key Principle that FPA members have a primary obligation to provide advice which is in the interest of and to the benefit of the client. The FPA believes that this restatement of a financial planner’s fiduciary duty to their client provides direction to FPA members in all aspects of their client relationships, as well as guiding them when addressing real and perceived conflicts of interest. Consequently, the FPA has developed seven Subsidiary Principles to follow in applying this key principle:* A financial planner will provide a client with clear, concise and comprehensive information so that the client will understand the advice and service being offered and its cost.
* Financial planning advice should be independent from and not tied to product recommendations.
* Where it is appropriate to recommend a product to a client, all FPA members should only offer products which suit the needs of the client and do not bring the industry into disrepute.
* No FPA member shall receive or reward any remuneration or benefits which are biased against or may not be in the interests of the client.
* A financial planner must disclose to a client any existing or potential financial interest (such as shareholdings or equity entitlements) they, or an entity in which they have an interest, have in the products or platforms they use and/or in their AFS licensee or related entity.
* There should be separate corporate governance in place between an AFS licensee and related fund managers and product/platform manufacturers within the same group.
* FPA members have a responsibility to abide by the FPA Principles to address any real or perceived conflict/s of interest.

The FPA emphasises that the draft Principles document is a basis for consultation. Although FPA Taskforce members are in general broadly comfortable with its direction, the document is not an agreed text where each provision has been endorsed by every Taskforce member and not every task force member agrees with every principle. In particular, attention needs to be given to the implications of each principle for advice concerning investment and financial protection products.The feedback from the current consultations will be used as a base for further discussion and consultation by the FPA. As a number of matters dealt with in the draft Principles are beyond the responsibility of financial planners, discussions are being held with IFSA to explore the potential for a co-operative approach on issues of common concern. The draft principles are available on the FPA [website](http://www.fpa.asn.au" \t "_new).**1.19 CESR launches a second consultation on dissemination of financial information and other implementing measures of the Transparency Directive** On 27 April 2005, the Committee of European Securities (CESR) published for a second round of consultation, its draft technical advice (Ref. CESR/05-267) on possible implementing measures covering five aspects of the Transparency Directive:* dissemination of regulated information;
* notification of major holding of voting rights;
* half yearly financial reports;
* equivalence of transparency requirements for third countries issuers; and
* the procedural arrangements whereby an issuer may elect its ‘home Member State’ competent authority for the purposes of the Directive.

The content of this second consultation paper responds to comments received during the consultation on CESR’s draft technical advice on dissemination and storage of regulated information published in October 2004 (Ref: CESR/04-511) and CESR’s proposed advice regarding notification of major holdings of voting rights, half yearly reports, equivalence and procedural arrangements published in December 2004 (Ref: CESR/ 04-512c).In relation to dissemination of regulated information (such as price sensitive information, half yearly financial reports, interim management statements, major shareholdings information):* CESR proposes a set of minimum standards that issuers should meet when disclosing regulated information. These principles include that the information should be made available to consumers without delay (particularly if the information is of a price sensitive nature);
* issuers should benefit from free competition when choosing media operators to disseminate information; and
* all investors should have access to the information and therefore it should not only be directed at specific categories of investors, but it should also be available across Europe and free of charge to investors.

CESR has chosen to remain neutral regarding which type of media should be used to publish company information. Nevertheless, CESR has sought to address concerns expressed during the first round of consultation, by specifying the types of media connections an issuer is expected to have as a matter of course in order to achieve its obligations under the Directive. These include press agencies, newspapers with a wide readership and websites dedicated to financial matters.CESR also recommends that issuers be free to choose to disseminate all regulated information themselves or to use a third party such as a service provider or operator to carry out this function. Where service providers are used by issuers, CESR proposes that the service providers must meet the minimum standards set for an issuer and, in addition, they must ensure they can meet some more specific minimum standards such as ensuring an appropriate level of security into their mechanisms to disseminate information. They must also be able to operate on a 24 hour basis, seven days a week. CESR has also further clarified proposed rules regarding separation of functions and charges in such cases where service providers also perform other functions. CESR does not, however, propose compulsory approval of service providers.In relation to notifications duties of major holding of voting rights in companies whose securities are admitted to trading on regulated markets, the key aspects of this part of the advice are:* A clarification regarding how shareholders should fulfil their notification duties when the voting rights attached to their shares have been passed to someone else, so called "Article 10 situations".
* CESR’s advice seeks to provide greater convergence regarding the information requirements that shall be included in the standard notification forms, and consults on a few technical issues, such as the resulting situation when a notifiable interest is no longer held.
* Greater clarity in relation to the question of independence to be complied with by a management company wishing to benefit from the exemption of aggregating holdings.

Further information is available on the CESR [website](http://www.cesr-eu.org/%22%20%5Ct%20%22_new).**1.20 Survey of buy-side and sell-side analysts** On 26 April 2005 the Australasian Investor Relations Association released a report on a survey of buy-side and sell-side analysts.**(a) Summary**This survey on investor communication has gathered the opinions, observations and suggestions of buy–side and sell–side analysts on current and desired communication practices of Australian listed entities.This report provides insights for CEOs, CFOs, Investor Relations Officers and other communicators, in listed entities on:* the information needs of investors and broking analysts;
* attitudes towards information disclosure;
* importance of the different information sources;
* what makes information sources effective; and
* the impact of communication styles of CEOs, CFOs and other communicators.

**(b) Information needs of analysts** Analysts need more information from listed entities about:* medium term strategies;
* competitive positioning;
* market place trends;
* long term vision;
* risk management;
* customers; and
* short term objectives.

Selected non–financial data (especially details on customers and employees) is highly regarded. Consistent application of reporting formats by listed entities is sought after.**(c) Attitude towards disclosure regimes** Analysts are more familiar with Australian disclosure guidelines and standards than they are with overseas practices. Sell–side analysts are more familiar with Australian disclosure requirements for listed entities compared with their buy–side counterparts.Most analysts believe Australia’s disclosure regime is appropriate. Some analysts have concerns that too much discretion is left to listed entities.Analysts believe listed entities observe disclosure regimes primarily out of legal compliance rather than wanting to support the spirit of disclosure regimes. There were mixed views on whether disclosure regimes have had a positive or negative impact on the amount and quality of information received from listed entities.A majority of analysts agree that relationships with listed entities have remained the same or improved with the current disclosure regime.Attitudes towards company blackouts are mixed. A majority of analysts support companies commenting on draft broker reports.**(d) Importance of information sources**Analysts rated the most important communication sources at results time as:* 1:1 meetings with CEO and/or CFO;
* group briefings with CEO/CFO;
* 1:1 meetings with other executives;
* conference calls;
* company emails; and
* group briefings with other executives.

Outside of results reporting and major announcements, analysts rated the most important communication sources as:* 1:1 meetings with CEO and/or CFO;
* 1:1 meetings with other executives;
* group strategy briefings;
* group briefings with other executives;
* group briefings with CEO/CFO; and
* site visits.

Analysts expect more contact with ASX 100 companies compared with smaller companies.**(e) Making information sources effective**Analysts indicated they would like "more" or a "lot more" communication via:* 1:1 meetings with CEO and/or CFO;
* 1:1 meetings with other executives;
* site visits;
* group briefings with CEO/CFO; and
* group strategy briefings.

Analysts identified the key characteristics of effective communication by listed entities. The majority of characteristics identified are strongly linked with:* planning;
* time management;
* honesty;
* respect;
* clarity and consistency of message; and
* track record of communicators.

**(f) Impact of communication styles**Analysts identified the factors giving them confidence in a CEO as:* track record;
* clear vision;
* logical and consistent;
* measurement of plans and performance; and
* KPIs linked to shareholder returns.

Analysts identified the following factors as confidence builders in a CFO:* track record;
* financial detail;
* business acumen;
* openness; and
* consistency.

Consistency, alignment and the ability to help reduce uncertainties about future earnings are factors used to assess an executive’s ability to execute a plan or strategy. Communication underpins most, if not all, these confidence builders. 100% of analysts said communication by a listed entity has a "significant" or "important" contribution to a company’s rating or assessment.**1.21 New Zealand finance companies asked to improve disclosure to investors**New Zealand Finance companies could improve the disclosure they make to investors according to the New Zealand Securities Commission in a report published on 22 April 2005.The report explains the Commission's expectations for disclosure by finance companies under the Securities Act and Securities Regulations. In particular the risks of the investment should be made clear to people who are considering investing with a finance company according to the Commission.The Commission's report does not comment on the prudential supervision or status of finance companies, as the Commission does not have a function as a prudential regulator.The report is available from the Commission's [website](http://www.sec-com.govt.nz" \t "_new).**1.22 UK simplified prospectus rules**On 22 April 2005, the UK Financial Services Authority (FSA) set out its final rules and guidance for implementing European requirements on product disclosure information for consumers in relation to collective investment schemes such as Unit Trusts and OEICs that hold a UCITS certificate enabling them to be marketed in other EEA countries.The product information will be contained in a new document known as the Simplified Prospectus. EU rules require this document to be offered to anyone who wants to invest in a collective investment scheme that holds a UCITS certificate. The FSA's approach builds on the existing UK regime for investment product information the key features document - by adding new information requirements only where it is necessary to meet the revised EU standards.The new EU information requirements include:* a "Total Expense Ratio" (TER) figure showing the costs and charges of the fund. The figure will not take account of front-end charges, exit costs or certain fund expenses such as dealing costs;
* a "Portfolio Turnover Rate" (PTR) figure, to reflect the volume of dealing within the fund; and
* the historic performance of each UCITS fund showing up to ten years' annual returns.

The new rules and guidance are effective from 1 May 2005 with a transitional period until the end of September 2005.Policy Statement 05/4 'Implementation of the Simplified Prospectus requirements: Feedback on CP 04/18 is available on the FSA [website](http://www.fsa.gov.uk/Pages/index.shtml%22%20%5Ct%20%22_new).**1.23 Report on US mutual fund trading abuses** On 22 April 2205, the US Government Accountability Office released a report titled "Mutual Fund Trading Abuses".**(a) Why GAO did this study?**Recent violations uncovered in the mutual fund industry raised questions about the ethical practices of the industry and the quality of its oversight. A widespread abuse involved mutual fund companies’ investment advisers (firms that provide management and other services to funds) entering into undisclosed arrangements with favoured customers to permit market timing (frequent trading to profit from short-term pricing discrepancies) in contravention of stated trading limits. These arrangements harmed long-term mutual fund shareholders by increasing transaction costs and lowering fund returns. Questions have also been raised as to why the New York State Attorney General’s Office disclosed the trading abuses in September 2003 before the Securities and Exchange Commission (SEC), which is the mutual fund industry’s primary regulator. Accordingly, the report (1) identifies the reasons that SEC did not detect the abuses at an earlier stage and the lessons learned in not doing so, and (2) assesses the steps that SEC has taken to strengthen its mutual fund oversight program and improve mutual fund company operations.**(b) What GAO found**Prior to September 2003, SEC did not examine for market timing abuses because agency officials viewed other activities as representing higher risks and believed that companies had financial incentives to control frequent trading because it could lower fund returns. While SEC faced competing examination priorities prior to September 2003 and made good faith efforts to mitigate the known risks associated with market timing, lessons can be learned from the agency not having detected the abuses earlier. First, without independent assessments during examinations of controls over areas such as market timing (through interviews, reviews of exception reports, reviews of independent audit reports, or transaction testing as necessary) the risk increases that violations may go undetected. Second, SEC can strengthen its capacity to identify and assess evidence of potential risks. Articles in the financial press and academic studies that were available prior to September 2003 stated that market timing posed significant risks to mutual fund company shareholders. Finally, GAO found that fund company compliance staff often detected evidence of undisclosed market timing arrangements with favoured customers but lacked sufficient independence within their organizations to correct identified deficiencies. Ensuring compliance staff independence is critical, and SEC could potentially benefit from their work.SEC has taken several steps to strengthen its mutual fund oversight program and the operations of mutual fund companies, but it is too soon to assess the effectiveness of certain initiatives. To improve its examination program, SEC staff recently instructed agency staff to conduct more independent assessments of fund company controls. To improve its risk assessment capabilities, SEC also has created and is currently staffing a new office to better anticipate, identify, and manage emerging risks and market trends. To better ensure company compliance staff independence, SEC recently adopted a rule that requires compliance officers to report directly to funds’ boards of directors. While this rule has the potential to improve fund company operations and is intended to increase compliance officers’ independence, certain compliance officers may still face organizational conflicts of interest. Under the rule, compliance officers may not work directly for mutual fund companies, but rather, for investment advisers whose interests may not necessarily be fully aligned with mutual fund customers. The rule also requires compliance officers to prepare annual reports on their companies’ compliance with laws and regulations, but SEC has not developed a plan to routinely receive and review the annual compliance reports. Without such a plan, SEC cannot be assured that it is in the best position to detect abusive industry practices and emerging trends.**(c) What GAO recommends**GAO recommends that SEC routinely assess the effectiveness of compliance officers and plan to review compliance reports on an ongoing basis. SEC agreed with these recommendations.The report is available on the GAO website at: [http://www.gao.gov/new.items/d05313.pdf](http://www.gao.gov/new.items/d05313.pdf%22%20%5Ct%20%22_new)**1.24 Compliance function at market intermediaries** In April 2005 the International Organization of Securities Commissions (IOSCO) Technical Committee published a consultation paper titled "Compliance Function at Market Intermediaries". The paper reviews the current IOSCO Principles for Market Intermediaries and recent initiatives by some regulators in the area of compliance. It also sets out a number of supplementary principles with measures for implementation to assist market intermediaries in increasing the effectiveness of their compliance function. The consultation period closes on 15 July 2005. The consultation paper is available on the IOSCO website at: [http://www.iosco.org/pubdocs/pdf/IOSCOPD198.pdf](http://www.iosco.org/pubdocs/pdf/IOSCOPD198.pdf%22%20%5Ct%20%22_new)**1.25 Report on oversight of auditors** In April 2005 the International Organization of Securities Commissions (IOSCO) Technical Committee and Emerging markets Committee published a report titled "Regulation and Oversight of Auditors".In response to widespread interest in the conduct and quality of audits and in oversight of auditors, IOSCO, in cooperation with a group of other international organizations, developed a survey on regulation and oversight of auditors. The goal of the survey was to obtain a point-in-time description of the structures and processes in place in 2004 for regulation and oversight of auditing around the world, to serve as baseline information for regulators and oversight bodies and other organizations that are working to enhance auditor oversight and international audit quality. Organizations in many countries around the world are presently considering and/or implementing changes to auditor oversight structures and quality assurance processes.IOSCO’s survey also sought to identify the extent to which the auditor oversight arrangements in place as of the end of 2004 encompass the IOSCO Technical Committee’s Principles for Auditor Oversight and Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor’s Independence. The report is available on the IOSCO website at: [http://www.iosco.org/pubdocs/pdf/IOSCOPD199.pdf](http://www.iosco.org/pubdocs/pdf/IOSCOPD199.pdf%22%20%5Ct%20%22_new) |
| **2. Recent ASIC Developments** |
| **2.1 ASIC issues guidance for registered liquidators where a proposed deed of company arrangement involves a creditors' trust**On 24 May 2005, the Australian Securities and Investments Commission (ASIC) published an ASIC guide for registered liquidators who are appointed under Part 5.3A of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the Act) as administrator of a company, or of a deed of company arrangement (DCA). The guide explains ASIC's interpretation of certain obligations of administrators where a DCA proposal involves a creditors' trust. In particular, it explains the information that ASIC thinks is material and should be disclosed to creditors in this situation.Creditors' trusts are explained in paragraphs 1.1-1.6 of the guide. ASIC is concerned that administrators appear not to be aware of, or are not properly considering, all the issues raised by the use of a creditors' trust, and therefore, are not acting in ways which adequately protect the interests of creditors, given the special risks that creditors' trusts pose for creditors. One of the key obligations of administrators is to give creditors sufficient material information to enable the creditors to make an informed decision about the future of the company.Copies of the ASIC guide are available from the Insolvency page of the ASIC [website](http://www.asic.gov.au" \t "_new), by emailing ASIC's Infoline or by calling 1300 300 630.**2.2 ASIC amends policy statement on wholesale foreign financial services providers** On 17 May 2005, the Australian Securities and Investments Commission (ASIC) released a number of revisions to Policy Statement 176 Licensing: Discretionary powers wholesale foreign financial services providers [PS 176]. [PS 176] outlines how ASIC will use its powers to provide relief from the financial services licensing regime for wholesale foreign financial service providers (FFSPs), who are regulated by overseas regulatory authorities.This policy statement has been revised to reflect amendments to the law made by the [Financial Services Reform Amendment Act 2003](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=74903" \t "default) and to clarify how ASIC policy applies.In particular, the revisions of [PS 176]: * clarify how ASIC identifies the relevant overseas regulatory authority of the FFSP;
* permit 6-monthly reporting (replacing a continuous requirement) of significant changes to the FFSP's regulatory regime and enforcement actions against it by overseas regulators;
* provide additional guidance on notification to ASIC by the FFSP of significant changes to the FFSP's relevant overseas regulatory regime;
* extend both the period of time in which an FFSP must notify ASIC of a failure to comply with certain requirements and the period of time in which ASIC must consider such notifications; and
* alter the legislative basis for the policy statement, from the general licensing exemption power under s911A(2)(l), to the specific exemption power under s911A(2)(h) for FFSPs.

ASIC has also varied the relief instruments issued under [PS 176] to implement these policy changes.A copy of the updated policy is available from the ASIC website at: [http://www.asic.gov.au/ps](http://www.asic.gov.au/ps%22%20%5Ct%20%22_new)**2.3 ASIC releases updated policy statements and licensing guidance papers** On 13 May 2005, the Australian Securities and Investments Commission (ASIC) released five updated ASIC policy statements and two updated guidance papers relating to financial services reform (FSR) requirements. The updated policy statements are: * [PS 166] Licensing: Financial requirements;
* [PS 167] Licensing: Discretionary powers;
* [PS 168] Disclosure: Product disclosure statements (and other disclosure obligations);
* [PS 169] Disclosure: Discretionary powers; and
* [PS 175] Licensing: Financial product advisers–Conduct and disclosure.

Policy Statement 164 Organisational capacities [PS 164] is currently being reviewed. ASIC plans to issue an updated version of [PS 164] later in the year, and an update to PS 165 Licensing: Internal and external dispute resolution [PS 165] is under consideration.The updated guidance papers are: * The Hawking Prohibitions (Hawking Guide); and
* Licensing: The Scope of the Licensing Regime: Financial Product Advice and Dealing (Advice and Deal Guide).

The policy statements and guides have been updated to take account of: * FSR regulations made on or after 1 June 2003, which came into effect on or before 6 May 2005.
* the [Financial Services Reform Amendment Act 2003](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=74903" \t "default);
* ASIC Class Orders issued between 11 March 2003 and 6 May 2005; and
* other ASIC documents announcing adjustments to ASIC policy and guidance issued between 1 November 2002 and 6 May 2005 (such as information releases and other guidance papers).

The amendments are largely of a minor and technical nature and do not raise significant new policy issues. Due to the nature and large number of changes, ASIC has not released marked up versions of the updated policy statements and guidance papers. Copies of the updated policy statements and guidance papers can be obtained from the ASIC website at: [http://www.asic.gov.au/fsrpolicy](http://www.asic.gov.au/fsrpolicy%22%20%5Ct%20%22_new) or by calling the ASIC Infoline on 1300 300 630.**2.4 ASIC expands class order relief for responsible entities of managed investment schemes** On 11 May 2005, the Australian Securities and Investments Commission (ASIC) expanded the class order relief available to responsible entities of managed investment schemes by releasing Class Order [CO 05/26] "Constitutional provisions about the consideration to acquire interests". This new class order replaces Class Order [CO 98/52] Relief from the consideration to acquire constitutional requirement. The new class order carries over the previous relief that ASIC provided in Class Order [CO 98/52], with some additional refinements. Class Order [CO 05/26] covers some circumstances for which ASIC previously granted relief on a case-by-case basis and now considers ought to apply to all responsible entities, other than timeshare responsible entities. A copy of the new class order is available from the ASIC website at: [http://www.asic.gov.au/co](http://www.asic.gov.au/co%22%20%5Ct%20%22_new)**2.5 Additional budget funding for ASIC**On 10 May 2005, it was announced that the Australian Securities and Investments Commission (ASIC) will receive an additional $13.4 million in funding over four years. The additional funding will be for the James Hardie Taskforce, the continuation of two enforcement actions and the implementation of the United States (US)-Australia Audit Regulation Programme.ASIC will receive $3.1 million in 2005-06 to fund fully the dedicated James Hardie Taskforce, which was established in late 2004 to investigate matters arising out of the James Hardie Special Commission of Inquiry. The funding will facilitate an early and comprehensive investigation of the complex issues that have been raised in this case. Initial funding of $4.3 million for this purpose was provided to ASIC in 2004-05.ASIC will also receive $4 million in 2005-06 to continue the investigation and litigation work relating to One-Tel and Offset Alpine Printing, without adversely affecting its broader enforcement programme. Initial funding of $3.2 million for this purpose was provided to ASIC in 2004-05. According to the government, in both these cases, well-resourced defendants have initiated costly appeals and challenges to ASIC's powers and processes. These tactics may have been adopted with a view to "pricing out" the regulator. Failure to proceed with these matters could have an adverse impact on community confidence in administration of the national corporations scheme, and lead to a perception that wealthy defendants may avoid sanctions under the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default).ASIC will be provided with $6.3 million over three years to implement the US-Australia Audit Regulation Programme. The programme will ensure that Australian auditors that are registered with the US Public Company Accounting Oversight Board (PCAOB) and their Australian audit clients that are registered with the US Securities and Exchange Commission can be regulated, as far as possible, solely by ASIC in relation to the audit requirements under the Australian and US regimes.This will reduce the regulatory burden and eliminate duplicated processes relating to audit inspections, thereby facilitating access to US capital markets.The programme will require some amendments to the [Australian Securities and Investments Commission Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56481" \t "default) to support the proposed cooperative audit arrangements between ASIC and the PCAOB. This funding will be subject to review in the 2007-08 Budget.**2.6 ASIC superannuation calculator** Comparing super funds has just become easier with the launch of the newest version of the Australian Securities and Investments Commission's (ASIC) superannuation calculator.From 1 July 2005, regulations require all superannuation funds to refer to the ASIC superannuation calculator in their product disclosure statements. The calculator is available on ASIC's consumer website at: [http://www.fido.gov.au/supercalc](http://www.fido.gov.au/supercalc%22%20%5Ct%20%22_new)**2.7 ASIC announces new limits on share buy-back relief for small parcels** On 6 May 2005, the Australian Securities and Investments Commission (ASIC) set limits on the maximum value of small parcels that can be bought back under share buy-backs treated as equal access schemes. ASIC provides case-by-case relief so that a company can buy back a small parcel of shares from each shareholder without the company obtaining a special resolution approving a selective buy-back, under the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). A buyback is selective if the shareholders are not treated equally. Without ASIC relief, a buyback of a small parcel is selective primarily because the small parcel represents a different percentage of the holding of each shareholder. Usually the company buys small parcels as part of a larger buyback involving a scale-back mechanism. After considering the submissions ASIC received on its consultation paper released in December 2004, ASIC has determined to impose the following maximum amounts on the size of small parcels:Companies with a market capitalisation of less than $1 billion: * $2,000 for shares to be bought back from each participating shareholder including the entire holding of participating shareholders whose holding is less than $2,000 (threshold parcel); and
* $500 where a participating shareholder's remaining shares are worth less than $500 after the threshold parcel is bought back (residual parcel).

Companies with a market capitalisation of more than $1 billion:* $5,000 for threshold parcels; and
* $2,000 for residual parcels.

The company's market capitalisation and the size of the parcel of shares to be bought back should be determined using a weighted average five-day trading share price, calculated four weeks prior to the announcement of the buybackASIC has adopted a two-tiered approach to the maximum amounts for threshold and residual parcels in response to submissions it received on its December consultation paper. These maximums strike a balance between the needs of very large companies in conducting buybacks and the risk that maximum amounts that are too high may impact the market in shares for smaller companies.Further issues regarding buybacks are covered in ASIC Policy Statement [PS 110], available from the ASIC website at: [http://www.asic.gov.au/ps](http://www.asic.gov.au/ps%22%20%5Ct%20%22_new)**2.8 ASIC promotes tailored financial services guides** On 3 May 2005, the Australian Securities and Investments Commission (ASIC) granted relief to promote the provision of tailored Financial Services Guides (FSGs). This is set out in ASIC Class Order [CO 05/27] Financial Services Guides-Tailoring Relief. This new class order promotes tailoring of FSGs by relieving financial services providers from the need to comply in all situations with the additional remuneration disclosure requirements currently prescribed by the [Corporations Regulations 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56758" \t "default).The [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) generally permits FSGs to include information limited to the reasonable information needs of the retail client to whom the FSG is actually provided. However, regulations 7.7.04(2) and 7.7.07(2) require FSGs to include specific additional information about remuneration, commissions and other benefits. This additional information must be included in all FSGs, even where: * the information is not relevant to the financial services that will be or are likely to be provided to the client receiving the FSG; or
* the remuneration, commission or other benefits relate solely to services for which an FSG would not be required.

Class Order [CO 05/27] exempts financial service providers from including any additional remuneration information required by regulations 7.7.04(2) and 7.7.07(2) in a FSG, where: * the information does not relate to a financial service that will be or is likely to be provided to the client; or
* the information relates exclusively to services which do not require the provision of a FSG (e.g. if the service is provided only to wholesale clients).

However, if the providing entity later provides another financial service to a retail client and the additional remuneration disclosures have not previously been made to the client in an FSG because of the relief in Class Order [CO 05/27], the providing entity will be required to give the client a new FSG or supplementary FSG including the relevant additional remuneration disclosures for that financial service.It should be noted that the Government's Proposals Paper Refinements to Financial Services Regulation issued on 2 May 2005 and discussed in Item 1.14 of this Bulletin, contains various additional proposals designed to further promote the ability of licensees to tailor disclosure documents to different types of clients or products (e.g. refer to Refinement Proposal 1.1).A copy of the Class Order is available on the ASIC [website](http://www.asic.gov.au" \t "_new).**2.9 ASIC guidance on disclosing the impact of IFRS for full-year financial reports** On 26 April 2005, the Australian Securities and Investments Commission (ASIC) outlined its expectations about the nature and extent of disclosure required under Australian Accounting Standard AASB 1047 Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards for 30 June 2005 annual financial reports.The objective of AASB 1047 is to inform financial report users about the impact of changes in accounting policies arising from the implementation of International Financial Reporting Standards (IFRS) in the financial reporting period leading up to the first financial report prepared in accordance with IFRS.AASB 1047 requires disclosure of: * any known or reliably estimable information about the quantified impacts on the financial report had it been prepared using IFRSs; or
* if such impacts are not known or reliably estimable, a statement to that effect. In this case AASB 1047, suggests that entities should also update their disclosures made in 2004 about the management of the transition to IFRSs and the explanation of the key differences in accounting policies expected to arise.

It is expected that the form and content of the disclosure will vary between entities. The information required by AASB 1047 should, however, be provided at a level of detail such that user of the financial report can understand the nature and extent of the significant impacts on the financial report.In the rare cases, where an entity's management of the transition to IFRS has unavoidably not reached a point where it is practicable to provide reliably estimable quantitative information, disclosure to that effect should be provided with an explanation as to the reasons and the directors' expectations about the ongoing management of the transition process. To the extent that an entity knows or is able to reliably estimate the quantitative impact of some, but not all of the key accounting policy changes, the disclosure should comprise the quantified impacts of those accounting policy changes that can be reliably estimated. For any items for which the quantified impacts cannot be reliably measured, a narrative explanation must still be provided. The narrative component should explain the reasons for not being able to quantify the impact and to the extent practicable indicate whether any impact on relevant financial statement line items is likely to be positive or negative. ASIC will be reviewing compliance with AASB 1047 as part of its ongoing review of financial reports of listed entities.Companies and entities required to prepare financial reports under the requirements of Chapter 2M of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) are required to comply with Australian equivalents to International Financial Reporting Standards (IFRS) for reporting periods beginning on or after 1 January 2005.Entities with 30 June year ends will publish their first IFRS financial reports for the half-year ended 31 December 2005 and for the year ended 30 June 2006.Further information is available on the ASIC [website](http://www.asic.gov.au" \t "_new). |
| **3. Recent ASX Developments** |
| **3.1 ASX review finds corporate governance disclosure satisfactory**The first ASX review of Australian listed companies’ corporate governance practices since the introduction of the ASX Corporate Governance Council’s principles and best practice recommendations has revealed that listed companies have satisfactorily fulfilled their reporting requirements. They fulfilled their obligations either by confirming adoption of ASX Corporate Governance recommendations or by providing “if not, why not” reporting.The average adoption rate for all ASX Corporate Governance Council recommendations for the whole market was 68%. In the case of the top 500 companies the adoption rate was almost 85%. In addition, alternative practices were adopted and disclosed in 16% of the whole market and 7% for the top 500. So, in short, disclosure in aggregate was 84% for the whole market and 93% for the top 500.ASX amended its Listing Rules to require companies to disclose in the corporate governance section of the annual report the extent to which they followed the Council’s recommendations. This requirement took effect for financial years beginning after 1 January 2003, making 2004 annual reports, for most companies, the first to contain this information.The review was based on 1,222 annual reports released between 1 August 2004 and 31 December 2004, focussing on those recommendations that had generated the most interest and discussion. This was a significant undertaking as each annual report was reviewed for disclosure in relation to each of the Council’s 28 recommendations equating to almost 34,000 individual actions.The review can be read in full on the ASX website at: [http://www.asx.com.au/supervision/governance/index.htm](http://www.asx.com.au/supervision/governance/index.htm%22%20%5Ct%20%22_new)**3.2 ASX Business Rules** As part of the twice yearly "house-keeping" of the Rules, ASX has conducted the 2004 "December tranche" of Market Rule amendments. The amendments that were made to the Market Rules range from typographical, formatting, cross-referencing and other minor drafting amendments to more substantive amendments to the Rules and were included in the March 2005 Exposure Draft of Market Rule amendments.The Treasury has advised that the non-disallowance period passed on Friday 15 May 2005 in relation to the typographical, formatting and miscellaneous minor drafting amendments, as well as amendments made to the following Rules:1. Rule 2.10 - definition of "Procedures"; 2. Rule 4.18.2 - Right of ASX to participate in proceedings;3. Rule 11.3 - Adjustments;4. Rule 16.1 - Dealing in financial products not yet granted Official Quotation;5. Rule 22.3 - Aggregation of Special Crossings of DTP Products; and6. Rule 26.5.2 - Suspension of Trading Permission in the Wholesale Loan Securities Market.The effective date for these amendments was Friday 27 May 2005. |
| **4. Recent Takeovers Panel Decisions** |
| **4.1 Austral Coal Limited – Panel declines to make a declaration of unacceptable circumstances**On 23 May 2005, the Takeovers Panel announced that it had declined to make a declaration of unacceptable circumstances in relation to the application Glencore International AG and a company controlled by Glencore, Fornax Investments Ltd (together Glencore), in relation to the affairs of Austral Coal Ltd (Austral Coal) and the scrip takeover offer for Austral by Centennial Coal Company Ltd. (Centennial).On 29 April 2005, Centennial announced as part of its quarterly report for the March 2005 quarter that its Munmorah coal mine (Munmorah) would be closed in August 2005. Glencore in its Application alleged that unacceptable circumstances existed in that Centennial had knowledge of the decision to close, or likelihood of a decision to close, Munmorah before this time, that this was information which was material to the value of Centennial shares and that, therefore, this information should have been disclosed to Austral shareholders at the time it became known.The Panel considered that the decision by the directors of Centennial to close Munmorah was not material to the decision by the shareholders of Austral Coal in deciding whether or not to accept the 10 for 37 scrip takeover bid by Centennial. The Panel therefore considered that the absence of disclosure in the Centennial bidder's statement or any supplementary statement of the possibility that Centennial may close Munmorah, or an actual decision of the board of Centennial to close Munmorah, before the closure was announced in Centennial’s third quarter results on 29 April 2004 (29 April Announcement), did not constitute unacceptable circumstances.The Panel noted Glencore's submissions as to the fall in price of Centennial shares in the days immediately after the 29 April Announcement. However, the Panel noted the submissions of Centennial as to the financial effects of, and the materiality of, Munmorah on Centennial, both prior to the decision to close, and as a consequence of the decision to close the mine. The Panel also noted the price recovery of Centennial shares in the short period after the 29 April Announcement. While not directly necessary for the Panel's decision, the Panel considers it likely that the sharp fall in price following the 29 April Announcement and the subsequent rise were more reflective of the incomplete disclosure of the effects of the closure on Centennial in the 29 April Announcement than of the materiality of the announcement.In this regard, the Panel noted the advices given by Centennial in its submissions to the effect that:(a) the Munmorah loss of $21.6 million as detailed in the Quarterly Activities Report released on 29 April 2005 was pre-tax and comprised:(i) $4.9 million expected cash operating loss for 2005;(ii) $2.8 million of depreciation for 2005;(iii) $13.9 million of one-off costs ($9.7 million after tax) associated with poor mine performance (purchased coal) or closure of the mine (this includes the carrying value of the Munmorah mine, which was $2.7 million and was non-cash); and(b) $7.8 million of this loss had already been included in profits for the 6 months to 31 December 2004. The one-off Munmorah cash costs of $11.2 million ($7.8 million after tax) are equivalent to 2.9 cents per Centennial share; (c) Munmorah represented less than 1% of Centennial's reserves and less than 5% of Centennial's revenue for the first half of its financial year ending 30 June 2005. The carrying value of Munmorah was 0.15% of Centennial's market capitalization; (d) Munmorah's earnings and cash flow were negative to at best break even; and(e) after the initial market overreaction, Centennial's share price recovered to $4.94 compared with $4.87 immediately prior to the announcement of the closure of Munmorah. The Panel noted the Centennial share price movement of $0.40 in the days immediately after the 29 April Announcement. However, the Panel was of the view that an assessment of the materiality of the decision to close Munmorah for the decision by an Austral Coal offeree was more appropriately done by assessment of the effect of the closure on the long term value of Centennial. Also, the Panel noted Centennial's submissions concerning market reactions to earnings downgrades at the relevant time. On the basis that closure of Munmorah was not material to the decision of Austral Coal shareholders, any lack of disclosure in relation to the prospect of the closure did not constitute unacceptable circumstances.In saying this, the Panel noted the assertions by Centennial that, with better explanation, the market and analysts considered that the closure of Munmorah did not have a material adverse effect on the value of Centennial. The Panel also noted that the operating losses which Centennial advised the Panel that Munmorah had been making in the first half of the financial year ending 30 June 2005 equalled close to 5% of Centennial's EBITDA (and were, on that basis, disproportionate to its value to Centennial). On that basis, the disclosure relating to Munmorah and the benefits associated with its closure, both prior to and in, the 29 April Announcement, may have been better. Further information is contained in the Panel’s media release which is available at [http://www.takeovers.gov.au/display.asp?ContentID=952](http://www.takeovers.gov.au/display.asp?ContentID=952" \t "_new)**4.2 Stericorp Limited - Panel declines to make a declaration of unacceptable circumstances** On 29 April 2005, the Takeovers Panel announced that it had declined to make a declaration of unacceptable circumstances in relation to SteriCorp Limited’s (SteriCorp) 1 for 1, non-renounceable rights issue (Rights Issue), the terms of which were set out in a prospectus dated 11 March 2005. The Rights Issue was underwritten by a major shareholder of SteriCorp, Catilina Nominees Pty Ltd (Catilina). The decision was in response to an application on 19 April 2005 (TP05/37) by SteriCycle, Inc (Stericycle), a major convertible note holder in SteriCorp.The Panel did not consider that the structure of the Rights Issue and underwriting arrangements made the Rights Issue inaccessible to SteriCorp’s shareholders or that SteriCorp shareholders were likely to have been materially misled by the Rights Issue prospectus.In coming to this decision, the Panel considered a number of issues including:* SteriCorp’s need for funds to repay a vendor finance loan (negotiated to be repaid early at a significant discount) and to fund previously announced capital projects;
* various fundraising alternatives had been investigated by SteriCorp with potential investors (including Stericycle);
* SteriCorp had taken legal and commercial advice with a view to structuring the Rights Issue and the underwriting arrangement with Catilina in accordance with Chapter 6; and
* the Panel considered that the Rights Issue prospectus and the supplementary prospectus had provided SteriCorp shareholders with the material information in relation to the potential increase in voting power of Catilina.

In considering whether any action was warranted in relation to any of the issues raised by Stericycle, the Panel also took into account the delay of the applicant in bringing the application to the Panel. Stericycle had not raised its concern with SteriCorp or ASIC until 14 April 2005, one day before the Rights Issue was due to close, despite the Rights Issue having been announced to ASX on 21 February 2005 and the prospectus having been issued on 11 March 2005.Stericycle and SteriCorp are currently involved in disputes in relation to (among other things) the performance of medical waste treatment equipment supplied by Stericycle to SteriCorp (Warranty Dispute). SteriCorp instituted proceedings in the Supreme Court of Victoria against Stericycle in relation to the Warranty Dispute on 14 April 2005.One of the complaints put by Stericycle related to the fact that Catilina, as underwriter of the Rights Issue, is also the major shareholder in SteriCorp holding 13% of the voting power in SteriCorp and that Catilina’s normal business did not include underwriting. The Panel noted that the fact that a major shareholder is the underwriter for a rights issue and that the normal business of the underwriter does not include underwriting are two of the criteria which the Panel normally considers when assessing whether or not a Rights Issue constitutes unacceptable circumstances. However, the Panel also noted that frequently, in relation to small companies, the major shareholder will be the only feasible source of financial support (i.e. underwriting of a Rights Issue) for such companies.The Panel considered the circumstances surrounding the SteriCorp Rights Issue and Catilina’s involvement as underwriter. The Panel considered that the involvement of Catilina did not contribute towards the Rights Issue constituting unacceptable circumstances.The Panel noted that there are certain aspects of the Rights Issue that weighed towards a finding of unacceptable circumstances.First, the Rights Issue was non-renounceable. Renounceability tends to create a market for rights and, subject to the rights having a value and demand existing for those rights, may facilitate the rights being acquired and exercised by a wider range of persons rather than all of the shares not taken up by existing shareholders flowing through to the underwriter. The Panel accepted SteriCorp’s submission that there was unlikely to be a significant market for the rights, but noted that the Panel considers that it is better practice for rights issues to be renounceable in the absence of material reasons for non-renounceability.Second, the Rights Issue was offered at a price which was very close to the market price of SteriCorp shares. The Panel received submissions from both parties as to the price of SteriCorp shares over various periods before the Rights Issue was announced. The Panel considered that the Rights Issue was not priced at a discount to the 1 month volume weighted average price of SteriCorp shares before the announcement, unless a significant value was attributed to the attached option. The Panel took into account that a significant discount was not possible given the low price of SteriCorp shares. The Panel found that the price was not so high as to deter shareholders from taking up their rights.Overall, the Panel considered that the factors weighing against unacceptability clearly outweighed the factors suggesting unacceptability. Accordingly, the Panel declined to make a declaration of unacceptable circumstances.Further information is available on the Takeovers Panel [website](http://www.takeovers.gov.au" \t "_new). |
| **5. Recent Corporate Law Decisions** |
| **5.1 Statutory derivative action by a joint venturer**(By Sabrina Ng and Martin Squires, Corrs Chambers Westgarth)Fiduciary v Morningstar Research [2005] NSWSC 442, New South Wales Supreme Court, Austin J, 9 May 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/may/2005nswsc442.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/may/2005nswsc442.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/index.html](http://cclsr.law.unimelb.edu.au/judgments/index.html%22%20%5Ct%20%22_new)**(a) Summary**In this case, the court granted leave to a former officer of a joint-venture vehicle to bring a statutory derivative action on behalf of that company against the other venturer and its board nominees.**(b) Facts**Mr Rich was the former managing director of Morningstar Research Pty Ltd (MR). MR was a vehicle for a joint venture between companies controlled by Mr Rich and Morningstar Inc (a Chicago-based company).Mr Rich and companies he controlled had commenced proceedings against MR, Morningstar Inc and the directors nominated to MR’s board by Morningstar Inc, seeking damages for wrongdoing of various kinds causing damage to the plaintiffs and to MR.Mr Rich now sought leave under section 237 of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) to bring a derivative action on behalf of MR against the other defendants.**(c) Decision**Section 237(2) contains the five criteria for the grant of leave. The criteria Austin J particularly considered in this case were whether Mr Rich was acting in good faith, and whether the action was in the best interests of the company.To determine whether Mr Rich was acting in good faith, Austin J considered whether Mr Rich was pursuing interests other than those of MR in making the application.Austin J was satisfied Mr Rich’s purpose was to obtain judgment for damages in favour of MR to redress the damage caused to MR and thereby increase the value of his indirect shareholding in MR. Clearly, part of his purpose was to obtain financial compensation, ultimately for his own benefit. However, Mr Rich was seeking to do this by proceeding on behalf of the company to the extent that the company in which he had an indirect interest had suffered loss. Austin J observed that MR’s causes of action arose from the same facts and circumstances that gave rise to Mr Rich’s causes of action. His Honour concluded there was nothing improper in Mr Rich seeking to invoke MR’s rights in a case such as this and that Mr Rich was acting in good faith.Austin J then considered whether a derivative action was in the best interests of the company. His Honour said that where the company is a joint venture vehicle, and one venturer alleges the other has acted unlawfully, causing the company loss, it will usually be appropriate to allow the complaining venturer to bring proceedings in the company’s name against the other venturer and its board representatives, even though there are no other shareholders and that the effect of success will be to indirectly benefit the complaining venturer. Austin J granted leave subject to certain terms to protect the company’s best interests. These included orders that Mr Rich be responsible for any costs ordered against MR and that the action be stayed until MR or Mr Rich provide security for costs.**5.2 Company registration-put your house on it** (By David Goldberg, Solicitor, Clayton Utz)Stanley Stergiou and Ekaterine Stergiou v Citibank Savings Ltd [2005] ACTCA 15 Supreme Court of the ACT, Court of Appeal, Crispin P, 3 May 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/act/2005/may/2005actca15.htm](http://cclsr.law.unimelb.edu.au/judgments/states/act/2005/may/2005actca15.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/index.html](http://cclsr.law.unimelb.edu.au/judgments/index.html%22%20%5Ct%20%22_new)**(a) Background**This case is an appeal from the ACT Supreme Court decision of Connolly J, who found that the Stergious had breached the terms of their mortgage, and made orders in favour of Citibank Savings Ltd for the possession of the house and payment of costs.**(b) Facts** Mr Stergiou, in the course of tendering evidence on his own and his wife's behalf at the appeal hearing, launched what Crispin P described as a "legal missile" when he submitted to the Court an historical company extract for Citibank Savings Ltd, provided by ASIC. The extract showed that Citibank Savings Ltd had been deregistered on and since 13 June 1996. It immediately became clear to Citibank Savings and the Court that "the consequences for the ensuing litigation had been... catastrophic". Relying on numerous authorities, Crispin P held that "[a]ll proceedings for or against a deregistered company are a nullity".Counsel for Citibank Savings sought and was granted an adjournment. A new notice of motion was filed, ostensibly on behalf of Citibank Savings Ltd and Citibank Pty Ltd. This sought orders to reinstate Citibank Savings Ltd under section 601AH of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). Citibank Pty Ltd was the company to which the rights under the mortgage had been assigned.Section 601AH provides that:The Court may make an order that ASIC reinstate the registration of a company if the Court is satisfied that it is just that the company’s registration be reinstated.If the Court makes an order under subsection (2), it may:* validate anything done between the deregistration of the company and its reinstatement; and
* make any other order it considers appropriate.

Reinstatement, if allowed, would restore Citibank Savings Ltd to the position it would have enjoyed had it never been deregistered. In effect, Citibank Savings Ltd would be taken to have existed throughout the period of litigation, and the proceedings the subject of this appeal "would not be seen as a nullity but would... have been retrospectively validated".**(c) Decision** Crispin P dismissed the notice of motion filed by Citibank. His Honour did so on several bases:* all proceedings for or against a deregistered company are a nullity;
* any orders sought in proceedings that are a nullity would equally be nullities;
* the application was made ostensibly on behalf of both Citibank Savings Ltd and Citibank Pty Ltd. Crispin P held that, as an unregistered company, Citibank Savings Ltd had no standing to make any such application. Further, the application by Citibank Pty Ltd could not be entertained, as it was not a party to either the mortgage or the proceedings;
* it would be an inappropriate exercise of the power conferred by section 601AH of the Corporations Act to reinstate a company "merely as a technical device intended to retrospectively validate proceedings that have been a nullity since their inception";
* even if Citibank Savings Ltd was reinstated, its claim was doomed to failure because it had divested itself of any rights under the mortgage and the proceedings were founded upon the service of a notice invalidly issued by a deregistered company demanding payment of a debt which had not been owed to it;
* nothing in section 601AH of the Corporations Act suggests an intention to "permit the retrospective validation of orders made in proceedings that were a nullity";Connolly J was not asked to consider whether Citibank Pty Ltd was entitled to possession of the appellants' house, and the appellants would effectively be denied a hearing on that issue if reinstatement was ordered; and
* it would in any event be inappropriate for the approach suggested by Citibank to be taken on appeal.

**(d) Lessons**When a company is party to litigation, it is imperative to verify that the company is properly registered under the Corporations Act. A party which is not registered or has been deregistered has no standing in the court.Section 601AH of the Corporations Act is not intended to confer upon a court the power to reinstate a company to overcome a technicality of litigation.Any company which seeks deregistration must be advised that all current or future proceedings by or against it will be a nullity. **5.3 When arrangements entered into during a winding up will be binding on a dissenting creditor – Corporations Act s 510** (By Jane Mevel, Corrs Chambers Westgarth)Ozem Kassem v Sentinel Properties Limited [2005] NSWSC 403, Supreme Court of New South Wales, Barrett J, 29 April 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/april/2005nswsc403.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/april/2005nswsc403.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Summary**The plaintiff was the liquidator of five companies in a group. The plaintiff applied to the Court to determine whether a resolution of creditors of one of the companies was binding on all of the creditors of that company under section 510 of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (Act), in circumstances where one creditor had dissented.Barrett J held that section 510 only operates to bind a dissenting creditor if the arrangement approved by the creditors is not discriminatory as regards that dissenting creditor. Discrimination exists where the creditors will not be paid from available funds on a pari passu basis.In the present case, the court found that the arrangement approved by creditors was not discriminatory (notwithstanding that it provided for the pooling of assets and liabilities of a group of five companies) as all creditors of each particular company were treated pari passu in terms of the distribution of the pooled funds. The arrangement was therefore binding on the dissenting creditor under section 510.On a collateral issue, Barrett J held that a resolution under section 510 need only be passed by a simple majority of creditors, determined according to the voting power established under section 510(2).**(b) Facts**The plaintiff was the liquidator of each company in a group of five companies. Each winding up was a creditors voluntary winding up. The plaintiff sought a determination, pursuant to section 511(1) of the Act, as to whether a resolution of creditors of one of the companies was binding on all the creditors of that company, notwithstanding that one creditor had voted against the resolution.The affairs of the five companies had been substantially intermingled. The proposal which the plaintiff put forward to creditors called for the pooling of assets and liabilities of the group and for the distribution of any surplus among all group creditors as though the companies were a single company in liquidation and the creditors were creditors of a single company in liquidation.The plaintiff convened separate meetings of the creditors of each company and meetings of the members of each company to consider the pooling proposal. The proposal was approved unanimously at all bar one meeting. At one creditor’s meeting however, one proxy vote was cast against the proposal. The chairman of the meeting declared the resolution passed.**(c) Decision**Section 510 of the Act states that "an arrangement entered into between a company about to be, or in the course of being, wound up and its creditors is, subject to subsection (4) …binding on the creditors if sanctioned by a resolution of the creditors": section 510(1)(b).The plaintiff sought confirmation that section 510 made the resolution passed at the relevant meeting binding on all the creditors, notwithstanding the dissent of one creditor.Barrett J accepted the authority that section 510 does not allow an arrangement that allows for discriminatory treatment of creditors to be binding on the disadvantaged creditors unless those disadvantaged creditors assent to the arrangement: *Dean-Willcocks v Soluble Solution Hydroponics Pty Ltd* (1997) 42 NSWLR 209, *Re Switch Telecommunications Pty Ltd* (2000) 35 ACSR 172.Discrimination will exist if the creditors will not be paid pari passu. In the present case, Barrett J found no such discrimination. Whilst the several groups of creditors would share in one consolidated fund made up of the total assets of all companies combined, this would not impact on the normal relativities within the body of creditors of any one company. The fact that there may become divisible among the members of any one company, on the pari passu basis, an aggregate that was greater or less than that which would have been so divisible if the pooling arrangement had not been implemented did not constitute discrimination.As there was no discrimination, section 510 operated to make the arrangement binding on all creditors. Barrett J also considered the meaning of the term "resolution" in section 510(1)(b) of the Act. Having noted that the section does not state what majority of positive votes is required for a creditors’ resolution to be passed under that section, he noted that, in the absence of any further specification, the common law rule should prevail. This rule requires a simple majority for a resolution to be passed: *Attorney General v Davy* (1741) 2 Atk 212; 26 ER 531. Finally Barrett J held that, as the resolution was part of a meeting governed by Part 5.5 of the Corporations Act, regulations 5.6.12 to 5.6.57 of the [Corporations Regulations 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56758" \t "default) governing the running of such meetings applied. **5.4 Winding-up of family companies by shareholder trustee of a family trust** (By Alexei Fedotov, Mallesons Stephen Jaques)Netbush Pty Ltd v Fascine Developments Pty Ltd [2005] WASC 73, Supreme Court of Western Australia, Simmonds J, 3 May 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/wa/2005/may/2005wasc0073.htm](http://cclsr.law.unimelb.edu.au/judgments/states/wa/2005/may/2005wasc0073.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Summary**Wide investment powers conferred on a trustee by a trust deed may be sufficient to authorise an application to wind-up companies of which the trust is a shareholder.The winding-up remedy under sections 233 and 461 is a remedy of last resort and may be refused where:* a less intrusive remedy is available (such as in this case);
* it would assist the breach of trust (which was not the case here); or
* it would allow the essential characteristics of the company to be subverted (which was not the case here).

Directors have no power to issue and allot shares to adjust the interests of beneficiaries of a trust which is its shareholder. However, a company can refuse to register the transfer of shares to the trustee of such a trust if it has concerns over the validity of the trustee’s appointment.**(b) Facts**The first defendant and second defendant ("Defendant Companies") in a family group of companies issued and allotted to the fifth defendant company (controlled by Mr Roberts (fourth defendant)) a new class of shares with special voting rights and participation entitlements. Those issues and allotments were said to have been intended to address the concerns about the administration of the family trust set up for the children of Mr Roberts ("Trust") (in particular, to protect the interests of minor children). The effect of the shares would have been to ensure that the fifth defendant had equivalent voting rights to those of the trustee on any shareholder approval of a distribution so that there would be no distribution by the Defendant Companies to, or for the benefit of, the adult children in which the minor children did not share pari passu and rateably with them. The Trust was a substantial shareholder of the Defendant Companies. The Defendant Companies also made loans to Mr Roberts. After the plaintiff ("Netbush") was appointed as a new trustee of the Trust, the Defendant Companies refused to register Netbush as a shareholder of the respective Defendant Companies.Netbush claimed that the issues and allotments of shares, loans to Mr Roberts and the refusal to register Netbush constituted "oppressive" conduct for the purposes of sections 232 and 461 of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) ("the Act") and sought:* to have the issues and allotments of shares set aside;
* rectification of the share registers of the Defendant Companies;
* an injunction to prevent exercise of the rights attached to the new shares; and
* to wind-up the Defendant Companies.

**(c) Decision** The Court set aside the issues and allotments of shares, ordered rectification of the share registers and granted the injunction. However, the Court refused to wind-up the Defendant Companies.**(i) Power of trustee to seek winding-up**The Defendant Companies raised two preliminary issues. Firstly, they objected to the ability of Netbush to seek a winding-up on the ground that Netbush as trustee did not have the power to seek a winding-up of the company in which the Trust was a shareholder. Secondly, they asserted it was inequitable to grant a winding-up application which itself was in breach of trust. As to the "lack of power" argument, Simmonds J decided that the powers conferred on Netbush by the trust deed effectively included the power to bring a winding-up application for a company in which the Trust held shares. Simmonds J relied upon the specific powers conferred on Netbush, in addition to the powers conferred by the Act, to:* "sell the shares";
* agree to, assent to, or join in, any arrangement relating to the sale of such shares; and
* "vary or transpose any investments into or for any other or others of any nature whatsoever".

As to the "inequity" argument, Simmonds J accepted that the Court could refuse to order a winding-up under section 461 if that remedy was sought in breach of trust. However, Simmonds J held that mere failure to consult the beneficiaries about the proposed action did not amount to a breach of trust. **(ii) Issues and allotments of shares**The Defendant Companies contended that the issues and allotment were for a legitimate purpose of protecting certain beneficiaries of the Trust from actions of Netbush adversely affecting their interests. Simmonds J decided that the adjustment between the interests within the Trust was a matter for the parties to the Trust, and not the companies in which the Trust was a shareholder. Therefore, the powers of the directors of the Defendant Companies to issue and allot shares could not be exercised to protect the interests of the beneficiaries of the Trust. Simmonds J emphasised the principle that shares cannot be issued to realign voting power enjoyed by the existing majority and noted that this principle applied even where the targeted class of shareholders was not a majority.The Defendant Companies further contended that the power to issue and allot shares was enlarged to enable the prevention of the subversion of the “essential characteristics” of the Defendant Companies by Netbush. Simmonds J dismissed this argument because the terms of the trust deed were not an "essential characteristic" of the Defendant Companies. The Defendant Companies also argued that unfairness in the proposed actions of Netbush in breach of trust prevented the issues and the allotments being "unfair" within the terms of section 232(e). Simmonds J decided that, whether or not Netbush’s conduct was in breach of trust, the response in the form of the issues and allotments was "unfair" in this case.Simmonds J decided that the issues and allotments of shares enlivened the discretion to grant relief against oppression under section 233(1). Having found that the improper exercise of the power to issue and allot shares by the directors of the respective Defendant Companies constituted oppression, Simmonds J concluded that the discretion in section 461(e) was also engaged.**(iii) Loans to Mr Roberts**It was not established that there was such impropriety in the loans by the Defendant Companies that an order for winding-up was required. In particular, Simmonds J confirmed that in a family company context, loans may not always be made on a commercial basis. **(iv) Refusal to register Netbush as a shareholder**Simmonds J decided that a concern about the validity of appointment of Netbush as trustee (ie the propriety of its entitlement to be the legal owner of the shares) permitted the directors of the Defendant Companies to refuse the registration until the validity had been properly addressed. Consequently, the refusal to register Netbush was not conduct that warranted a remedy against oppression.**(v) Exercise of discretion and appropriate form of relief**In relation to both sections 233 and 461, Simmonds J reiterated the orthodox principle that a remedy which is the least intrusive, that would eliminate the oppression, should first be considered by the Court. Thus, the winding-up remedy is a remedy of last resort and ought not to be granted if "other less drastic relief is available and appropriate".Pursuant to section 467(4) the Court must order a winding-up where the application is made on the "just and equitable" ground (section 461(1)(k)), or on the ground that the directors have "acted in a manner that appears to be unfair or unjust to other members" (unless the Court is of the opinion that some other remedy is available and the applicants are acting unreasonably in seeking to wind-up the company instead of that other remedy). Simmonds J held that the “unfair or unjust” ground referred to in section 467(4) included applications under sections 461(1)(e), (f) and (g). Simmonds J identified the following circumstances as relevant to the exercise of the discretion whether or not to order a winding-up of the defendant companies:* whether the remedy sought by Netbush formed part of a larger agenda, the result of which would have been a breach of trust;
* whether the actions of Netbush would subvert the “essential characteristics” of the respective Defendant Companies; and
* whether Netbush’s appointment was valid.

Ultimately, Simmonds J held that the invalidation of the issues and allotments of shares would eliminate the oppression in this case. Therefore, the winding-up remedy was inappropriate.**5.5 Novation of a debt as a breach of directors’ duties** (By James Burchnall, Freehills)Angas Law Services Pty Ltd (in liq) v Carabelas [2005] HCA 23, High Court of Australia, Gleeson CJ, Gummow, Kirby, Hayne and Heydon JJ, 27 April 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/high/2005/april/2005hca23.htm](http://cclsr.law.unimelb.edu.au/judgments/states/high/2005/april/2005hca23.htm%22%20%5Ct%20%22_new) or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Summary**The first respondent, a legal practitioner, and the second respondent, his wife, were at all material times the holders of the two issued shares in the capital of Angas Law Services Pty Ltd ("ALS"). They were also the only directors of ALS. ALS was wound up in 1994 on the ground of insolvency, after which ALS and its liquidator brought two claims against the respondents. The first claim sought compensation for alleged breaches of duties owed by the directors under sections 229(2) and 229(4) of the former Companies (South Australia) Code ("the Code"). The second claim was an application for orders under section 588FF(1) of the former Corporations Law for transactions involving unfair preferences.The claims concerned certain "transactions" that were alleged to have taken place. The first transaction involved a mortgage given by ALS to the Commonwealth Bank ("CBA"), which was stated to be in consideration of an advance made by CBA to the first respondent. The second series of transactions was allegedly evidenced by the accounts of ALS, in which it appeared that the first respondent had caused debts owed by himself personally to ALS to be novated to insolvent companies under his control. The third series of transactions were also allegedly evidenced by the accounts of ALS. Debts owed by the first respondent to his companies were "netted off" against the debts owing to the first respondent by his companies. This "netting off" process was intended to show that ALS and the other companies had no assets, so that they could be de-registered rather than wound up.It was alleged that the mortgage and novation transactions were in contravention of: * section 229(2) of the Code, which requires an officer of a corporation to act with a reasonable degree of care and diligence; and
* section 229(4) of the Code, which prohibits an officer of a corporation from making improper use of his or her position to gain an advantage for himself or herself or for any other person or to cause detriment to the corporation.

The appellants also contended that the “netting off” transactions involved unfair preferences, such that they should be deemed voidable transactions under sections 588FA and 588FC of the Corporations Law.The first respondent contended that his various companies operated as a joint venture and that the accounts must be viewed in this context. It was the first respondent’s contention the he did not borrow money from CBA as principal, but rather as the agent of his various companies. Accordingly, it was contended that no debt novation had occurred and that the reason why the accounting entries showed that the debts were owed to ALS by the insolvent companies was because the first respondent had borrowed money as the agent of these companies, rather than borrowing as principal. Williams J of the Supreme Court of South Australia found in favour of ALS, ordering that that the respondents pay costs and an amount of $1,206,373, being compensation of $474,950 and interest of $731,423. On appeal, the Full Court of the Supreme Court of South Australia found that no impropriety or want of reasonable care had been shown. The Full Court also rejected the preference claims on the bases that the ALS account entries were not a true record of any transactions and that no such transactions had occurred that were binding on ALS or the other companies. The appeal to the High Court of Australia was dismissed.**(b) Facts** In June 1998, the first respondent approached CBA seeking an advance of up to $2.5 million. At the time, it was estimated that the total value of properties owned by the first respondent and companies under his control was approximately $3.6 million. On or about 15 July 1988, CBA advanced $1,750,000 to the first respondent. As security, the bank obtained a first mortgage over all real estate owned by the first respondent or by his companies. Part of the $1,750,000 advance was used to pay off a pre-existing debt of $435,040 owed by ALS to Hindmarsh Building Society, which had been secured by a mortgage over a property owned by ALS in Angas St, Adelaide. Having discharged the mortgage to Hindmarsh Building Society, ALS then gave a mortgage over the Angas St property to CBA, which was stated to be in consideration of advances made by CBA to the first respondent. Following this transaction, the accounts of ALS showed a loan by the first respondent to ALS of $435, 040, giving rise to a debt owed by ALS to the first respondent of the same amount. On 11 October 1989, the Angas St property was sold for $910,000. The entire proceeds of the sale went to CBA (after payment of the agent's costs and commissions and other minor items) and were applied to reduce the first respondent’s indebtedness. This was reflected in the accounts of ALS as a debt owed by the first respondent to ALS of $446,710.31. This figure represented the proceeds of the sale minus the $435,040 owed by ALS to the first respondent.When the financial statements of ALS for the year ended 30 June 1990 were prepared, the first respondent's bookkeeper made another journal entry purporting to correct the prior entry. The new entry showed that the amount of $446,710.31 was owed to ALS by the first respondent in conjunction with various other companies controlled by him, rather than by the first respondent alone as had previously been indicated.In April 1994, ALS was wound up by order of the Supreme Court of South Australia on the ground of insolvency. The petitioning creditor was the Deputy Commissioner of Taxation, who was owed $25,408 in unpaid capital gains tax. When ALS was wound up, its accounts were not up to date. Subsequently, the accounts for the years ending 30 June 1992 and 30 June 1993 were prepared by the first respondent’s bookkeeper in such a way as to show that ALS and the other companies controlled by the first respondent had no assets, so that they could be de-registered rather than wound up. This was done by “netting off” amounts owed by the first respondent to his companies with amounts owing to the first respondent by his companies.In 1997, ALS and its liquidator commenced proceedings in the Supreme Court of South Australia to recover compensation from the respondents for breaches of directors’ duties involved in the alleged novation transactions and unfair preferences in the "netting off" transactions. **(c) Decision** In a joint judgment, Gleeson CJ and Heydon J upheld the Full Court’s conclusion that no impropriety or want of reasonable care had been shown. With regard to the appellants’ contention that a novation had occurred, resulting in the discharge of the first respondent’s liability to ALS and the loss by ALS of a valuable asset in the form of that debt, their Honours concluded that no transaction of novation was shown to have occurred. Their Honours noted that the respondents' joint venture argument had been dismissed by Williams J at the first instance and again by the Full Court. However, their Honours found that the bookkeepers’ misconception that the companies operated as a joint venture formed the basis of the entries in the ALS accounts. Their Honours rejected the appellants' contention that the accounting entries were evidence of novations and consequently dismissed the appellants' allegations of the existence of transactions contravening sections 229(2) and 229(4) of the Code. If novations of this kind had occurred, their Honours conceded that this would have involved a contravention of section 229(4) of the Code. Their Honours also dismissed the unfair preference claims under sections 588FA and 588FC of the Corporations Law, concluding that the journal entries were not a true record of any transaction and that there was no transaction that was binding on ALS or the other companies. In another joint judgment, Gummow and Hayne JJ agreed with the reasons given by Gleeson CJ and Heydon J and with the orders proposed. Gummow and Hayne JJ also dealt with the detailed submissions that had been made by the parties with regard to section 229 of the Code. Their Honours discussed the legislative history of section 229 and considered the meaning of the word “improper” within the context of section 229(4). Having reviewed the authorities on this issue, their Honours concluded that the starting point in assessing the standard of propriety required of a director must be the general duty to act in the best interests of the company and that the best interests of the company will depend on various factors including solvency. Their Honours held that the standards of propriety were not breached by the respondents, given that ALS was solvent at the time when it granted a mortgage to CBA and the granting of the mortgage was authorised by the shareholders.Kirby J also agreed with the orders proposed by Gleeson CJ and Heydon J and with their reasons. However, his Honour reserved his opinion on the additional observations made by Gummow and Hayne JJ. The appeal was dismissed with costs, except to the extent that the matter was remitted to the Full Court to consider an amendment to the statement of claim.**5.6 Terminating a share buy back agreement** (Jack Cai, Articled Clerk, Clayton Utz)Alan Davis Group v Rivkin Financial Services [2005] NSWSC 369, New South Wales Supreme Court, Gzell J, 26 April 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/april/2005nswsc369.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/april/2005nswsc369.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Summary**The defendant, Rivkin Financial Services Pty Ltd ("Rivkin"), entered into an agreement with the plaintiff, Alan Davis Group Pty Ltd ("Davis Group"), to buy back its shares in exchange for shares in Drillsearch Energy Ltd plus cash. The agreement needed Rivkin shareholder approval under the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). One of the clauses in the buy back agreement required the directors of Rivkin to recommend to its shareholders that they vote in favour of the buy back. In the notice of meeting, one of Rivkin's directors recommended a vote against the agreement and the majority of directors recommended a vote in favour only if Drillsearch shares were trading below a certain price. Davis Group purported to terminate the buy back agreement for breach of contract.Gzell J held that Davis Group was entitled to a declaration that the share buy back agreement between it and Rivkin was validly terminated. It did not need any alternative order under the [Australian Securities Investments Commission Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56481" \t "default) ("ASIC Act") that the agreement be declared void.However, Davis Group was not entitled to a declaration that it was entitled to vote at the forthcoming general meeting, or that on the proper construction of section 257H of the Corporations Act 2001 (Cth) it was entitled to vote at that meeting on all matters other than in favour of the resolution to approve the buy back of its shares in Rivkin. Davis Group was not entitled to an order that Rivkin be restrained from disregarding, or not counting as valid votes at the general meeting, such votes as may be cast by it as the holder of ordinary shares in Rivkin.**(b) Facts** Rivkin entered into agreements with a number of shareholders to buy back their shares. Those agreements required the approval of Rivkin shareholders under section 257D.The agreement with one of the shareholders, Davis Group, contained the following provisions:* clause 2.1 - the agreement and the buy back were subject to and conditional on the approval of the shareholders of Rivkin under section 257D(1) of the Corporations Act 2001 (Cth);
* clause 2.2 - Rivkin and Davis Group were required to use their best endeavours to procure the fulfilment of the condition in clause 2.1;
* clause 4.2 - the directors of Rivkin agreed to recommend that shareholders of the company vote in favour of the buy back.

The consideration for the buy back was the transfer to Davis Group of shares in Drillsearch Energy Ltd plus cash. During the contract negotiations, Davis Group rejected a Rivkin proposal to include a provision that would, in the Court's words, give "practical expression to an exception from obligation under cl 4.2 if to recommend in favour of the buyback might render the directors liable to a breach of statutory or fiduciary duty because of an upward movement in the value of the Drillsearch shares".In the notice convening the general meeting of Rivkin shareholders for the purpose of considering the buy backs, the majority of the Rivkin directors recommended that the shareholders approve the buy back if Drillsearch shares were trading at or below a specified average price for the last five trading days before the meeting. One of the directors recommended that the shareholders vote against the resolution. Davis Group purported to terminate the buy back agreement.**(c) Decision** **(i) The contractual claim**Gzell J held that clause 2.2 of the buy back agreement did not require the directors of Rivkin, in all circumstances, to urge shareholders to vote in favour of the resolution to approve the buy back from Davis Group. It only required the directors to do all they reasonably could in the circumstances to achieve that contractual object, but no more.However, clause 4.2 of the buy back agreement was different. Rivkin argued that clause 4.2 contained an implied term that any recommendation by its directors would be subject to their statutory or fiduciary duty in the event of an increase in the value of Drillsearch shares. Gzell J rejected this. He pointed to the fact that Davis Group had rejected a clause which was intended to allow the Rivkin directors to vary the agreement if Drillsearch shares went up. The Rivkin directors knew this before they agreed on clause 4.2. To imply the fiduciary-out term suggested by Rivkin would be tantamount to limiting the obligation under clause 4.2 to circumstances in which the Drillsearch market value remained static, thereby re-introducing the object of the clause that Davis Group had rejected during negotiations. Nor did the implied fiduciary out term sit comfortably with the absolute language in which clause 4.2 was couched. If parties contracted in such terms, they should be held to their bargain. If they wished the obligation to be conditional, they could have said so. Therefore Rivkin had bound its directors to unanimously support the buy back agreement without any qualifying conditions such as the prevailing market price of Drillsearch shares.Gzell J subsequently held clause 4.2 was an essential condition of the buy back agreement. Therefore, Davis Group was entitled to terminate the buy back agreement for Rivkin's breach of a condition of the agreement. Davis Group would be entitled to damages for the breach if it suffered loss. However that issue was to be determined separately.**(Ii) ASIC Act issues**In light of the above finding, Gzell J did not consider it was necessary to perform a detailed analysis of whether the agreement should be declared void under section 12GM of the ASIC Act. However his Honour did say that he agreed with Davis Group's submission that clause 4.2 of the buy back agreement would have constituted a representation that was misleading or deceptive under section 12DA(1) of the ASIC Act. **(iii) Voting issue - statutory exclusion**Because the agreement had been terminated, the statutory suspension of Davis Group's voting rights under section 257D(1) was lifted. Gzell J declined to comment on Davis Group's submission that the suspension of rights in section 257H(1) of the Corporations Act 2001 (Cth) was limited to the entry into an unconditional contract. Davis Group argued that there was a statutory distinction between an agreement, meaning an unconditional agreement, and an offer, meaning a conditional agreement, to buy back. His Honour said that this was too important an issue to be considered by an obiter dictum.**(Iv) Voting issue - listing rules exclusion**Gzell J held that IWL Ltd ("IWL") (which negotiated the buy back agreement and depended on the success of the buy back agreement to perform other transactions) and Davis Group were acting in concert and Davis Group was an associate of IWL for the purpose of the voting exclusion statement in relation to the resolutions under listing rule 14.11. The chairman of the meeting was entitled to refuse to receive any votes by Davis Group on these resolutions. **5.7 Review of APRA power to disqualify persons under section 25A of Insurance Act 1973** (By Joel Cox, Phillips Fox)Kamha v Australian Prudential Regulation Authority [2005] FCA 480, Federal Court of Australia, Gyles J, 22 April 2005[http://cclsr.law.unimelb.edu.au/judgments/states/federal/2005/april/2005fca480.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2005/april/2005fca480.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Summary**The applicant sought to challenge a decision of an Australian Prudential Regulation Authority (APRA) delegate to disqualify the applicant from acting as a director or senior manger of certain insurance organisations on the basis that he is not a fit and proper person to so act. The power to disqualify was exercised pursuant to section 25A of the [Insurance Act 1973](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6398" \t "default) ("the Act").The applicant made three submissions objecting to the decision, the first based on grounds of objection under the [Administrative Decisions (Judicial Review) Act 1977](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=7119" \t "default) and the second and third objections alleging that the decision was beyond APRA's power and took into account irrelevant considerations. His Honour Justice Gyles dismissed the first two submissions, but upheld the third on the basis that the decision of APRA's delegate was influenced by a need to deter others from similar conduct, which was an irrelevant consideration under the Act. The matter was remitted to APRA to be dealt with according to law.**(b) Facts** **(i) The legislative provisions**Section 25A(1) of the Act provides that APRA may disqualify a person if it is satisfied that the person is not a fit and proper person to be or to act as someone referred to in paragraph 24(1)(a), (b) or (c). Section 24(1) states that a disqualified person must not act as:(a) a director or senior manager of a general insurer (other than a foreign general insurer); or(b) a senior manager, or agent in Australia for the purpose of section 118, of a foreign general insurer; or(c) a director or senior manager of an authorised NOHC.**(Ii) The conduct of the applicant**The applicant commenced employment with FAI General Insurance Limited (FAI General) in 1994 as the General Manager of one of the organisation's three main divisions (Commercial and Professional Insurance Division). The applicant remained in this position until he left FAI General in September 1998.On 9 August 2004 APRA sent a Show Cause Notice to the applicant detailing proposed disqualification under section 25A of the Act. The disqualification was to be made on the basis that a delegate of APRA deemed the applicant not a fit and proper person in accordance with section 25A of the Act. The APRA delegate based this decision on information from the findings of the Royal Commission held into the collapse of HIH Insurers, of which FAI General was a subsidiary.The applicant had earlier given APRA an undertaking pursuant to section 126 of the Act stating that he would not act in the positions listed in section 24(1) of the Act. Nevertheless, in his reasoning for the decision, the APRA delegate said:"I am nonetheless of the view there is a public interest in proceeding to disqualify you for the purposes of section 25A, particularly given the concerns I have regarding your honesty and probity."**(Iii) The submission of the applicant**The applicant invoked many grounds of challenge to the process undertaken by APRA pursuant to the Administrative Decisions (Judicial Review) Act 1977. His Honour Justice Gyles did not consider these in detail on the basis that the proper means for resolving such complaints was through a reconsideration of the decision by APRA and a review by the Administrative Appeals Tribunal. It was not disputed that both avenues were open to the applicant.In addition, the applicant challenged the discretion of the APRA delegate on the basis that the decision was beyond power and influenced by irrelevant considerations. The applicant submitted that APRA had no power to make the decision because the applicant has not been in a position as set out in section 24 of the Act for some years and there was no immediate threat of him taking up such a position. The applicant also submitted that irrelevant considerations which influenced the decision of the APRA delegate were an intention to punish the applicant and to deter others from like conduct.**(c) Decision** **(i) Lack of power**His Honour found that APRA's power under section 25 of the Act is not limited to people who are in one of the three alternative positions from which they could be disqualified. His Honour agreed that the section could be applied to a wide group of people even though they had never had anything to do with insurance.**(Ii) Irrelevant considerations**His Honour found no authority on the power conferred by section 25A of the Act. In the absence of such authority, he found the power was entirely protective. His Honour said:"It appears to me that the legislature has chosen a particular means of protecting the public, namely, by disqualification from participation in the affairs of the company rather than by the stigmatism of the individual as an example to others…It follows that, in my opinion, the delegate misconstrued section 25A and so took into account an irrelevant consideration."The matter was remitted to APRA for determination according to the law. **5.8 Multiparty payment netting arrangement where a participant is insolvent** (By Oren Bigos, Mallesons Stephen Jaques)International Air Transport Association v Ansett Australia Holdings Limited [2005] VSC 113, Supreme Court of Victoria, Mandie J, 22 April 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/vic/2005/april/2005vsc113.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2005/april/2005vsc113.htm%22%20%5Ct%20%22_new)or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Summary**"Payment netting" arrangements rely on "contractual set-off", which, flexibly, does not require mutuality. In liquidation, contractual set-off is displaced by "insolvency setoff", which applies to "mutual debts and claims" ([Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) section 553C). Multiparty payment netting arrangements cannot operate where a participant is in liquidation, as there is a lack of mutuality. Legislation may override these limitations in relation to specific arrangements, eg [Payment Systems and Netting Act 1998 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=5859" \t "default) section 10.Involving a clearing house in the arrangement may assist, depending on the role of the clearing house. British Eagle had shown that where the role of the clearing house is merely to clear payments between participants, the arrangement is "multilateral netting" which, in the liquidation of a participant, would fall foul of the pari passu rule (Corporations Act section 555) and would not satisfy the requirements for insolvency setoff, which is an exception to pari passu.Ansett shows, that, in contrast to British Eagle, where the clearing house is interposed as the central counterparty to every transaction, the result is a series of "bilateral netting" arrangements which do not contravene the pari passu rule.**(b) Facts**The International Air Transport Authority (IATA) Clearing House operates a netting arrangement in relation to payment for services performed by airlines for one another. Ansett, a participating airline, had performed services for other airlines and accepted services from other airlines. It went into voluntary administration. On a net basis Ansett owed amounts but had not yet paid them at the time when the periodic netting was supposed to take place. A deed of company arrangement was executed, which provided for distributions to ordinary unsecured creditors "on a pro rata basis". The Clearing House sought to prove the net amount as a debt in Ansett's administration. Ansett's administrators argued that the netting arrangement had ceased to operate in relation to Ansett when the deed of company arrangement was executed. They based their disregard of the netting arrangement on British Eagle.*British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758 (HL) had also involved the IATA Clearing House. The Clearing House rules had provided for the Clearing House to clear and collect and pay amounts, and that debits and credits were payable or receivable by participants through the Clearing House. Transactions were between participants, resulting in participants being indebted (or otherwise obliged under some innominate choses in action) to one another. The Clearing House was not a party to the transactions, and no debts arose between the Clearing House and participants. This amounted to a multilateral netting arrangement. The House of Lords held that the arrangement could not survive in the liquidation of one participant because it would result in the contravention of the pari passu rule. This was a principle which could not be contracted out of, for public policy reasons. Insolvency setoff was not satisfied as there was no mutuality between the parties.By the time of Ansett, the IATA Clearing House rules had been amended. Importantly, they provided that "no liability for payment and no right of action to recover payment shall accrue between members. In lieu thereof members shall have liabilities to the Clearing House".**(c) Decision**The court distinguished *British Eagle* on the basis of the different wording in the IATA Clearing House rules. The amended rules provided that no liability accrued between participant airlines. A liability would arise only between each airline and the IATA Clearing House. Although services were performed by one airline for another, the contracts under which those services were performed were subject to the overriding effect of the IATA Clearing House rules. Transactions between participants gave rise to obligations not between participants, but between a participant and the Clearing House. So there was a successful "bifurcation" (novation) of the transactions to the Clearing House. In contrast with the previous rules (discussed in *British Eagle*) which involved multilateral netting, the reworded rules (in Ansett) created a series of bilateral netting arrangements with the Clearing House as the central counterparty. There was no debt owed by Ansett to another participant, and there was no debt owed by another participant to Ansett. The relationship of debtor and creditor existed between Ansett and the Clearing House. Hence it could not be said that unsecured creditors were deprived of an asset of Ansett (represented by a debt owed by another participant to Ansett) such that the participant airlines received more than other unsecured creditors in contravention of the pari passu principle.The court in Ansett was invited to distinguish *British Eagle* on the further basis that *British Eagle* was concerned with liquidation, while in Ansett the company was in voluntary administration. The court declined to give its view. As a matter of principle, the pari passu rule (and other principles of priorities set out in Pt 5.6, Div 6, Sub-Div D of the Corporations Act) should not be imported into the voluntary administration regime (see Crosbie, in the matter of *Media World Communications Ltd (Administrator Appointed)* [2005] FCA 51). Those principles operate only in liquidation. Prima facie, a deed of company arrangement may validly specify a scheme of distribution to unsecured creditors which diverges from the pari passu principle. The fact that Ansett was in administration, rather than liquidation, should have given the court a further basis for distinguishing British Eagle.**5.9 Shareholder application to inspect books** (Jonathan Stewart, Blake Dawson Waldron)Chuen v Laredo Pty Ltd [2005] WASC 58, Supreme Court of Western Australia (In Chambers), Commissioner Siopis SC, 13 April 2005The full text of this judgement is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/wa/2005/april/2005wasc0058.htm](http://cclsr.law.unimelb.edu.au/judgments/states/wa/2005/april/2005wasc0058.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Facts**This case involved an application by Lau Chak Chuen to inspect the books and records of Laredo Pty Ltd, Nullagine Investments Pty Ltd and Esplanade Lodge Pty Ltd. Chuen was a director and shareholder of 10% of Laredo Pty Ltd and a former director of Nullagine Investments and Esplanade Lodge Pty Ltd (which are both subsidiaries of Laredo Pty Ltd). The application for the inspection of the books and records was made under sections 247A and 290 of the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) and the common law.The background of the application involves a bitter history of allegations of financial irregularities in relation each of the companies and fractious relationships amongst shareholders and also amongst directors. The application was made after Chuen had unsuccessfully attempted to have certain other shareholders buy his stake in Laredo Pty Ltd. The affidavit lodged in support of Chuen's application by his Singaporean solicitor, Mr Herbert, set out the financial irregularities that Chuen claimed warranted orders permitting access to the books and records of each company for investigation. These matters had been first raised by Chuen in letters written in May and June 2000 but he had not subsequently pursued the matters.There was also an earlier court order that permitted Chuen access to the financial statements of Laredo Pty Ltd that came from an earlier application. Chuen had never sought to exercise the inspection rights under that order.**(b) Decision****(i) Application to inspect books under section 247A**Commissioner Siopis rejected the application for inspection under section 247A. Section 247A relevantly provides that a shareholder who has brought or can bring an action against the company under section 237, can apply to a Court for an order authorising the inspection of books of a company. Before granting that order, the Court must be satisfied that the applicant is acting in good faith and the inspection is to be made for a proper purpose. Siopis rejected the application on the basis that the generality of the evidence presented to the Court did not discharge the onus of establishing that Chuen was acting in good faith. Commissioner Siopis held that:* Chuen's delay in investigating the alleged financial irregularities;
* Chuen's failure to exercise his right of inspection previously granted; and
* the evidence establishing that Chuen's application was an attempt to force the other shareholders to purchase his shareholding in Laredo Pty Ltd; established that Chuen was not acting in good faith.

Commissioner Siopis also considered that there was no basis for holding that the inspection was to be brought for a proper purpose. Commissioner Siopis decided this on the basis that:* there was no direct evidence as to the potential action Chuen was considering bringing (pursuant to section 237) against the Company; and
* Chuen's dominant purpose of bringing the application was to put pressure on the other shareholders to buy his shareholding in Laredo Pty Ltd.

**(ii) Application to inspect books under section 290**Commissioner Siopis rejected the application for inspection under section 290. Section 290 gives the director of a company a right of access to the company's financial records and permits a Court to order inspection of those financial records of a company by a person on the director's behalf. Commissioner Siopis rejected this application on the basis that such an order would involve the duplication of the earlier Court order, which was made in relation to the same subject matter. Commissioner Siopis stated that otherwise court process would be undermined.**(Iii) Application to inspect books under common law**Commissioner Siopis rejected the application for inspection under the common law. The common law right to inspect a company's books is an incident of a director's fiduciary duty to act in the interests of the company. A court presumes, upon an application by a director for inspection, that the director seeks to exercise the right for the benefit of the company. Commissioner Siopis held that, on the unusual facts of this case, that presumption was rebutted as Chuen was making the application for the purpose of benefiting himself in his capacity as a shareholder by using it to put pressure on the other shareholders to purchase his shareholding. **(c) Conclusion**Chuen's application to inspect the company’s books was dismissed. **5.10 Insider trading - possession of inside information and principles on sentencing** (By Justin Jiang, Mallesons Stephen Jaques)R v Doff [2005] NSWCCA 119, New South Wales Court of Criminal Appeal, Wood, Adams and Bell JJ, 8 April 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/april/2005nswcca119.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/april/2005nswcca119.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Summary**This decision concerns an appeal against a conviction on a count of insider trading and an appeal by the Crown against the leniency of the associated sentence, and principally considers:* whether the verdict that the appellant was guilty of insider trading was unreasonable having regard to the evidence on the question of whether inside information was in the appellant’s possession; and
* principles applicable on sentencing following a conviction on a count of insider trading.

**(b) Facts** The appellant, a real estate agent, attended a meeting relating to the potential sale of real property by his client, Rene Rivkin. The prospective purchaser (GM) had previously informed the appellant that he would be interested in purchasing the property if another transaction in which GM was involved was successful. In the course of the meeting GM elaborated in the presence of the appellant that that transaction involved the possible sale of part of GM’s business, Impulse Airlines (Impulse), to, or merger of that business with, Qantas subject to regulatory approval.Approximately 3 hours after the meeting with GM, the appellant’s broker purchased 20,000 Qantas shares at the instruction of the appellant in the name of a private company of which the appellant was a 50% shareholder and sole director and secretary. Following the public announcement by Impulse and Qantas to the effect that Impulse was ceasing independent operations and had entered into a commercial relationship with Qantas to operate in connection with the Qantas brand, those Qantas shares were sold at the appellant’s instruction for a profit of $11,400.70.The appellant was convicted on a count of insider trading pursuant to sections 1002G(2) and section 1311(1) of the [Corporations Act (Cwlth) 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (note, section 1002G(2) has since been superseded by section 1043A), and was sentenced to serve 350 hours of community service and to pay a $30,000 fine. He was also ordered to pay a penalty under the [Proceeds of Crime Act (Cwlth) 2002](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=65667" \t "default) of $37,225.75.The appellant appealed against the conviction on the grounds that:* the verdict was unreasonable having regard to evidence on the question of whether inside information identified by the Crown was in the possession of the appellant; and
* the verdict was otherwise unreasonable having regard to the evidence.

The Crown appealed against the leniency of the sentence on the contention that the sentence was manifestly inadequate for reasons including:* that insufficient weight was given to the seriousness of the offence of insider trading and the need for general deterrence in so far as insider trading undermines the efficacy and integrity of the public securities market;
* that there was a lack of parity in relation to the sentence of 9 months periodic detention and a $30,000 fine for Rene Rivkin, who was convicted for insider trading for his use of the same information regarding the Impulse/Qantas transaction, and that the sentence was manifestly inadequate by reference to the range of sentences passed for other offences of insider trading;
* that inappropriate allowance was made for the finding that the appellant should receive a discount for the fact that his trial was conducted by his lawyers in an efficient and exemplary manner; and
* that a community service order was an inappropriate punishment for insider trading, given the leniency that is “built into” such an order.

**(c) Decision** The Court dismissed the appeal against the conviction and dismissed the Crown’s appeal against the leniency of the sentence.**(i) Possession of inside information**The primary issue for the Court in determining whether to dismiss the appellant’s appeal was whether the jury ought to have entertained a reasonable doubt that the inside information alleged by the Crown, that being information to the effect that there was a deal for the merging of Impulse’s business with Qantas that was subject to ACCC approval, was in the possession of the applicant. Witnesses gave differing accounts of what GM had said in the presence of the appellant at the meeting. Evidence was given that GM had variously spoken of a “sale of part of” Impulse, of a "financial arrangement" between Impulse and Qantas, and of a transaction under which Impulse would "merge its business with" Qantas. The appellant argued that there was a material difference between statements to the effect that there was a “deal for the merging” of the businesses and statements to the effect that there was a "process for sale of part" of Impulse to Qantas. It was argued by the appellant that if the jury considered it reasonably possible that the words used by GM to describe the transaction were "sale of part of" Impulse or a "financial arrangement" between the businesses, then the jury had to have a reasonable doubt about whether the appellant was in possession of information to the effect that there was a deal for the "merging" of Impulse’s business with Qantas.The Court was not persuaded by the appellant's arguments. The Court based this determination on the grounds that: the testimony of one witness that GM had stated that "Impulse is going to merge its business with Qantas" was unchallenged; the word "merging" had no particular technical meaning; it was important to consider the component of the information regarding the merger of the business together with the other component of the inside information regarding the need for ACCC approval; and the appellant’s purchase of shares in Qantas gave rise to the strong inference that he had received information which he understood as being likely to cause a rise in the price of Qantas shares once it was released to the public.In considering this issue, the Court noted the importance of the inside information being properly identified, since it not only defined the element of the offence of insider trading that the insider possesses inside information, but it also impacted on the questions of whether the inside information was or was not generally available and whether the information would or would not have been likely to have a material effect on the price of the relevant financial product.The Court also rejected submissions by the appellant that it was reasonably possible that the information was generally available and that there was insufficient evidence to support the contention that the inside information was price sensitive.**(Ii) Principles on sentencing**In considering the Crown’s appeal against the leniency of the appellant’s sentence, the Court noted that it did not "suggest anything other than a stern approach should be taken to offences of insider trading". The Court further stated that insider trading "remains a serious offence, and there needs to be a considerable deterrent aspect reflected in order to protect the integrity and efficacy of the market. Those in a position of trust who receive price sensitive information in relation to securities are expected to confirm [sic] to exacting standards of honesty, and transgression can normally be expected to lead to custodial sentences as well as pecuniary penalties".The Court also observed that, notwithstanding the trial judge’s finding that the seriousness of the offences of the appellant and Rene Rivkin should be regarded as falling towards the lower end of seriousness for the reason that they were not involved as directors or executives of either Impulse or Qantas, nevertheless their offences involved serious infringements of the insider trading laws.In any case, the Court was not persuaded to intervene in the appellant’s sentence. The Court’s reasons for this decision included:* the relative seriousness of the appellant’s and Rene Rivkin’s culpability, particularly in light of the fact that the appellant did not have the experience and knowledge expected of Rene Rivkin as a long term stockbroker, share trader and investment adviser, and the fact that the appellant invested less than half of the amount invested by Rene Rivkin;
* the terms of Rene Rivkin’s sentence and the fact that any significant increase in the appellant’s sentence would give rise to an issue of parity;
* the Court could not see a reason why the efficiency of the conduct of the appellant’s trial, which showed a willingness to facilitate the course of justice, should not be taken into account in sentencing;
* the monetary penalty of $30,000 was considerable and the requirement to perform 350 hours of community service was also a considerable burden on the appellant and a significant restriction of his liberty for at least twelve months; and
* the fact that the appellant was still required to pay $37,225.75 under the Proceeds of Crime Act, was automatically disqualified from managing a corporation and could face further action under the [Fair Trading Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=3955" \t "default) in relation to the appellant’s real estate licence.

**5.11 Signatory of cheque not personally liable where cheque signed as representative of the drawer of the cheque** (By Michelle Burton, Phillips Fox)Valamios v Demarco [2005] NSWCA 98, New South Wales Court of Appeal, Beazley JA, Tobias JA and Brownie AJA, 6 April 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/april/2005nswca98.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/april/2005nswca98.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Summary**The appellant, George Valamios, signed 16 cheques as payment to the respondent. The cheques were dishonoured, and because each of the dishonoured cheques had been signed by the appellant, the respondent pleaded that the appellant was liable on the cheques either as the drawer or, if he was not the drawer, because he was otherwise liable.The primary judge found that Valamios had signed the cheques as a person to be held liable, and Valamios appealed against this finding to the NSW Court of Appeal.His Honour Justice Tobias found, following the English Court of Appeal decision in *Bondina Ltd v Rollaway Shower Blinds Ltd* [1986] 1 WLR 517, that it was apparent on the face of the cheques that the appellant signed them as the representative of E&C Valamiou trading as V&P Produce, who were the drawers of the cheque, and as such it was equally apparent that he did not intend to be under a personal liability on the cheques. Accordingly the appeal was allowed, orders made by the trial judge were set aside, and judgment for the appellant was entered.**(b) Facts**The appellant traded under the business name of V&P Produce at Flemington Markets. In or about November 2001 the respondent, Demarco, agreed to sell and the appellant agreed to purchase on behalf of V&P Produce various quantities and types of onions which were duly supplied between 2 December 2001 and 12 February 2002. As V&P Produce failed to pay for the onions, the respondent instituted proceedings against it in the District Court of New South Wales in June 2002 claiming the sum of $210,546 for unpaid invoices with respect to goods sold and delivered. Between February 2002 and May 2002, 16 cheques drawn on the account of V&P Produce and signed by the appellant, George Valamios, were dishonoured. In October 2002 the respondent amended his statement of claim to plead the appellant's liability on those cheques. Because each of the dishonoured cheques had been signed by the appellant, the respondent pleaded that he was liable on the cheques either as the drawer or, if he was not the drawer, because he was otherwise liable. The proceedings between the appellant and the respondent were heard by the primary judge who on 2 June 2004 found in favour of the respondent and on 10 June 2004 entered judgment against the appellant in the sum of $209,691.04. The reasons given were as follows:"(i) The defendant signed the cheques to pay for produce delivered to V&P Produce.(Ii) The defendant did not place any qualification on the cheques that he was signing in a representative capacity for agent for V&P Produce.(Iii) The defendant's name was on the notice of dishonour given to the plaintiff from the Bank.(Iv) He did not comply with the provisions of section 33 of the [Cheques Act 1986 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6689" \t "default) (the Act) to avoid liability on the cheques.(v) The defendant was in the best position to explain the basis on which he signed and did not give evidence, although available to do so at the trial.(vi) The inference was drawn that the defendant signed as a person to be held liable on the cheque."It was against that order that the appellant appealed to the NSW Court of Appeal.**(c) Decision**Section 75(2)(b) of the Act, provides that "A person who signs a cheque shall… be presumed… to have signed the cheque intending to become liable on the cheque, unless it is apparent, on the face of the cheque, that the person did not sign the cheque intending to become liable on the cheque."The appellant's submission was that it was clear on the face of the cheques that he did not sign them intending to become personally liable but signed them as the authorised signatory on the account of the defendants trading as V&P Produce.His Honour Justice Tobias referred to the case of *Bondina Limited v Rollaway Shower Blinds Limited* [1986] 1 WLR 517, where it was held to be plainly arguable that a cheque drawn on a bank cheque form printed with a company name, bank account number and signed by a director of the company was drawn on the company's account and was not the personal liability of the signing director notwithstanding that he had given no indication that he was signing as a representative of the company and not on his own behalf.It was apparent from a physical examination of the cheque that (i) the account upon which the cheques were drawn was that of E&C Valamiou t/as V&P Produce as printed by Westpac Banking Corporation (the Bank) in the bottom left hand corner of the cheque, (ii) that the cheques were indorsed by the Bank with the computerised cheque, branch and account numbers, and (iii) the signature (being that of the appellant) had been placed at the bottom right hand corner of the cheque on the printed line provided for the signature of the person or persons authorised to sign on the account.Accordingly, his Honour Justice Tobias found, following Bondina, that it was apparent on the face of the cheques that the appellant signed them as the representative of E&C Valamiou trading as V&P Produce who were the drawers of the cheque, and as such it was equally apparent that he did not intend to be under a personal liability on the cheques. The appeal was allowed, orders made by the trial judge were set aside and judgment for the appellant was entered. **5.12 Validation of notice of variation extending takeover period** (David Chin, Blake Dawson Waldron)Primelife Corporation Ltd v Aevum Ltd [2005] NSWSC 269, New South Wales Supreme Court, Hamilton J, 31 March 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/march/2005nswsc269.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/march/2005nswsc269.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new) **(a) Summary**This case concerns the lapsing of an off market bid due to a defective notice of variation. The defect in the notice was the omission of section 650D(1)(a)(ii) information (rights to withdraw acceptances), which needed to be included for more than 1 month. Hamilton J found that the solicitor drafting the notice was acting honestly and did not realise that a 30 day extension in the month of February would constitute an extension for more than 1 month. Subject to the plaintiff providing certain undertakings, Hamilton J validated the notice after being satisfied that no substantial injustice has been or is likely to be caused to any person. **(b) Facts** Primelife Corporation Limited ("plaintiff") made an off-market bid for shares in Aevum Limited (“defendant”) with an initial offer period scheduled to end on 7 February 2005. The plaintiff wished to extend the offer period but as the bid was subject to a ‘defeating condition', a notice extending the bid for more than 1 month had to include section 650D(1)(a)(ii) information that offerees who had accepted the bid had the right conferred by section 650E to withdraw their acceptances. On 31 January 2005, the plaintiff gave notice of variation extending the offer period by 30 days and omitted the section 650D(1)(a)(ii) information in the notice. However, the solicitor drafting the notice did not realise that a 30 day extension constituted more than 1 month since February contains only 28 days and the notice sought to extend the offer period from 7 February 2005 to 9 March 2005. By omitting the section 650D(1)(a)(ii) information in the notice, there was no valid notice of variation extending the offer period and the offer lapsed. The plaintiff then sought to validate the defective notice. **(c) Decision** Hamilton J validated the notice of variation using the remedial provisions in sections 1322(4) and 1325D of the Act. **(i) Section 1322(4)**To make an order under section 1322(4) of the Act, Hamilton J held that section 1322(6)(c) of the Act needed to be fulfilled such that 'no substantial injustice has been or is likely to be caused to any person'. Hamilton J held that section 1322(6)(c) was satisfied by the plaintiff's undertakings. The plaintiff undertook to send a notice informing members of the defendant, who had accepted the plaintiff's offer, of their section 650E right to withdraw their acceptances. Hamilton J also accepted an undertaking by the plaintiff to treat any action by any member of the defendant who accepted the bid, which was inconsistent with the terms of the offer and which occurred between 8 February 2005 and the date of receipt of the withdrawal notice by such member, as a valid exercise of that member's right to withdraw acceptance of the offer.The plaintiff undertook to lodge the withdrawal notice with ASIC, and send it to the ASX, the defendant and all members of the defendant. Hamilton J made an order under section 1322(4)(d) of the Act allowing for the 1 month to run from receipt of the withdrawal notice. **(Ii) Section 1325D**Hamilton J held that section 1325D(1) of the Act allowed the Court to declare a document 'not invalid' because a person has contravened a provision of Chapter 6 of the Act 'if the Court is satisfied that the contravention ought to be excused in all the circumstances'. Hamilton J was satisfied that the omission of section 650D(1)(a)(ii) information when drafting the notice of variation was caused by the solicitor's 'inadvertence', which ought to be excused under the circumstances. **5.13 Distribution of reinsurance proceeds in a winding up** (By Robert Feiner, Freehills)HIH Casualty & General Insurance Ltd [2005] NSWSC 240, Supreme Court of New South Wales, Barrett J, 29 March 2005The full text of this judgment is available at:[http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/march/2005nswsc240.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2005/march/2005nswsc240.htm%22%20%5Ct%20%22_new)or[http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/%22%20%5Ct%20%22_new)**(a) Summary**This case focused on the distribution of reinsurance proceeds in the winding up of an insurance company. Two relevant legislative provisions, section 562A of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) ("the Act") and section 116(3) of the [Insurance Act 1973](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6398" \t "default) ("Insurance Act"), provide conflicting direction on how this class of assets should be distributed.Certain subsidiaries of HIH Insurance Ltd had applied to the Court for an order under section 411 of the Act to convene a meeting to consider a proposed scheme of arrangement. The court considered that the scheme proposed by the subsidiaries interpreted the effect of sections 562A and section 116(3) incorrectly, and declined to approve the scheme meeting. The court suggested steps to incorporate into the scheme that would appropriately reconcile section 562A with section 116(3).**(b) Facts** The application concerned eight companies which are wholly owned subsidiaries of HIH Insurance Ltd and that are in the course of being wound up ("Scheme Companies"). The liquidators of each of the Scheme Companies applied for an order under section 411 of the Act for the convening of meetings of the Scheme Companies’ creditors in order to consider a proposed scheme of arrangement.The principal assets of the Scheme Companies comprised cash, investments and reinsurance recoveries. The reinsurance recoveries gave rise to existing and potential claims for payment by reinsurers to the Scheme Companies. The reinsurers were located in several countries, including Australia, the United Kingdom and the United States. **(i) Proposed scheme of arrangement**The proposed scheme of arrangement was characterised as a "run-off" scheme. It included provision for a cut-off date for the making of claims by creditors, the continuation of the run-off of the insurance business of the Scheme Companies until this cut-off date, and the resolution of any outstanding claims thereafter by an estimation process. The terms of the scheme were relatively complex. In summary, the scheme provided for the assets of each of the Scheme Companies to be allocated among three funds. Fund 1 consisted of assets that were Australian assets. Fund 2 consisted of reinsurance proceeds, excluding those determined to be Australian, UK or US assets. Fund 3 consisted of UK and US reinsurance proceeds and all other assets.In the application of Fund 1, Australian assets were to be applied to Australian liabilities in the following order:* the full costs associated with each fund;
* "Priority Claims", meaning any debt or liability described in section 556 and 562 of the Act (which both afford priority to certain claims in a winding up);
* "Threshold Liabilities", meaning claims of not more than $50,000 settled by the administrators of the scheme; and
* pro rata discharge of remaining claims.

Fund 3 assets were to be applied to liabilities in the same order as Fund 1, except to liabilities at large (rather than only to Australian liabilities). Fund 2 assets were to be applied in the same order as Fund 1, except no priority was afforded to Priority Claims and the liabilities to be met were insurance liabilities without territorial qualification. **(Ii) Key issues considered by the court**Nine entities claiming to be a creditor of one or more of the Scheme Companies were granted leave to be heard without becoming parties. The Australian Securities and Investments Commission ("ASIC") was granted leave to appear as amicus curiae.ASIC and the nine entities submitted that relevant statutory provisions to the scheme had been applied incorrectly. The issue most extensively considered by the court was whether the scheme was based on a correct view of the interaction between and the effects of section 562A of the Act and section 116(3) of the Insurance Act. Section 562A of the Act relates to the payment by a wound up insurer of amounts received by it under contracts of reinsurance. Reinsurance proceeds are to be paid towards satisfaction of relevant contracts of insurance in priority to all other debts, including those outlined in section 556 of the Act. Section 116(3) of the Insurance Act is not concerned with priority among claims, however, it forbids any course of action that does not involve application of Australian assets to liabilities in Australia, until either the assets in Australia are exhausted, or the liabilities in Australia are fully discharged.These two provisions appear inconsistent. Section 562A does not confer a specific priority on amounts received under contracts of reinsurance to liabilities in Australia. Section 116(3) provides that claims over liabilities in Australia must be discharged from the wound up insurer’s assets in Australia, in priority to all other claims. In formulating the proposed scheme, the liquidators had complied with section 116(3) of the Insurance Act, as Fund 1 provides for the discharge of Australian assets to Australian liabilities. However, the scheme did not comply with section 562A as no provision was made for reinsurance proceeds from Australia, or any other jurisdiction, to be paid towards the satisfaction of contracts of insurance held by creditors. The liquidators argued that section 562A could not displace the effect of 116(3) for a number of reasons. For example, section 116(3) derives from legislation dealing specifically with insurance companies, whereas section 562A deals with companies generally and should therefore be displaced in the present circumstances. Further, it was contended that, consistent with past judicial interpretation, the wording of section 116(3) requires all liabilities in Australia to be treated equally, and creditors in Australia could therefore not enjoy any preferred position under section 562A.**(c) Decision** Justice Barrett held that the effect of section 562A of the Act and section 116(3) of the Insurance Act could be reconciled in such a way that both provisions would be observed by the scheme. His Honour did not consider that section 116(3) displaced section 562A to the extent of any inconsistency. In addressing the main arguments submitted by the liquidators, his Honour held that both provisions deal in a general sense with the winding up of insurance companies, with the result that where there is any inconsistency, this cannot be resolved by viewing section 562A as standing alone. In addition, his Honour did not consider that section 116(3) requires all liabilities in Australia to be treated equally, or that it is concerned with the order of application of assets. Rather section 116(3) only provides that assets in Australia must be applied to the discharge of liabilities in Australia.His Honour set out a procedure that should be observed where a winding up is governed by section 562A of the Act and section 116(3) of the Insurance Act. In summary, the steps to be followed are:* amounts received by a wound up company under contracts of reinsurance in Australia are to be applied in accordance with section 562A to liabilities under contracts of insurance in Australia;
* amounts received under contracts of reinsurance by a wound up company which are not assets in Australia are to be applied in accordance with section 562A to liabilities under contracts of insurance outside Australia;
* assets which are assets in Australia are to be applied to liabilities in Australia, with those debts ranking in accordance with section 556 of the Act; and
* remaining assets are to be applied towards satisfaction of debts proved in the winding up that have not been met in full at the conclusion of step 3, with the debts ranked according to section 556 of the Act.

In relation to these steps, his Honour added certain matters of refinement, relating to the identification of relevant contracts of insurance under section 562A, and the allocation of residual proceeds from reinsurance contracts after claims by creditors under contracts of insurance had been met. Given that a scheme of arrangement under section 411 is capable of departing from the statutory regime for a winding up under the Act, his Honour also considered whether the liquidators could modify the effect of section 562A. His Honour found, however, that the liquidators could not modify its effect as section 562A(7) provides that section 562A has effect despite any agreement or arrangement (such as in this case) to the contrary. |
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