New South Wales Bar Association Conference 13 March 2021

Update on Corporations Law

Justice Ashley Black

A Judge of the Supreme Court of New South Wales

Introduction

I will review several developments in corporations and insolvency law in the last two years or so. I will first consider several cases concerning directors' and officers' duties. I also review recent cases considering the availability of market-based causation in claims for misleading announcements and breach of continuous disclosure requirements and the proposed amendments to the continuous disclosure provisions under the Treasury Laws Amendment (2021 Measures No 1) Bill 2021.

I then turn to several significant cases and further legislative reform in insolvency. I then address developments in financial services regulation, a recent appellate decision dealing with the scope of "personal advice" and the best interests obligation under s 961B of the Corporations Act 2001 (Cth), the product intervention powers conferred on the Australian Securities and Investments Commission (ASIC) and legislative amendments dealing with increasing criminal and civil penalties under the Corporations Act. I will finally spend some time on the outcomes of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Directors and officers liability

Breach of statutory directors' and officers' duties and general law duties

Dealing first with directors' duties, I should briefly refer to the ultimate outcome in the *Cassimatis* proceedings. At first instance in *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 336 ALR 209; [2016] FCA 1023, Edelman J (then sitting in the Federal Court of Australia) held that the directors of Storm Financial, Mr and Mrs Cassimatis, had contravened s 180 of the Corporations Act in exercising their powers as directors of Storm in a manner that caused or permitted (by omission) Storm to contravene the suitability requirements in former s 945A of the Act by causing inappropriate advice to be given by that entity to the class of investors who were, inter alia, retired or close to retirement and had little or no prospect of rebuilding their financial position if they suffered substantial loss. In the penalty judgment in *Australian Securities and Investments Commission v Cassimatis (No 9)* [2018] FCA 385, Dowsett J noted the continuance of the relevant conduct over a lengthy period, raised the possibility that the financial penalty of $70,000 sought by the Australian Securities and Investments Commission ("ASIC") against each of them was on the "low side", but imposed that penalty, and also ordered that Mr and Mrs Cassimatis be disqualified for seven years from managing a company.

On appeal in *Cassimatis v Australian Securities and Investments Commission* (2020) 376 ALR 261; (2020) 144 ACSR 107; [2020] FCAFC 52, Mr and Mrs Cassimatis challenged Edelman J's finding that Storm had contravened s 945A of the Act and his Honour's finding that they had contravened s 180 of the Act, and contended that Storm's corporate interests were identical to their interests as its only shareholders. The majority (Greenwood and Thawley JJ) upheld both findings and held that the Mr and Mrs Cassimatis had breached their duty by failing to guard against foreseeable harm to Storm Financial arising from the contravention of former s 945A of the Act. The decision provides an important analysis of what has been described as "stepping stone" liability[1], and the majority recognised that liability in that case was established in a different manner.

Greenwood J observed (at [79]) that:

> "… shorthand phrases such as stepping stones to liability on the part of a director or officer are unhelpful and apt to throw sand in the eyes of the analysis. The appellants were not found to have contravened s 180 of the Act because the corporation contravened the Act. The contraventions of the Act by Storm were a necessary element of the harm, but not sufficient by themselves to result in a contravention of s 180 by the appellants as directors. The foundation of the liability of the appellants resides entirely in their own conduct in contravention of the objective degree of care and diligence…"

His Honour then observed (at [178]) that:

> "the contravention of s 180(1), by [Mr and Mrs Cassimatis], did not arise simply because the corporation contravened [former s 945A]. The contraventions by Storm arose out of a primary failure on the part of the appellants, as directors, to act in accordance with the objective standard of care and diligence required of them by s 180(1), and features of that conduct engaged conduct which brought about the contraventions by Storm of the identified sections of the Act."

His Honour also observed (at [196]) that:

> "the shareholders cannot sanction, ratify or approve, qua themselves as directors, their own conduct in contravention of s 180. Nor can they release themselves from such a contravention. That follows because of the normative, objective, irreducible standard of care and diligence directors must

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[1] See A Herzberg and H Anderson, "Stepping Stones — From Corporate Fault to Directors' Personal Civil Liability" (2012) 40 *Federal Law Review* 181; T Bednall and P Hanrahan, "Officers' Liability for Mandatory Corporate Disclosure: Two Paths, Two Destinations?" (2013) 31 *C&SLJ* 474; AJ Black, "Directors' Statutory and General Law Accessory Liability for Corporate Wrongdoing" (2013) 31 *C&SLJ* 511; R Teele Langford, "Corporate Culpability, Stepping Stones and Mariner: Contention Surrounding Directors' Duties Where the Company Breaches the Law" (2016) 34 *C&SLJ* 75; M McGregor, "Stepping-Stone Liability and the Directors' Statutory Duty of Care and Diligence" (2018) 36 *C&SLJ* 245; A Emmett and H Gallagher, '*Cassimatis v ASIC*: Another tear in the Corporate Veil?' (2020) *BCLB* [384]; R Teele Langford, '*Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52 – Dystopian accessorial liability or the end of "stepping stones" as we know it?' (2020) 37 *C&SLJ* 362.

> live up to, as adopted by the Parliament according to the text of the section …".

Thawley J similarly observed (at [464]-[465]) that:

> "ASIC's case was that the conduct of Mr and Mrs Cassimatis as directors of Storm failed to meet the standard of care and diligence required by s 180(1). Their conduct exposed Storm to a foreseeable risk of harm, in circumstances where reasonable directors, with the same responsibilities as Mr and Mrs Cassimatis, in Storm's circumstances, would not have done so or would have taken some preventative action. The material facts which gave rise to the foreseeable harm included that their conduct caused Storm to contravene the Corporations Act. …
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> A breach of s 180(1) lies in the director's conduct in not meeting the relevant standard in light of such matters. A company's contravention might be a material fact relevant to the question whether a director failed to meet the standard mandated by s 180(1) by exposing a company to risk; but it is not an essential ingredient of liability in the way it is in a case of accessorial liability."

His Honour also observed (at [465]) that Edelman J had approached the matter as a question of direct liability of Mr and Mrs Cassimatis for failing to meet the standard of care and diligence set by s 180(1) and not as a "backdoor method" for visiting accessorial liability upon them for a contravention by Storm.

His Honour also held (at [472]) that:

> "It is of course relevant to the degree of care and diligence which s 180(1) requires to have regard to the fact that the corporation's interests include the interests of the shareholders and that acquiescence on the part of the shareholders might affect the practical content of what s 180(1) requires ... But it is step too far to say that 100% shareholders can approve their own contravention of s 180(1) as directors. Shareholders cannot release directors from the statutory duties imposed by ss 180, 181 and 182 … It might also be observed that, in a situation where a company nears insolvency, 100% shareholders could not ratify their decisions as directors where those decisions prejudice the interests of creditors."

Rares J agreed with the majority in upholding the finding at first instance that Storm had contravened former s 945A of the Act but dissented as to the finding of a contravention of s 180 of the Act.

The Full Court's decision seems to me rightly to recognise that "stepping stone" liability generally involves no more than an orthodox finding of breach of directors' duties in a particular case, where an element of the breach is a failure to take steps to bring about compliance with another statutory requirement. A special leave application to the High Court was dismissed with costs in March 2020 ([2020] HCASL 158), where Gageler and Keane JJ succinctly observed that "[t]here is insufficient reason to doubt the correctness of the reasoning of the majority of the Full Court of the Federal Court of Australia to warrant the grant of special leave to appeal.".

In *Australian Securities & Investments Commission v King* (2020) 376 ALR 1; [2020] HCA 4, the High Court considered the scope of the definition of "officer" in s 9 of the Corporations Act. A person falls within that definition if (a) he or she is a director of a corporation, or is (b) a person who (i) "makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation" or (ii) "who has the capacity to affect significantly the corporation's financial standing" or (iii) "in accordance with whose instructions or wishes the directors of the corporation are accustomed to act" (with an exclusion of certain advice). This decision concerned the extension in s 9(b)(ii) to a person "who has the capacity to affect significantly the corporation's financial standing".

The defendant, Mr King, was the former chief executive officer and an executive director of MFS Limited (formerly Octaviar Limited) but was not a director of its subsidiary, MFS Investment Management Ltd ("MFSIM"), which was the responsible entity for a managed investment scheme known as the Premium Income Fund. MFSIM paid a substantial amount, without formal documentation or security, to another entity in the MFS Group and part of that amount was then used to repay a borrowing of the MFS Group. That amount was lost to MFSIM and investors in the Premium Income Fund when the MFS Group subsequently failed.

At first instance, the Supreme Court of Queensland had held that MFSIM had breached its duties as a responsible entity under s 601FC of the Act; that Mr King had been knowingly concerned in MFSIM's breaches of the Act; and that Mr King was also an "officer" of MFSIM within s 9(b)(ii) of the Act although he did not hold a designated office within MFSIM and had contravened the duty to act honestly and for proper purposes under s 601FD of the Act. On appeal, the Court of Appeal of the Supreme Court of Queensland upheld other claims against Mr King, but reversed that finding that he had contravened s 601FD of the Act on the basis, broadly, that he did not hold any recognised position within MFSIM. That finding resulted in a reduction in the monetary amount of the civil penalty ordered against Mr King and a variation of the costs orders in respect of the trial.

The Court of Appeal's decision in that respect was set aside on ASIC's appeal to the High Court. The judgments in the High Court noted the findings at first instance as to Mr King's executive role in MFS Group and his specific involvement with MFSIM, and that his actions or inactions had the capacity to significantly affect its financial standing. The plurality (Kiefel CJ, Gageler and Keane JJ) observed (at [43]) that s 9(b)(i)-(ii) were directed to persons who met the relevant descriptions and did not hold a named office in a corporation. The plurality also recognised (at [46]) the risk to which shareholders and creditors would be exposed if "the CEO of the parent company of a group of companies is allowed to act in relation to the other companies in the group untrammelled by the duties that attach to officers of each of the other companies in the group" and observed that:

> "It would be an extraordinary state of affairs if those who actually determine the course of a company's financial affairs could avoid responsibility for their

> conduct by the simple expedient of deliberately eschewing any formal designation of their responsibilities."

Nettle and Gordon JJ reached the same result and observed (at [88]) that the definition of "officer" in s 9(b) of the Act extended to a person who was involved in the management of a corporation and whose actions or failure to act had the capacity to affect the whole or a substantial part of the corporation's business. I interpolate that that may often be established in respect of a senior executive of a holding company who gives real attention to the affairs of its major subsidiaries. Nettle and Gordon JJ also identified (at [91]) several relevant factors to determining whether a person is an "officer" in this sense, namely the person's role in relation to the corporation, what he or she did or did not do in that role, and the relationship between his or her action or lack of action and the corporation's financial standing. The High Court reinstated the higher pecuniary penalty order made against Mr King at first instance and made orders as to costs against Mr King.

Both the plurality judgment (at [42]) and the judgment of Nettle and Gordon JJ (at 96]) recognised that the definition of "officer" could extend to third parties such as lenders, particularly where a company was in financial difficulty, although this may require that lenders do more than give "advice" to the company. That risk has long been recognised by lenders and their advisers.

This decision confirms the utility to regulators and claimants of the extending provisions in the definition of "officer" and reaches an appropriate policy outcome. It also highlights the possibility that senior executives of a holding company, particularly a chief executive officer or chief financial officer, could be treated as statutory officers of a subsidiary and breach statutory duties of care and diligence, proper purposes or honesty in respect of that subsidiary. That difficulty may be acute if, for example, a holding company is planning to take steps that may be contrary to a subsidiary's interests, including any duty and potentially the interests of the subsidiary's creditors in a situation of near insolvency.

In *Australian Securities and Investments Commission v Mitchell (No 2)* (2020) 382 ALR 425; 146 ACSR 328; [2020] FCA 1098, ASIC brought proceedings against the chair and a non-executive director of Tennis Australia, in respect of Tennis Australia's decision in May 2013 to renew domestic broadcast rights held by a television broadcaster ("Seven") for five years for a substantial payment. ASIC alleged that Mr Healy, the chair of Tennis Australia, had breached s 180 of the Corporations Act, primarily by not including additional documents in board packs for board meetings, and that conduct had deprived Tennis Australia of the opportunity to obtain a higher fee for broadcast rights from a competitive tender. The claim against Mr Healy failed.

Beach J undertook a detailed review of the duties of the chair of a public company board. His Honour observed (at [1397]) that the standard of reasonableness required by s 180 is an objective standard and requires directors to act with the skill and diligence which ordinary prudence would require under similar circumstances, and it is necessary to consider the corporation's circumstances and position and the director's responsibility

within the corporation. His Honour reviewed the case law as to the role of a chair (at [1398]ff) and observed that the chair's responsibilities depended on what he or she has undertaken to do and has represented that he or she would do, and that there are also general expectations of a chair's role, including not only to chair board meetings and shareholders' meetings, but also to set the agenda for board meetings, ensure that the board has sufficient information and sufficient time to consider issues, ensure that board members work effectively together and promote workable and harmonious relationships between directors (in particular non-executive directors) and the chief executive officer and executive management. His Honour also observed (at [1416]) that the chair has particular responsibility for ensuring that the board sets and implements the company's culture and appropriate corporate governance structures. His Honour noted that the chair is also expected to supervise the task of monitoring the performance of each director and the performance of board committees and the board as a whole and matters relating to the appointment of new directors and ensure continuing education and development of directors and to ensure appropriate communication with shareholders and that their interests are properly considered.

His Honour also considered the scope of the duty of care and diligence and the business judgment rule defence. His Honour observed (at [1431]) that, in order for conduct to contravene s 180 of the Act, it must have created at least a foreseeable risk of harm to the company's interests, and that an assessment of such a risk and any potential benefit of the action will take place with reference to the corporation's circumstances and the director's responsibility and office. His Honour observed (at [1433]-[1434]) that a plaintiff had the onus of establishing the elements of a breach of s 180(1) of the Act, although a defendant director may have an evidentiary onus in some respects. His Honour also noted (at [1435]) that a director had the legal and evidentiary onus of establishing each of the elements of the business judgment rule defence and a plaintiff need not disprove that defence, following *ASIC v Rich* (2003) 236 FLR 1 at [7283]ff as to the elements of that defence. His Honour doubted (at [1441]) whether the question of what information was provided to a company's board was a business judgment for the purpose of that defence. In the particular facts, his Honour held (at [1446]) that the chair's duty of reasonable care and diligence did not require that he countermand the chief executive officer's assessment of what information should be put before the board in the relevant circumstances and that ASIC had not shown a foreseeable risk of harm following from the alleged acts and omissions on the part of the chair.

ASIC also alleged that a non-executive director of Tennis Australia, Mr Mitchell, had breached ss 180, 182 and 183 of the Corporations Act. Beach J observed (at [1516]ff) that the test whether conduct is improper for the purposes of ss 182-183 is objective and (at [1517], citing *R v Byrnes* (1995) 183 CLR 501 and *Doyle v ASIC* (2005) 227 CLR 18), that impropriety is established when a director is in "breach of the standard of conduct that would be expected of a person in his position by reasonable persons with knowledge of the duties, powers and authorities of his position as a director" and (at [1518]) whether impropriety is established is to be assessed by reference to

the particular duties and responsibilities of the director. His Honour held (at [1523]) that a director's purpose is an element of the contravention, directed to "the end sought to be achieved". His Honour observed (at [1525]) that a contravention of s 182 is established if a director "made improper use of his position for the purpose of gaining an advantage for himself or for some other person" and that it was not necessary to show that conduct brought about that advantage. His Honour identified (at [1537]) the aspects of ASIC's case against Mr Mitchell as comprising communications with Seven and private discussions with a Seven executive; interference with Tennis Australia's senior management including undermining its chief executive officer's authority; and withholding information from the board of Tennis Australia. His Honour found (at [1725]) that a breach of s 180(1) was established and that no breach of s 183 was established because, even if there was objective impropriety, the purposive element was missing. His Honour foreshadowed that declarations of breach would be made in respect of Mr Mitchell, a moderate pecuniary penalty would be ordered but no disqualification order should be made.

In *Australian Securities and Investments Commission (ASIC) v Mitchell (No 3)* (2020) 148 ACSR 630; [2020] FCA 1604, his Honour then made a declaration as to the contravention and imposed a moderate penalty on Mr Mitchell of $90,000, recognising a need for general deterrence. I have not located any information as to whether a special leave application will be or has been brought from these decisions.

There have also been two significant legislative amendments in this area. Section 184 of the Corporations Act was also amended by the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 (Cth) to delete the reference to "intentionally", and to define the term "dishonest" in that section as "dishonest according to the standards of ordinary people". The penalty for a contravention of that section has also been increased from a maximum of 5 to 15 years. Part 9.1A of the Corporations Act, introduced by the Treasury Laws Amendment (Registries Modernisation and Other Measures) Act 2020, will also require all Australian directors to obtain and hold a director identification number. This requirement is one aspect of the Government's response to "phoenix" activity in respect of insolvent companies, which I address further below.

Continuous disclosure

Misleading announcements, continuous disclosure and market-based causation

Claimants in Australian securities class actions, particularly in respect of allegations of misleading announcements to ASX or breach of the continuous disclosure requirements in Ch 6CA of the Corporations Act typically rely on principles of indirect or "market-based" causation. In *Re HIH Insurance Ltd (in liq)* (2016) 113 ACSR 318; [2016] NSWSC 482 ("*HIH Insurance*"), Brereton J accepted that causation could be established by a form of indirect or market-based causation. That approach has been addressed in somewhat different ways in recent decisions of the Federal Court of Australia.

In *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Ltd* [2019] FCA 1747, it appears that Beach J would have accepted an approach based on market-based causation, but his Honour held that no loss was established where the market had approached profit and earnings guidance given by the relevant company with scepticism and the market price had reflected that scepticism. On the other hand, in *Masters v Lombe (liquidator): In the matter of Babcock & Brown Ltd (in liq)* [2019] FCA 1720, Foster J noted a conflict in the authorities; noted, with reference to *HIH Insurance*, that the question of causation was a factual question to be addressed in conjunction with the quantification of damages and could not be assumed as part of a theory of market-based causation; and identified (at [392]-[393]) difficulties with that approach, including that it would be unsatisfactory to allow recovery of compensation by persons who knew the truth or did not care about it, and with sales subsequently made at prices no less than that paid for the shares. His Honour indicated (at [394]) that he did not need to express a final view as to that theory and it did not assist the plaintiffs in that case.

A class action alleging contravention of the continuous disclosure provisions and misleading or deceptive conduct failed in *Crowley v Worley Limited* [2020] FCA 1522, largely on factual grounds. The plaintiff did not establish its claim for a contravention of s 674 of the Act, which it put on two alternative bases. First, Gleeson J held (at [617]) that the plaintiff had not established that Worley Limited ("Worley") did not have a reasonable basis for an earnings guidance statement in August 2013, so as to give rise to any obligation to disclose the absence of a reasonable basis for that statement to ASX. Her Honour also held (at [618]) that the plaintiff had not established a contravention of s 674 of the Act by a failure to disclose that Worley's FY14 earnings were likely to fall materially short of a consensus expectation of analysts covering its securities, because it did not establish either a consensus expectation of earnings in that range or a likelihood at any relevant time that Worley's earnings would fall materially short of such an expectation.

The plaintiff also did not establish its misleading or deceptive conduct claim, which alleged that Worley had made a misleading or deceptive representation that it expected to achieve NPAT in excess of $322 million in FY14 and had reasonable grounds to expect that it would do so. Gleeson J treated that pleaded representation (at [633]) as relating to a future matter to the extent that it conveyed Worley's expectation as to its earnings for FY14, as distinct from the present fact whether it had reasonable grounds for that representation. On that basis, Worley would be taken, by s 4(2) of the Australian Consumer Law and s 12BB(2) of the ASIC Act, not to have reasonable grounds for making that representation unless it adduced evidence to the contrary. Her Honour found (at [634]ff) that Worley had established that it had reasonable grounds for that earnings expectation, by reason of its FY14 budget process and its board's review of that budget, and displaced a finding of misleading or deceptive conduct. The plaintiffs' several further claims failed by reason of these findings.

In summary, while the bulk of the case law now seems to favour the availability of market-based causation in claims of this nature, as a matter of principle, that issue is perhaps not closed and the effect of that approach in any particular case will depend on the facts.

Recent cases have also involved claims for breach of directors' duties and accessorial liability in respect of continuous disclosure breaches. In *Australian Securities and Investments Commission v Big Star Energy Ltd (No 3)* [2020] FCA 1442, ASIC alleged that Big Star Energy Ltd ("Big Star") had breached its continuous disclosure obligations under s 674 of the Act by announcing that it had entered into two sale agreements in respect of significant assets, without disclosing the identity of the purchaser or the fact that it had not assessed the prospect of the purchaser completing the sale agreement or that the purchaser had advised that it had funding in place in respect of only one of those agreements. ASIC also contended that Mr Cruickshank, who was a director of Big Star, was knowingly involved in that contravention or had alternatively contravened s 180(1) of the Act by failing to exercise due skill and care in causing or permitting the company to contravene s 674 of the Act.

Banks-Smith J found (at [455]) that Big Star had contravened s 674(2) of the Act by failing to notify ASX of three matters, the identity of the purchaser under the relevant agreements, that it had not verified or determined the purchaser's capacity to complete the agreements and that it had been informed by the purchaser that it had not yet received all funding approvals necessary to complete the purchase of the assets. Her Honour followed earlier authorities, including *Australian Securities and Investments Commission v Vocation Ltd (in liq)* [2019] FCA 807, in holding that knowing involvement in that contravention required not only that a director knew the underlying facts, but also that he or she knew that the information was material in the relevance sense. Her Honour found that it was not established that Mr Cruickshank had actual knowledge that the information was of a nature that it had to be disclosed, and his knowing involvement in the company's contravention of the continuing disclosure obligation was therefore not established.

However, her Honour found that Mr Cruickshank had contravened s 180 of the Act by failing to exercise reasonable care and diligence in respect of the disclosure, that failure had caused Big Star to contravene the continuous disclosure requirements under s 674 of the Act and it was foreseeable that that contravention might harm Big Star's interests. This approach is similar to that taken by Nicholas J in *Australian Securities and Investments Commission v Vocation Ltd (in liq)* above. Again, this is an example of the approach sometimes described as "stepping stone" liability, although it again seems to me to be no more than a finding of breach of directors' duties in the particular case, where that breach arises from a failure to take adequate steps to comply with another statutory requirement. Her Honour also found, reaching the same result as *Australian Securities and Investments Commission v Vocation Ltd (in liq)* above, that a director's decision to cause a company not to disclose information was not a business judgment for the purposes of the

business judgment rule in s 180(2) of the Act, and that the factual elements of that rule were not made out in any event.

The statutory continuous disclosure requirements were narrowed by the Corporations (Coronavirus Economic Response) Determination (No 2) 2020, initially for six months from 26 May 2020 and then extended until 23 March 2021, to apply a test whether a disclosing entity knows or is reckless or negligent with respect to whether the information would, if it were generally available, have a material effect on the price or value of ED securities (as defined) of the entity, rather than an objective test. The Government has now announced permanent changes to these provisions and the misleading and deceptive conduct prohibition in this context, to introduce a requirement for intent, recklessness or negligence to establish civil penalty liability for a continuous disclosure breach, under the proposed Treasury Laws Amendment (2021 Measures No 1) Bill 2021. The amendments are complex and will raise difficult questions of interaction with other liability regimes.

Insolvency

Case law

A range of issues in respect of voluntary administrations were considered by decisions in the voluntary administration of the Virgin Group. As is now common practice in large administrations, orders were made modifying the manner in which notice of meetings of creditors in a voluntary administration is given to permit such notice to be made by publication in a newspaper, provision of information on a website maintained by the administrator and email notice to known creditors, and to facilitate electronic delivery of communications with creditors in *Strawbridge, Re Virgin Australia Holdings Ltd (admins apptd)* [2020] FCA 571 at [27]-[29]. The court's power to extend the period for administrators to give notice to lessors of property under s 443B was considered in *Strawbridge, Re Virgin Australia Holdings Ltd (admins apptd)* above at [44]ff. The court's power to extend the convening period for the second meeting of creditors under s 439A was considered in *Strawbridge, Re Virgin Australia Holdings Ltd (admins apptd) (No 2)* [2020] FCA 717 at [64]ff. The court's power to limit the liability of an administrator under s 447A, particularly in a large administration, was also considered in that decision at [87]ff.

Section 561 of the Act provides for priority employee claims to be paid from circulating assets (as defined by s 340 of the Personal Property Securities Act 2009 ("PPSA")) ahead of the claims of secured creditors. The scope of the section was considered in *Re RCR Tomlinson Ltd (admins apptd)* [2020] NSWSC 735, which determined questions of priorities as between the Commonwealth of Australia in respect of payments made under the Fair Entitlements Guarantee Scheme and secured lenders. The Supreme Court of New South Wales held that whether assets were circulating or non-circulating assets, for the purposes of s 561, was to be determined at the "relevant date", being the date on which the winding up was taken to have begun under Part 5.6 (in that case, the date of appointment of administrators to the RCR Tomlinson Group); that approach is consistent with that previously taken in

decisions in respect of a similar issue arising under s 433 of the Act. The Court also considered whether particular assets were circulating or non-circulating assets for the purposes of s 340 of the PPSA and this section. The Court there held that (1) "surplus proceeds", being an amount that would be refunded to the company only if a counterparty called on a performance bond and remitted those proceeds to the company, were too uncertain to be "property" or to fall within the definition of "account" in the PPSA or to be a circulating asset for the purposes of this section, adopting a similar approach to *Strategic Finance Ltd (in liq) v Bridgman* [2013] NZCA 357; (2) "subcontractor proceeds", being an amount received if a company in the RCR Group called on a bond given by a subcontractor after the appointment date, also did not comprise a circulating asset for the purposes of this section, because the obligation to pay could not arise before the relevant bond was called and it was not an existing obligation at the appointment date to pay an identifiable monetary sum to the company; and (3) work in progress ("WIP") was a circulating asset where the provision of goods or services under a contract was completed prior to the relevant date, although not yet invoiced; WIP was also a circulating asset where payment was subject to certification and issue of an invoice, which would occur after the appointment; and several other categories of WIP were not circulating assets or did not need to be decided.

A transaction which is an unfair preference within the scope of s 588FA of the Act may be recoverable by a liquidator under Pt 5.7B Div 2 of the Act. A transaction is an unfair preference for the purposes of that section if a creditor of the company, at the time of the transaction, is party to that transaction; and the transaction allows the creditor to receive more from the company in respect of an unsecured debt than it would have received from the company in respect of that debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company: s 588FA(1)(b). Differing views have been expressed in the case law as to whether a payment by a head contractor of debts owed by a subcontractor to secondary subcontractors is "received from the company" for the purposes of this section.[2] In *Cant (as liquidator of Eliana Construction and Developing Group Pty Ltd (in liq) v Mad Brothers Earthmoving Pty Ltd* [2020] VSCA 198, the Court of Appeal of the Supreme Court of Victoria held that whether a company's assets were reduced by a payment is relevant to whether the payment was made or received from the company for the purposes of s 588FA(1)(b), and a payment made by a third party, although authorised by the company, did not satisfy that criterion. The Court of Appeal there approved the view taken by Brereton J in *Re Evolvebuilt Pty Ltd* [2017] NSWSC 901 that whether a payment was directed or authorised by a company bears only on the question whether it is party to the transaction, and not on whether the

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[2] *Re Emanuel (No 14) Pty Ltd (in liq): Macks v Blacklaw & Shadforth Pty Ltd* (1997) 147 ALR 281; 24 ACSR 292; 15 ACLC 1099; *Re Imobridge Pty Ltd (in liq) (No 2)* [2000] 2 Qd R 280; (2000) 18 ACLC 29; *Woodgate as liquidator of Marketing Results Pty Ltd v Network Associates International BV* [2007] NSWSC 1260; *Re Burness, Denward Lane Pty Ltd (in liq)* (2009) 259 ALR 339; 74 ACSR 1; [2009] FCA 893; contrast *Re Evolvebuilt Pty Ltd* [2017] NSWSC 901, largely affirmed on appeal in *Hosking v Extend N Build Pty Ltd* (2018) 128 ACSR 555; [2018] NSWCA 149.

payment was made "from the company"[3], and held (at [120]) that the words "from the company" in s 588FA(1)(b) retained the requirement under the previous law that a preference be received from the company's own money, being money or assets to which it is entitled, and that requirement will only be satisfied if the receipt of the payment by the creditor diminishes assets of the company available to creditors, and not where a payment is made by a third party which does not have that effect.

This line of authority was reviewed by Rees J in *Re Western Port Holdings Pty Ltd (recs & mgrs apptd)*[2021] NSWSC 232, where her Honour observed (at [38]-[39]) that:

> "I am left with some disquiet by the reasoning in *Cant v Mad Brothers*. The language of section 588FA(1)(b) does not readily permit a construction that it is necessary to demonstrate a diminution in the assets of a company for there to be an unfair preference. As the High Court observed in *International Air Transport Association v Ansett Australian Holdings Ltd* (2008) 234 CLR 151; [2008] HCA 3, "Insolvency law is statutory and primacy must be given to the relevant statutory text" as opposed to general principles developed from earlier case law or statutes: at [78] per Gummow, Hayne, Heydon, Crennan and Kiefel JJ. Statutes are to be construed and applied according to their terms, not under the influence of "muffled echoes of old arguments" concerning other legislation: *R v Commonwealth Conciliation and Arbitration Commission; Ex parte Association of Professional Engineers of Australia* (1959) 107 CLR 208 at 276 per Windeyer J. Further, the Court in *Cant v Mad Brothers*, in following *VR Dye [& Co v Peninsula Hotels Pty Ltd (in liq)* [1999] 3 VR 201; [1999] VSCA 60] and *McKern* [*v Minister Administering the Mining Act 1978 (WA)* (2010) 28 VR 1; [2010] VSCA 140], has applied reasoning developed in cases which did not concern third party payments to a case which did.
>
> Nonetheless, the Court's conclusion in *Cant v Mad Brothers* was open in circumstances where the question had been left open in *Kassem* [*Commissioner of Taxation v Kassem* (2012) 205 FCR 156; [2012] FCAFC 124] and *Hosking* [*v Extend N Build Pty Ltd* (2018) 128 ACSR 555; [2018] NSWCA 149], there is no contrary binding appellate authority and three appellate courts have considered that *VR Dye* is not plainly wrong: *Beveridge v Whitton* [[2001] NSWCA 6]; *McKern* and *Kassem*. I am not entitled to depart from a considered judgment of an intermediate appellate court simply because I might prefer a different view: *N & M Martin Holdings Pty Ltd v Commissioner of Taxation* [2020] FCA 1186 at [43]-[45] per Steward J. Ultimately, as Nettle JA observed in McKern, "If the reasoning in *VR Dye* is to be overturned, it is for the High Court to say so": at [27]."

Turning now to running accounts, a single transaction is not a preference at general law if it forms part of a larger series of transactions, or running account, which do not confer a preference on a creditor, and the "ultimate effect" principle requires whether payment to a creditor to secure ongoing services from it is a preference to be determined by whether it results in a

[3] The Court of Appeal also noted that, when the issue was addressed on appeal in *Hosking v Extend N Build Pty Ltd* (2018) 357 ALR 795; [2018] NSWCA 149, the Court of Appeal found that the Company was not party to the transaction by which the head contractor made the payments, and whether they were made "from the company" did not arise.

decrease of net value of the other assets available for creditors.[4] Under s 588FA(3), transactions which are an integral part of a continuing business relationship between the company and a creditor, such as a running account, are treated as a single transaction; whether an unfair preference is being given is determined by reference to that single transaction; and the amount of any unfair preference is limited to the difference between the highest amount owing during the relevant period and the amount owing on the last day of the period.

Several decisions of the Federal Court of Australia have considered unfair preference claims arising out of the liquidation of Gunns Ltd.[5] These cases held that payments made to timber-harvesting and haulage contractors were recoverable as unfair preferences and considered the application of the "running account" defence under s 588FA(3) of the Corporations Act. The liquidator sought to quantify the preference claimed in reliance on the "peak indebtedness" rule, which allows a liquidator to quantify the amount of a preference from the point of "peak indebtedness" during a continuing business relationship within the relation-back period. The defendants relied on the approach taken by the New Zealand Court of Appeal in *Timberworld v Levin* [2015] 3 NZLR 365, which rejected that approach and held that a corresponding section required all payments and transactions within a continuing business relationship to be netted off, rather than allowing a liquidator to exclude transactions prior to the point of peak indebtedness. Davies J held that the peak indebtedness rule continued to apply in Australia, because the introduction of s 588FA(3) gave statutory effect to, but did not alter, existing common law principles relating to preferences, including that rule. Any further attack on that rule would therefore likely need to be made at appellate level.

Section 588FE(2) provides that an unfair preference which is an insolvent transaction is voidable if entered into during the 6 months ending on the relation-back day or after that day but on or before the winding up began. Subsections 588FE(2A)-(2B) deal with the position where a company was under administration or subject to a deed of company arrangement immediately before the company resolved that it be wound up, or the court ordered that it be wound up, and a transaction is not voidable under those sections where it is respectively entered into, or done, on behalf of the company by, or under the authority of, a voluntary administrator or deed administrator. In *Yeo, Re Ready Kit Cabinets Pty Ltd (in liq) v Deputy Commissioner of Taxation* [2020] FCA 632, Middleton J held that tax payments made by a company while it was subject to a deed of company arrangement, but after it had been returned to a director's control under that deed, were not made by or under the authority of the deed administrator for the purposes of s 588FE(2B), and that decision was affirmed on appeal in

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[4] *Richardson v The Commonwealth Banking Co of Sydney Ltd* (1952) 85 CLR 110 at 132; [1952] ALR 315; (1952) 25 ALJ 734; *Air Services Australia v Ferrier* (1996) 185 CLR 483; 137 ALR 609; *Kassem & Secatore v Commissioner of Taxation* [2012] FCA 152 at [32].

[5] *Bryant, Re Gunns Ltd (in liq) (recs and mgrs apptd) v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423; [2020] FCA 713; *Bryant, Re Gunns Ltd (in liq) (recs and mgrs apptd) v Bluewood Industries Pty Ltd* [2020] FCA 714; *Bryant, Re Gunns Ltd (in liq) (recs and mgrs apptd) v Edenborn Pty Ltd* (2020) 381 ALR 190; 145 ACSR 20; [2020] FCA 715.

Commissioner of Taxation v Yeo as Liquidator of Ready Kit Cabinets Pty Ltd (in liq) [2020] FCAFC 199.

Section 596A of the Act deals with examination of company officers and the court is required to summon a person falling within the specified categories for examination about a corporation's "examinable affairs" (as defined in s 9) if the application for the summons is made by an eligible applicant. In *ACN 004 410 833 Ltd (formerly Arrium Ltd) (in liq) v Walton* [2020] NSWCA 157, the Court of Appeal of the Supreme Court of New South Wales held that an examination order that was sought by a person authorised by ASIC could nonetheless be set aside if the predominant purpose of the examination was a private purpose, rather than the purpose of benefiting the company, its contributors and creditors, including where that purpose was to seek to investigate potential claims by shareholders in a class action. The High Court has granted special leave to appeal from that decision.

"Phoenix" transactions

The Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2019 (Cth) ("Amending Act") commenced on 18 February 2020, subject to transitional provisions.[6] As its name implies, the Act targets "phoenix" activity, generally understood as transferring of assets to a successor company prior to liquidation, to avoid any liabilities owed by the former company to creditors, often on a repeated basis.

The Amending Act introduces a further voidable transaction provision directed to a "creditor-defeating disposition." That term is defined in s 588FDB(1) as a disposition of company property that has certain characteristics and has the effect of preventing, hindering or significantly delaying a company's property becoming available to meet the demands of the company's creditors in a winding up, and s 588FDB(2)-(3) extends that provision to specified dealings with a company's property. Broadly, a transaction is voidable under s 588FE(6B) if it is a creditor-defeating disposition made by a company at the time when it is insolvent or, because of the disposition, the company immediately becomes insolvent or (in certain circumstances) enters external administration within the 12 months after the transaction. The defences under s 588FG(1)–(2) (in respect of good faith) do not apply in relation to an order based solely on a transaction being a creditor-defeating disposition, and a defence as to market value consideration applies: s 588FG(7). The Court cannot make an order under s 588FF in relation to a creditor-defeating disposition if the safe harbour under s 588GA applies to an officer of the company in relation to the disposition: s 588FG(8). It is also a defence to a claim in respect of a creditor-defeating disposition that the relevant property was disposed of for market value consideration (as defined), as determined

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[6] For commentary, see Corrs Chambers Westgarth, "The fall of the phoenix? Parliament passes new laws aimed at combating illegal phoenix activities", 28 February 2020, McCullough Robertson, "New laws come into effect to address illegal phoenixing", 21 February 2020..

either when the relevant agreement for the disposition was entered into or when the property was transferred: s 588FG(9).

The Amending Act allows ASIC, at a liquidator's request or on its own initiative, to make specified orders under s 588FGAA in relation to property received by a voidable creditor-defeating disposition, including ordering the recipient of that property to return the property; pay to the company an amount representing the benefit the recipient has received; or transfer to the company property purchased with the proceeds of the creditor-defeating disposition. These represent a significant, and possibly controversial, expansion of the nature of powers that may be conferred on a regulator. A criminal penalty also applies under s 588FGAC where a person fails to comply with an administrative order made by ASIC under its new powers introduced by the Amending Act. The Court has a somewhat limited power to set aside such an order made by ASIC under 588FGAE, which is subject to a 60 day period to bring the application and, it appears, is to be exercised by reference to the written reasons given by ASIC for making the orders, leaving open the question of the extent to which the Court can examine the underlying facts of the transaction.

The Amending Act also introduces new criminal and civil penalties in respect of creditor-defeating dispositions. A creditor-defeating disposition is prohibited if it is made when the company is insolvent, or becomes insolvent because of the disposition, or within the 12 months prior to the company entering external administration, if that disposition contributed to it entering external administration: s 588GAA. Contravention of the prohibition is a criminal offence and is also subject to civil penalty liability. Section 588GAB extends the offence and civil penalty provisions to procuring a company to make a creditor-defeating disposition, and that prohibition potentially extends to persons involved in a contravention. A safe harbour defence is available if a disposition is made in connection with a course of action that is reasonably likely to lead to a better outcome for the company than proceeding immediately to voluntary administration or winding up: s 588GA(1). Other defences to a criminal offence and civil penalty provision arising from these matters are set out in s 588GA(3). Compensation may be ordered against a person who contravened a civil penalty provision or an offence in relation to a creditor-defeating disposition, including if that person has not been convicted or made subject to a civil penalty order: ss 588J–588K, 588M.

For completeness, the Amending Act also confers new powers on the Australian Taxation Office, extending the director penalty regime to unpaid PAYG withholding amounts; authorising the ATO to retain tax refunds while a the taxpayer has outstanding lodgements and/or disclosures; and allowing the Commissioner to collect estimates of anticipated GST and, in specified circumstances, to recover unpaid GST liabilities against a company's directors. The Amending Act also includes provisions that seek to prevent a director backdating his or her resignation and also prevent a director of a company resigning where it will leave the company without directors. Broadly, if a resignation of a director is reported to ASIC more than 28 days after the purported resignation, it takes effect from the day it is reported to ASIC: s

203AA(1). ASIC or the Court may allow a resignation that is lodged after the 28 day period to take effect from an earlier date, if it is satisfied that the director in fact resigned on that earlier date and, in the case of an application to the Court, if the applicant satisfies the Court that it is just and equitable to make the order: s 203AA(2)–(3). There are time limits on such an application to ASIC and the Court: s 203AA(5). A director may also not resign if a resignation would leave a company without a director: s 203AA(8), s 203AB(1). This provision will significantly restrict the circumstances in which the director of a one-director company may resign, where that company is in financial difficulty, and may encourage early resignation where a company in financial difficulty has several directors.

Debt restructuring and liquidation reforms

On 24 September 2020, the Commonwealth Government announced that it would introduce a new debt restructuring process and a new form of liquidation for businesses with liabilities of less than $1 million, to commence from 1 January 2021, and these amendments have now taken effect under the Corporations Amendment (Corporate Insolvency Reforms) Act 2020. The new regime partly draws on aspects of the restructuring process based on the "debtor-in-possession" model adopted in Chapter 11 of the US Bankruptcy Code , but also has similarities to the moratorium regime introduced in the United Kingdom by the Corporate Insolvency and Governance Act 2020 (UK) and to the company voluntary arrangement procedure in the United Kingdom.

The debt restructuring regime allows directors to continue to exercise control of a company, subject to a moratorium on creditor enforcement, so as to put a debt restructuring proposal to creditors, with the involvement of a small business restructuring practitioner. The object of Pt 5.3B is in turn specified in s 452A as to:

> "provide for a restructuring process for eligible companies that allows the companies:
>
> (a) to retain control of the business, property and affairs while developing a plan to restructure with the assistance of a small business restructuring practitioner; and
>
> (b) to enter into a restructuring plan with creditors."

A company may appoint a small business restructuring practitioner and enter this regime if the eligibility criteria for the restructuring based on the liabilities of the companies, specified as $1 million, are satisfied and the company's board resolves that it has reasonable grounds for suspecting that it is or is likely to become insolvent at a future time and that a small business restructuring practitioner should be appointed. The eligibility criteria include a limitation on the same directors capacity to use the restructuring plan process more than once every seven years .

The small business restructuring practitioner appointed to a company is required to make a declaration of relevant relationships and has a role in

determining if a company is eligible for debt restructuring under this regime; assisting the company's directors to develop and implement a debt restructuring plan; reviewing the company's financial plan; indicating whether he or she considers the company can meet repayments contemplated by the plan and has provided proper disclosure of its affairs; and managing repayments once a plan is in place. The restructuring practitioner has power to terminate the restructuring in specified circumstances. The company has control of its business, property and affairs during the restructure but its management may only enter transactions in the ordinary course of the company's business or with consent of the restructuring practitioner or by an order of the court.

The court has power to adjourn the hearing of an application for a winding up order and not to appoint a provisional liquidator if the company is under restructuring and the court is satisfied that it is in the interests of the company's creditors for the company to continue under restructuring. There are restrictions on enforcement action by creditors during a restructuring and on unsecured creditors and some secured creditors taking action against the company, subject to leave of the Court. Personal guarantees cannot be enforced against directors or associated persons in respect of company debts during a restructuring, except with the Court's leave. The moratorium does not extend to a secured creditor who enforces its security over all or substantially all of the company's assets during the decision period. Ipso facto clauses are subject to a similar restriction to that which applies in voluntary administration.

Pt 5.3B Div 3 deals with restructuring plans. Directors and the restructuring practitioner will have a 20 business day period to develop a debt restructuring plan. Creditors will vote on the proposed restructuring plan as a single class, within 15 business days, but related party creditors are excluded from voting and a plan approved by a 50% majority of creditors by value would bind all unsecured creditors and, in the case of secured creditors, binds them to the extent their debt exceeds the realisable value of the security interests. The focus on majority of creditors by value will potentially lead to a different result than the voluntary administration process, if a single creditor holds (or, depending upon process adopted for assessing creditor claims, claims to hold) the majority of the debt by value. A safe harbour for directors for transactions entered during a restructuring process and in the ordinary course of the company's business is introduced in s 588GAAB. A company can also declare its intention to access the debt restructuring regime, in the period from 1 January 2021 to 31 March 2021, and obtain a further 3 month period of protection in respect of insolvent trading liability and creditor's statutory demands.

The amendments also introduce a simplified liquidation regime for a "small business" in Pt 5.5 Div 3 of the Act, which limits the circumstances in which unfair preferences can be recovered from creditors not related to the company; narrows the requirement for a liquidator to report potential misconduct to ASIC; removes requirements to call creditors' meetings and establish a committee of inspection; simplifies dividend and proof of debt

processes; and increases use of electronic voting and communications. The limitation on recovery of preference payments may reduce a disincentive to suppliers continuing to supply an insolvent or near insolvent company, but operates at the cost of other creditors who will potentially receive lower recoveries in the liquidation and may be disadvantageous to liquidators who may rely on such recoveries to fund their remuneration.

Financial services regulation

Personal and general advice

In *Australian Securities and Investments Commission v Westpac Securities Administration Ltd* [2019] FCAFC 187, the Full Court of the Federal Court considered the scope of the term "personal advice" as defined in s 766B(3) of the Act, which is relevant to the best interests obligations imposed by Pt 7.7A Div 2 of the Act. The Full Court there held that a marketing campaign in respect of the consolidation of superannuation accounts had involved giving "personal advice" and had failed to comply with the provider's "best interests" duty under s 961B of the Act, and also upheld the finding at first instance that that marketing campaign had contravened the "efficiently, honestly and fairly" requirement in s 912A of the Act.

The High Court dismissed an appeal from that decision in *Westpac Securities Administration Ltd v Australian Securities and Investments Commission* [2021] HCA 3. That appeal was directed to whether Westpac had given "personal advice" for the purposes of s 766B(3)(b) of the Act, and it was common ground that, if it had done so, it had breached, inter alia, the best interests duty in s 961B(1) of the Act, which applies to an adviser who gives personal advice to a retail client. The plurality (Kiefel CJ, Bell, Gageler and Keane JJ) held that the advice given by Westpac in that case was personal advice, because a reasonable person in the position of each of the superannuation account holders who received that advice might expect it to have considered one or more of their objectives, financial situations and needs. The plurality observed (at [20]) that s 766B(3)(b) contemplated a consideration of at least one aspect of a client's objectives, financial situations or needs and could apply where the relevant decision was focused on one aspect of the client's financial affairs.

Gordon J observed (at [57]) that s 766B(3)(b) establishes an objective test to determine whether advice is "personal advice", to be applied at the time that financial product advice is given and having regard to the circumstances in which that advice is given, and (at [58]-[59]) that the paragraph "captures circumstances where a reasonable person might expect the provider to have taken into account, had regard to, or given attention to, one or more of the person's objectives, financial situation and needs." Her Honour also observed (at [65]) that s 766B(3)(b):

> "… focuses on what a reasonable person would expect "the provider" – not the retail client – to have done. It is a consumer protection provision in which the notion of "considered" includes not only circumstances involving a certain type, level or duration of consideration (as where there is an opportunity for active, mature, intellectual reflection over time) but also where an adviser provides a prompt or immediate response. It thus ensures that advisers

> cannot avoid the disclosure and conduct obligations which attach to the provision of personal advice simply by failing to consider one or more of the person's objectives, financial situation and needs."

Her Honour observed (at [67]) that s 766B(3) is engaged if an adviser (in fact or by reasonable apprehension) considers at least an aspect of one of the three categories – namely, a person's objectives, financial situation or needs – and whether that has occurred will be a fact specific inquiry" and held that Westpac gave personal advice within the meaning of s 766B(3)(b) of the Act on the relevant facts. This decision will preserve a reasonably wide operation for the concept of "personal advice" and associated obligations, including the statutory best interests duty in s 961B of the Act.

Product intervention power and design and distribution obligations

Part 7.9A of the Corporations Act, introduced by the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019 (Cth), confers a product intervention power on ASIC. That power applies to financial products regulated by the Corporations Act that are, or are likely to be, available for acquisition by retail clients by way of issue and also extends to products that may be provided by a person in the course of engaging in a credit activity or proposed credit activity for the purposes of the National Consumer Credit Protection Act 2009 (Cth), including credit contracts, mortgages and guarantees, and consumer leases. Broadly, the product intervention power allows ASIC to intervene in relation to a product (or class of products), where ASIC is satisfied that the product (or class of products) has resulted in, or is likely to result in, significant detriment to retail clients.[7] ASIC may then order that a specified person must not engage in specified conduct in relation to the product or class of products, either entirely or except in accordance with conditions specified in the order. ASIC must take specified matters into account in considering whether a financial product has resulted in, or will or is likely to result in, significant detriment to retail clients.[8] ASIC has now exercised its product intervention power in respect of a form of short-term credit[9]; an affected party has brought proceedings challenging the exercise of that power and, in *Cigno Pty Ltd v Australian Securities and Investments Commission* [2020] FCA 479, the Federal Court of Australia upheld that product intervention order. Stewart J there considered the scope of the power to make such an order and observed (at [42]) that the exercise of that power does not require that a financial product or a class of financial products directly causes a detriment, and that power extends to:

> "detriment caused indirectly by the financial product or a class of financial products in the sense of there being something in the circumstances of the availability of the product or the class of products to retail clients that causes the detriment. The causal requirement is satisfied if the detriment would not

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[7] Corporations Act s 1023D.

[8] Corporations Act s 1023E; see also ASIC CP 313, *Product Intervention Power* June 2019; ASIC CP 316, *Using the Product Intervention Power: Short Term Credit*, July 2019; S Morris, 'Product Design and Distribution Obligations and ASIC's Intervention Powers' (2017) 29(5) *Australian Superannuation Law Bulletin* 83.

[9] ASIC Corporations (Product Intervention Order — Short Term Credit) Instrument 2019/917.

have occurred but for the financial product or the class of financial products being made available in those circumstances."

ASIC also considered use of its product intervention power in respect of over-the-counter binary options and contracts for difference offered to retail clients.[10]

Design and distribution obligations in respect of financial products were also originally set to commence on 5 April 2021, following a two year transition period. The commencement date for the design and distribution obligations in respect of financial products has now been deferred until 5 October 2021 as a result of the COVID-19 pandemic.

Penalties

The Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 extends the range of provisions under the Corporations Act to which the civil penalty regime applies, and introduces civil penalties for, among other things, the obligations of an Australian financial services licensee not being carried out "efficiently, honestly and fairly" under s 912A of the Act; the breach reporting obligations under s 912D of the Act; and provisions relating to the handling of client monies. The maximum pecuniary penalty applicable to a breach of a civil penalty provision has also been increased in respect of contraventions by both individuals and companies. The maximum civil penalty applicable to an individual will be the greater of 5,000 penalty units ($1.05 million) or three times the benefit derived or detriment avoided by a contravention; and the maximum civil penalty for a body corporate will be the greater of 50,000 penalty units ($10.5 million), three times the value of the benefit obtained or detriment avoided by the contravention or 10% of the company's annual turnover, subject to a cap of 2.5 million penalty units or $525 million. The amendments also introduce provision for "relinquishment orders", which are in the nature of a disgorgement remedy, directed to the benefit derived or detriment avoided because of a contravention. The maximum term of imprisonment that applies to the prohibition of market manipulation and making false and misleading statements under ss 1041B and 1041E of the Corporations Act has also been significantly increased, from 5 to 15 years, and potential fines applicable to offences have also been increased.

Developments following the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry[11]

The broad history of the Royal Commission will be well known to this audience, although it is important to recognise that the matters identified by the Royal Commission are a continuation of earlier issues in Australian

[10] ASIC CP 322, *Product Intervention: OTC Binary Options and CFDs*, 22 August 2019.
[11] This part of this paper draws on two earlier presentations, "Conflict of interest regulation after the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry", 29 March 2019 and "Misconduct in Banking and Financial Services: Implications of Australia's recent Royal Commission", paper presented at the University of Oxford, 26 February 2020.

financial services regulation and matters that had been identified by ASIC and in several earlier inquiries.[12] The Royal Commission was tasked to:

> "inquire into, and report on, whether any conduct of financial services entities might have amounted to misconduct and whether any conduct, practices, behaviour or business activities by those entities fell below community standards and specifications."[13]

The Royal Commission was therefore not limited to determining whether conduct was unlawful, although it ultimately concluded that a range of conduct had in fact been unlawful. It focused on conduct in the retail sector, directed to consumers and small and medium enterprises, rather than in the wholesale market.

The Royal Commission was established in late 2017, its Interim Report was published on 28 September 2018 and its Final Report was published on 4 February 2019. The Royal Commission summarised its conclusions in strong terms, observing that conduct of financial services firms over "many years", had caused substantial loss to consumers and yielded substantial profit to those firms, had often broken the law and, where it had not been unlawful, had "fallen short of the kind of behaviour the community not only expects of financial services entities but is also entitled to expect of them."[14] Both the Interim and Final Reports of the Royal Commission emphasised, and identified significant non-compliance with, several norms of conduct, expressed in general terms, requiring participants in the financial services industry (1) to obey the law; (2) not to mislead or deceive; (3) to act fairly; (4) to provide services that are fit for purpose; (5) to deliver services with reasonable care and skill; and (6) when acting for another, to act in the best interests of that other. These norms of conduct are not novel, although they are framed as general standards, by comparison with several wider standards and many specific obligations already contained in the existing Australian regulatory regime directed to fairness, conflicts of interest and acting in a client's "best interests" which were then overlaid in some cases by fiduciary

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[12] These include issues identified in the report of the Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia* (November 2009) (identifying matters that contributed to losses suffered by investors during the global financial crisis, including a lack of independence of advisers, where advice was funded by product issuers, the perverse incentives created by commission payment arrangements and the inadequacy of disclosure to address those issues, and recommending implementation of a "quasi–fiduciary" duty on financial advisers, later partly implemented by the Future of Financial Advice ("FOFA") reforms); reviews undertaken by ASIC in 2011 and 2012, and again in 2013 (indicating issues as to the quality of advice to retail investors; a Senate Economics Committee in 2014 (highlighting perceived weaknesses in enforcement in several high profile matters and issues with the performance of financial advisers); the Financial Services Inquiry Final Report, December 2014 (again recognising difficulties with advice provided to financial consumers and pointing to the need to address educational standards and recommending the introduction of product design and distribution obligations); and a review undertaken by ASIC (January 2018) of advice provided by integrated financial intermediaries (ASIC Report 562, *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018).

[13] Royal Commission, Final Report, p 1.

[14] Royal Commission, Final Report, p 1.

obligations under the general law.

The Royal Commission made some 76 recommendations, many of which require legislative reform or government action. The Commonwealth Government largely accepted those recommendations and foreshadowed implementing most of the changes by mid-2020 and completing implementation by the end of 2020, although aspects of this have been delayed. The Government also identified several additional steps that it proposed to address the issues raised by the Royal Commission.[15]

The Financial Sector Reform (Hayne Royal Commission Response - Protecting Consumers (2019 Measures) Act 2019, which deals with unfair contract terms in insurance contracts, funeral expenses facilities, funeral benefits, mortgage brokers and mortgage intermediaries, received Royal Assent on 17 February 2020. Schedule 1 of the Act (unfair contract terms in insurance contracts) will commence on 5 April 2021 and Schedules 2 and 3 (funeral expense facilities and mortgage brokers) commenced on 18 February 2020. The Financial Sector Reform (Hayne Royal Commission Response – Stronger Regulators (2019 Measures)) Bill 2019, dealing with regulatory issues, also received Royal Assent on 17 February 2020 and the whole of this Act commenced on 18 February 2020. Further amendments have been made by the Financial Sector Reform (Hayne Royal Commission Response) Act 2020 and are proposed under the Financial Sector Reform (Hayne Royal Commission Response No 2) Bill 2020.

To take some examples of specific reforms in respect of financial services:

- The Royal Commission highlighted issues as to the effectiveness of Pt 7.7A Divs 3 and 4 of the Corporations Act, which regulate ongoing fees to clients and conflicted remuneration, and particularly focused on fees charged by product manufacturers and advisers who did not provide corresponding services. The Royal Commission recommended amendment of the provisions relating to ongoing fees[16] and the Government accepted this recommendation. The proposed Financial Sector Reform (Hayne Royal Commission Response No 2) Bill 2020, which has not yet been passed by Parliament, would broadly amend Pt 7.7A Div 3 of the Act to require a financial services provider which

[15] For commentary on the Royal Commission's findings and recommendations, see G Gilligan, "The Hayne Royal Commission and trust issues in the regulation of the Australian financial sector" (2018) 12 *Law & Fin Mkt Rev* 175; D Millhouse, "From Campbell to Hayne: W[h]ither Australia: Australian Financial Regulation and Supervision at a Cross-Roads" (2019) 13 *Law & Fin Mkt Rev* 81; G Gilligan, The Hayne Royal Commission – Just Another Piece of Official Discourse" (2019) 13 *Law & Fin Mkt Rev* 114 (which is not as critical of the Commission as its title suggests); J O'Brien, "Because They Could: Trust, Integrity and Purpose in the Regulation of Corporate Governance in the Aftermath of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry" (2019) 13 *Law & Fin Mkt Rev* 141; T Marsh, "The Hayne Report – One Giant Leap Forward for Australia" (2019) 13 *Law & Fin Mkt Rev* 157; D Millhouse, "Empirical Analysis Supports the Hayne Long Run Reform Thesis" (2019) 13 *Law & Fin Mkt Rev* 162; S Humphrey, *Post-Hayne to the Wallis 2.0 Era Fairness Unfettered*, Andromeda Partners, 2019, which focusses on the emphasis on fairness in the Commission's Report,

[16] Royal Commission, Final Report, Recommendation 2.1.

receives fees under an ongoing fee arrangement to provide its clients with a single document each year which outlines the fees to be charged and the services to be provided in the next 12 months and seeks the client's written consent to the annual renewal of the ongoing fee arrangement; and would require that provider to obtain that written consent before deducting fees under an ongoing fee arrangement from the client's account.

- The Royal Commission also recommended that the grandfathering provisions for conflicted remuneration be repealed as soon as practicable.[17] That recommendation is implemented by the Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019. Sections 963M-963P, also introduced by those amendments, deal with rebating conflicted remuneration. The Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations 2019 also requires Australian financial services licensees that receive conflicted remuneration in relation to financial product advice that remains payable on or after 1 January 2021 to rebate that commission to affected retail customers by means of payments or other monetary benefits, and impose associated record-keeping requirements.

- The Royal Commission made several recommendations as to superannuation and insurance, including recommending the extension of unfair contracts legislation to insurance contracts.[18] The Royal Commission also recommended the removal of the exemption for insurance claims handling from the definition of "financial service" under the Corporations Act[19] and a new Part 7.7 Div 3A, introduced by the Financial Sector Reform (Hayne Royal Commission Response) Act 2020. The Royal Commission also recommended a prohibition on the "hawking" of superannuation and insurance products and a new prohibition, introduced by the Financial Sector Reform (Hayne Royal Commission Response) Act 2020, commencing on the later of 5 October 2021 or the day after royal asset, will address that recommendation.

- The Royal Commission also considered the larger issue of vertical integration of product manufacturers and advisory firms, where, for example, product manufacturers both provide advisory services and own advisory firms that provide such services.[20] The Royal Commission did not recommend a statutory prohibition on vertical integration of financial services businesses, but noted that more effective regulation of conflicts of interest would place pressure on those structures.

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[17] Royal Commission, Final Report, Recommendation 2.4.
[18] Royal Commission, Final Report, Recommendation 4.7.
[19] Royal Commission, Final Report, Recommendation 4.8.
[20] See also ASIC Report 562, *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018.

The Royal Commission also observed that the fact that the Australian regulatory regime for financial services "is now spread over so many different levels and is as complex as it is" indicated the need for simplification; noted that lobbying by the financial services industry was a significant contributor to the present position; and also observed that law reform would:

> "require examination of how the existing laws fit together and identification of the various policies given effect by the law's various provisions. Only once this detailed work is done can decisions be made about how these policies can be given better and simpler legislative effect".

The Royal Commission also recognised the undesirability of adding further regulation to an already complex regime and suggested that simplification would avoid "distract[ing] attention from the very simple ideas that must inform the conduct of financial service entities." The legislative amendments that have now been made and are proposed may not be wholly consistent with that observation. At the same time, the Australian Law Reform Commission has been allocated the herculean task of seeking to simplify the present regime within its existing policy settings.

Individual accountability

The Royal Commission also recommended the extension of the Banking Executive Accountability Regime to all APRA-regulated entities, including insurers and superannuation funds. The Government went further to indicate that it would introduce a similar regime for executives in non-prudentially regulated financial firms; to apply to holders of Australian financial services licences and Australian credit licences, market operators and clearing and settlement facilities. Treasury issued a consultation paper in late January 2020 dealing with how the proposed changes should be implemented (under the name "Financial Accountability Regime" ("FAR")), as distinct from whether they should be implemented, which includes a proposal to extend civil penalties for breach of the regime to officers of financial firms.

Enforcement

The Royal Commission recommended that ASIC should adopt an approach to enforcement that takes, as its starting point, the question of whether a court should determine the consequences of a contravention;[21] that infringement notices should only be used for matters involving administrative failings, and are generally not appropriate for matters involving evaluative judgment or in respect of large organisations, other than in respect of administrative failings; and that enforcement and non-enforcement interactions with regulated entities should generally be separated within ASIC. The Government accepted that recommendation, and ASIC has since indicated that it has adopted a "why not litigate?" enforcement stance.[22] ASIC has now created a separate Office of Enforcement and has also implemented a "Close and Continuous Monitoring program" which places ASIC staff on-site at major banks and a major

[21] Royal Commission, Final Report, Recommendation 6.2.
[22] ASIC Media Release — 19-035MR, *ASIC Update on Implementation of Royal Commission Recommendations*, 19 February 2019.

Australian life insurer. ASIC’s Corporate Plan 2019–23 (issued in August 2019) also emphasises an enforcement focus, directed to “cases with high deterrence value and that involve the most serious misconduct, including cases that involve the exploitation of vulnerable consumers”; cases involving large institutions; cases that allow ASIC to use its new powers and remedies to achieve better outcomes; and cases seeking to hold individuals accountable for poor governance or conduct resulting in harm. The Royal Commission also referred several matters to ASIC for potential enforcement action. Further proceedings have now been commenced and some determined in respect of some of those matters.

There are, of course, some possibly good answers to the question that ASIC will now ask itself, “why not litigate?”, by reference to issues of delay, cost, uncertainty of outcome and the risk that that approach will encourage an equally litigious approach by regulated entities. The enforcement stance to which ASIC has now returned also has echoes of an approach adopted by its predecessor, the Australian Securities Commission, in the early 1990s which was modified in later years with the lessons of experience. Time will tell whether the “why not litigate?” stance may also require variation with time and experience. There is also a question as to the consequences of successful litigation brought against a bank or major financial institution, which has received substantial international attention. The Royal Commission emphasises that such an action may vindicate a legal principle and that it will have deterrent effect. The extent of that deterrence may be qualified, at least in Australia, by the practical reality that it likely would not be possible to impose a sanction that would substantially prejudice the operation of one of the four major banks. Obviously, there is also a risk (not unique to Australia) that fines imposed on financial intermediaries following successful proceedings, however large, will ultimately be treated as a cost of business that is borne by consumers of the financial institution's services or by its shareholders.