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| **Corporate Law Bulletin**  **Bulletin No. 78, February 2004**  Editor: [Professor Ian Ramsay](mailto:i.ramsay@unimelb.edu.au), Director, Centre for Corporate Law and Securities Regulation  Published by [LAWLEX](http://www.lawlex.com.au" \t "default) on behalf of [Centre for Corporate Law and Securities Regulation](http://cclsr.law.unimelb.edu.au" \t "_new), Faculty of Law, the University of Melbourne with the support of the [Australian Securities and Investments Commission](http://www.asic.gov.au" \t "_new), the [Australian Stock Exchange](http://www.asx.com.au" \t "_new) and the leading law firms: [Blake Dawson Waldron](http://www.bdw.com.au" \t "_new), [Clayton Utz](http://www.claytonutz.com" \t "_new), [Corrs Chambers Westgarth](http://www.corrs.com.au" \t "_new), [Freehills](http://www.freehills.com" \t "_new), [Mallesons Stephen Jaques](http://www.mallesons.com" \t "_new), [Phillips Fox](http://www.phillipsfox.com" \t "_new).  ***Use the arrows to navigate easily across the bulletin*** = back to Brief Contents = back to top of current section |
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| **1. Recent Corporate Law and Corporate Governance Developments** |
| **1.1 United States SEC to publish proposals to modernise regulation of equity markets**  On 24 February 2004, the United States Securities and Exchange Commission voted to publish for public comment Regulation NMS, which would contain four interrelated proposals designed to modernize the regulatory structure of the U.S. equity markets. The substantive topics addressed by proposed Regulation NMS are (1) trade-throughs, (2) intermarket access, (3) sub-penny pricing, and (4) market data. In addition, Regulation NMS would update the existing Exchange Act rules governing the national market system, and consolidate them into a single regulation.  **(a) Trade-throughs**   * Regulation NMS would establish a uniform trade-through rule for all market centers that would affirm the fundamental principle of price priority, while also addressing problems posed by the inherent difference in the nature of prices displayed by automated markets, which are immediately accessible, compared to prices displayed by manual markets, which are not. * Specifically, the proposal would require self-regulatory organizations (SROs), as well as any market centre that executes orders, to establish procedures to prevent the execution of an order for national market system stocks at a price that is inferior to the best bid or offer displayed by another market centre at the time of execution. * At the same time, the proposal would include two exceptions to the general trade-through rule. * First, a market centre would be allowed to execute an order that trades through a better-priced bid or offer on another market centre if the person entering the order makes an informed decision to affirmatively opt out of the trade-through protections. Informed consent would need to be given on an order-by-order basis. This exception is designed to provide greater flexibility to informed traders while preserving the average customer's expectation of having his or her orders executed at the best price. * Second, an automated market - one that provides for an immediate automated response to incoming orders for the full size of its best displayed bid or offer, without restriction - would be able to trade through a better displayed bid or offer on a non-automated market up to a de minimis amount of one to five cents, depending on the stock's price. This exception reflects the comparative difficulty of accessing market quotes of non-automated markets. * Overall, the proposal is designed to be a practical response to developments in the marketplace that still preserves the important customer protection and market integrity goals of best execution and the protection of limit orders. * The proposed trade-through rule would not change a broker-dealer's existing duty to obtain best execution for customer orders.   **(b) Intermarket access**  **Non-discriminatory access**   * Regulation NMS would establish a uniform market access rule that would help assure non-discriminatory access to the best prices displayed by market centres, but without mandating inflexible, "hard" linkages such as the Intermarket Trading System (ITS). * At its core, the proposal would prohibit a market centre from imposing unfairly discriminatory terms that prevent or inhibit any person from accessing its quotations indirectly through a member, customer, or subscriber. * This standard is intended to assure that a member, customer, or subscriber of a market centre can sponsor access to quotes and order execution without receiving disparate treatment in the handling of those orders with respect to fees, speed, or other terms.   **Quote standardization**   * Regulation NMS also would establish an access fee standard. This standard - designed to promote a common quoting convention - is intended to harmonize quotations and facilitate the ready comparison of quotes across the national market system. * The proposal would establish a de minimis fee standard for all market centres and broker-dealers that display attributable quotes through SROs. Specifically, access fees would be capped at $0.001 per share, and the aggregation of this fee would be limited to no more than $0.002 per share in any transaction.   **Locked and crossed markets**   * Finally, the proposed rule would require each SRO to establish and enforce rules requiring its members to avoid - and prohibiting them from engaging in a pattern or practice of - locking or crossing the markets.   **(c) Sub-penny pricing**   * Regulation NMS would ban sub-penny quoting in most stocks. Specifically, it would prohibit market participants from accepting, ranking, or displaying orders, quotes, or indications of interest in a pricing increment finer than a penny in national market system stocks, other than those with a share price below $1.00. * This proposal is intended to prevent sub-penny pricing from being used by some market participants to "step-ahead" of customer limit orders for an economically insignificant amount. This "sub-pennying" could, over time, discourage investors from placing limit orders, which are an important source of market liquidity.   **(d) Market data**   * Regulation NMS would amend the existing arrangements for disseminating market data in order to better reward SROs for their contributions to public price discovery, as well as implement most of the recommendations of the Commission's Advisory Committee on Market Information. * Under existing rules and joint industry plans, the trades and best quotes in thousands of listed and Nasdaq stocks are made available on a real-time and consolidated basis. * The proposal would replace the current plan formulas for allocating revenues derived from market data fees to the SROs, which are based solely on the number of trades or share volume reported by an SRO. This method of allocation has led to serious economic and regulatory distortions, creating incentives for "print" facilities, "wash" trades, and "shredded" trades. In addition, those markets that generate the highest quality quotes (i.e., the best prices and the largest sizes) are not necessarily rewarded. * In general, the proposed new formula would divide market data revenues equally between trading and quoting activity, in order to reward markets that publish the best accessible quotes. * The proposal also includes a number of improvements that were recommended by the Advisory Committee on Market Information. For example, the proposal would broaden participation in plan governance by creating advisory committees composed of non-SRO representatives. Such committees would help assure that interested parties have an opportunity to be heard on plan business, prior to any decision by the plan operating committees. * In addition, the proposal would authorize market centres to distribute their own additional data, such as limit order books, separate from other markets, as well as establish uniform standards for the terms of such distribution.   **1.2 Australia's $2.8b not-for-profit sector needs reform: study**  The regulatory framework behind Australia's not-for-profit sector is riddled with inconsistencies and is undermining an economically valuable sector, according to a new University of Melbourne study.  In a first of its kind, this study by University of Melbourne's Centre for Corporate Law and Securities Regulation researcher Susan Woodward, surveyed over 1700 not-for-profit (NFP) companies. The final research report (A Better Framework: reforming not-for-profit regulation) makes recommendations designed to achieve a balance between the needs of the sector and the broad public interest in NFP accountability.  Recent ABS figures confirm that NFPs play a vital role in our society, with the sector adding more to Australia's GDP than the mining industry. In economic terms alone Australians give more than $2.8 billion annually to NFP organisations. But Ms Woodward said, "The underlying health of the not-for-profit sector is at risk. The regulatory framework that underpins the sector is complex and riddled with inconsistencies. It's time for some preventative medicine".  Ms Woodward said that to meet both the needs of the sector and the needs of its stakeholders, the relevant laws and regulatory bodies needed to be fair, consistent and clear in order to promote NFPs that are transparent, accountable and credible. She comments, "If the regulatory fundamentals are sound, then growth and innovation are more likely to occur."  Ms Woodward said the legal structures in the NFP sector were more varied and complex than in the business sector, and she has proposed several reform recommendations, the principal one being the need for a single, Commonwealth regulatory regime. Other recommendations include:   * ASIC becoming the new regulator for all incorporated NFPs (associations and companies), at least until any sector specific regulator is introduced * establishing a specialist NFP unit within ASIC * developing a plain language guide and replaceable rules for NFPs * establishing an independent NFP advisory body to provide assistance to NFPs with a range of legal, taxation, training and dispute resolution issues.   Ms Woodward said if important reforms are to take place, the sector itself will need to lobby for change, and government (State and Federal) will need to be committed to streamlining and reforming NFP regulation.  The report was launched at Freehills 101 Collins Street, Melbourne on 19 February 2004. Copies of the report will be available at:  [http://cclsr.law.unimelb.edu.au/activities/not-for-profit/index.html](http://cclsr.law.unimelb.edu.au/activities/not-for-profit/index.html" \t "_new)  **1.3 Corporate governance principles for New Zealand**  On 18 February 2004, the Securities Commission of New Zealand delivered its report on Corporate Governance Principles for New Zealand to the Minister of Commerce. The report followed extensive public consultation last year.  "The Commission has developed nine high level principles for good corporate governance in New Zealand," Commission Chairman Jane Diplock said.  "There was strong support for the concept of a principles-based approach to corporate governance, and the final document is in line with the public views that came from the consultation process."  Corporate governance practices and research from relevant overseas jurisdictions were also taken into account in drafting the Principles.  "This will bring New Zealand into line with best practice overseas," Jane Diplock said. "It will increase the integrity of the New Zealand securities markets and make them more attractive to investors."  The Principles focus strongly on reporting and disclosure of corporate governance structures and processes, as well as on reporting of financial and other material matters.  **(a) The Principles and listed entities**  The Principles do not impose a new regulatory regime on listed entities.  The Commission believes that listed entities with high standards of corporate governance, which disclose these under the NZX Listing Rules, will probably not have to do any additional reporting to be consistent with the Principles.  **(b) The Principles apply to a wide range of entities**  The Commission's Principles of Corporate Governance have been designed to be adopted by a wide range of entities.  These include all issuers of securities, unit trusts and other collective investment schemes, state-owned enterprises, and statutory bodies in the public sector.  The Commission encourages entities of all types to consider, adopt and report against the Principles as a means to achieving high quality corporate governance.  **(c) Principles do not impose new legal requirements**  The Securities Commission's Principles of Corporate Governance do not impose a new mandated requirement for issuers of securities.  The Principles identify good corporate governance behaviours. The Commission encourages entities of all types to adopt and report against these Principles.  "Many issuers in New Zealand do achieve good corporate governance," Chairman Jane Diplock said. "However, the Commission has seen and commented on some very poor corporate governance by directors and boards that have raised money from the public. These companies have not met the standards of corporate governance investors have the right to expect."  The Commission will continue to keep corporate governance high on its priorities for enforcement activity. When poor corporate governance is identified it will publicly report on this.  The Commission's report, Corporate Governance Principles for New Zealand, is available on its [website](http://www.sec-com.govt.nz/" \t "_new).  **1.4 Challenging the role and responsibilities of listed company audit committees**  The push for compulsory audit committees was a major part of the Ramsay Report into Auditor Independence and it has been included as a central part of the proposed audit reforms in CLERP 9 that makes it compulsory for the Top 500 listed companies to have audit committees.  It is evident that in recent years, there have been significant changes in expectations about what audit committees can contribute to risk management, disclosure and governance generally. In the past audit committees were simply considered sub-committees of Boards that met with auditors and dealt with matters raised by them.  “Now expectations are much wider and require audit committees to be responsible for overseeing many aspects of the management of a corporation,” said Mr Michael O’Sullivan, President of the Australian Council of Superannuation Investors (ACSI).  “The compulsory requirements for the existence of Board Audit Committees will sharpen our attention on the responsibilities of Boards generally and on Board sub-committees in particular. However, the opportunity must not be missed to require disclosures that would enable greater scrutiny to be focussed on what Boards and committees are actually doing on behalf of shareholders.”  “In the context of audit committees, unless copies of audit committee charters are publicly available, and unless annual reports clearly described the activities undertaken by audit committees, the investors will be unable to ask informed questions of Boards and generally hold directors accountable in relation to financial and other governance risks” said Mr O’Sullivan.  “The ASX Corporate Governance guidelines do not spell out minimum terms of reference for an audit committee. This has meant that, in many respects, the operation of Australian audit committees may be falling well short of best practise,” Mr O’Sullivan added.  In response to these gaps in guidelines, Professor Bob Walker, Professor of Accounting at the University of NSW, has reviewed literature to chart changes in ideas on audit committees over the last three decades. The paper was presented by Professor Bob Walker at an ACSI seminar in Sydney and the recommendations for a model charter have been supported by the ACSI.  “Based on prior governance failures and the losses that have ensured, it is clear that one factor contributing to the scale of these disasters was that Boards received financial information that was, at best, inadequate (or, at worst, misleading). Best practice guidelines on the operation of audit committees have not addressed this; rather, they have focussed on external reporting,” explained Professor Walker.  The paper argues that some basic responsibilities that could be assumed by audit committees continue to be overlooked in formal guidelines.  “Best practice guidelines do not refer to any steps that might be taken to ensure confidence in the quality of information being presented to Boards or external stakeholders… Indeed, most guidelines even fail to refer to governance arrangements in subsidiaries," said Professor Walker.  A second element of the paper is to compare expectations about what audit committees should do with the practices adopted by major Australian listed entities.  Finally, the paper puts forward a suggested audit committee model charter. The charter reflects current expectations about what such a board sub-committee should do in order to make an effective contribution to the governance of major organisations.  It is intended that the model charter supplement existing regulatory and industry standards, with the ultimate aim to provide trustees of superannuation funds, as significant investors in listed companies with a benchmark in which to assess listed companies’ performance in this area.  Further information is available on the [ACSI website](http://www.acsi.org.au/" \t "_new).  **1.5 New IFAC study explores enterprise governance; recommends actions to strengthen corporate performance**  The culture and tone at the top, the chief executive, the board of directors and the internal control system are the four key determinants of corporate success and failure, according to a new study released on 17 February 2004 by the International Federation of Accountants (IFAC) and The Chartered Institute of Management Accountants (CIMA).  Enterprise Governance: Getting the Balance Right includes an in-depth analysis of corporate successes and failures in 27 case studies from 10 countries. These countries are Australia, Canada, France, Hong Kong, Italy, Malaysia, the Netherlands, Thailand, the United Kingdom and the United States. Ten industries are covered in the case studies, including telecommunications, retail, financial services, energy and manufacturing.  The IFAC Board requested its Professional Accountants in Business (PAIB)  Committee to conduct the study in conjunction with CIMA to explore and define the emerging concept of enterprise governance, determine its role in preventing or contributing to corporate failures and to recommend actions that can strengthen governance. The study complements previous research done by the IFAC Task Force on Rebuilding Confidence in Financial Reporting, which recommended actions that could be taken by all those in the financial reporting supply chain to restore the credibility of financial reporting and corporate disclosure.  “Although poor corporate governance can ruin a company, the study revealed that good governance on its own cannot make a company successful. Companies need to balance conformance with performance. This is a fundamental component of enterprise governance,” emphasizes Bill Connell who chairs both the IFAC PAIB Committee and CIMA’s Technical Committee.  In the study, conformance is defined as “corporate governance.” It covers such issues as board structures and roles and executive remuneration. The performance dimension focuses on strategy and value creation.  “Unlike the conformance dimension, there are no dedicated oversight mechanisms, such as audit committees, in the arena of strategy. Several of the high-profile companies highlighted in this study fell into difficulties as a consequence of their strategic choices. There is a danger that in the laudable attempt to improve standards of control and ethics, insufficient attention is paid to the need for companies to create wealth and ensure that they are pursuing the right strategies to achieve this. It is both easy and common for boards to fall into the trap of getting immersed in detail at the expense of focusing on overall strategic risks and opportunities that drive shareholder value,” points out Mr. Connell.  An analysis of the case studies showed that, in addition to the corporate governance issues mentioned above, there were several other key strategy issues contributing to corporate success and failures:           Choice and clarity of strategy;          Strategy execution;          Ability to respond to abrupt changes and/or fast-moving market conditions; and          Ability to undertake successful mergers and acquisitions (M&As).  Unsuccessful M&As were the most significant cause of strategy-related failure.  A complete chapter on how enterprise governance can be used to control M&A activities is therefore included in the report.  The report also gives detailed information about CIMA’s development of a  Strategic Scorecard for enterprise governance as a means of addressing the strategic oversight gap and avoiding the sort of strategic failures that were apparent in the case studies.  In addition to introducing the concept of the strategic scorecard, the report offers guidance on enterprise risk management, the acquisition process, and managing board performance. An appendix features a synopsis of recent international corporate governance developments.  Enterprise Governance: Getting the Balance Right may be downloaded free of charge from IFAC’s website by going to [http://www.ifac.org/store](http://www.ifac.org/store" \t "_new). Print copies may be obtained by contacting <mailto:mdamarysgil@ifac.org> or <mailto:mjasmin.harvey@cimaglobal.com>  **1.6 United States SEC adopts enhanced mutual fund expense and portfolio disclosure; proposes improved disclosure of board approval of investment advisory contracts and prohibition on the use of brokerage commissions to finance distribution**  On 11 February 2004, the United States Securities and Exchange Commission (SEC) took the following actions.  **(a) Shareholder reports and quarterly portfolio disclosure by funds**  The Commission adopted several amendments to its rules and forms that are intended to improve significantly the periodic disclosure that mutual funds and other registered management investment companies provide to their shareholders about their costs, portfolio investments, and performance.  The amendments include the following:           **Enhanced mutual fund expense disclosure in shareholder reports.** The amendments will require open-end management investment companies (mutual funds) to disclose fund expenses borne by shareholders during the reporting period in their shareholder reports. Shareholder reports will be required to include: (i) the cost in dollars associated with an investment of $1,000, based on the fund’s actual expenses for the period; and (ii) the cost in dollars, associated with an investment of $1,000, based on the fund’s actual expense ratio for the period and an assumed return of 5 percent per year. The first figure is intended to permit investors to estimate the actual costs, in dollars, that they bore over the reporting period. The second figure is intended to provide investors with a basis for comparing the level of current period expenses of different funds. The expense disclosure will also be required to include the fund's expense ratio and the account values as of the end of the period for an initial investment of $1,000.           **Quarterly disclosure of fund portfolio holdings.** The amendments will require a registered management investment company (fund) to file its complete portfolio holdings schedule with the Commission on a quarterly basis. These filings will be publicly available through the Commission’s Electronic Data Gathering, Analysis, and Retrieval System (EDGAR). This amendment is intended to enable interested investors, through more frequent access to portfolio information, to monitor whether, and how, a fund is complying with its stated investment objective.           **Use of summary portfolio schedule.** The amendments will permit a fund to include a summary portfolio schedule in its semi-annual reports that are delivered to shareholders in lieu of the complete schedule, provided that the complete portfolio schedule is filed with the Commission and is provided to shareholders upon request, free of charge. The summary portfolio schedule will include each of the fund’s 50 largest holdings in unaffiliated issuers and each investment that exceeds one percent of the fund’s net asset value. This amendment is intended to provide investors with information about portfolio holdings in a format that is more useful and understandable.           **Exemption of money market funds from portfolio schedule delivery requirements.** The amendments will exempt money market funds from including a portfolio schedule in reports to shareholders, provided that this information is filed with the Commission and is provided to shareholders upon request, free of charge. Because the investments of money market funds must be high-quality, are circumscribed by rules under the Investment Company Act of 1940, and have short-term maturities, detailed portfolio information has limited utility for money market fund investors.            **Tabular or graphic presentation of portfolio holdings in shareholder reports.** The amendments will require fund reports to shareholders to include a tabular or graphic presentation of a fund’s portfolio holdings by identifiable categories (e.g., industry sector, geographic region, credit quality, or maturity). This presentation is intended to illustrate, in a concise and user-friendly format, the allocation of a fund’s investments across asset classes.            **Management’s discussion of fund performance.** The amendments will require a mutual fund to include Management’s Discussion of Fund Performance (MDFP) in its annual report to shareholders. Currently, a fund is permitted to include MDFP in either its prospectus or its annual report to shareholders. MDFP is more appropriately located in the annual report, together with other “backward looking” information, such as the fund’s financial statements.  The new requirements will apply to shareholder reports and quarterly portfolio disclosure for reporting periods ending on or after 120 days following publication in the Federal Register.  **(b) Disclosure regarding approval of investment advisory contracts by directors of investment companies**  The Commission proposed amendments to its rules and forms that would improve the disclosure that mutual funds and other registered management investment companies provide to their shareholders regarding the reasons for the fund board’s approval of an investment advisory contract. The proposals are intended to encourage fund boards to consider investment advisory contracts more carefully and to encourage investors to consider more carefully the costs and value of the services rendered by the fund’s investment adviser.  The proposals would require fund shareholder reports to discuss, in reasonable detail, the material factors and the conclusions with respect to these factors that formed the basis for the board of directors’ approval of any investment advisory contract. The proposed new disclosure would be similar to disclosure currently required in the fund’s Statement of Additional Information, or SAI, and fund proxy statements about the basis for the approval of the fund’s existing advisory contract and any board recommendation that shareholders approve an advisory contract.  The proposals also include several enhancements to the existing disclosure requirements in the SAI and proxy statements that would parallel the proposed disclosure in fund shareholder reports. These enhancements would require the following:           **Selection of adviser and approval of advisory fee.** The proposals would clarify that the fund should discuss both the board’s selection of the investment adviser and its approval of amounts to be paid under the advisory contract.           **Specific factors.** The fund would be required to include a discussion of (1) the nature, extent, and quality of the services to be provided by the investment adviser; (2) the investment performance of the fund and the investment adviser; (3) the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the fund; (4) the extent to which economies of scale would be realized as the fund grows; and (5) whether fee levels reflect these economies of scale for the benefit of fund investors.           **Comparison of fees and services provided by adviser.** The fund’s discussion would be required to indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (e.g., pension funds and other institutional investors).  Comments on the proposed rule amendments will be due approximately 60 days following their publication in the Federal Register.  **(c) Prohibition on the use of brokerage commissions to finance distribution**  The Commission proposed an amendment to rule 12b-1 under the Investment Company Act of 1940 that would prohibit open-end investment companies (mutual funds) from directing commissions from their portfolio brokerage transactions to broker-dealers to compensate them for distributing fund shares. The Commission also asked for comment on the need for additional changes to rule 12b-1.  In an increasingly competitive marketplace, one way that fund advisers reward broker-dealers for promoting mutual fund shares is through brokerage commissions. Advisers often either select broker-dealers that sell fund shares to execute fund portfolio transactions, or rely on another broker-dealer to execute the transactions, but direct a portion of the brokerage commission to selling brokers. The conflicts of interest that surround the use of brokerage commissions (which are fund assets) to finance distribution may harm funds and their shareholders in a number of ways, including compromising best execution, causing advisers and brokers to circumvent limits on sales charges, increasing portfolio turnover, concealing distribution costs, and influencing broker-dealers’ recommendations to their customers.  The proposed rule amendment would:           prohibit funds from compensating a broker-dealer for promoting or selling fund shares by directing brokerage transactions to that broker-dealer;           prohibit “step-out” and similar arrangements under which a fund directs brokerage commissions to selling brokers that do not execute fund portfolio securities transactions as compensation for selling fund shares; and           require funds that use a selling broker-dealer to execute portfolio securities transactions to adopt, and the fund’s board of directors (including its independent directors) to approve, policies and procedures reasonably designed to prevent: (i) the persons who select executing broker-dealers from taking into account brokers’ distribution efforts; and (ii) any agreement under which the fund is expected to direct brokerage commissions for distribution.  The Commission also is requesting comment on the need for additional changes to rule 12b-1 to address other issues that have arisen under the rule. One of these issues is the current practice of using 12b-1 fees as a substitute for a sales load. In addition, the Commission is requesting comment on an alternative approach to rule 12b-1 that would require distribution-related costs to be deducted directly from shareholder accounts rather than from fund assets. Finally, the Commission is seeking comment on whether rule 12b-1 continues to serve the purpose for which it was intended, and whether it should be repealed. The comments the Commission receives will determine whether a proposal for further amendments to rule 12b-1 is appropriate.  Comments on the proposed rule amendment and additional request for comment will be due approximately 60 days after the proposed rule is published in the Federal Register.  **1.7 GMI releases global governance ratings – improvements seen but governance risks remain**  GovernanceMetrics International (GMI), the corporate governance research and ratings agency, announced on 9 February ratings on 2,100 global companies. Twenty-two companies – eighteen American, two British, one Australian and one Canadian - received scores of 10.0, GMI’s highest rating (see below). As a group, these companies outperformed the S&P 500 Index as measured by average total returns for each of the last one, three and five-year periods by 3.0%, 9.4% and 6.9% respectively. Gavin Anderson, GMI’s President and CEO, said “This is another example of a growing body of research suggesting a correlation between corporate governance and portfolio returns when measured across a number of variables and across a multi-year period.”  On a national level, Canadian companies had the highest overall average rating of 7.6, followed by the United States (7.0), Australia (6.9) and the United Kingdom (6.7). Japanese companies had the lowest overall average rating at 3.0. In Europe, companies from Greece (3.8), Austria (4.0), Portugal (4.0) and Denmark (4.0) had the lowest overall average ratings.  Looking just at the two largest markets rated by GMI, the United States and the United Kingdom, the average rating for the top 100 US companies was 8.0 and the top 100 UK companies was 7.8. In the July 2003 GMI ratings release, these numbers were 7.7 and 7.1, respectively. These improvements are indicative of the governance changes taking place in both markets.  Mr. Anderson said, “While US, Canadian, UK and Australian firms had higher average scores than others, it would be a mistake to conclude that there was little governance risk in companies from these markets. Indeed we are still seeing practices in companies in all four markets that warrant significant shareholder concern. Two examples are a US concern which claims it does not control its overseas operations despite controlling 85% of the voting power of the entity. This same company has had two earnings restatements and its outside auditor recently resigned over management misrepresentations of related-party transactions. In the second example, the Chairman of a Canadian company, who controls the company with a special class of shares, received almost $25 million last year in special fees for ‘business consulting and development services.’ Certainly in the latter case, investors have become much more familiar with this kind of activity in the last few months as managements at some controlled companies enriched themselves at the expense of both shareholders and bondholders.”  As part of its rating process, GMI identifies issues of concern to investors and “red flags” companies that are undergoing regulatory investigation, have high potential options dilution, unequal voting rights or other practices that represent additional risk to equity or debt holders. Parmalat was one such company GMI flagged in July of last year, months before the Italian company imploded and became Europe’s Enron. In its current universe GMI has issued red flags at 675 companies. The market sectors with the highest percentages of red flags are Technology (56%), Media (50%), Telecommunications (45%) and Healthcare (39%). In addition, GMI identified 211 companies that have taken an unusual and non-recurring charge of 5% or more of revenues in the last year, 190 companies that have been cited or found guilty for a breach of law involving non-accounting issues, and 189 companies that have been subject to a regulatory investigation for a material issue other than an accounting matter.  Another area of concern is compensation. While 1,835 companies covered by GMI had a compensation committee, in 414 cases an executive sat on the compensation committee. In 59 instances, it was the CEO. Of particular interest also is director independence, and the question of whether board leadership comes from a combined Chairman/CEO or an independent Chairman or lead outside director. In this latest ratings release, GMI found that in just the last six months there has been a significant shift. While the total number of independent directors increased marginally from 56.1% to 57.5%, the number of combined Chairman and CEO positions fell from 47.3% to 41.6%, the number of independent chairman grew from 13.2% to 21.2% and the change in the number of lead directors jumped from 23.3% to 33.4%. Fifty percent increases in six months is a very significant change and were found not only in the United States, but also in Europe and Australia.  GMI’s rating system incorporates hundreds of data points across six broad categories of analysis: board accountability, financial disclosure and internal controls, executive compensation, shareholder rights, ownership base, takeover provisions, plus corporate behaviour and social responsibility.  **(a) Companies with a global score of 10.0 (the highest rating) are:**   |  |  | | --- | --- | | 3M Company (US) | Intel Corporation (US) | | Air Products & Chemicals (US) | McDonald’s Corporation (US) | | BCE Inc. (Canada) | Peoples Energy Corporation (US) | | Colgate-Palmolive Company (US) | PepsiCo, Inc. (US) | | Cooper Industries Ltd. (US) | Pfizer Inc. (US) | | E.I. DuPont de Nemours & Co. (US) | Praxair Inc. (US) | | Entergy Corp. (US) | Scottish & Southern Energy plc (UK) | | Exxon Mobil Corp. (US) | Target Corporation (US) | | General Electric Co. (US) | Vodafone Group plc (UK) | | General Motors Corp. (US) | Westpac Banking Corp. (Australia) | | Great Lakes Chemical Corp. (US) | Wisconsin Energy Corporation (US) |   **(b) Average overall ratings by country**   |  |  |  |  | | --- | --- | --- | --- | | **Country** | **Number of Companies** | **Pct. of all Rated Companies** | **Avg. Overall Rating** | | Australia | 49 | 2.3% | 6.9 | | Austria | 2 | 0.1% | 4.0 | | Belgium | 10 | 0.5% | 5.0 | | Canada | 60 | 2.8% | 7.6 | | Denmark | 5 | 0.2% | 4.0 | | Finland | 6 | 0.3% | 6.3 | | France | 47 | 2.2% | 4.6 | | Germany | 34 | 1.6% | 5.5 | | Greece | 7 | 0.3% | 3.8 | | Ireland | 5 | 0.2% | 6.6 | | Italy | 32 | 1.5% | 4.6 | | Japan | 225 | 10.6% | 3.0 | | Netherlands | 26 | 1.2% | 5.8 | | Norway | 5 | 0.2% | 4.6 | | Portugal | 4 | 0.2% | 4.0 | | Spain | 35 | 1.7% | 4.6 | | Sweden | 29 | 1.4% | 5.5 | | Switzerland | 27 | 1.3% | 5.2 | | UK | 354 | 16.7% | 6.7 | | USA | 1159 | 54.6% | 7.0 | | **All Companies** | **2121** | **100.0%** | **6.3** |   **(c) Average overall rating by sector**  Utilities (105) 6.8 Energy (91) 6.8 Basic resources (73) 6.6 Retail (104) 6.6 Non-cyclical goods and services (91) 6.5 Technology (198) 6.5 Insurance (96) 6.5 Chemicals (63) 6.5 Healthcare (150) 6.4 Banks (152) 6.2 Industrial goods and services (328) 6.2 Financial services (203) 6.1 Media (96) 6.1 Food and beverage (73) 6.1 Cyclical goods and services (154) 6.0 Telecommunications (47) 5.9 Automobiles (43) 5.3 Construction (54) 5.3  **1.8 Financial Services Reform Act 2001** **–** **Relief for advice provided by accountants in relation to self managed superannuation**  On 9 February 2004, the Australian Federal Treasurer announced that new regulations were to be made to provide relief from the [Financial Services Reform Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=58127" \t "default) (FSRA) for accountants who provide advice to their clients on the decision to acquire or dispose of an interest in a self managed superannuation fund (SMSF).  The Government accepts that such advice should not require licensing under the FSRA regime. The new regulation will be consistent with a recommendation made by the Parliamentary Joint Committee on Corporations and Financial Services which considered this matter.  The regulation would be limited to ‘recognised accountants’ that hold appropriate qualifications to provide the advice. A recognised accountant would be exempted from the previous restriction in [Corporations Regulation 7.1.29](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56758" \t "default) that they not make ‘a recommendation that a person acquire or dispose of a superannuation product’ in relation to a SMSF. The exemption will not cover the provision of advice about the particular investments that a SMSF may hold and such advice will remain subject to FSRA licensing.  The new regulation is intended to promote certainty for accountants. It acknowledges the important role that accountants currently play in providing a range of professional advice and expertise to their business and other clients.  It ensures that advice on the establishment of a SMSF, which often forms a part of overall business arrangements, is treated comparably with other FSRA exempt advice provided to a client, such as on business structuring and taxation. The exemption for advice on the establishment of a SMSF is in keeping with the policy of exempting such advice from the FSRA.  The regulation will have effect from the end of February 2004, before the conclusion of the FSRA transitional period on 11 March 2004.  **1.9 UK Myners review wins government endorsement for wide-ranging changes to shareholder voting process**  Paul Myners’ report to the Shareholder Voting Working Group (SVWG), published on 3 February 2004, outlines a comprehensive action programme to remove obstacles to casting votes by institutional investors at UK company meetings. The report, "A review of the impediments to voting UK shares", details a series of actions required from: beneficial owners of shares, companies or issuers, company registrars, investment managers, custodians and proxy voting agencies. The report also makes recommendations to the Department for Trade and Industry, the Financial Services Authority (FSA) and the Financial Reporting Council.  Speaking about the report Paul Myners commented:  "There has been continuing concern that the system for registering proxy votes at company meetings is not as efficient as it should be. Complications arise from the number of different participants involved and the confusing lines of responsibility. There is no single simple solution, no silver bullet to the problem of ‘lost votes’. However, significant improvements can be achieved through concerted action by all interested parties. There is nothing inherently flawed in the pipework that carried votes from the investor to the issuer. What has previously been lacking is a commitment on the part of participants to make it work effectively”  The report has been welcomed by Industry Minister Jacqui Smith and has also been endorsed by the Institutional Shareholders’ Committee³, the British Bankers' Association, the Institute of Chartered Secretaries and Administrators and the Association of Private Client Investment Managers and Stockbrokers.  Among the conclusions and recommendations contained in the report are:           **voting policy -** beneficial owners should determine a voting policy and engage fully in its implementation          **electronic voting -** beneficial owners of shares should require their agents (custodians, investment managers etc) to have an electronic voting capability as part of their standard service conditions;          **registering title to shares -** beneficial owners should consider requiring their shares to be registered in a nominee company with designation in their own name or some other unique designation, rather than in an undesignated omnibus nominee account;          **date for the appointment of proxies -** the current 48 hour limit should be amended to two business days to take account of bank holidays and weekends;          **stocklending -** borrowing stock for the purpose of voting is not appropriate as it gives a proportion of the vote to an agent who has no on-going economic interest in the company. Beneficial owners should be fully aware of the implications for voting if their shares are lent and, when a resolution is contentious, should recall the related stock;          **accountability -** investment managers should actively exercise the votes in shares they hold or manage for beneficial owners and have a stated, public and regularly reviewed policy on voting UK shares;          **voting resolutions at company meetings -** best practice should be to call a poll (rather than a show of hands) on all resolutions at company meetings;          **disclosing the results of polls and proxy votes -** quoted companies should disclose on their websites and in summary in annual reports the results of polls of general meetings. The FSA should make it a listing requirement for the results of polls to be disclosed as a regulatory announcement to the market;          **recognising votes withheld -** votes consciously withheld can be a useful tool in communicating shareholders' reservations about a resolution, provided there is a clear explanation to the company as to why the vote has been withheld. Companies should provide a 'vote withheld' box on all proxy forms;          **improving the powers of proxies -** Company Law should be changed to give more rights to proxies so that they can speak and vote on a show of hands as well as a poll;          **scrutiny of polls -** Company Law should be amended to require independent scrutiny of polls if requested by shareholders.  **1.10 New accounting standard on director and executive remuneration**  David Boymal, Chairman of the Australian Accounting Standards Board (AASB), announced on 28 January 2004 the gazettal of a new Accounting Standard, AASB 1046 Director and Executive Disclosures by Disclosing Entities, that will be effective for years ending on or after 30 June 2004. The main aim of the new Standard is to improve the quality and comparability of disclosures by listed companies about the remuneration of those responsible for its governance. Mr Boymal said the increase in disclosures required from Australian companies is in line with increases for listed companies in major capital markets overseas.  Mr Boymal commented “Controversies about what should be disclosed about whom and how to treat executive share options have contributed to delays in producing AASB 1046. Progress has also been hindered by trying to fit into schedules for issuing new Australian Standards equivalent to those of the  International Accounting Standards Board (IASB). However, the AASB has decided that issuing AASB 1046 should not be delayed any longer, particularly since it covers an area that the IASB has stated it will leave to national jurisdictions.”  The majority of the disclosures in AASB 1046 were initially proposed in Exposure Draft ED 106 Part 1 Director and Executive Disclosures by Disclosing Entities (May 2002). Those proposals have been amended to reflect the responses received, subsequent decisions of the IASB (on share-based payment) and redeliberation by the AASB. The method required for measuring equity compensation has been changed from the vesting date method proposed in ED 106 to the grant date method expected in the IASB’s forthcoming IFRS 2 Share-based Payment. Unlike IFRS 2, AASB 1046 does not require equity grants to be recognised as expenses but it does require disclosure for each specified director and specified executive; specified directors being the directors of the entity required to prepare the financial report and specified executives being at least five executives in the economic entity (or entity) with the greatest authority.  Disclosing entities applying AASB 1046 will be exempt from complying with requirements on director disclosures in AASB 1017 Related Party Disclosures. The requirements in AASB 1034 Financial Report Presentation and Disclosures for the banded disclosures of executive remuneration will be withdrawn. However, disclosing entities will still need to provide the other disclosures required by AASB 1017. Corporate non-disclosing entities will remain subject to all requirements of AASB 1017, including the disclosure requirements for directors. AAS 22 Related Party Disclosures, applicable to non-corporate, non-public sector reporting entities, is not changed by the issue of AASB 1046. It is expected that the AASB will address remuneration disclosures for all non-disclosing reporting entities when considering the adoption of IAS 24 Related Party Disclosures.  AASB 1046 is available on the [AASB website](http://www.aasb.com.au/" \t "_new)**.**  **1.11 US directors & officers liability insurance premiums up 33%**  On 26 January 2004, Towers Perrin's 2003 Directors & Officers Liability Survey was released indicating that directors and officers (D&O) liability insurance premiums increased approximately 33% on average from 2002 to 2003. While employee lawsuits were significant for all types of respondents, entities with more than 500 shareholders saw most of their claims come from shareholders. Despite record premium increases during the year, the 2003 D&O Premium Index indicates that the market started stabilizing toward the end of 2003 with premium increases beginning to level off. The survey, which included 2,139 participants, is the 26th in a series of studies on D&O liability claims and insurance purchasing patterns and the only study of its type.  The 2003 D&O Premium Index median and average premiums were the highest ever reported by survey participants, with 70% of US respondents reporting an increase in premiums from a prior policy and only 19% reporting a decrease. Signs of stabilization occurred toward the end of the year, with 62% of US participants with renewals reporting a premium increase in the third quarter, compared with 76% in the third quarter of 2002.   **(a) Key findings from the survey include:**           Coverage available despite decreased capacity levels: According to information provided by D&O insurance carriers, $1.35 billion in full limits capacity was available during 2003, which is the lowest capacity level since 1997. Yet few survey participants cited availability problems. 2003 was the eleventh consecutive year that less than 5% of all US participants not purchasing D&O coverage made their decision because coverage was completely unavailable to them.           Employment practices liability (EPL) saw the most significant increase in incidence of D&O claims: During 2003, 91% of D&O claims against nonprofits organizations were brought by employees. At for-profit companies with fewer than 500 shareholders, 50% of D&O claims were brought by employees, compared with 24% at companies with more than 500 shareholders. Employment discrimination (40%) was the most frequently cited employment-related claim, followed by wrongful termination (24%).           D&O claims decreased slightly: Though there was a dip in the frequency of D&O claims, severity excluding shareholder claims increased by 40%. The severity of shareholder claims averaged $14.2 million per claim award in 2003, down from $23.4 million in 2002.            M&A activity more than doubled odds of D&O claims: Twenty-seven percent of US respondents were involved in a merger, acquisition or divestiture during 2003, and these companies were more than twice as likely to have at least one D&O claim. On average, they also had three times as many D&O claims as their counterparts that did not undergo such reorganization.           Brokers/Carriers: In the survey, the leading US D&O primary insurance brokers continue to be Woodruff-Sawyer & Company and Alburger Basso De Grosz, while Chubb and AIG continue to underwrite the largest share of US D&O primary insurance.  **(b) Premium Index: record high, but hints of market stabilization**  Since 1974, when Tillinghast developed a standardized premium index for D&O coverage, premium medians and averages have fluctuated with the highest values for both in the period 1994 to 1995. However, 2003 set a new record for both of these measures, with the median premium index for purchasers of D&O insurance up 13% from 2002 and the average up 33%. The spread between the average and median of premium has increased significantly since 1999.   **(c) Predictions for 2004 D&O market**  Tillinghast predicts the D&O market will take the following shape in 2004:           Capacity will increase: After bottoming in 2003, capacity should bounce back this year with new entrants coming into the market.           Market will remain hard: In spite of the increase in capacity, the market will not begin to soften. Though premium increases will stabilize overall, some industry sectors will still experience increases of 30% or more.           Narrowing of coverage: There will be some continued narrowing of coverage by virtue of more restrictive coverage forms and carriers imposing more exclusions. However, most of this is anticipated to occur in the first half of 2004 with coverage stabilization likely during the second half of the year.           Sarbanes-Oxley creates interesting dynamic: Regulation from Sarbanes-Oxley will likely make buyers more concerned about having enough coverage limits. However, insurers will be concerned about claim frequency increasing, and may become more selective in offering coverage limits.  **(d) Participant profile**  The 2,139 companies surveyed comprised 2,068 from the US and 71 in Canada, in 15 business classes across all major industry groups. In the US, the largest representation was from the technology and biotechnology & pharmaceuticals business classes. Companies with under $100 million in assets accounted for 69% of US respondents, while 13.5% had assets greater than $1 billion. A wide variety of Canadian industrial groups were represented by the 71 Canadian participants, 31% of which have under $100 million in assets and 34% had more than $2 billion. Nonprofits (including governmental) organizations represented 11% of participants in both the US and Canada.  Of the for-profit participants, 44% were publicly traded corporations. Within the past five years, 58% of the US for-profit participants reported an after-tax loss in one or more years, 10% were involved in an initial public offering (IPO) and 27% experienced merger, acquisition or divestiture activity. Among Canadian for-profit participants, the corresponding figures were 41%, 7%, and 66%.  **1.12 US takeover defences slow in 2003**  The pace of adoption of most takeover defences slowed in the last two years, says the United States Investor Responsibility Research Center in its 2004 edition of “Corporate Takeover Defenses” (CTD) as released on 21 January 2004. This may reflect heightened sensitivity in the aftermath of numerous corporate scandals, where lack of management and board accountability to shareholders were contributing factors in many cases. Nevertheless, a substantial majority of major US companies are still protected by a range of barriers that make it difficult for a hostile acquisition to succeed.  The latest edition of CTD surveys corporate control features at a total of 1,982 public firms as of the end of 2003. As in previous years, the most prevalent defences of the profiled firms re-main blank check preferred stock, advance notice requirements, classified boards, poison pills, and golden parachutes, each of which is found at a majority of the nearly 2,000 firms tracked. The prevalence of classified boards appears to have peaked at just under 60 percent of companies, and poison pill adoptions and supermajority merger vote requirements are also holding steady at about 55 percent and 15 percent, respectively.  On the other hand, companies continue to establish advance notice requirements for shareholder proposals—prevalence of that impediment to shareholder protestation rose to 77 percent as of the end of 2003, from less than 72 percent two years earlier and only about 44 percent when these were first tracked in 1995. The only other anti-takeover feature to show significant gain in the past two years is golden parachute arrangements—typically consisting of severance based on three-times pay in the event of a change-in-control related termination—which jumped from 67.7 percent of the companies analysed two years ago to 73.4 percent today. That extends the pattern of steady expansion of these often costly benefits since 1995, when IRRC tracked them at only 53 percent of companies.  Meanwhile, shareholders are not sitting idly by as anti-takeover measures continue to proliferate. Shareholders have made it clear they object to boards using these devices to impede investor value or entrench management at their expense. In the last few years, shareholder proposals to eliminate classified boards and supermajority vote requirements, and to eliminate or allow a shareholder vote on poison pills, have garnered support averaging at least 60 percent at the 2,000 companies where IRRC tracks voting results on an annual basis. More than a quarter of the profiled companies has faced one or more corporate governance shareholder proposals since 1984.  **1.13 Canadian securities regulators implement new investor confidence measures**  On 16 January 2004 securities regulators in Canada released three new rules to address investor confidence and uphold the reputation of Canada’s capital markets.  National Instrument 52-108 Auditor Oversight has been adopted in all Canadian jurisdictions.  Multilateral Instruments 52-109 Certification of Issuers’ Annual and Interim Filings and 52-110 Audit Committees have been adopted in every Canadian jurisdiction except British Columbia. These new rules will take effect March 30, 2004, pending provincial ministerial approvals.  Nationally, the new rules will require reporting issuers to hire auditors who are members of the Canadian Public Accountability Board (CPAB).  In most provinces and territories, the new rules will require:           chief executive officers and chief financial officers of reporting issuers to provide annual and interim certifications with respect to their issuer’s annual information form, audited financial statements, and management’s discussion and analysis (MD&A), and          reporting issuers to have an independent and financially literate audit committee with prescribed duties.  Exemptions from certain requirements are available to venture issuers, controlled companies and U.S.-listed companies that are subject to the Sarbanes-Oxley requirements.  The CSA is moving ahead with the new requirements after a thorough public consultation process designed to ensure that the proposed regulations are appropriate for Canada’s capital markets.  Copies of the adopted rules as well as summaries of comments received can be found on the websites of several provincial securities commissions.  The CSA is a council of the 13 securities regulators of Canada's provinces and territories. It coordinates and harmonizes regulation for the Canadian capital markets. More information is available at the [CSA website](http://www.csa-acvm.ca/" \t "_new).  **1.14 Canadian securities regulators propose corporate governance rules for issuers**  On 16 January 2004, the Ontario Securities Commission (OSC) published proposals that describe best corporate governance practices and require issuers to make disclosures relating to these best practices. The proposals are being considered as well by securities regulators in Saskatchewan, Alberta, Manitoba, Nova Scotia, Newfoundland and Labrador, New Brunswick, Prince Edward Island, the Yukon Territory, the Northwest Territories and Nunavut.   "The proposed policy describes best corporate governance practices that have evolved through legislative and regulatory reforms and through initiatives of other capital market participants" said OSC Chair David Brown. "Our proposals provide greater transparency for the marketplace regarding the nature and adequacy of issuers' corporate governance practices."  The best practices include measures related to the composition of the board, its mandate and its committees; director education and assessment; as well as codes of business conduct and ethics.  "We propose to require issuers to disclose the corporate governance practices they adopt," added Mr. Brown. "However, because we appreciate that many smaller issuers may have less formal procedures in place to ensure effective corporate governance, our proposal provides for lesser disclosure for venture issuers."  In order to avoid regulatory duplication and overlap, the Toronto Stock Exchange intends to revoke its corporate governance guidelines and related disclosure requirements when the proposals become effective.   The commissions request comment by 15 April 2004, on proposed Multilateral Policy 58-201 Effective Corporate Governance and proposed Multilateral Instrument 58-101 Disclosure of Corporate Governance Practices.  **(a) Summary and discussion of the proposed policy and proposed instrument**  **The proposed policy**  The Proposed Policy confirms as best practice certain governance standards and guidelines that have resulted from legislative and regulatory reforms and the initiatives of other capital market participants. The best practices it recommends include:           maintaining a majority of independent directors on the board of directors (the **board**);          holding separate, regularly scheduled meetings of the independent directors;          appointing a chair of the board who is an independent director, or where this is not appropriate, appointing a lead director who is an independent director          adopting a written board mandate;          developing position descriptions for directors and the chief executive officer;           providing each new director with a comprehensive orientation, as well as providing all directors with continuing education opportunities;          adopting a written code of business conduct and ethics;          appointing a nominating committee composed entirely of independent directors;          adopting a process for determining what competencies and skills the board as a whole should have, and applying this result to the recruitment process for new directors;          appointing a compensation committee composed entirely of independent directors;          conducting regular assessments of board effectiveness, as well as the effectiveness and contribution of each board committee and each individual director.  Although the Proposed Policy applies to all reporting issuers, the recommendations in the Proposed Policy are not intended to be prescriptive. Instead, the OSC encourages issuers to adopt the suggested measures, but they should be implemented flexibly and sensibly to fit the situation of individual issuers.  In developing the Proposed Policy and Proposed Instrument, the OSC recognizes that corporate governance is in a constant state of evolution. Consequently, the OSC intends to review both the Proposed Policy and the Proposed Instrument during the two years following the implementation of these initiatives, to ensure that their recommendations and disclosure requirements continue to be appropriate for issuers in the Canadian marketplace.  **Meaning of independence**  Similar to the definition of "independence" in Multilateral Instrument 52-110 Audit Committees, the definition of "independence" used in both the Proposed Policy and the Proposed Instrument is based upon corresponding definitions in the United States. For the purpose of the Proposed Policy and the Proposed Instrument, a director is independent if the he or she has no direct or indirect material relationship with the issuer. A "material relationship" is a relationship which could, in the view of the issuer's board, reasonably interfere with the exercise of a director's independent judgment. However, an individual described in subsection 1.4(3) of Multilateral Instrument 52-110 Audit Committees (other than an individual described in clauses 1.4(3)(f)(i) or (g) of that instrument) is considered to have a material relationship with the issuer. The relationships included in clauses 1.4(3)(f)(i) and (g) were derived from SEC rules applicable to audit committee members only. Consequently, as in the United States, the test of whether or not a director is independent is less onerous than that used for the purposes of determining the independence of an audit committee member.  The proposed policy is available on the [OSC website](http://www.osc.gov.on.ca/" \t "_new).  **1**.**15** **Canadian securities regulators propose mutual fund governance regime**  On 9 January 2004, Canada's securities regulators published a proposed rule that would require investment funds to establish fund governance structures that focus on managing and resolving conflicts of interest in mutual funds. The Canadian Securities Administrators (CSA) has requested public comment on proposed National Instrument 81-107 Independent Review Committee for Mutual Funds, by 9 April 2004.  The proposed rule builds on concepts introduced 1 March 2002 by the CSA in the Concept Proposal 81-402 Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers and brings regulators one step closer towards implementing a mandatory fund governance regime for all publicly offered mutual funds in Canada.  Under the proposed rule, each mutual fund manager is required to establish an independent review committee (IRC) for its funds. The IRC is charged with reviewing all matters involving a conflict of interest between the fund manager's own commercial or business interests and its fiduciary duty to manage its mutual funds in the best interests of those funds. These conflicts include transactions with entities that are related to the manager, trades between mutual funds, certain changes which currently require an investor vote, as well as situations when a person would question whether the manager is in a conflict of interest.  The proposed rule is available on the [CSA website](http://www.csa-acvm.ca/" \t "_new).  **1.16 Market abuse: European Commission adopts first implementing measures**  On 7 January 2004, the European Commission announced that it had adopted three implementing measures related to the Directive on insider dealing and market manipulation (market abuse - 2003/6/EC). These implementing measures cover among other things detailed criteria for determining what constitutes inside information, which non exhaustive factors have to be examined when assessing possible market manipulation as well as provisions on how and when issuers must disclose inside information.  They also set out standards for the fair presentation of investment recommendations (including the disclosure of conflicts of interest). Finally, they set out conditions for benefiting from exemptions from the prohibitions of market abuse in the case of share buy-back programmes and price stabilisation of financial instruments. These implementing measures are the first to be drawn up under the new procedure for deciding and applying securities legislation agreed by the European Council in March 2001 and endorsed by the European Parliament in February 2002 (see IP/02/195).  The three implementing measures comprise two Commission Directives and one Commission Regulation. The first Commission Directive establishes detailed criteria for determining when inside information is precise and price sensitive. In addition, it specifies a series of factors to be taken into account when examining whether specific behaviour might constitute market manipulation. Additional factors can also be considered depending on the circumstances of the case. For issuers, this implementing Directive specifies the means and time-frame for the public disclosure of inside information and details circumstances under which issuers would be able to delay such disclosure in order to protect their legitimate interests.  The second Commission Directive establishes standards for the fair presentation of investment recommendations and the disclosure of conflicts of interest. The implementing Directive makes a distinction between those producing investment recommendations (who must conform to higher standards) and those merely disseminating investment recommendation produced by a third party.  In conformity with Article 6 of the Market Abuse Directive this second implementing Directive takes into account the rules, including self-regulation, governing the profession of journalist. This means that the very specialised sub-category of financial journalists recommending or disseminating investment recommendations would have to comply with certain general principles.  However, this is subject to safeguards and allows for use of self-regulatory mechanisms to determine how these basic principles should be applied. This is a balanced solution which fully protects press freedom while also shielding investors and issuers against any risk of market manipulation by journalists exploiting for personal gain their sometimes considerable ability to influence prices.  Finally, a Commission Regulation establishes technical conditions for share buy-back programmes and price stabilisation of financial instruments. According to Article 8 of the Market Abuse Directive, and provided that such activity is carried out in compliance with these conditions, the prohibitions of the Market Abuse Directive will not apply.  In preparing the measures and in accordance with the rules of the new procedure for deciding and applying securities legislation, the Commission took account of technical advice from the Committee of European Securities Regulators (CESR). The Commission then published a preliminary draft of the legal texts for possible drafting comments from the public in March (see IP/03/345) and issued amended texts in June, taking on board comments by Member States, the European Parliament and stakeholders. The European Securities Committee (ESC) made up of representatives of national governments subsequently agreed unanimously to the three draft texts on 29 October 2003. On 20 November 2003 the European Parliament considered that the implementing measures, as agreed in the ESC, respected the mandate given to the Commission and did not give rise to any further remarks.  The measures described above are designed to establish in detail how some provisions of the Directive on market abuse, adopted by the European Parliament and Council of Ministers in December 2002 (see IP/02/1789), will be implemented in practice.  The Directive - due to be written into national law by Member States by 12 October 2004 - will:           reinforce market integrity;           contribute to the harmonisation throughout Europe of the rules against market abuse;           establish a strong commitment to transparency and equal treatment of market participants;          require closer co-operation and a more exchange of information between national authorities, thus ensuring the same framework for enforcement throughout the EU and reducing potential inconsistencies, confusion and loopholes.  The Directive covers both insider dealing and market manipulation. The same framework applies to both categories of market abuse. This will simplify administration and reduce the number of different rules and standards across the European Union.  It covers all financial instruments admitted to trading on at least one regulated market in the European Union. The Directive requires each Member State to designate a single authority to tackle insider dealing and market manipulation. It also establishes transparency standards requiring that people who recommend investment strategies to the public or to distribution channels take reasonable care to ensure that these strategies are fairly presented and disclose their interests or indicate conflicts of interest.  The Commission Directives and Commission Regulation are available at:  [http://europa.eu.int/comm/internal\_market/en/finances/mobil/market-abuse\_en.htm](http://europa.eu.int/comm/internal_market/en/finances/mobil/market-abuse_en.htm" \t "_new)  **1.17 Survey finds two-thirds of US corporate boards logged more time in past year**  In the wake of corporate scandals, the new Sarbanes-Oxley law and other governance and accounting requirements, nearly two-thirds of US corporate boards of directors spent more time on their duties during the past year, according to the PricewaterhouseCoopers Management Barometer which was released on 6 January 2004.  Despite the added workload, the survey found that board compensation increased at only 20 percent of companies, and remained the same at 47 percent. The remainder was either uncertain about board compensation or did not report. For those receiving a raise, the average increase was 17.9 percent.  The survey of senior executives at 177 large, US multinational companies found that 62 percent of boards increased the time and effort spent on corporate governance over the past year—including 30 percent that spent much more time; and 32 percent, somewhat more. Fourteen percent spent about the same amount of time, and two percent less time. The remainder did not report.  Eighty-nine percent of boards receiving increased compensation had put in additional time and effort. However, only 29 percent of boards putting in more time were rewarded with increased compensation.  Looking ahead, only 10 percent of companies plan to increase board compensation over the next 12 months, with an average increase of 10 percent. Compensation will stay about the same for 42 percent, and none will receive a pay cut. The remaining 48 percent were either not certain or did not report.  Boards at 94 percent of companies planning an increase had put in added time and effort, but only 16 percent of boards putting in more time and effort are slated for a raise. Of those, more than half received a raise in the past year.  Between the past year and the next 12 months, a net of only 24 percent of boards will have received increased compensation, 92 percent of which put in added time and effort.  Increased board responsibilities had a mixed impact on recruiting new board members. While 28 percent reported no problems, 18 percent described recruiting as difficult. Twenty-seven percent did not need to recruit new members, and 27 percent did not report.  For board audit committees, whose duties have been significantly increased by the Sarbanes-Oxley Act, 68 percent spent more time, including 42 percent much more time, and 26 percent somewhat more, the survey found. Five percent spent about the same time, and none less time. The remainder did not report.  Despite the added workload, total compensation for audit committee members stayed about the same for 41 percent of companies surveyed. Only six percent received greatly increased compensation; and another 16 percent, somewhat increased remuneration. None were paid less, 14 percent were not certain, and 23 percent did not report. For those with an increase, the average increment was a substantial 26.2 percent.  Ninety-seven percent of audit committees receiving increased compensation had put in greater time and effort, but only 31 percent of those putting in more time and effort were rewarded with increased compensation.  For the year ahead, 10 percent of companies plan higher compensation for audit committee members, with an average raise of 9.7 percent. Compensation will stay about the same for 42 percent, and none will receive a pay cut. The remainder was either not certain about future increases or did not report.  Ninety-four percent of audit committees slated for an increase had devoted greater time commitment and effort. However, only 14 percent of audit committees putting in more time and effort are to receive a raise, including six percent that got one in the past year.  Between the past year and next year, a net of 28 percent of audit committees will have received increased compensation, including 95 percent that have logged additional time and effort.  **1.18 IRRC’s study shows corporations overhauling boards and director pay**  Spurred by investor outcry and more stringent stock exchange listing rules, companies made dramatic increases in board independence levels in 2003, finds the latest edition of IRRC’s annual Board Practices/Board Pay study released in December 2003. At the same time, outside directors’ total pay packages declined, due to lower option grant values.  IRRC’s analysis of nearly 1,500 US companies in the S&P 500, MidCap, and SmallCap indexes shows that 83 percent of the firms now have a majority of independent directors on the board, up from 78 percent last year and 72 percent five years ago.  What’s more, the average board is now 69 percent independent, compared with 66 percent last year, and 62 percent five years ago. The increase appears to result from a deliberate change in the composition of boards—13 percent of this year’s directors joined a board for the first time during the last two years, and 80 percent of those new directors are independent from the company where they now serve.  IRRC’s study tracks trends in both board practices and board pay at S&P “Super 1500” companies. Despite increased demands on board members “post-Enron,” total remuneration for a typical director dropped by 4 percent in 2003 to approximately $102,000. This is the first time in five years this figure declined, triggered by a 22 percent decline in the average value of stock option grants. The value of directors’ annual retainers, consisting of cash and unrestricted shares, on the other hand, rose by 10 percent last year to about $32,000.  Meanwhile, awards of deferred stock, time lapsing restricted stock, and stock units are on the upswing. The average annualized value of total long-term stock awards increased by 7 percent in 2003, and the prevalence of companies using these types of long-term stock awards rose from 24 percent to 28 percent. A few companies, including American Express, Bank of America, General Electric, J.P. Morgan Chase, KeyCorp, Safeco, Temple-Inland, and Waste Management recently stopped granting options to non-employee directors altogether; each of these companies adopted or boosted long-term stock awards as replacements.  Other important findings of this year’s Board Structure/Board Pay study include the following:           Board size is down. The average board size decreased, from 10 to nine directors, for the first time since IRRC began tracking such information in 1997. This change appears to have resulted from many affiliated directors stepping down to allow the company to comply with more strict independence rules.          Independent leadership is growing. Thirty percent of companies now separate their chair and CEO positions—that’s up from 26 percent in 2001, the biggest three-year jump ever seen. Also up—the proportion assigning the job to an independent director (9 percent this year, versus 7 percent just last year). Even more remarkable is the upsurge in “lead” or “presiding” directors. Nearly a fifth of companies reported a lead or presiding director in 2003, up from only 3 percent last year. These board leaders are almost always independent directors. Overall, 23 percent of companies examined now have some form of independent board leadership, up from just 10 percent in 2002. More than half the companies with a non-employee chairperson pay extra compensation for that service. On average, that fee ($92,389) is more than twice the typical extra amount some companies pay to a lead or presiding director ($38,000).          Board committees are also more independent. Nearly 80 percent of audit committees are fully independent, a dramatic increase over the last five years (in 1999, only 56 percent of companies surveyed had fully independent audit committees). Also, nearly 80 percent of compensation committees are fully independent, up from about 70 percent five years ago. Only 57 percent of nominating committees are fully independent, however. On the other hand, nearly 90 percent of companies now have a nominating committee in place, compared with 74 percent last year; and a remarkable 75 percent now have committees that are assigned corporate governance responsibilities, up from just 40 percent last year.          Board meetings are flat, but attendance—and fees—are up. Despite the increased focus and demands on board members, the average number of in-person meetings held in 2003—seven—has not changed in more than five years. Directors are receiving higher pay to attend meetings, however—an average fee of about $1,600 per meeting as of 2003, up 7 percent from the prior year. Attendance is also improving—only 13 percent of companies reported having any directors who missed more than 25 percent of requisite meetings, compared with 21percent in 1999. That’s despite the fact that less than 1 percent of study companies have disclosed that they penalize absentee directors.          Other director “service” pay also rises. In response to the increasing demands on members of key committees, companies are paying these directors more for their time and services. As of 2003, 82 percent of companies pay additional compensation to a member of the audit and/or compensation committee, up from 77 percent in 2002. Also, 70 percent of companies now pay additional compensation to the chair of an audit and/or compensation committee, up from 56 percent last year. The average chair retainer ranges from approximately $5,700 on the compensation committee to about $7,200 on the audit committee. Disparities are not as pronounced with respect to meeting fees, however, which range from about $1,100 for attending a compensation committee meeting to almost $1,200 for audit committee attendance, on average.          Stock ownership guidelines are spreading, slowly. About 15 percent of study companies disclosed stock ownership guidelines for directors, up from 11 percent last year. Whether expressed in a dollar value, a number of shares, or a multiple of retainer, the average value of ownership thresholds among these 190 companies is approximately $139,000. |
| **2. Recent ASIC Developments** |
| **2.1 ASIC guidelines for interim relief for low value non-cash payment facilities**  On 24 February 2004, the Australian Securities and Investments Commission (ASIC) provided some guidance on interim licensing and disclosure relief it is willing to consider for some non-cash payment facilities.  **(a) What is a non-cash payment facility?**  A non-cash payment facility is one that permits payments to be made without the need to use actual notes and coins. Examples of these facilities include arrangements that involve payments through gift vouchers and university campus stored-value cards.   For further guidance on ASIC's approach to the regulation of non-cash payment facilities, read the answer to the frequently asked question '[How are non-cash payment facilities regulated?](http://www.asic.gov.au/ASIC/asic.nsf/ASIC%2BFSR%2BFAQ%2BDisplayW?ReadForm&unid=7B3E933D10242504CA256D8E00207F5D" \t "_new)' (QFS 120) on the ASIC website at [www.asic.gov.au/fsrfaq](http://www.asic.gov.au/fsrfaq" \t "_new)  **(b) What interim relief will ASIC consider?**  The interim relief from the licensing and disclosure provisions of Parts 7.6 and 7.9 of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) that ASIC is prepared to consider would only apply to a dealing in or advising by, or on behalf of, the issuer of low value non-cash payment facilities that are conducted on a small scale or for a limited purpose and are not part of another financial product.   The interim relief would apply until 30 June 2005. This will allow the Federal Government and ASIC to adequately consider technical aspects of the application of the FSR licensing and disclosure regime, and its application to the variety of non-cash payment facilities. This will include consideration of practical compliance problems and whether any permanent ongoing relief is appropriate.   ASIC intends to finalise any position with industry as early as possible before the end of the interim relief period.  **(c) Scope of the relief**  Relief under ASIC's interim approach for low value non-cash payment schemes will be considered on a case-by-case basis. Under the terms of the proposed interim relief, providers must:   |  |  | | --- | --- | | 1. | have an internal dispute resolution system that meets the Australian Standard AS 4269–1995: Complaints handling; | | 2. | hold all client money in a trust account until a payment is made by the use of the facility; | | 3. | before the facility is issued to a person, or where the person is an existing client, as soon as reasonably practicable after the date of this interim relief:   |  |  | | --- | --- | | (a) | ensure the person is, or has been, provided with a written document (disclosure document) setting out the key terms and conditions of the facility, in a manner that is clear, concise and effective; and | | (b) | where the key terms and conditions include a term that:  (i) the issuer may unilaterally vary the terms or conditions of the facility; or (ii) there is an expiry date by which the client must use the facility; ensure that those key terms are also displayed in a prominent manner to the client in the disclosure document; | | | 4. | give clients 30 days written notice of any material changes to the terms and conditions of the facility; | | 5. | provide means whereby clients can check their balances from time to time at no cost; and | | 6. | give periodic reports in writing to ASIC when requested about the operation of the facility. |   These conditions are designed to address basic consumer protection issues during the period of relief.  It should not be assumed that any relief will be extended beyond 30 June 2005, or that ASIC's final position will be the same as, or similar to, the interim relief.  For more information on applying for relief, see the Financial Services homepage on the ASIC website, [www.asic.gov.au/fs](http://www.asic.gov.au/fs" \t "_new).  **2.2 ASIC guidelines for interim relief for loyalty schemes**  On 24 February 2004, the Australian Securities and Investments Commission (ASIC) provided some guidance on interim licensing and disclosure relief it is willing to consider for loyalty (or reward) schemes that constitute or include a non-cash payment facility.  **(a)** **What is a loyalty scheme?**  Loyalty schemes are operated by, or on behalf of, a person (the 'issuer') linked to the goods and services (for example, credit card services, flight services and store goods) they offer or provide. The loyalty scheme is designed to encourage the issuer's customers to use, or spend on, the issuer's goods and services.   Loyalty schemes may include a rewards redemption facility whereby points or credits ('points') allocated to the customer under the loyalty scheme can be used to:           make payment, or cause payments to be made, for goods and services;          obtain a discount on goods and services; or           obtain points for other loyalty schemes.  Loyalty schemes may have different features. Some schemes may attribute a monetary value to the customer's points. Loyalty schemes may also allow the customer to 'top up' points by contributing cash in exchange for the extra points they need to qualify for a particular reward.   Many loyalty schemes are likely to constitute or include a non-cash payment facility and may be regulated under Chapter 7 of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (the Act) as a financial product within the meaning of the Act. For further guidance on ASIC's approach to the regulation of non-cash-payment facilities, read the answer to the frequently asked question '[How are non-cash payment facilities regulated?](http://www.asic.gov.au/ASIC/asic.nsf/ASIC%2BFSR%2BFAQ%2BDisplayW?ReadForm&unid=7B3E933D10242504CA256D8E00207F5D" \t "_new)' (QFS 120) on the ASIC website at [www.asic.gov.au/fsrfaq](http://www.asic.gov.au/fsrfaq" \t "_new).   **(b) What interim relief will ASIC consider?**  Relief under ASIC's interim approach for loyalty schemes will be considered on a case-by-case basis where ASIC is satisfied that:  (a) the scheme is either designed to reward customer loyalty or reasonably likely to promote spending on the goods and services of the issuer;  (b) the scheme includes a reward redemption facility whereby clients are allocated points as a result of using, or spending on, the issuer's goods or services, whether or not a monetary value is expressly attributed to the points; (c) the points allocated to a client can be used by the client to make payment, or cause payments to be made, for goods or services, to obtain a discount on goods or services or to obtain points for other loyalty schemes ('reward redemption'); and (d) clients can only make a cash contribution in exchange for points where they are making a specific reward redemption and the number of points exchanged for cash does not exceed 20 per cent of their existing points used for the reward redemption.  The interim relief would only apply until 30 June 2005. This will allow the Federal Government and ASIC to adequately consider technical aspects of the application of the FSR licensing and disclosure regime to loyalty schemes that constitute or include a non-cash payment facility. This will include consideration of any practical compliance problems and whether any permanent ongoing relief is appropriate.   ASIC will consult with industry before its policy position on loyalty schemes is finalised.   Under the terms of the proposed interim relief, issuers must:   |  |  | | --- | --- | | 1. | have an internal dispute resolution system that meets the Australian Standard AS 4269–1995: Complaints handling; | | 2. | have adequate resources (including arrangements giving access to adequate resources) to reasonably ensure customers are able obtain the goods or services, the discount on goods and services, or the points for other loyalty schemes they are seeking to redeem as and when the customer makes a rewards redemption under the loyalty scheme; | | 3. | before a person joins or participates in the loyalty scheme, or where the person is an existing member or participant of the loyalty scheme, as soon as reasonably practicable after the date of this interim relief:   |  |  | | --- | --- | | (a) | ensure the person is, or has been, provided with a written document (disclosure document) setting out the key terms and conditions of the loyalty scheme, in a manner that is clear, concise and effective; and | | (b) | where the key terms and conditions include a term that:  (i) the issuer may unilaterally vary the terms or conditions of the loyalty scheme; or (ii) there is an expiry date by which the client can use their points to make a reward redemption; ensure that those key terms are also displayed in a prominent manner to the client in the disclosure document; | | | 4. | give the clients 30 days written notice of any material changes to the terms and conditions of the loyalty scheme (as they apply to existing clients); | | 5. | provide means whereby clients can ascertain the points available to them under the loyalty scheme from time to time at no cost; and | | 6. | give periodic reports to ASIC when requested about the operation of the loyalty scheme. |   These conditions are designed to address basic consumer protection issues during the period of relief.  It should not be assumed that any relief will be extended beyond 30 June 2005, or that ASIC's final position will be the same as, or similar to, the interim relief.  **(c)** **Single merchant payment facilities and low value non-cash payment facilities**  Single merchant payment facilities are not regulated as non-cash payment facilities pursuant to an exception under paragraph 763D(2)(a)(i) of the Act. Where the loyalty scheme provides for redemption of rewards supplied, directly or indirectly, by only one person (for example, the issuer) it is more likely that the loyalty program will be excluded as a non-cash payment under the single merchant payment facilities exception. Other examples could include department store card loyalty schemes where the rewards consist only of goods and services obtained from, and provided by, the store issuing the card.  However, where the rewards available for redemption under the loyalty scheme are provided by more than one person (whether directly to the client, or indirectly, through the issuer, to the client), the single merchant payment facilities exception does not apply. For further guidance, read the answer to the frequently asked question '[How are non-cash payment facilities regulated?](http://www.asic.gov.au/ASIC/asic.nsf/ASIC+FSR+FAQ+DisplayW?ReadForm&unid=7B3E933D10242504CA256D8E00207F5D)' (QFS 120) on the ASIC website at [www.asic.gov.au/fsrfaq](http://www.asic.gov.au/fsrfaq" \t "_new).  ASIC will also consider granting interim relief, on a case-by-case basis, from full compliance with the licensing and disclosure requirements of Chapter 7 for certain low value non-cash payment facilities.   For more information about ASIC's regulatory approach to low value small-scale non-cash payment facilities, see Information Release [IR 04/07](http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/IR+04-07+ASIC+guidelines+for+interim+relief+for+low+value+non-cash+payment+facilities?openDocument" \t "_self) ASIC guidelines for interim relief for low value non-cash payment facilities.  **(d) Loyalty schemes that are managed investment schemes**  Some loyalty schemes may also constitute a managed investment scheme (under Chapter 5C of the Act). ASIC has previously considered and granted case-by-case relief from Chapter 5C requirements to those who operate loyalty schemes.   Applicants considering applying for the interim relief should also consider whether they need to apply for relief from the registration and operational requirements for managed investment schemes in Chapter 5C. For more information about ASIC's regulatory approach to granting relief from Chapter 5C requirements, see ASIC [Policy Statement 136](http://www.asic.gov.au/asic/asic.nsf/lkuppdf/ASIC+PDFW?opendocument&key=ps136_pdf) Managed investments: Discretionary powers and closely related schemes [PS 136].  For more information on applying for relief, see the Financial Services homepage on the ASIC website, [www.asic.gov.au/fs](http://www.asic.gov.au/fs" \t "_new).  **2.3 Proposed ASIC CLERP 9 policy papers timetable**  On 4 February 2004, the Australian Securities and Investments Commission (ASIC) announced a timetable for releasing policy proposal papers and other guidelines for Implementing the [Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=74342" \t "default) (CLERP 9 Bill).  Based on the current timetable for introduction of CLERP 9, prior to 1 July 2004, ASIC aims to release policy proposals and final policy statements on:           Auditor registration;          When ASIC might use its powers to adapt requirements in the CLERP 9 Bill that relate to audit and financial reporting. This policy will also discuss how the Bill affects existing ASIC policy on audit and financial reporting;          When ASIC might use its powers to adapt requirements in the CLERP 9 Bill that relate to disclosure. This policy will also discuss how the Bill affects existing ASIC disclosure.          What insurance requirements should apply for companies that provide audit services (authorised audit companies). A final policy statement on this topic will be issued after 1 July;          Conflicts of interest. ASIC has already issued policy proposals on the proposed obligation for licensees to have adequate arrangements to manage conflicts of interest. ASIC plans to use a final policy statement before 1 July (noting that this new obligation will not commence until January 2005); and          A guide on ASIC's processes regarding the proposed power to issue infringement notices for breaches of the continuous disclosure regime.  Further details are set out in ASIC's implementation plan, which is available on the CLERP 9 section of the [ASIC website](http://www.asic.gov.au/clerp9).  **2.4 ASIC extends statement of advice exemption for some overseas listed products**  On 28 January 2004, the Australian Securities and Investments Commission (ASIC) announced it had extended a legislative exemption to allow retail advice related to some financial products traded on approved foreign markets to be provided without a Statement of Advice (SoA) being given. The relief is contained in class order [CO 04/10].  The [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) already contains an existing exemption from the SoA requirements for further market related advice about transactions on licensed markets in Australia. This existing exemption requires that an earlier SoA is given to the client and that there are no significant changes to the personal circumstances of the client between the time of the initial SoA and the subsequent advice. The existing exemption, however, does not include a reference to any overseas markets on which Australians may be trading.  ASIC has decided to extend this exemption to further market related advice about some financial products able to be traded on the approved overseas financial markets listed in the attached Schedule. The exemption applies if the entity giving the advice is a participant on a licensed market or an approved foreign market (or their authorised representative) and the advice relates to securities, interests in a managed investment scheme or derivatives that are able to be traded on the approved foreign market.  **Approved foreign markets**  ASIC has approved the main boards of the following foreign markets for the purposes of relief from the SoA provisions:  (a) American Stock Exchange, Deutsche Borse, Euronext Amsterdam, Euronext Paris, Italian Exchange, Kuala Lumpur Stock Exchange (Main and Second Boards), London Stock Exchange, New York Stock Exchange, New Zealand Stock Exchange, Singapore Exchange, Stock Exchange of Hong Kong, Swiss Exchange, Tokyo Stock Exchange or Toronto Stock Exchange; or (b) the NASDAQ National Market.  Following previous assessments of these markets, ASIC believes that users of these markets are able to obtain relevant disclosure information about listed entities for the purposes of making investment decisions. This list has been formulated having regard to:           The 1992 ASIC ‘Report on the Promotion and Sale of Foreign Securities in Australia’;           ASIC Policy Statement 72, ‘Foreign securities prospectus relief’;          Regulation 1.2A.02 listing certain exchanges for the purposes of providing continuous disclosure relief; and          Other ASIC class orders (such as class order [CO 03/184]).  **2.5 ASIC review into disclosures by eligible rollover funds**  The Australian Securities and Investments Commission (ASIC) released the results of its review of disclosure practices provided by eligible rollover funds (ERFs) on 27 January 2004.  An ERF is a publicly-offered superannuation fund that accepts members that are automatically transferred from other funds. Generally, ERFs accept members who are usually lost, or have not made decisions about where they want their superannuation monies to be transferred, although they can operate like other superannuation funds.  **(a) The Review**  ASIC’s review sought to identify the adequacy of information provided by ERFs to their members, and the processes by which ERFs ensure the delivery of information to members. Specifically, ASIC sought to assess compliance with the transitional disclosure requirements and some FSR disclosure obligations:           to ensure ERFs provide adequate disclosure to locatable members; and          to ensure adequate disclosure by feeder funds so that the basis for, and implications of being transferred to an ERF are more clearly understood. It is considered that better disclosure may reduce the incidence of lost members (ie better disclosure has potential to drive active consumer involvement with their benefit).  The review was carried out in mid 2003 with a total of 16 ERFs visited and reviewed. The disclosure about ERFs made by 15 feeders funds was also subject to review as consumers generally get transferred to ERFs from other funds without their consent.  **(b) Findings**  ASIC found that most of the ERFs reviewed needed to improve disclosure to their members about fees and charges. While very few ERFs deduct fees from a member’s account balance or benefit, ASIC found that most ERFs deduct fees before the investment allocation to members is made. In one case, these fees amounted to 5 per cent of the assets of the fund annually. Disclosure about these fees was not always clear or effective, and in a few cases, was potentially misleading.  ASIC also found deficient processes for ensuring that disclosure is provided to members who are entitled to it (ie. locatable members). While superannuation funds do not have to provide disclosure documents to ’unlocatable members’, in most ERFs, disclosure was being withheld for ’lost members’. Trustees must make reasonable efforts to locate a member before withholding disclosures from them.  **(c) Outcomes**  As a result of the report, ASIC observed an improvement in industry disclosure standards going forward into FSR. Most ERF trustees responded positively to ASIC’s concerns, and have taken the findings of the review into account when designing new disclosure documents. ERF trustees also revisited compliance procedures for identifying unlocatable members.  Two of the funds have faced specific regulatory action. One ERF is currently the subject of an enforcement action under the [Superannuation Industry (Supervision) Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6785" \t "default) for its failure to provide any disclosure to any fund members.  The other ERF is currently the subject of enforcement action, under the [ASIC Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56481" \t "default), for providing misleading information about fees.  **(d) Further initiatives**  The report identified a supporting role for consumer education to raise awareness about the role of ERFs, such as when benefits can be transferred to an ERF, and the implications of a transfer. While ERFs play an important role in accepting superannuation unwanted by other superannuation trustees, ASIC believes that most consumers would be unaware that their superannuation benefit can be  transferred into an ERF without their consent.  To overcome this, ASIC believes consumers must be made aware of the advantages of taking an interest in their super benefit. ASIC will be undertaking some targeted consumer education in this area to highlight the importance of notifying a change of address, and encouraging consumers to take a more active role in deciding how to manage their money if it is in an ERF. |
| **3. Recent ASX Developments** |
| **3.1 ASX share ownership study – 2003 findings**  Australians are maintaining their reputation as a “nation of shareholders” following the release of the 2003 ASX Share Ownership Study (SOS) on 3 February 2004. The SOS, the latest in an ASX series stretching back to 1986, showed that Australians not only follow the market more closely than ever, they are more committed and increasingly active participants.  Carried out in November 2003 among a large sample of 2,402 adult Australians randomly selected from across the country, the SOS provided a detailed snapshot of the nation’s shareholding ranks, measuring their numbers, circumstances, behaviour and attitudes.  The overall share ownership levels showed a slight improvement on the last year’s headline figures, which were themselves impressive enough. An estimated 51% of the adult population own shares – the equivalent of 7.4 million people. This includes both those who hold them in their own name and those who hold them indirectly through, say, a self-managed super fund or managed investment fund.  Those holding the shares directly amount to 39% of the population, or 5.7 million people. In both cases though, the figures are slightly higher than the late-2002 SOS, conducted when the market was still experiencing a general bear-market lull.  These investors are spread evenly across the states, and more likely to be in the cities, and are more likely to be male. They tend to be aged 35-54, although older Australians are well represented. The youngest age-bracket surveyed, those aged 18-24, evidenced a slight decline in ownership levels, perhaps prompted by the focus on the investment-property activity.  They are increasingly using the Internet to research their investments, buy shares and track their holdings – and they are monitoring those investments far more often. The [ASX website](http://www.asx.com.au/) remains a key source of information, as does the financial press.  The underlying SOS results provide encouraging detail to suggest a subtly changing market of investors that is growing more experienced and, arguably at least, smarter at it. Diversification is always a key consideration for investors and 28% of shareowners hold stocks in eight or more companies – triple the number reported in 1998. On average there are seven stocks in a typical portfolio - still not sufficient, although better than the average of three recorded only five years ago. The average portfolio is valued at $40,800, up 14 % on the previous year.  Equally, their trading activity is improving steadily. On average those with a direct investment bought or sold six times in 2003, up by one from the previous year. The average value of those share parcels was $10,650 – up a significant 20% on the previous year.  Other notable findings of the Share Ownership Study included an increase in share ownership spread fairly evenly across the states (but demonstrating particular gains in New South Wales, Queensland and South Australia). Those with higher education or on higher income were proportionately more likely to own shares and to have increased their holdings.  The slight increase in on-market activity built on progress of previous years. Investors traded on average six times a year, and in general they tended to trade parcels of higher value. This was highlighted by the decrease in sub-$5,000 share parcels traded, and by the 20% increase in the value of the average transaction - to $10,650 for each trade, near double that of four years ago.  A full copy of the Share Ownership Study 2002 is available on the [ASX website](http://www.asx.com.au/" \t "_new).  **Highlights of the study**           51% of Australia’s adult population, or 7.4 million people, own shares either directly or indirectly through a managed fund or self-managed superannuation fund (up from 50% in 2002).          This consists of 39% of Australia’s adult population, or 5.7 million people who own shares directly (up 2%).          The proportions of both men and women who own shares directly have increased since 2002. In 2003 44% of males and 35% of females own shares directly.          The incidence of share ownership continues to increase with age. Compared to 2002, there has been an increase in direct ownership of those aged 35-to-54. The trend among those aged 55-plus continues, with one in two owning shares in their name. The only decline has been among those aged 18 to 24.          The high incidence of share ownership nationwide appears to have been maintained, with NSW, QLD and SA all reporting significant increases.          Investors are again more likely to have more stocks in their portfolio – from 3 to 7 since 1999. 51% have at least 4 companies in their portfolio in 2003, compared to 26% in 1998.          The average portfolio value has increased 14% (since 2002) to $40,800.          Shareholders are trading more often (average 6 times a year – up from 5 in 2002), with higher-valued parcels ($10,650 an increase of 20% since 2002).          Newspapers continue to be the most popular main source of advice on shares (22%). There has been a decrease in investors regarding their financial planner to be their main source (19% down from 22% in 2003), and an increase in those seeking such advice from their broker (from 10% in 2002 to 14%).          In 2003, 50% of direct investors intend to purchase shares in the next 12 months - a significant increase from 40% on the year before.  **3.2 Other developments at ASX**  **(a) Market & C&S Licence Variation and Rules**  ASX formally lodged with ASIC on 6 February 2004 the following:         ASX’s licence variation application to consolidate the market activities of ASX and ASX Futures (ASXF);        Options Clearing House’s licence variation application to clear derivatives, securities and managed investments; and         ASX Settlement and Transfer Corporation’s licence variation application to settle transactions in securities, derivatives and managed investments.  The new licences will take effect on 11 March 2004, subject to Ministerial approval.  **(b) New Rules**  As a result of the above licence changes, ASX has restructured its trading, clearing and settlement rules for all its markets into the following consolidated rule books: the new ASX Market Rules, ACH Clearing Rules and the ASTC Settlement Rules. These rules were also formally lodged with ASIC on 6 February 2004, and will become effective on 11 March 2004 subject to Ministerial non-disallowance.  In conjunction with the formal lodgment on 6 February 2004, ASXOnline has been updated, ensuring Participants have access to the most recent version of the new Rules and Procedures.  The Rules and Procedures are available under the “What’s New” section of the ASXOnline homepage. Participants can directly access the Rules by following the link:  [https://www.asxonline.com/participants/CSSR\_FSR/NewDraftRules.htm](https://www.asxonline.com/participants/CSSR_FSR/NewDraftRules.htm" \t "_new)  Final printed copies of the new rules and procedures will be distributed in late February early March (date to be confirmed).  In conjunction with the introduction of the new rules, ASX is conducting seminars for participants. All enquiries should be directed to ASX Compliance Services on 9227 0000.  **(c) ASIC Licensing Unit**  ASX is cooperating with the ASIC Licensing Unit in the lead-up to the 11 March 2004 deadline for licensing of financial services providers. The objective is to monitor progress of participants towards being licensed, to pre-empt any failure of a participant to obtain a licence and to consider related licensing issues arising from FSR.  **(d) Payment from NGF to ACH**  In early February 2004 Treasury released a public consultation paper on the application by ASX for payment out of the National Guarantee Fund (NGF). The NGF is a fund that covers certain losses related to transactions on ASX’s markets and clearing and settlement facilities. The purpose of the application by ASX to split the fund is to allow more efficient use of the portion of those funds which form the clearing guarantee for transactions on ASX’s markets. The NGF would continue to provide fidelity cover in relation to ASX participants, and responsibility for clearing and settlement support would be transferred to Australian Clearing House. Submissions close on 5 March 2004. A copy of the paper can be obtained from Treasury at the following link:  [http://www.treasury.gov.au/contentitem.asp?pageId=&ContentID=796](http://www.treasury.gov.au/contentitem.asp?pageId=&ContentID=796" \t "_new)  **(e) Trade Cancellations**  Subject to Ministerial non-disallowance, from March 2004 ASX will have the power, in order to maintain an orderly market, to cancel a trade entered into on the basis of an error regardless of whether the parties to the transaction or the Trading Participants who entered into the transaction agree to the cancellation. Currently the agreement of the relevant Trading Participants is a pre-requisite to the cancellation of a SEATS trade. The onus for advising clients of this change rests with the brokers. However, ASX is initiating an extensive communications programme in order to support brokers. The programme will commence as soon as non-disallowance is advised to ASX.  **(f) Market Structure Consultation Paper**  A consultation paper on Equity Market Structural Reforms was released by ASX on 29 November 2003 with submissions due by 28 February. The consultation paper outlines proposals to change certain aspects of the microstructure of ASX’s equity market.  The most significant change proposed relates to the dissemination of broker identification numbers. Currently, broker identifiers are only visible to ASX Participating Organisations. ASX is proposing to implement changes to its equity market design such that investors and brokers will have the same access to broker identification numbers. The options canvassed are:           everyone sees broker IDs;          no one sees broker IDs; or           Broker IDs are transparent to everyone unless the investor or broker chooses to enter an anonymous order (a model operating in the Canadian market).  The paper also contains a discussion of alternative models aimed at improving mid to small cap liquidity in ASX’s market.  The market consultation paper and a separate Supplement - Request for Comment containing the list of questions for which ASX is seeking feedback are available on the ASX website at the following link:  [http://www.asx.com.au/about/l3/MarketStructuralReforms\_AA3.shtm](http://www.asx.com.au/about/l3/MarketStructuralReforms_AA3.shtm" \t "_new)  **(g) ASX regulatory structure**  ASX’s new regulatory division, the ‘Integrity Division’ came into effect from 1 January 2004 and is headed by Karen Hamilton as Chief Integrity Officer (CIO). The Integrity Division will manage and administer all market integrity and supervisory functions conducted by ASX, including supervision of listed companies and of market participants.  The new structure underlines ASX’s strongly held conviction that market supervision is a core element of its business as a licensed market operator and is in line with the reports and recommendations of ASX Supervisory Review and ASIC.  **(h) Corporate governance awards**  On 9 February, ASX hosted a function to acknowledge those companies who had voluntarily reported against the ASX Corporate Governance Principles in the 2003 annual reporting season and to recognise the excellent disclosure of corporate governance practices in their annual reports by 6 listed companies. The companies were:           Westpac – for overall excellence in its corporate governance reporting;          BlueScope Steel – for outstanding reporting on environmental issues;          Leighton Holdings – for an excellent example of exception reporting against the Principles;          BHP Billiton – for exemplary reporting by a company listed in more than one jurisdiction;          Telecom Corporation of New Zealand – for its comprehensive reporting on director independence; and          CSL – for its excellent continuous disclosure reporting.  **(i) Corporate governance teporting obligations**  Under Listing Rule 4.10.3, the majority of listed companies will be providing their first disclosure against the principles in annual reports for the financial year ending 30 June 2004. In support of this obligation ASX has sent out companies updates to listed companies making them aware of their obligations and helping them to identify some of the more difficult corporate governance disclosure issues. Preparation is also being made to carefully scrutinize compliance with the obligation.  **(j) Review of compensation arrangements in the financial services sector**  On 24 December 2003 Treasury released a position paper which sets out the Government's preferred position in relation to compensation for loss in the financial services sector. In summary, the Government's proposal is as follows.  1. There isn't a need for a broad statutory compensation scheme for licensees. 2. Instead, licensees will need to have compensation arrangements to cover their conduct in dealing on behalf of, advising or providing custodial or depository services to retail clients in relation to financial products. 3. The primary way of meeting this requirement will be via professional indemnity insurance or some alternative approved by ASIC. 4. There will be some exemptions built in to carve out certain licensees from the obligation to have professional indemnity insurance. Basically a licensee will fall within the exemption if it is regulated by APRA, if it has a sufficiently large balance sheet, or if its obligations are guaranteed by such an entity.  5. The market compensation arrangements (NGF and fidelity funds) will be retained. For regulatory neutrality reasons new markets will be obliged to have market compensation arrangements. 6. While the requirement to maintain market compensation arrangements will continue the Government is prepared to consider various modifications to them. In particular:            they are seeking submissions on the capping of claims and/or restricting access to the NGF to retail clients; and           it seems that the Government accepts the need to cap NGF's levy powers but is seeking submissions as to the appropriate capping formula.  The paper is available at:  [http://www.treasury.gov.au/contentitem.asp?pageId=&ContentID=774](http://www.treasury.gov.au/contentitem.asp?pageId=&ContentID=774" \t "_new) |
| **4. Recent Takeovers Panel Decisions** |
| **4.1 Village Roadshow Limited: Panel makes declaration of unacceptable circumstances and final orders**  On 18 February 2004, the Panel made a declaration of unacceptable circumstances in the Village Roadshow Limited (VRL) proceeding in relation to contraventions of section 672B of the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (Act).  **(a) Background**  VRL alleged in an application to the Panel that its shareholder Boswell Filmgesellschaft mbH (Boswell) and Boswell’s sole shareholder Rosco Film GmbH (Rosco) and sole director Mr Hans Brockmann failed to disclose information required to be disclosed with respect to their relevant interests in VRL shares and any instructions received from other parties with respect to the acquisition, disposal or voting of the shares.  Boswell, which is incorporated in Germany, holds 1000 ordinary shares and 1000 preference shares in VRL (Boswell Parcel).  VRL is listed on Australian Stock Exchange Limited (ASX) and has two classes of shares on issue, ordinary shares and preference shares.  On 26 September 2003, VRL issued a scheme booklet which proposed a buy-back and a scheme of arrangement between VRL and holders of VRL preference shares under which VRL would buy back all preference shares (the First Scheme). The Court did not approve the First Scheme. That decision is subject to an appeal.  On 12 December 2003, VRL issued a further scheme booklet which proposed another scheme of arrangement (the Second Scheme) on the same terms as the First Scheme, however, with different voting entitlements. The buy-back resolution proposed (Buy-back Resolution) has not received sufficient votes to be passed and on 10 February 2004, the general meeting of VRL shareholders was closed with the results of the poll taken at that meeting to be announced on ASX pending the outcome of proceedings before the Court and the Panel.  VRL issued tracing notices under section 672A to Boswell and others to obtain information prescribed by section 672B of the Act.  On 7 November 2003, in response to a tracing notice, Boswell disclosed that it acted in its own name, it had not received instructions by any third party, it is 100% owned by Rosco Film GmbH (Rosco) and Mr Hans Brockmann is the managing director.  In response to a tracing notice, Hans Brockmann disclosed that he was the beneficial owner of the Boswell Parcel.  ANZ Nominees Limited (ANZ) was before 21 January 2004, the registered holder of shares (ANZ Parcel) representing approximately 8.6% of the VRL ordinary shares and 15.4% of the VRL preference shares.  In response to a tracing notice, ANZ disclosed by letter dated 29 October 2003 that it held the ANZ Parcel as nominee for SegaIntersettle AG (SegaIntersettle), a Swiss securities services corporation.  In response to a tracing notice, SegaIntersettle by facsimiles dated 28 October 2003 and 10 November 2003 (in relation to ordinary shares) and 20 January 2004 (in relation to preference shares), disclosed that it held the ANZ Parcel as nominee for:           Schroders and Co Zuerich (Schroders) as to 15,443,174 ordinary shares and 34,707,843 preference shares; and           Swissfirst Bank Zuerich (Swissfirst) as to 4,823,854 ordinary shares and 3,885,428 preference shares.  In response to a prior tracing notice, by emails dated 11 June 2003 and 25 June 2003, Schroders indicated that it acted only “as Bare Trustee” and due to “Swiss Banking Secrecy” it was not entitled to disclose any information.  In response to a prior tracing notice, by a letter dated 13 February 2004 from its legal advisers, Swissfirst indicated and due to “Swiss Banking law” it was not entitled to disclose any information without the explicit prior relief from the obligation granted by its customer or the Swiss Federal Banking Commission.  Citicorp Nominees Pty Limited (Citicorp) was, before 21 January 2004, the registered holder of shares (Citicorp Parcel) representing approximately 1.6% of the VRL ordinary shares.  In response to a tracing notice, Citicorp disclosed by report dated 29 October 2003 that it held the Citicorp Parcel as nominee for GNI Limited (GNI).  In response to a tracing notice, GNI disclosed by letter dated 20 January 2004, that it holds:           3,656,850 shares in VRL as nominee for Mr Thomas Davis, c/o The Meridian Group located in Bermuda; and           150,067 shares in VRL as nominee for Mr Stefan Hamm of the British Virgin Islands.  In response to a tracing notice, Meridian Corporate Services Limited disclosed, by email dated 4 February 2004, that shares are held at GNI under the name of 001invest World Currency Fund Ltd of which Mr Tom Davis is a director, however, Mr Davis has no beneficial ownership in the shares.  Under its application to the Panel VRL sought a declaration of unacceptable circumstances and orders that:           Boswell and other parties disclose:   * the identity of the person or persons who are “using them as a front”; and * the instructions they received in relation to that purpose; and            if the Panel considers that either or both:   * the conduct of the persons behind Boswell; or * the failure of either or all of Boswell and the other parties described to properly respond to the tracing notices and the fact that this led to VRL and the market being uninformed, was unacceptable, the votes of the persons behind Boswell be disregarded for the purpose of determining whether the Buy-back Resolution was passed on 21 January 2004.   VRL suggested that one option open to the Panel is to order that the poll on the Buy-back Resolution be reconducted at the resumed general meeting with the Boswell Parties prohibited from voting against the resolution.  In submissions, ASIC proposed that the ANZ Parcel and the Citicorp Parcel be vested in ASIC and sold.  **(b) The Panel’s Decision**  The Panel decided that the continuing failure of Schroders, Swissfirst and 001invest World Currency Fund Limited to respond fully and adequately with respect to VRL ordinary shares held by them to notices served on them under section 672A(1)(b) of the Act constituted a breach of section 672B. The Panel also noted that the relevant parties had failed to respond fully and adequately to requests for information sent to them by the Panel.  As the shares to which this non-disclosure relates constitute approximately 10.2% of the total number of ordinary VRL shares on issue and represent a substantial proportion of the free float of VRL ordinary shares, the Panel considers that the breach of section 672B results in unacceptable circumstances and has made a declaration to that effect.  The Panel considered that, despite technical non-compliance with the time restrictions and form for responses to tracing notices by Boswell and Mr Stefan Hamm, there had been reasonable efforts made by those parties to comply substantively with the requirements of section 672B of the Act. Because the parcels held by those parties were not material in size and there was substantial compliance by those parties, the Panel considered that any breach in relation to shares held by those parties did not result in unacceptable circumstances.  In relation to parties’ interests in preference shares, the Panel considers that as the preference shares are not “voting shares” for the purposes of the Act, a person cannot issue a secondary tracing notice under section 672A(1)(b) directing a person to make the prescribed disclosure in relation to preference shares. Therefore there has been no breach in relation to any VRL preference shares held by the parties.  **(c) Orders by the Panel**  The Panel has received submissions from the parties concerning the orders that should be made on the basis of the Panel’s declaration of unacceptable circumstances.  The Panel does not consider that the unacceptable circumstances identified in these proceedings would be remedied by an order affecting the result of the Buy-back Resolution. Such an order would not address the fact that substantial parcels of ordinary shares in VRL are held by unidentified parties and that the market is therefore trading on an uninformed basis.  The Panel also considers that it would be inappropriate to make an order disallowing the votes cast in relation to the ANZ Parcel and the Citicorp Parcel in relation to the Second Scheme. Such an order would have an unnecessary retrospective effect, as there is no clear nexus between the unacceptable circumstances and the outcome of the buy-back resolution.  The Panel has made final orders in relation to the VRL ordinary shares held by Schroders, Swissfirst and 001invest World Currency Fund Limited, requiring that those shares be vested in ASIC (with registration of those shares in the name of ASIC), pending their sale. The shares will be sold by an independent stockbroker through a bookbuild process, subject to conditions requiring that the shares be sold for a price as close as possible to the market price when a trading halt was imposed before this decision was announced, with no one purchaser being allocated more than 1% of the total number of issued VRL ordinary shares, and no purchaser may be associated with any other purchaser or any person who previously had an interest in the shares being divested. ASIC is to seek further orders, which may include an extension of the 6-week period, if it is unable to sell the shares at this price.  The Panel has used this sale structure in order to minimize the impact of the divestiture on the market for VRL shares. The relevant shares have been identified to ensure that parcels of VRL shares held by the relevant nominees (ANZ and Citicorp) on behalf of unrelated clients are not effected.  The Panel has also made an ancillary order that VRL must not put any resolutions to members for a period of 6 weeks or such lesser time as it takes for the shares to be sold. ASIC’s policy is not to vote any shares which have been vested in it. Therefore this order is necessary to ensure that the vesting order does not distort the voting process on any significant resolution. VRL may apply to the Panel for relief from this order should the need for urgent consideration of a resolution by members arise.  **(d) Interim orders**  The Panel made interim orders on 12 February 2004 in relation to specified parcels of shares, requiring that those shares not be transferred until further orders by the Panel.  As the Panel has now made final orders in relation to this proceeding, those shares specified in the interim orders are no longer subject to the restrictions set out in those interim orders. Those shares that are subject to the vesting orders made by the Panel must be transferred to ASIC as soon as possible.  **4.2 Forest Place Group Limited: Panel to discontinue proceedings**  The Takeovers Panel has considered the application (Application) from Peter Joseph O'Shea and John Patrick O'Shea (the Applicants) dated 7 January 2004 alleging unacceptable circumstances in relation to the affairs of Forest Place Group Limited (FPG).  On 12 February 2004, the Panel announced that it had discontinued proceedings.  **(a) Application**  The Applicants are shareholders in FPG. The Applicants allege that unacceptable circumstances arise as a result of entry by two of the directors of FPG, Francis Withey and Raymond Munro (the Directors), into a pre-bid agreement (Pre-bid Agreement) with FKP Limited (FKP) on 7 November 2003.   The Pre-bid Agreement provides for FKP to make a takeover offer for all of the issued capital of FPG. This bid was made under offers dated 4 December 2003 for a consideration of 50 cents per share.   Subject to FKP's bid becoming unconditional and FKP obtaining a relevant interest in more than 50% of the shares in FPG, the Pre-bid Agreement also provides for FKP to make payments to companies controlled by the Directors in consideration of the termination of a marketing agreement and a design and construction agreement with FPG (Existing Agreements) and the assignment of rights under certain related agreements.   On 22 December 2003, FKP declared its offer unconditional. At the time of declaring its offer unconditional, FKP also announced that all acceptances received on or before 31 December 2003 would be paid by 20 January 2004.  The Applicants sought orders that:           the parties to the Pre-bid Agreement be prevented from performing the requirement of that agreement that provides for the termination of the Existing Agreements and monetary consideration for the termination of those agreements; and          the consideration under FKP's bid be increased to take account of the amounts paid under the Pre-bid Agreement, which the Applicants put at 4 cents per share.  The Panel considered that the materials provided with the Application did not allow it to conclude that the termination payments did, or did not, involve a collateral benefit in contravention of section 623 of the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (Act).    The Panel agreed to commence proceedings in relation to the application on the basis of assurances from the Applicants that they would provide additional evidence supporting the Application concerning the Pre-bid Agreement.  The additional information received by the Panel was the report (Report) of an expert, retained by the Applicants, regarding the present values of the Existing Agreements based on information provided by all interested parties.  The expert concluded in the Report that, having regard to the limited contractual rights to terminate the Existing Agreements, the amounts payable under the Pre-bid Agreement for the termination of the Existing Agreements fairly represent the present value of those agreements. The Panel has, therefore, decided that neither the Report nor any other information it has been given supports a conclusion that the amounts payable under the Pre-bid Agreement for the termination of the Existing Agreements involve impermissible collateral benefits.   **(b) Decision**  Accordingly, the Sitting Panel has terminated proceedings on the Application and dismisses the Application on the basis that there was no prospect that it would regard the circumstances identified in the Application as being unacceptable.  **(c) Interim Orders**  Given the proceedings before the Panel, FKP sought an interim order to defer making acceptance payments until further order of the Panel. In order to preserve the existing circumstances while the Application was considered, the Panel made interim orders on 20 January 2004 restraining FKP from giving effect to the relevant clause of the Pre-bid Agreement and from paying consideration or transferring shares under the contracts arising from acceptances under the bid while the proceedings continued.   The Panel considered any prejudice to shareholders resulting from the interim orders to be reasonable, since the orders preserved the status quo and the scope for the Panel to make any final orders required by the circumstances and the proceedings concerned a possible benefit to shareholders (other than the Directors) through an increase in the bid consideration.  As the sitting Panel has now determined proceedings in relation to the Application, the Interim Orders cease to have effect as of the  date of this release in accordance with section 657E(2) of the Act. The parties are therefore required to comply with the contractual obligations under the bid and the Pre-Bid Agreement.  The Panel received an application seeking alternate interim orders. The Panel declines to make alternate interim orders, on the basis that the original interim orders have now ceased to have effect. |
| **5. Recent Corporate Law Decisions** |
| **5.1 Existence of a partnership – carrying on a business in common: mutuality and agency**  (By Tarik Abdulhak, Mallesons)  Kem Weichoreak Kang-Kem v Marilyn Jean Paine [2004] NSWSC 3, Equity Division of the New South Wales Supreme Court, Barrett J, 3 February 2004.  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/february/2004nswsc3.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/february/2004nswsc3.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  On the plaintiff’s summons seeking declarations as to the existence of a partnership between him and the defendant, and associated orders, the Court held that:           the businesses the subject of the proceedings were not carried on “in common,” and, therefore, there was no partnership between the parties;          although the plaintiff and the defendant both had interests in the relevant businesses:  o        the rights and obligations arising from the businesses were separate or several; and o        no agency or mutuality of rights existed between the parties.  The case emphasises the need for the elements of agency and mutuality of rights and obligations to be present for a finding that a business is “carried on in common” for the purposes of a partnership.  **(b) Facts and evidence**  In 1991, the plaintiff, who had experience in the hospitality industry, but was at the time a bankrupt, expressed to the defendant (then his de facto partner) an interest in opening a restaurant in Newcastle.  **The Junction Restaurant**  A restaurant known as Milano Junction Café Restaurant (the “Junction Restaurant”) opened in May 1992 in Newcastle. The lease of the restaurant premises was in the defendant’s name and contained a clause allowing sub-letting to the plaintiff.  Shortly before the opening of the restaurant the defendant opened an account in her name (the “ANZ Account”) and deposited $100,000 into it, to be used for the fit-out of the restaurant. Both parties had authority to operate the account. The defendant alleged the deposited funds were a loan to the plaintiff. The plaintiff denied the existence of a loan and alleged that one half of the funds represented payment of moneys the defendant had owed him.  Additional evidence adduced by the parties regarding the restaurant included the following:           There was an informal sub-lease of the restaurant premises to the plaintiff from approximately 1997;          Through his tax agent, the plaintiff had represented himself as the principal of the business in statements given to Westpac Banking Corporation, documents drafted in connection with an immigration application, as well as tax returns in 1999, 2000 and 2001;          The business name registration was initially in both names, but in 1998 the plaintiff alone was registered, and in 2002 the name was registered to a company controlled by him;          The plaintiff dealt with all financial matters relating to the restaurant. The defendant did not draw funds from the ANZ Account (into which some takings were banked) without the plaintiff’s consent. Cash takings were deposited into a safe located at the parties’ joint residence, but the defendant did not use this money;          The defendant was involved in the recruitment of new staff, spent time at the restaurant, showed interest in its appearance and cleared the till on a regular basis; and          The defendant alleged that, after the establishment of the restaurant, she was involved in its management only when the plaintiff did not attend to matters, and from a point in 2003 when the plaintiff lost interest in the business.  **The Lake Restaurant**  A second restaurant, known as Milano’s on the Lake (the “Lake Restaurant”), was opened at Pelican on Lake Macquarie in 2001. The sub-lease for the premises and a [Liquor Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=4063" \t "default) licence were in the defendant’s name alone. Of $150,000 used for the fit-out, $115,000 came from a Westpac overdraft account held in the names of the plaintiff and the defendant (secured by a mortgage over the defendant’s home) and the rest came from the ANZ Account.  Both parties attended the restaurant for business purposes and were seen instructing and hiring staff. Until May 2003 the plaintiff paid the staff and had a financial and operational management role in relation to the business. The defendant had an active involvement in the recruitment of staff but her role was otherwise confined to the day to day management of the restaurant. The takings were dealt with in the same way as those from the Junction Restaurant. From May 2003 the plaintiff was no longer involved and the defendant assumed general management.  **(c) Relief sought**  The plaintiff sought, inter alia, declarations that the parties were in a partnership from 1992, and that the two restaurants were assets of the partnership. He also sought orders that the affairs of the alleged partnership be wound up, that a receiver be appointed and an account be taken.  **(d) Credibility issues**  The plaintiff gave much of his evidence under a section 128 [Evidence Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=4459" \t "default) certificate, given that potential self-incrimination issues arose out of apparently false statements in his tax returns and representations to immigration authorities. The former statements were to the effect that the defendant was the sole owner of the Junction Restaurant, while the latter were that the plaintiff was its sole owner. Both were inconsistent with the plaintiff’s evidence in the proceedings.  The defendant’s evidence was also subject to issues of credibility. She acknowledged in cross examination that she had made incorrect statements in connection with her liquor licence application in 2001, but said that those statements had been prepared for her by a solicitor on the plaintiff’s instructions, and that she had signed them without first reading them.  Barrett J approached the plaintiff’s evidence with considerable reservations and held that it could not be relied upon unless supported by other means. By contrast, having accepted the defendant’s evidence as to the circumstances surrounding her past incorrect statements, his Honour did not find the same clear need for independent verification in relation to her evidence.  **(e) Decision**  **Partnership - agency and mutuality principles**  Barrett J referred to subsection 1(1) of the [Partnership Act 1892 (NSW)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=5850" \t "default), which defines partnership as “the relation which exists between persons carrying on a business in common with a view of profit.” His Honour stated that the central question in the present case was whether the businesses were carried on “in common.” His Honour also set out the matters which section 2 requires to be considered in determining the existence of a partnership (and which include joint property, the sharing of gross returns and the sharing of profits), but found that none of those matters were shown by the plaintiff to indicate the existence of a partnership in the present case.  His Honour applied the decision in The Duke Group Ltd v Pilmer (1999) 73 SASR 64, where the court had considered the meaning of the words “carrying on a business in common,” and had referred to earlier decisions dealing with the partnership concept. In Pilmer the court held that the requirement of a “business in common” did not mandate that each partner should take an active role in the management of the business. A partnership imports the concept of an agency, where each partner is at the same time an agent for the other partners, as well as a principal, so that a partner is bound by another partner’s contract entered into in carrying on the trade (Cox v Hickman (1860) 8 HL Cas 268; 11 ER 431; Lang v James Morrison & Co Ltd (1911) 13 CLR 1).  The decision in Pilmer further emphasised that, in addition to an agency, there must be mutuality of rights and obligations between the parties, as opposed to common interests in something divided between them (Smith v Anderson (1880) 15 Ch D 247). The court quoted section 5 and subsection 6(1) of the [Partnership Act 1891 (SA)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=28743" \t "default), which reflected the requirements of agency and mutuality.  **Findings and conclusions**  Barrett J held that the above elements were absent in the present case and that no partnership existed between the parties.  His Honour found that, until some time in the first half of 2003, the plaintiff played the principal role in the operation of the two restaurants, dealt with all financial matters relating to them and controlled the proceeds. The defendant’s interests in the restaurants extended to protecting her investment, and supporting the plaintiff as her de facto partner. She enjoyed being associated with the businesses, but her interest was that of an investor rather than a proprietor. Her predominant role in managing the businesses emerged only when the plaintiff lost interest in them.  The evidence showed that the plaintiff had himself represented the Junction Restaurant to have been owned solely by the defendant until 1997, with operating rights passing to the plaintiff together with the sublease in 1997. The initial funds of $100,000 in the ANZ Account were a loan by the defendant to the plaintiff.  Barrett J held that the plaintiff and the defendant did not act as each other’s (or as the alleged partnership’s) agents in the affairs of the business. Further, there was no mutuality of rights and obligations between the parties (with the sole exception of the borrowing from Westpac). Despite the fact that they both played a role in the totality of the activities of the business, their rights were separate or several. Their interest in seeing the businesses operate successfully was not an interest in common.  The claims were dismissed with costs.  **5.2 An interlocutory application dismissed for the appointment of a receiver/manager to the Western Australian division of the One Nation Party**  (By Nghi Tran, Phillips Fox)  McLean v McKinlay [2004] WASC 2, Supreme Court of Western Australia, Johnson J, 16 January 2004  The full text of the judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/wa/2004/january/2004wasc2.htm](http://cclsr.law.unimelb.edu.au/judgments/states/wa/2004/january/2004wasc2.htm" \t "_new) or  [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Facts**  This was a dispute between two factions of the Western Australian division of the One Nation Party (Party); one supporting the plaintiff, Ronald McLean and the other supporting the first defendant, John McKinlay. The application for the appointment of a receiver/manager was brought by the McKinlay faction. A significant motivation for seeking such an appointment was the expectation that a receiver/manager could resolve the dispute within the Party. The dispute between the McLean faction and the McKinlay faction was being fought in the primary action, with both factions claiming entitlement to the management of the Party at the State executive level, and incidentally, entitlement to operate the State executive bank account.  The dispute arose when in September 2001, McKinlay stood down as State President to embark on a working holiday. In June 2002, when McKinlay returned from overseas to resume his position as State President, it was alleged that the Party was under the control and management of the McLean faction. There was an Annual General Meeting in July 2002 at which the Party’s Constitution was amended and McLean was elected as State President. The McLean faction maintained that the elections and the change to the Party’s Constitution effected at the 2002 AGM were valid.  **(b) Legal principles**  The following legal principles were considered by Johnson J in determining the application for the appointment of a receiver/manager:  1. The application was brought under section 25(9) of the [Supreme Court Act 1935 (WA)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=15947" \t "default) which provides that a receiver may be appointed by an interlocutory order of the Court or a Judge in all cases in which it appears to the Court or a Judge to be just or convenient that such order should be made; and any such order may be made either unconditionally or upon such terms and conditions as the Court or Judge thinks just. His Honour Johnson J referred to Parker v Campden London Borough Council [1986] Ch 162 per Donaldson MR, at 173 in pointing out that although the power to appoint a receiver seems unlimited in its terms, it is to be exercised judicially and with due regard to authorities which are binding on the court.  2. In his Honours’ view, the proper approach to the appointment of a receiver is best described by the extract from 65 American Jurisprudence 2d as reproduced by the Full Court in National Australia Bank Ltd v Bond Brewing Holdings Ltd [1991] 1 VR 386, at 541-542:  "A court in exercising its discretion to appoint or refuse a receiver must take into account all the circumstances and facts of the case, the presence of conditions and grounds justifying the relief, the ends of justice, the rights of all the parties interested in the controversy and subject matter, and the adequacy and effectiveness of other remedies. This discretion is to be exercised with great caution and circumspection, after full consideration of the facts of a particular case and the interests of all parties concerned, for a reason strongly appealing to the judge to whom the application is made."  3. His Honour considered that the role of a receiver is to take possession of the property as the Court's officer with the duty of dealing with it fairly in the interests of all the parties to the proceedings: Re Newdigate Colliery Ltd [1912] 1 Ch 468 at 478. His Honour cited Co-operative Farmers' & Graziers' Direct Meat Supply Ltd v Smart [1977] VR 386, at 391 in stating that the receiver's responsibility is to the Court. The receiver is not the agent of, or the trustee for, any of the parties, nor subject to their control.  4. Johnson J was not aware of any authority which addressed the appointment of a receiver to a political party. His Honour acknowledged that for some time the law considered disputes between members of political parties as not justiciable: Cameron v Hogan [1934] 51 CLR 358. However, more recent single judge decisions have distinguished Cameron v Hogan on the basis that the statutory recognition of a political party under the State and Commonwealth Electoral Acts, including an entitlement to the provision of public moneys, took a Party beyond the ambit of a mere voluntary association and therefore disputes between members of the political party were justiciable: Clarke v Australian Labour Party (SA Branch) (1999) 74 SASR 109. In his Honour’s view, there was no impediment to the Court appointing a receiver to a political party if the circumstances warrant it.  5. His Honour noted that although the protection of property was a necessary part of the remedy, it need not be the primary motivation for the appointment of a receiver. The case of Duffy v Super Centre Development Corp Ltd [1967] 1 NSWR 382 was cited as an example of the appointment of a receiver/manager for the primary purpose of resolving a dispute within an organisation, whilst at the same time preserving the organisation's property. In his Honour’s view, providing there is property to be preserved, the appointment of a receiver/manager is an available remedy despite the fact that it is primarily being sought to resolve conflicts within the party.  6. His Honour considered the principle that a Court will not appoint a receiver where there is a grave risk of injury to the interests of other parties, referring to the statement of the House of Lords in Owen v Homan (1853) 10 ER 752 at 766.  7. According to Johnson J, a principle having significant bearing on this case is that a Court will not appoint a receiver on a disputed claim where its effect would be to prejudice the action. His Honour considered the case of Marshall v Charteris [1920] 1 Ch 520 where the defendant in an ejectment action was in actual occupation of a house which was in dispute whilst not paying rent. The Court refused, on an interlocutory application, to exercise its discretionary jurisdiction by appointing a receiver of the rents and profits of the house and ordering the defendant to give up possession to the receiver. The judge in that case observed that if the plaintiff obtained the orders she was seeking, in substance the plaintiff would be obtaining judgment in the action on an interlocutory motion.  **(c) Conclusion**  The McKinlay faction was seeking the appointment of a receiver/manager on an interim basis pending the holding of fresh elections. A receiver/manager would have to act in accordance with the Party’s Constitution, however, the appropriate Constitution was in dispute. The Court was asked to determine whether the original Constitution or the amended Constitution would bind a receiver/manager in conducting fresh elections. Johnson J held that the affidavit material indicated such a rift between the State factions that it cautioned him against drawing an inference as to the validity of the amended Constitution, in the absence of direct and tested evidence.  His Honour dismissed the application for the appointment of a receiver/manager to the Party on the grounds that the practical effect of granting such relief would be to finally determine the dispute without a hearing. The validity of the Party’s Constitution was a dispute that required a full hearing to resolve.  **5.3 Knowing assistance by directors and the authority of managers**  (By Grant Dixon, Freehills)  NCR Australia v Credit Connection [2004] NSWSC 1, New South Wales Supreme Court, Austin J, 14 January 2004  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/january/2004nswsc1.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2004/january/2004nswsc1.htm" \t "_new) or  [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  This case involved an examination of two distinct legal doctrines:           actual and ostensible authority: whether a national credit manager of a large company operating nationally has the authority, actual or ostensible, to bind the company in his dealings with other parties; and          the second limb of the Barnes v Addy test for liability for knowing assistance of a breach of trust: what level of knowledge is required for directors to be held liable as constructive trustees for a breach of trust by a company.  **(b) Facts**  The plaintiff, NCR Australia Pty Ltd (“NCR”), is an Australian subsidiary of a multinational corporate group. The terms on which NCE operated its business of selling ATMs and computer systems often involved the provision of credit to its customers. Collection of this credit was performed in part by the first defendant, Credit Connection Pty Ltd (in liq) (“CC”) in the period from December 1996 to early 1999. The sole shareholders and directors of CC were the second and third defendants, Mr and Mrs Maumoski. The fourth defendant, Mr Cannon, was employed by NCR as the national credit manager during 1998 and early 1999.  The initial engagement by NCR of CC as its credit collection agent occurred in December 1996, with the terms of the engagement being set out in a letter sent by CC to NCR (“Engagement Letter”). Although the Engagement Letter only constituted an offer by CC to act on those terms, the subsequent conduct of the parties until August 1998 was sufficient evidence for Justice Austin to find that the Engagement Letter was the contractual basis of the commercial relationship between the two companies.  However, on reviewing the contents of the Engagement Letter, Justice Austin could not find any conferral of authority upon CC to deduct its commissions and expenses from the money collected and held on trust for NCR. Indeed, it was held that CC was under an obligation to account for any recovery it made without deduction, with commission and legitimate expenses to be billed separately to NCR. There was also no obligation on NCR to transfer any particular quantity of credit invoices to CC for collection.  Following the engagement of another credit collection agency by NCR in August 1998, a number of changes were made by CC to its accounting procedures for NCR and the process by which CC billed its commission. CC began to offset the commission it had purportedly earned against the recoveries it had made on behalf of NCR, including for payments made directly to NCR by NCR’s debtors (ie, CC had not collected the debt itself). CC also deducted a substantial sum of money for what it claimed were legal expenses incurred in recovering debts on behalf of NCR, with the amount charged based upon a long list of estimated costs.  CC sought to justify its changed accounting and billing practices by relying upon the apparent acceptance of these changes by Mr Cannon, the national credit manager of NCR. In particular, CC pointed to the two deeds purportedly entered into between NCR and CC on 11 August 1998 and 18 November 1998 (“First Deed” and “Second Deed”, respectively). The First Deed was signed by Mr Cannon for and on behalf of NCR and by Mr Naumoski for and on behalf of CC, with neither signature being witnessed. The Second Deed was also signed by Mr Cannon for and on behalf of NCR, though this time with an employee of CC witnessing, and by the affixing of the seal of CC, witnessed by Mr Naumoski and the same employee of CC who witnessed Mr Cannon’s signature.  Justice Austin, however, found on the basis of evidence to the contrary (with particular reference made to the billing details of the law firm that prepared the Deeds) that the Deeds were not brought into existence until at least the second half of December 1998, primarily for the purpose of justifying the changes made by CC to its accounting and billing procedures.  **(c) Decision**  **(i) Actual or ostensible authority**  Justice Austin outlined four principal questions in respect of Mr Cannon’s actual and ostensible authority, the answers to which turned largely on the facts specific to this case:  1.      Did he have authority, on behalf of NCR, to enter into the agreements represented by the Deeds? 2.      Did he have authority to execute the Deeds on behalf of NCR? 3.      Did he have NCR’s authority to authorise CC to recover debts owing on target accounts (ie, the accounts of key clients of NCR)? 4.      Did he have NCR’s authority, otherwise than under in respect of the Deeds, to:  a) undertake to refer debts to CC when they were 60 days overdue; b) authorise CC to take legal proceedings for recovery of debts and incur expenses in doing so without complying with NCR’s internal procedures for authorisation of legal proceedings; or c) authorise CC to deduct commissions and expenses from monies it recovered on behalf of NCR?  In light of the documented authorisation procedures of NCR (which did not appear to provide Mr Cannon with the authority to enter into significant operational commitments on behalf of NCR) and the evident lack of any conferral of such authority, Mr Cannon, in his capacity as national credit manager, was held not to have possessed any actual authority in respect of any of Justice Austin’s four questions.  In considering whether ostensible authority existed, Justice Austin stated the relevant test was whether NCR had “by representation or other conduct, or acquiescence in a state of affairs, held Mr Cannon out to have the authority so to act on its behalf, notwithstanding the absence of actual authority”. His Honour further expanded upon this test by outlining two steps that must be taken into consideration:  1.      Examination of whether the agent possessed usual authority by virtue of the office he held, or assumed to occupy with the acquiescence of the principal, and whether any limitations imposed by the principal upon the scope of the office were communicated to the third party with whom the agent dealt; and 2.      Consideration of whether there was, on the part of the principal, any specific representation, other conduct or acquiescence in a state of affairs having the effect of clothing the agent with the appearance of authority going beyond the usual authority of a person holding the office occupied by the agent.  Justice Austin held that the office of national credit manager does not imply any authority to commit a company to the institution of legal proceedings nor any authority to bind the company to a formal written agreement or deed with a supplier of services (eg, CC). There was, though, implied authority to give specific instructions to a credit collection agency for the recovery of debts under pre-existing arrangements. His Honour also cited with approval previous authority to the effect that, in respect of ostensible authority, “the question is not whether the agent with whom the third party dealt made any representation about his or her authority to bind the principal, but whether a person with actual authority to bind the principal did so”.  In applying this reasoning, and again on the basis of the specific evidence, Mr Cannon was held not to have ostensible authority, except in respect of question 3, to act on behalf of NCR. Consequently, as Mr Cannon had no actual or ostensible authority, the deductions made by CC for payment of its commission and legal expenses was in breach of the trusts under which CC held the money recovered by it for NCR as a beneficiary.  **(ii) Knowing assistance of a breach of trust**  Although Justice Austin expressed some reservations about the clarity of the Australian law in this regard, he nevertheless applied the existing authorities relating to the second limb of the Barnes v Addy test for “knowing assistance” as a basis upon which an agent can be held liable as constructive trustee for a breach of trust by the trustee.  The case of Consul Development Pty Ltd v DPC Estates Pty Ltd (1995) 132 CLR 373 was noted as the leading Australian authority for interpreting the level of knowledge required before an agent will be made liable. Justice Austin concluded from the various judgments in that case that the following observations as to when liability will arise could be made:  1.      where the agent has actual knowledge of the dishonest and fraudulent design of the trustee; 2.      where the agent has deliberately shut his or her eyes to such a design; 3.      where the agent has abstained in a calculated way from making such inquiries as an honest and reasonable person would make, where such inquiries would have led to discovery of the dishonest and fraudulent design; or 4.      where the agent has actual knowledge of facts which to a reasonable person would suggest a dishonest and fraudulent design.  There is no liability, however, if the agent merely knows facts that would have been investigated by a reasonable person acting diligently, thereby discovering the truth, where the agent has innocently but carelessly failed to make the appropriate investigations.  As the effective operator and controller of CC, Mr Naumoski was found to have been the principal instigator of the changes to the accounting and billing procedures instituted by CC in August 1998. Justice Austin further concluded that the preparation and backdating of the Deeds was also done at the behest of Mr Naumoski. Consequently, His Honour had little difficulty in finding that Mr Naumoski had actual knowledge of the dishonest and fraudulent design of CC in making the changes to the accounting and billing procedures for NCR.  Mrs Naumoski, however, was not involved to any great extent in the operation of the business, despite also being a director of CC. She professed to have no knowledge about any aspect of the commercial relationship between CC and NCR, nor to have ever signed any financial accounts of the company.  Despite her evidence, Justice Austin also held that Mrs Naumoski was liable as a constructive trustee under the second limb of Barnes v Addy. In distinguishing her situation from that of a sleeping director failing to act with proper attention to the affairs of the company, Justice Austin relied heavily upon the fact that she was a qualified accountant, who would therefore be aware of her responsibilities as a director with respect to financial statements. Consequently, he concluded that “this is a deliberate shutting of the eyes, tantamount to actual knowledge of what would have been know had the eyes been kept open”, as Ms Naumoski had knowingly turned her back on the discharge of her duties and failed to make further inquiries for the purpose of avoiding liability.  **5.4 Disclaimer of onerous property by a liquidator in the context of ISDA master agreements**  (By Sonia McMillan, Phillips Fox)  Anthony Milton Simms and Neil John Singleton in their capacity as liquidators of Enron Australia Finance Pty Ltd (in liq) v TXU Electricity Ltd and Anor; Enron Australia v TXU Electricity [2003] NSWSC 1169, New South Wales Supreme Court, Austin J, 24 December 2003.  The full text of the judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/december/2003nswsc1169.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/december/2003nswsc1169.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) The Facts**  Enron Australia Finance Pty Ltd (‘Enron’) and TXU Electricity Ltd (‘TXU’) were traders in the Australian electricity derivatives market. In December 2000 the parties entered into an electricity swap contract, in the form of the 1992 ISDA Standard Master Agreement for multi-currency-crossborder transactions (the Agreement).  An electricity swap contract is a trade for the notional sale and purchase of electricity over a fixed period to be delivered in the future. One party agrees to pay a fixed price for a nominated type and quantity of electricity, and the other party agrees to pay a floating price (or spot price) for the same electricity. Payments fall due at specified payment dates during the course of the swap contract.  Enron and TXU entered into various swap contracts. In some contracts Enron paid the fixed price, and in others the floating price of the electricity.  On 3 December 2001, when Enron commenced voluntary administration, 78 swap contracts remained outstanding. From that date, no payments were made between the parties. On 29 January 2002 Enron was placed into liquidation by its creditors.  A similar situation arose in respect of swap contracts entered into between Enron and Yallourn Energy Pty Ltd (‘Yallourn’) in August 2000, also pursuant to a master contract. The case as between Enron and Yallourn (as second defendant) was heard together with TXU. While the judgment focuses on the position of TXU, the findings apply equally to Yallourn.  **(b) The Agreement**  Section 2(a) of the Agreement deals with the payment obligations of the parties. Subsection 2(a)(iii) provides that the payment obligations between the parties are suspended if an Event of Default occurs or is occurring.  An Event of Default, as defined by subsection 5(a)(vii)(6), occurred when Enron went into voluntary administration on 3 December 2001, and continued during the course of the administration until 29 January 2002. The Event of Default has continued since that time, with the result that the payment obligations have continued to be suspended.  Section 6(a) deals with the right to terminate following an Event of Default. It permits a Non-defaulting Party to give notice to the Defaulting Party, designating an Early Termination Date in respect of all outstanding Transactions.  Section 6(c) further provides that if an Early Termination Date has been effectively designated, no further payments or deliveries are required in respect of the Terminated Transactions, and the amount payable (if any) is determined under Section 6(e).  Section 6(e)(i) deals with the payments to be made if an Early Termination Date has been designated because of an Event of Default, to be calculated in accordance with the methods outlined in subparagraph 6(e)(i)(3) called the ‘Second Method and Market Quotation’.  **(c) TXU’s position**  In the circumstances, the above sections conferred upon TXU a contractual right to designate an Early Termination Date in respect of all outstanding transactions, and then to settle by making or receiving a payment calculated under section 6(e)(i)(3).  As at 28 February 2003, if TXU exercised this right, TXU was liable to Enron in excess of $3.3 million.  However, TXU was not obliged to exercise this right and chose not to do so, instead relying on the defaulting conduct of Enron and section 2(a)(iii). As a consequence of the occurrence of an Event of Default, TXU was not required to make any payments before the last trade expires on 31 December 2005. As a result TXU’s payment obligations under all 78 outstanding swap contracts remained suspended whilst Enron was in liquidation.  **(d) Enron’s position**  The liquidator of Enron argued that because of the substantial sum purportedly owed to them by TXU ($3.3 million according to Enron and $2.9 million in the case of Yallourn), the Agreement was a valuable asset of Enron. Their commercial objective was to realise this asset as soon as possible, rather than waiting for the expiry of the last trades.  In order to do this, they sought to disclaim the Agreement. Accepting that the Agreement was not ‘unprofitable’ for the purposes of s 568(1A) of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), Enron needed the leave of the Court to disclaim the Agreement.  In addition, Enron was concerned that by disclaiming the Agreement without further orders of the Court, it would forfeit its right to recover the full value of the Agreements, being entitled only to the payment obligations airing prior to 3 December 2001. Enron therefore sought the following orders:  ‘2. An order that, in the event the plaintiffs disclaim the TXU contract pursuant to the leave granted in order 1,  (a) TXU determine an amount payable in respect of an Early Termination Date in accordance with Section 6(e) of the TXU contract, as though TXU had designated the date the disclaimer takes effect under s 568C as the Early Termination Date and TXU was the Non-defaulting Party;  (b) if the amount so determined is a negative number, TXU pay the absolute value of that amount, together with interest thereon calculated in accordance with Section 6(d)(ii), to Enron; and  (c) if the amount so determined is a positive number, TXU lodge a proof of debt for that amount with the plaintiffs.’  Enron argued that the statutory language, the structure of the provisions, their legislative history, and the general legislative intention of section 568 supported this application.  **(e) Section 568 of the Corporations Act**  The disclaimer of ‘onerous property’ is dealt with in Division 7A of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) which applies generally to disclaimer both by a liquidator in a voluntary winding up and by a court-appointed liquidator.  The most relevant provisions in this case were sections 368(1A) and (1B) which apply to disclaiming a contract:  ‘568(1A) A liquidator cannot disclaim a contract (other than an unprofitable contract or a lease of land) except with the leave of the Court.’  ‘568(1B) On an application for leave under subsection (1A), the Court may:  (a) grant leave subject to such conditions; and  (b) make such orders in connection with matters arising under, or relating to, the contract;  as the Court considers just and equitable.’  Section 568D was also an important provision, dealing with the practical effect of the disclaimer:  ‘568D(1) A disclaimer is taken to have terminated, as from the day on which it is taken because of subsection 568C(3) to take effect, the company's rights, interests, liabilities and property in or in respect of the disclaimer property, but does not affect any other person's rights or liabilities except so far as necessary in order to release the company and its property from liability.  (2) A person aggrieved by the operation of a disclaimer is taken to be a creditor of the company to the extent of any loss suffered by the person because of the disclaimer and may prove such a loss as a debt in the winding up.’  **(f) The decision**  Austin J held that section 568(1B) of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) does not confer a discretionary power upon the Court to vary the contractual arrangements between the parties. He rejected the orders proposed by Enron on the basis that such orders would vary the rights and obligations of the parties to the contracts.  While acknowledging that the language of section 568(1B) is framed in broad terms, Austin J held that it is not boundless in scope. The order sought by Enron against TXU would force TXU to designate an Early Termination Date, thereby causing final net payment to be calculated under section 6(e). This would make TXU immediately liable to Enron. This is a substantive right that Enron did not have under the contract which it was seeking to disclaim. Austin J was not prepared to deprive TXU of its contractual right not to designate an Early Termination Date under section 6(a) after an Event of Default occurs, and the right under section 2(a)(iii) not to make a payment under section 2(a)(i) while an Event of Default continues.  Austin J stated that the broad, discretionary language of section 568(1B) must be read together with, and be moderated by, the non-discretionary provisions of section 568D(1) with respect to the consequences of disclaimer. The words of section 568(1B) cannot therefore be construed as overriding the latter provisions of section 568D(1).  Finally, Austin J also held that while one of the legislative purposes of Division 7A is to facilitate the efficient administration and distribution of an insolvent estate, this purpose is not intended to include the variation of contractual rights and liabilities of other parties existing before the disclaimer, even where such a variation might contribute to the efficient administration of the liquidation.  His Honour noted that he was inclined to order Enron to pay TXU’s costs, but gave the parties the opportunity to make submissions with respect to costs, and any submissions as to the form of orders.  **5.5 The principles of sentencing and white collar crime**  (By Chelsea Gorr, Blake Dawson Waldron)  R v Howard [2003] NSWSC 1248, New South Wales Supreme Court, Kirby J, 23 December 2003  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/december/2003nswsc1248.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/december/2003nswsc1248.htm" \t "_new) or  [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Introduction**  The case concerned the sentencing of William Herbert Howard, who pleaded guilty to one count of contravention of section 184(2)(a) of the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) ("Act") and one count of contravention of section 184(2)(b) of the Act.  **(b) Background**  Howard joined HIH Casualty and General Insurance Ltd ("HIH") as an accountant in 1996. In 1999 he became General Manager (Finance) and in December 2000 was appointed as Chief Investment Officer. At the time of his appointment HIH had obvious financial difficulties and its employees had been instructed to pay only core expenses.  In December 2000 Howard was given the task, by the CEO, Raymond Williams, shortly before his resignation, to resolve the claims of Bradley Cooper. Cooper was the head of Home Securities International Inc, which jointly owned, with HIH, FAI Home Security Pty Ltd. HIH also held a share of Home Securities International Inc.  Cooper and Williams had negotiated an agreement whereby HIH would sell its share of FAI Home Security Pty Ltd and Home Securities International Inc to Cooper for $1.25 million to be paid in instalments. As part of the agreement Howard was to resolve Cooper's claims against HIH.  **(c) The indictments**  The following indictments were made against Howard:  Count 1: Between 2 December 2000 and 15 March 2001, Howard, contrary to section 184(2)(b) of the Act, used his position as employee of HIH dishonestly, reckless as to whether such use would result in Cooper directly or indirectly gaining an advantage, in that he dishonestly received from Cooper cash sums totalling $124,000 in return for his facilitating payments by HIH, or its subsidiaries, in favour of Cooper, or companies associated with him.  There were 4 claims by Cooper involved in count 1 and in each circumstance Howard, in resolving the claim, assisted Cooper in gaining an advantage. In short, the arrangements made between Cooper and Howard involved:           A HIH agreement to sponsorship arrangement, with one of Cooper's companies Vision Publishing Pty Ltd, for $1.2 million. While the proposed seminars never took place, Howard agreed that the $817,000 debt owed to HIH by Cooper would be offset again the $1.2 million owed in relation to the sponsorship deal, with HIH paying the balance of $347,000.          An agreement relating to an increase in the commission paid to Home Security Pty Ltd by a finance company owned by HIH called FAI Finance Corp. As the management of FAI Finance Corp refused to pay this increase, Howard forwarded, in advance, $2.65 million to Cooper's companies in December 2000.          An agreement whereby HIH paid $1 million to Cooper's companies in relation to a dubious claim for stock issued to FAI Insurance but which Cooper claimed should have been partly issued to his companies.           A joint venture between HIH and Cooper in America called publiCARD. Cooper then bought all the shares in publiCARD from HIH for 65% of their value, US$163,800. When Cooper later complained that in fact the purchase price should have been in AUD, Howard agreed to pay a refund of A$148,200  Count 2: Between 2 January 2001 and 16 January 2001 Howard, contrary to section 184(2)(b) of the Act, used his position dishonestly, with the intention of directly or indirectly gaining an advantage for Cooper, by facilitating a payment of $737,500 by HIH to a company associated with Cooper, knowing that the payment obligation had already been discharged.  The second indictment related to HIH's to sponsorship of Vision Publishing Pty Ltd. Following the initial settlement described above, Howard and Cooper agreed to duplicate the sponsorship payment. Howard, failing to inform Williams of the initial settlement, urged him to settle the sponsorship claim. Williams agreed to pay Vision Publishing Pty Ltd a further $737,5000.  **(d) The sentence**  Howard pleaded guilty to both counts and it was left to Kirby J to pass sentence. The maximum penalty in respect of each offence was 5 years imprisonment and/or a fine of $200,000.  To determine the appropriate sentence Kirby J assessed the objective seriousness of the offences and weighed this against the circumstances of the offender.  Kirby J emphasised the importance of deterrence in imposing a sentence, noting:  "The punishment imposed should be sufficiently severe to warn like-minded persons of the consequences of such conduct, once detected. In the context of crimes of this sort, deterrence is especially important."  Kirby J noted there were three aspects of Howard's circumstances that entitled him to a discount upon his sentence:           Guilty plea – not only did Howard plead guilty but he went to the authorities before he was charged. Kirby notes that the benefit of a guilty plea is the saving of the expense of a trial, particularly where the trial is likely to be long and complex as in these circumstances. The value of the discount has generally been between 10% and 25%.          Ellis discount – Kirby J followed the principle expounded in R v Ellis (1986) 6 NSWLR 603 where it was held that "where it is unlikely that guilt would be discovered and established were it not for the disclosure by the person coming forward, then a considerable element of leniency should properly be extended by the sentencing judge."          Past and future assistance to the Crown – following the Court of Criminal Appeal in R v Cartwrights (1989) 17 NSWLR 243, Kirby J held that in cases of white collar crime "the policy of encouraging those with information to break ranks and come forward has special relevance". He noted that proof and successful prosecution are more difficult to establish in these cases, hence the temptation, of those involved, to 'stick together' is greater. As a result the motivation presented by the courts to 'break ranks' must be greater.  Kirby J concluded that the criminality in count 2 is worse that that in count 1, however, the beneficiary in count 2 was Cooper and there was only one breach of trust. As a result he held that the same sentence of 3 years should be imposed in respect of each count.  For the reasons set out above, but setting aside future assistance Howard has undertaken to provide, Kirby J discounted the sentence for the first count by approximately 40% and the second count by 33 1/3%.  In view of the savings of time and money Howard's assistance will provide to the Crown and the considerable personal cost, both emotionally and financially, to Howard in undertaking this assistance, Kirby J further reduced Howard's sentence to a suspended sentence.  **5.6 Extension of time to lodge charge**  (By Ron Schaffer and Alastair Young, Clayton Utz)  National Australia Bank Ltd v T2 Trading Pty Ltd [2003] FCA 1477, Federal Court of Australia - WA District Registry, French J, 9 December 2003  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/december/2003fca1477.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2003/december/2003fca1477.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  The Federal Court has exercised its discretion to extend the period for lodgement of a charge over a company's property affirming that ignorance of the law can be an excuse  **(a) Introduction**  In this case, the Court exercised its discretion under section 266(4) of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56582" \t "default) (the "Act") to extend the period by which a person is required to lodge a notice with the Australian Securities and Investments Commission ("ASIC") of the creation of a charge over a company's property. The Court exercised its discretion upon the application of a creditor holding a charge who wished to protect its security over a debt owing to it by a company under administration. If the application was unsuccessful, the charge would be void as against the administrator, leaving the creditor with no security.  This case is interesting in two respects. Firstly, it is a reminder that the rationale underpinning the lodgment requirement is the integrity of the Australian Register of Company Charges (the "Register") that is kept by ASIC and the protection of lenders who rely on it. Secondly, this case illuminates the manner in which the Court will exercise its discretion to extend the lodgment period to preserve a chargee's security in the hands of administrators. Particularly interesting is the finding that ignorance of the Act can amount to a valid excuse for failing to lodge a charge within the 45 day lodgment period.  **(b) The facts of the case**  In August 2003 National Australia Bank Limited (the "Bank") provided various financial services, including overdraft facilities, to several companies comprising the Tec Plus Group (the "Group") in return for the creation of various charges over the Group's property. Notices of the creation of the charges were lodged in September and October 2003, after the 45 day period following their creation. Officers of the Bank adduced evidence that they were unaware of the 45 day lodgment period, believing the period to be 60 days and that the only consequence of late lodgment was a penalty fee.  Subsequently, administrators were appointed to one of the companies in the Group. The Bank, realising the risk to its security, made an application to the Court to extend the lodgment period in respect of all the charges. The administrators, after advising other creditors of the application and satisfying themselves that no creditors lent money to the Group after September 2003, advised the Bank that they did not oppose the application.  **(c) The law**  Part 2K.2 of the Act governs the lodgment of notices of the creation of charges with ASIC, and the subsequent registration of those charges. Section 263, in conjunction with section 270(1) of the Act, provides that a notice in respect of a charge is to be lodged by the company that created it, or any other person, within 45 days of the event. Where a company fails to lodge a notice of a charge within that time an offence, in contravention of section 270(2), is also committed.  In practice, lodgment of a notice of a charge is usually attended to by the chargee because a failure to lodge will imperil the chargee's security, as a charge will be, pursuant to section 266(1) of the Act, void against a liquidator or administrator of the company if, inter alia, notice of it is not lodged in time.  Section 266(4) of the Act provides in its entirety:  "The Court, if it is satisfied that the failure to [lodge](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s9.html#lodge) a [notice](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s9.html#notice) in respect of a [charge](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s9.html#charge), or in respect of a variation in the terms of a [charge](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s9.html#charge), as [required](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1314html#required) by any [provision](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1314html#provision) of [this Part](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1371html#this_part):  (a) was accidental or due to inadvertence or some other sufficient [cause](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s9.html#cause); or  (b) is not of a nature to prejudice the position of creditors or shareholders;  or that on other grounds it is just and equitable to grant relief, may, on the application of the [company](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1302html#company) or any [person](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s9.html#person) [interested](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s9.html#interest) and on such terms and [conditions](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s9.html#condition) as seem to [the Court](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s58aahtml#the_court) just and expedient, by [order](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1371html#order), [extend](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s9.html#extend) the period for such further period as is specified in the [order](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1371html#order)."  The repeated use of the disjunctive "or" rather that the conjunctive "and" in this section indicates that the Court need not be satisfied of the existence of all the elements of the section. It is, therefore, both conceivable and within a reasonable (albeit formalistic) interpretation of the law, that a failure to lodge a charge due to inadvertence may precipitate an extension notwithstanding the existence of prejudice to a creditor or shareholder.  **(d) The issues confronting the court**  There were three main issues confronting the Court in this case. Firstly, whether the failure to lodge the notice in time, due to the Bank's officers' ignorance of the provisions of the Act, constituted "inadvertence" under section 266(4). Secondly, whether the failure to lodge in time prejudiced the position of creditors or shareholders. Finally, whether it was appropriate in this case for the Court to exercise its discretion to extend the lodgement period.  **(e) The decision of the court**  The Court ordered that the time limit for the lodgement of the notice be extended. The effect of this decision was to validate the Bank's security. However, the Court, exercising caution, and in considering the position of other potential creditors, ordered that the extension be "without prejudice" to any person who, through any dealings with the chargor company, dealt with the company's property that was the subject of the charges after the date the charges were created but before the date of the late lodgment.  In respect of the first of the three above issues before the Court, the Court found that under section 266(4) of the Act ignorance of the law, causing omission, constitutes "inadvertence". French J, in arriving at that conclusion, followed the cases of Scarfe Steel Supplies Pty Ltd v SMP Pty Ltd (1980) 5 ACLR 262 and Sanwa Australia Finance v Ground-Breakers Pty Ltd (in Liq) (1991) 2 Qd R 456. In Sanwa it was held (at 461) that "ignorance of the law may amount to inadvertence". French J questioned the decision of Rynmarc Pty Ltd v Classic Ergonomic Chairs Pty Ltd (1994) 12 ACLC 1038 where Underwood J stated "I do not understand how, 'ignorance of the law may amount to inadvertence'". French J found that (at [23]):  "Ignorance of the law is generally not available as a defence to a criminal prosecution... [However,] I am quite satisfied that [the Bank's] failure to lodge the charges for registration within time was due to inadvertence constituted by or caused by [its] ignorance"  In respect of the second of the above issues before the Court, it was found that no creditor or shareholder would be prejudiced by the decision to extend the time period.  The rationale of timely lodgement, and subsequent registration of company charges, is corporate financial transparency. It would have been interesting if, in this case, a creditor was found to have dealt with the company, especially in respect of the property that was the subject of the charges, in reliance on the accuracy of the Register, after the 45 day period, but before the extended time period. As there was no evidence before the Court that this occurred, prejudice to third parties was not a primary concern. Nevertheless, the prevailing importance of this consideration is reflected in the order that the extension of time be "without prejudice" to a potential class of persons who may, as a result of the extension, suffer a detriment.  The final issue before the Court was decided in the affirmative. The ratio decidendi of this aspect of the case was that it was fair and equitable that the Bank not "be deprived of the benefit of its security" (at [29]). This was because no prejudice would be suffered by another, and, crucially, if the extension was not made, a "windfall" would be conferred upon unsecured creditors to the unfair detriment of the Bank. This is because, if the company were to be wound-up, the value of the property that was the subject of the void charge could be divided among unsecured creditors (assuming that property was free from any other debenture), of which the Bank would be a mere pro rata member.  **(f) In summary**  The key points of this case are that the lodgment requirements are fundamental to the reliability of the Register and that the Court's discretion to extend the period of lodgement of charges is limited. Nevertheless, lenders will be heartened by the affirmation that ignorance of the law can be a valid excuse as far as section 266(4) of the Act is concerned.  **5.7 Statutory demand with substantial compliance with prescribed form held to be valid**  (By Seeyan Lee, Corrs Chambers Westgarth)  Quitstar Pty Ltd v Cooline Pacific Pty Ltd [2003] NSWCA 359 revised, New South Wales Court of Appeal, Full Court, Sheller JA, Hodgson JA, McColl JA, 9 December 2003  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/december/2003nswca359.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/december/2003nswca359.htm" \t "_new) or  [http://cclsr.law.unimelb.edu.au/judgments](http://cclsr.law.unimelb.edu.au/judgments" \t "_new)  **(a) Summary**  A statutory demand which refers to the “Corporations Law” instead of the “Corporations Act 2001” was held to be a valid statutory demand under s459E of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) (“Corporations Act”).  **(b) Facts**  This is an “appeal of right” bought by the appellant Quitstar Pty Limited (“Quitstar”) under s101 of the [Supreme Court Act 1970 (NSW)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=3748" \t "default), against the respondent (“Cooline”) for leave to appeal from a decision of Barrett J in the Equity Division. Barrett J had upheld the validity of a statutory demand served by Cooline on Quitstar.  Quitstar’s fundamental submission was that the document served by Cooline did not constitute a “statutory demand” under the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), because:  (i) it was not served under s459E of the Corporations Act; (ii) it was purported to be served under the Corporations Law, a New South Wales statute which ceased to have effect on 15 July 2001; and (iii) it was not in the prescribed form under s459E of the Corporations Act as it did not refer to the “Corporations Act 2001”.  **(c) Decision**  The Court dealt with the submissions of Quitstar by considering the following issues in turn:           whether the document served on Quitstar was a statutory demand;          if so, what is the effect of the relevant departure from the prescribed form; and          whether the prescribed form itself is invalid.  **(i) Was the document a statutory demand?**  The Court held that in determining this issue, one can take into account other factors apart from the reference in the document to the Corporations Law and the absence of the reference to the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). The Court considered the following factors to be relevant:   *          the document followed the exact form prescribed under s459E of the Corporations Act, except that it has the words “Corporations Law” where it should have the words “Corporations Act 2001”;          the document was addressed to Quitstar, an existing corporation, by Cooline, a creditor of that corporation; and          at the time of service, the only relevant legislation dealing with statutory demands on companies was the Corporations Act 2001. * After considering the above factors, the Court held that the document “manifests a clear intention” to operate and was served as a statutory demand under the applicable law relating to corporations. * Although s459E says that the demand “must” be in the form prescribed by the regulations, the Court held that: *          there is “substantial compliance” with the prescribed form, as required by s25C of the [Acts Interpretation Act 1901 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=6818" \t "default); and          having regard to s459J of the Corporations Act, which sets out the circumstances in which a court will set aside a statutory demand, the legislation was not making strict compliance with the form a prerequisite for validity. * Thus, the Court held that statutory demand served upon Quitstar was a valid statutory demand under s459E of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). * **(ii) Effect of departure from the prescribed form and validity of the prescribed form.**   The Court held that even if the discrepancy between the prescribed form constitutes a defect in the statutory demand, s459J manifests a clear intention that such a defect will cause the demand to be set aside only if “substantial injustice” is caused. The Court held that “substantial injustice” is not caused in this case as it would be “plain” to the readership of the ‘statutory demand’, ie to a person with knowledge of the Corporations legislation that there was a mistake made by the creditor on the form of the document. The mistake would be unlikely to be misleading. Thus, the Court held that the form of Cooline’s statutory demand to be valid.  The appeal by Quitstar was dismissed with costs.  **5.8 Shareholder approval may bind a company to directors’ decisions in breach of their duties to the company**  (By James Morley, Corrs Chambers Westgarth)  Carabelas v Scott [2003] SASC 389, Full Court of the Supreme Court of South Australia, Doyle CJ, Prior and Vanstone JJ, Austin J, 5 December 2003.  The full text of the judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/sa/2003/december/2003sasc389.htm](http://cclsr.law.unimelb.edu.au/judgments/states/sa/2003/december/2003sasc389.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Background**  This case primarily revolves around breaches of section 229 of the former Companies (South Australia) Code (“Code”). These sections are equivalent to sections 180 to 184 and section 1317H of the [Corporations Act 2001 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) which deal with directors’ duties.  **(b) Facts**  **(i) Compensation claims**  Mr and Mrs Carabelas were the only directors and shareholders of Angas Law Services Pty Ltd (“ALS”). They were also the only directors and shareholders of five other companies (“the other companies”). All six companies will be referred to as “the group”.  Commonwealth Bank of Australia (“CBA”) provided a loan of $1.75 million to Mr Carabelas in July 1988 after ALS and the other companies provided a mortgage to CBA. Mr Carabelas then provided $435,040 of the loan to ALS. In October 1989, ALS sold the property which was the subject of the mortgage for $910,000, all of which was taken by CBA. The book entries of ALS show that the money was allocated as a repayment of the loan to ALS by Mr Carabelas and a subsequent loan to Mr Carabelas of the balance (close to $474,950). However, a subsequent “correcting” book entry dated the same day as the above entry (but apparently made on 30 June 1990) stated that the balance money was allocated not as a single loan to Mr Carabelas but as several loans spread between the other companies and only a small amount allocated to Mr Carabelas. The other companies had no ability to pay the debts and never paid them. ALS, some time later, wrote the debts off.  ALS (through its liquidator Scott) then sued Mr and Mrs Carabelas for the balance claiming that their actions, in relieving Mr Carabelas of his liability to ALS by replacing it with a worthless liability for which their was no valid commercial reason, were in breach of section 229. At trial, the judge agreed and ordered that defendants repay the amount of the balance to ALS.  **(ii) Preference claims**  In April 1994, ALS was wound up and accounts were prepared for it and the other companies. In the books of ALS, Mr Carabelas was listed as a creditor and in the books of the other companies, Mr Carabelas was listed as a debtor. In preparing the accounts, Mr Carabelas’s accountant engaged in the process of “netting off” the amounts owing between members of the group and between the group and Mr Carabelas. This netting-off process did not involve any money changing hands, but were only book entries made in order that the companies would have no assets the subject of administration and therefore could be deregistered.  The liquidator claimed the netting off resulted in unfair preference payments made to specific creditors of ALS (the other companies) and sought to have these transactions made void under section 588FE of the then Corporations Law. The trial judge found in favour of the plaintiff and required the defendants to pay $234,576.97 pursuant to section 588F(1).  **(c) Current proceeding**  Mr and Mrs Carabelas appealed on all grounds, also arguing that the claims by the plaintiff were “out of time” and, due to section 1317K of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default), the action should be dismissed.  **(i) Compensation claim**  The appellants argued that the group was engaged in a joint venture, that Mr Carabelas borrowed money on behalf of the group and that it was intended that he would allocate any amounts required to each group member himself. He argued that each member was jointly and severally liable to him for the entire amount of the loan and that the entire proceeds from the sale of the ALS property went to CBA for this reason. Under this arrangement, he argued, he was never liable to ALS for the balance but the other members of the group were liable according to the joint venture arrangement.  Doyle CJ, who delivered the only judgment with which the other Justices agreed, found that it was open to the trial judge to find that there was no joint venture arrangement between the members of the group and that in granting the mortgage to secure the loan to Mr Carabelas, and in paying to CBA the entire proceeds from the sale of the ALS property, the directors permitted Mr Carabelas to make improper use of his position to gain an advantage for himself or for another company.  However, the appellants argued that as there had been shareholder approval of the transaction, ALS was bound by the decision of the directors. In doing so, the appellants referred to Re Duomatic Ltd [1969] 2 Ch 365 in which the directors drew company sums as remuneration with the knowledge and consent of the shareholders but with no formal resolution authorising them to do so. Buckley J stated that where the transaction is within the directors’ power and honest, and especially if it is for the benefit of the company, it cannot be upset if the assent of the shareholders is given.  Doyle CJ considered that Re Duomatic Ltd focused on correcting a lack of formality and not, as in this case, whether a company can seek redress from directors whose actions, while in breach of their duties to the company, have been authorised by shareholder approval.  In reviewing this question, Doyle CJ examined the broad positions taken in various cases such as Attorney General for the Dominion of Canada v The Standard Trust Company of New York [1911] AC 498 where Viscount Haldane stated at 504-505 in regard to the four directors who were also the sole shareholders in the company that the “law gave them the complete control of [the company’s] action. Under that control the company gave effect to the policy of the only persons who had any beneficial interest in its capital” and that subsequently, the company “was completely bound by the transaction sought to be impeached.”  However, Doyle CJ referred to the High Court decision in Macleod v R (2003) 197 ALR 333 which applied a limit to this principle. In this case, a sole shareholder, sole director misappropriated money (in breach of trust) held by the company on trust for the purpose of film production. The High Court stated “the conduct or state of mind” of shareholders and directors “is not always to be attributed to the [company]; this is particularly evident upon an insolvent winding-up.” The court also added that the “self-interested “consent” of the shareholder, given in furtherance of a crime committed against the company, cannot be said to represent the consent of the company.”  Doyle also examined the decision in ANZ Executors & Trustee Company Limited v Quintex Australia Limited [1991] 2 Qd R 360 at 367 where McPherson J said that the right to vote “may confer control over the affairs and property of the company; but it does not follow that the holder may always do whatever he pleases with the corporate assets. For they are the property of the company and not of the shareholder, who has no legal or equitable interest in them: Macaura v Northern Insurance Co [1925] AC 619, at 626. That is the inescapable consequence of treating the company in law as an entity distinct from its members.”  Doyle CJ placed weight on the judgment of Street J in Kinsela v Russell Kinsela Pty Ltd (In Liq) (1986) 4 NSWLR 722 who stated that in a solvent company, the shareholder’s proprietary interests entitle them to be regarded “as the company” and if the shareholders authorise or ratify a particular action of the directors “there can be no challenge to the validity of what the directors have done.” However, Street J went on to say that “where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company’s assets”.  In this regard, Doyle CJ considered Pascoe Limited (in liquidation) v Lucas (1999) 75 SASR 246 which, at [265]-[266], agreed shareholder approval of directors’ decisions can bind the company subject to the company being solvent, the transaction being within the power of the company and the directors making full disclosure and acting in good faith.  In upholding the appeal, Doyle CJ stated that it is difficult to reconcile the varied decisions and observations made by the courts on this issue but that none of the “qualifications or limits on the ability of all of the shareholders to assent … to a transaction that would otherwise involve a breach of duty by the directors” applied in this case. The company was not insolvent at the time, there were no other shareholders, there was no other person with a claim to the property in question and there is no allegation that this was a dishonest or fraudulent transaction. His Honour stated that the shareholders had implicitly authorised the grant of the mortgage, because it was given with their knowledge and apparent approval and on that basis there could be no breach of section 229.  **(ii) Preference claims**  Doyle CJ also upheld the appeal in relation the “unfair preference” payments made to certain creditors of ALS through the process of “netting-off”. The court found that the book entries were not related to transactions made prior to winding-up but were merely accounting entries made to reflect a decision made after winding-up had begun as to how the accounts of ALS were to be presented. As the entries were made after winding-up had begun, Mr Carabelas and his accountant did not have the authority to enter into them and accordingly the entries are voided by section 468 of the Corporations Law and the accounts therefore reverted to their position prior to the entries being made.  **(iii) Out of time**  In regard to the appellant’s claim that the proceeding were out of time, Doyle CJ dismissed their appeal. The [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) at section 1383 provides that the Act will apply to a proceeding that had already commenced but not concluded under a provision of the “old corporations legislation of a State”. The “old corporations legislation of a state” is defined to include the Corporation Law but not the Companies Code. Section 85 of the Corporations Law allows the continuance of all proceedings under the Companies Code in relation to matters arising before the commencement of the Corporations Law. Therefore, as this proceeding is in relation to matters arising before the commencement of the Corporations Law, it operates outside the Corporations Act and the six year limitation on compensation order proceedings under section 1317K does not apply.  **5.9 Operating without an Australian financial services licence – injunctive and declaratory relief sought by ASIC**  (By Elizabeth O’Donovan)  ASIC v Triton Underwriting Insurance Agency [2003] NSWSC 1145, New South Wales Supreme Court, Barrett J, 3 December 2003  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/december/2003nswsc1145.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2003/december/2003nswsc1145.htm" \t "_new) or [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) Summary**  ASIC brought proceedings against two insurance companies, Triton Underwriting Insurance Agency Pty Ltd (Triton) and Trans Pacific Insurance Corporation (Trans Pacific), on the basis that they were carrying on activities which required an Australian financial services licence in accordance with the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default).  ASIC applied for declarations that Triton and Trans Pacific were in breach of section 911A, section 1041E and section 1041F of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) as well as section 12DA of the Australian Securities and Investments Commission Act 2001. ASIC sought interim injunctive relief under section 1324(1) of the Corporations Act 2001 restraining the Defendants from carrying on activities in the insurance field which are not able to be conducted without an appropriate licence. ASIC also sought orders under section 1323 of the Corporations Act 2001 prohibiting the movement of money and property out of Australia.  Triton brought a cross-claim seeking orders compelling ASIC to consider a pending application by Triton for an Australian financial services licence.  In his findings, Barrett J did not consider that the circumstances were such that it was “desirable” under section 1324(1) of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) that the Court should restrain the business activities of Triton and Trans Pacific pending trial. Barrett J granted the orders sought under section 1323 of the Corporations Act 2001 subject to the defendants having the opportunity to apply to the Court for approval on 48 hours notice if they wished to make particular payments or remittances. The matter was stood over to the Corporations list to determine the cross-claim brought by Triton and to consider the progress of the proceedings as a whole.  **(b) Facts**  Triton and Trans Pacific were insurance companies who did not hold licences from APRA to carry on business as insurers in Australia. Neither Triton nor Trans Pacific held Australian financial services licences under the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). Trans Pacific was incorporated in the Cayman Islands and was permitted under Cayman Islands law to carry on insurance business outside the Cayman Islands. Triton was a company incorporated in Australia.   ASIC claimed that Triton, as the agent of Trans Pacific, was arranging and issuing insurance in Australia and engaging in conduct aimed at influencing Australians to acquire insurance issued by Trans Pacific. ASIC alleged that these activities involved dealing in a financial product and providing financial product advice which, in the absence of an Australian financial services licence, contravened Division 2 of Part 7.6 of the Corporations Act 2001.  ASIC submitted that the unlicensed activities of Triton and Trans Pacific exposed the public to financial solicitation by an entity which had not been found to conform with the statutory and administrative standards for the grant of licences.  ASIC submitted that its claim for interlocutory relief allows the Court to grant an interim injunction pending determination of an application under section 1324(1) of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) where “in the opinion of the Court it is desirable to do so.”   Barrett J accepted that there was a serious question to be tried on the issue of statutory contravention. His Honour then considered whether the Court ought to apply the same principles which apply to an application for an interlocutory injunction under the Court’s equitable jurisdiction. Barrett J referred to the decision in ASIC v Pegasus Leveraged Options Group Pty Ltd (2002) 41 ACSR 561 and, in particular, agreed with Palmer J’s summary of the relevant authorities and concluded that the jurisdiction which the Court exercises under section 1324 is a statutory jurisdiction and it is not the Court’s traditional equity jurisdiction.   Barrett J then went on to consider the balance of convenience. ASIC submitted that it was in the public interest to ensure that unlicensed persons do not undertake activities which require a licence, since the interests of the public were protected by the licensing process which involves screening and vetting applicants who are then subject to ongoing supervision.   However, Barrett J noted that Triton had demonstrated that it was willing to become a licensee and had taken substantial steps to obtain a licence. Triton had applied to ASIC for an Australian financial services licence but it was not the correct type of licence but ASIC had suspended the licence application due to an ASIC investigation.   Barrett J noted that there was no evidence that any member of the public had lost money or was likely to lose money through the activities of either Triton or Trans Pacific. Triton submitted that it would suffer severe and perhaps irreparable harm if its business was interrupted even for a week or two.  **(c) Decision**  Barrett J held that the balance of convenience was in favour of the defendants as the hardship that the defendants would suffer if interim injunctive relief was granted, outweighed the potential hardship in the form of the risk to the public if the injunction was not granted. Barrett J also placed considerable weight on the evidence that Triton had made a legitimate and determined attempt to obtain a licence and the defendants had fully cooperated with ASIC in this regard.   In summary, Barrett J did not consider that the circumstances were such that it was “desirable” that the Court should restrain the business activities of Triton and Trans Pacific pending trial. However, Barrett J qualified his findings on the basis that the Court did not condone the continuation of unlawful activities to the extent to which those activities required a licence.   Barrett J granted the orders sought under section 1323 of the [Corporations Act 2001](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default) subject to the defendants having the opportunity to apply to the Court for approval on 48 hours notice if they wished to make particular payments or remittances.  **5.10 Specific terms of a scheme of arrangement do not override general terms of a company's constitution**  (By Jacqueline Christie, Senior Associate, Clayton Utz)  Ashton Millson Investments Ltd v Colonial Ltd [2003] VSCA 188, Supreme Court of Victoria, Court of Appeal, Ormiston, Batt and Buchanan JJ, 26 November 2003  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/november/2003vsca188.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2003/november/2003vsca188.htm" \t "_new) or  [http://cclsr.law.unimelb.edu.au/judgments/](http://cclsr.law.unimelb.edu.au/judgments/" \t "_new)  **(a) The decision**  The Supreme Court of Victoria has found that the specific terms of a scheme of arrangement do not override the general terms of a company's constitution in circumstances where the competing terms are not wholly inconsistent and there is no clear intention that the terms of the scheme should override the company's constitution.  **(b) The facts**  On 10 March 2000, Colonial Limited ("Colonial") and Commonwealth Bank of Australia ("CBA") announced a proposal to merge such that Colonial would become a wholly owned subsidiary of CBA. The merger was subsequently implemented by schemes of arrangement dealing with Colonial's ordinary shares, preference shares and options.  This case arose out of the scheme relating to ordinary shares. The relevant scheme proposed that the ordinary shares in Colonial would be transferred to CBA at the ratio of 7 CBA shares for each 20 Colonial shares. The terms of the scheme provided that:  "If the number of Scheme Shares held by a Scheme Shareholder is such that the aggregate entitlement of that Scheme Shareholder to Commonwealth Bank Shares is less than one whole Commonwealth Bank Share, the entitlement of that Scheme Shareholder will be rounded up to one whole Commonwealth Bank Share."  In May 2000, Justin Sykes, a college lecturer in London, joined forces with Bradley Maguire, a computer programmer in Western Australia, to attempt to profit from the terms of the scheme. Maguire's company, Gothic Software Pty Ltd, purchased 120,000 Colonial shares. Sykes incorporated 91 companies in New Zealand. The shares were transferred by Gothic Software Pty Ltd to the New Zealand companies and to three individuals in 120,000 separate combinations of joint shareholdings so that no two shares were held in the same interest. The transfers were effected by 120 instruments each containing a schedule of 1,000 share transferees. The aim was to exchange each single Colonial share (trading at approximately $8) for one CBA share (trading at approximately $27).  On 1 June 2000, the duly stamped instruments of transfer were lodged at the share registry of Colonial for registration. Notwithstanding that the transfers were otherwise in order and able to be registered, on 6 June 2000 the directors of Colonial refused to register the transfers relying on:           Article 5.6 of Colonial's constitution, which provided that the directors may decline to register any transfer of shares if the Listing Rules permit Colonial to do so; and           ASX Listing Rule 8.10.1(h), which provided that Colonial was entitled to refuse to register a paper based transfer of shares if registration of the transfer would create a new holding which is less than a marketable parcel (a "marketable parcel" being a parcel of shares valued at not less than $500).  The scheme provided that the persons entitled to participate in the scheme (the "scheme shareholders") were those persons who were registered as the holders of Colonial shares as at the "merger record date". The scheme also provided that, for the purposes of establishing who were scheme shareholders, paper based dealings in Colonial shares would only be recognised if transfers in respect of those dealings were received on or before the merger record date. Clause 6.2 of the scheme provided that Colonial "must" register registrable transfers received on or before the merger record date by the merger record date.  **(c) The matter in dispute**  The transferees of the 120,000 Colonial shares ("transferees") brought proceedings in the Supreme Court seeking orders requiring Colonial to register the transfers as at the merger record date and requiring CBA to issue and allot the relevant CBA shares. Essentially the matter turned on whether the obligations imposed on Colonial by clause 6.2 of the scheme would override the rights of Colonial conferred by Article 5.6 of its constitution and Listing Rule 8.10.1(h).  The transferees argued that clause 6.2 of the scheme obliged Colonial to register the transfers and excluded the power of directors to refuse to register a transfer of less than a marketable parcel. They argued that clause 6 of the scheme was an exclusive code of conduct for dealings in Colonial shares in the short period before the merger record date. The transferees further argued that the word "must" in clause 6.2 imposed a mandatory obligation on Colonial to register the transfers. They noted that this obligation was inconsistent with Article 5.6 and Listing Rule 8.10.1(h) but argued that the inconsistency was to be resolved in favour of the terms of the scheme.  **(d) Trial judge's findings**  The trial judge rejected the transferees' contentions. Her Honour held that clause 6.2 of the scheme was not inconsistent with Colonial's constitution and the Listing Rules. The word "must" in clause 6.2 required Colonial to register transfers by a particular date, but otherwise was not intended to override the provisions of the constitution and the Listing Rules governing registration of transfers.  **(e) Court of Appeal's findings**  On appeal, the transferees reiterated their view that clause 6 of the scheme solely determined whether a transfer of shares should be registered in the period between the date of approval of the scheme and the merger record date (in this case a period of 7 days). There is authority for the proposition that the terms of a scheme will override the constitution of a company where there is inconsistency. According to the transferees, Article 5.6 was inconsistent with clause 6.2 of the scheme and therefore was overridden by that clause. The transferees further argued that Listing Rule 8.10 no longer applied once the Colonial shares ceased to be quoted on the stock exchange (they had ceased trading at close of trading on the date of approval of the scheme).  The Court of Appeal found that the purpose of clause 6.2 of the scheme was to create a duty to register transfers by a particular time, not to remove the power of the directors to reject the registration of transfers.  The reasons given for the Court of Appeal's findings were twofold. Firstly, in Colonial's constitution there was no time period specified for registering a transfer of shares following receipt of the transfer. Listing Rule 8.21 addressed this issue by requiring that a transfer be registered within 3 business days after the date on which a transfer is lodged. Clause 6.2 of the scheme altered this position so that transfers lodged in the 3 business days prior to the merger record date had to be registered by the merger record date. The obligation inherent in the word "must" was limited to the time in which transfers were to be registered. Secondly, if clause 6.2 of the scheme was construed in the manner put forward by the transferees, transferees of unmarketable parcels who used the CHESS system would not be entitled to registration whereas transferees of unmarketable parcels using the relatively unusual paper based system would be entitled to registration (clause 6.2 related only to paper based transfers of shares).  The Court of Appeal also stated that that the shares in question comprised a collection of rights and obligations relating to an interest in Colonial. The content of those rights and obligations depended on the provisions of the Corporations Law, including section 180 (now section 140 of the Corporations Act 2001), which made Colonial's constitution a contract between Colonial and its members. The restrictions on transfer contained in the constitution in part defined the property represented by the shares rather than being something external that was imposed on a pre-existing item of property. Clause 6.2 of the scheme was not intended to abrogate the rights and obligations which defined the property constituted by the shares.  The Court of Appeal upheld the findings that clause 6.2 of the scheme did not override Article 5.6 or Listing Rule 8.10.1(h), and accordingly the directors of Colonial were entitled to refuse to register the transfers lodged by the transferees.  **(f) Conclusion**  This case may have limited implications as it can be distinguished on its facts. However, a general principle illustrated by the case is that although the terms of a scheme of arrangement will generally override the constitution of a company where there is inconsistency, this will not be the case unless the competing terms are wholly inconsistent or there is a clear intention that the terms of the scheme should override the company's constitution. |
| **6. Recent Corporate Law Journal Articles** |
| **(a) Company and Securities Law Journal**  Vol 22, No 1, February 2004  **M Broderick and M Lenicka, Uncommercial transactions – corporate governance for insolvent companies**  The uncommercial transaction regime was enacted as part of the [Corporate Law Reform Act 1992 (Cth)](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=12036" \t "default). Despite being introduced as a new concept, the test imposed for characterising a transaction as uncommercial is remarkably similar to tests adopted by Courts of Chancery over a century ago to ascertain if directors upheld the requisite standards of care and diligence in managing the affairs of a company. This article draws comparisons with the Business Judgment Doctrine, the Business Judgment Rule and other standards of corporate governance to better understand the nature of an uncommercial transaction through a comparative analysis. Other topical issues such as the need to prove insolvency to avoid and uncommercial transaction, the reasons for the slow development of the regime, corporate groups, insolvent trading, defences and remedies are also considered in this article.  **T Ciro, Trading in financial derivatives: does it increase market volatility and systemic risk?**  The article examines the legal and non-legal risk factors affecting the markets for financial derivatives. Contrary to popular belief, there appears to be little evidence to suggest that trading in financial derivatives increases the probability of systemic risk or market volatility. The tenuous relationship between financial derivatives and underlying market volatility is further supported by recent empirical studies undertaken by researchers at the Bank for International Settlements. Similarly, other non-legal risk factors appear to have no discernible effect on risk. Instead, it is argued that legal risk and in particular, legal uncertainty creates considerable harm to market participants, and adversely affects market efficiency and market volatility. This is borne out by recent United States legislative initiatives, which are aimed at reducing legal risk through incremental measures designed to improve both legal certainty and systemic instability.  **M Duffy, Procedural dilemmas for contemporary shareholder remedies – derivative action or class action?**  Shareholders seeking relief in relation to corporate misconduct or negligence face the basic dilemma of whether the conduct complained of infringes a personal right of the shareholder or a right of the corporation. An important indicator that a right is corporate in nature will be that the only loss to the shareholder is a diminution in the value of his or her shareholding. Such a loss will generally not be personally actionable by the shareholder though exceptions to this general rule have developed and may develop further. Where there are personal rights of a shareholder, the “class action” procedure in the Federal Court now allows personal rights to be pursued by large numbers of shareholders. It is amenable to a number of types of claim including claims under the Corporations and other Acts and at common law. In the case of infringement of company rights, however, the shareholder will need to seek relief on the corporation’s behalf. This will mean seeking leave to bring a statutory derivative action which since 13 March 2000 has been governed by the statutory provisions in pt 2F.1A of the [Corporations Act](http://research.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "default). In both cases the rules on legal costs are such that there are still significant disincentives to an individual shareholder taking such an action.  **(b) Other Journal Articles**  M Albert, “Because we said so: the SEC’s overreaching efforts to regulate mini-tender offers” (2003) 45 Arizona Law Review 897  M McKee, “The unpredictable future of European securities regulation: a response to four predictions about the future of EU securities regulation by Gerard Hertig and Ruben Lee” (2003) 18 Journal of International Banking Law and Regulation 277  J Abugu, “Technology, Globalisation and Nigerian Securities” (2003) 18 Journal of International Banking Law and Regulation 284  E Neocleous, “Cypriot trusts and international companies” (2003) 18 Journal of International Banking Law and Regulation  S Choi and J Fisch, “How to fix Wall Street” (2003) 113 The Yale Law Journal 269  E Adams, “Corporate governance after Enron and Global Crossing: comparative lessons for cross-national improvement” 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