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**Recent developments in corporate law<sup>1</sup>**

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**A Judge of the Supreme Court of New South Wales**

**Introduction**

This paper reviews several significant developments in corporate law. I will first consider several important decisions in proceedings brought by the Australian Securities and Investments Commission (“ASIC”) against directors in respect of breach of the statutory duty of care and diligence and I will also consider the decision of the Court of Appeal of the Supreme Court of Western Australia in the Bell Group appeal.

I will also note developments in continuous disclosure, including the release of a draft revised Guidance Note to rule 3.1 of the Australian Stock Exchange Listing Rules and the Fortescue Metals Group decisions. In the area of insolvency, I will note the range of amendments made by the *Personal Property Securities (Corporations and Other Amendments) Act 2010* (Cth) which took effect on 30 January 2012; the introduction of provision for ASIC to wind up companies under the *Corporations Amendment (Phoenixing and Other Measures) Act 2012* (Cth); and the proposed *Insolvency Law Reform Bill 2012* which would make wider reforms to the regulation of insolvency practitioners and the conduct of insolvency administrations.

In the area of financial services regulation, I will note developments in relation to the regulation of litigation funding schemes and the introduction of the Future of Financial Advice measures which will largely take effect from 1 July 2013. I will also consider two important decisions of the Federal Court of Australia dealing with claims arising from the sale of sophisticated financial products. Finally, I will note several important decisions dealing with market manipulation and insider trading.

**Directors and officers**

*James Hardie*

The appeals to the High Court of Australia in the James Hardie litigation have given rise to two significant decisions of that Court and a further important decision of the Court of Appeal of the Supreme Court of New South Wales.<sup>2</sup> Before turning to the

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<sup>1</sup> This paper draws in part on material contained in AJ Black, “Overview: Developments In Corporations Law 2012”, contained in Australian Corporations Legislation 2013 edition, LexisNexis Butterworths 2013.

<sup>2</sup> A Hargovan, “Identifying Company Officers: Judicial Signposts by the High Court in the James Hardie Decisions” [2012] *BCLB* [472]; AR Emmett, “Thoughts on the James Hardie litigation” [2012] *BCLB* [557]; A Hargovan, “The role of general counsel and company secretary: Walking the legal tightrope in *Shafron v Australian Securities and Investments Commission*” (2012) 27 *AJCL* 112; T

High Court's decisions, reference should be made to the decisions in the courts below. At first instance in *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 256 ALR 199; 71 ACSR 368; [2009] NSWSC 287, the Supreme Court of New South Wales (Gzell J) held that a draft announcement to Australian Stock Exchange Limited concerning the establishment and funding of the Medical Research and Compensation Foundation had been approved by the board of James Hardie Industries Limited; that several non-executive directors of James Hardie had, inter alia, breached the duty of care and diligence under s 180 of the *Corporations Law* (the then applicable Corporations legislation) in approving that announcement; and that two overseas non-executive directors had breached their duty of care in joining in the resolution to approve that announcement without first having obtained a copy of it. Gzell J also found contraventions of s 180 of the *Corporations Law* by the company secretary/general counsel of James Hardie in failing to advise the board appropriately in several respects.

The Court of Appeal of the Supreme Court of New South Wales allowed appeals by the non-executive directors against the findings of contravention and pecuniary penalties and disqualification orders made against them in *Morley v Australian Securities and Investments Commission* (2010) 274 ALR 205; 81 ACSR 285; [2010] NSWCA 331, on the basis that ASIC had not established that the draft announcement had been approved by the board, and also placed some weight on ASIC's failure to call the company's legal adviser who had been present at that meeting when there was a significant probability that he could have given relevant evidence. An appeal by the company secretary/general counsel succeeded in part, but the Court of Appeal upheld the finding at first instance that he had contravened s 180 by his failure to advise the board of the need to consider whether to disclose a significant corporate restructure to Australian Securities Exchange Ltd ("ASX").

In *Australian Securities and Investments Commission v Hellicar* (2012) 286 ALR 501; 88 ACSR 246; [2012] HCA 17, the High Court allowed ASIC's appeal from the decision of the Court of Appeal, holding that the fact that the draft announcement had been tabled and approved at the relevant board meeting was established, where minutes of the directors' meeting recording that matter were confirmed as an accurate record at the next board meeting. The High Court's decision emphasises the importance of close review of board minutes to confirm that they are in fact an accurate record and that it will be difficult for directors who have approved board minutes as an accurate record of meeting later to establish the contrary. In *Shafron v Australian Securities and Investments Commission* (2012) 286 ALR 612; (2012) 86 ALJR 584; 88 ACSR 126; [2012] HCA 18, the High Court upheld the finding that the company secretary/general counsel had breached s 180 of the *Corporations Law* by failing to provide adequate advice to the company's board and chief executive officer in respect of compliance with its disclosure obligations. The court held (at [18]) that an officer's "responsibilities" within the corporation referred to in s 180 "are not confined to statutory responsibilities; they include whatever responsibilities the officer concerned had within the corporation, regardless of how or why those responsibilities came to be imposed on that officer" and rejected an argument that a contravention of s 180 could not be established by a breach of duties relating to the performance of the officer's duties as general counsel rather than as company

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Bednall & V Ngomba, "The High Court and the c-suite: Implications of Shafron for company executives below board level" (2013) 13 C&SLJ 6..

secretary. The court also noted that the company secretary/general counsel was an “officer” of the corporation within the meaning of s 9(b)(i) of the *Corporations Law* because his actual responsibilities involved participation in significant company decision-making, although the ultimate decisions were made by others, and observed that the question of participation in decision-making is one of fact and degree.

The High Court remitted the James Hardie proceedings to the Court of Appeal of the Supreme Court of New South Wales to determine an appeal from the penalties imposed at first instance. In *Gillfillan v Australian Securities and Investments Commission* [2012] NSWCA 370<sup>3</sup>, the Court of Appeal noted that non-executive directors were not entitled simply to rely on management when voting to approve the release to ASX of an important announcement presented to the board for its endorsement and that two overseas-resident directors’ failure to obtain a copy of the relevant announcement involved an abdication of their responsibility to ascertain and consider its contents and a significant departure from their duties as directors. The court dismissed an appeal by the overseas-resident directors from the trial judge’s decision not to relieve them from liability under s 1317S of the *Corporations Law*. Consistent with earlier authorities, the court noted that the seriousness of a contravention is to be determined by reference to the degree of departure from the requisite standard of care and diligence and the potential and actual consequences of the contravention, although it imposed somewhat lesser penalties on the non-executive directors than those imposed at first instance.

The decision also contains important observations as to the manner in which directors’ meetings should be conducted. Barrett JA emphasised that the process for voting at directors’ meetings contemplated by s 248G of the *Corporations Act* required decision-making by the passage of a resolution, determined by the casting of votes, and that the procedures adopted at directors’ meetings should be such that each member of the board who is entitled to vote and wishes to do so may communicate that vote and have it taken into account, and noted the danger of the Chair indicating a consensus had been reached without appropriate formality. His Honour also noted that the form of technology adopted for remote participation in a directors’ meeting must allow each director access to the content of any document to be discussed or tabled at the meeting.

### *Grimaldi v Chameleon Mining*

In *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296; 287 ALR 22; 87 ACSR 260; [2012] FCAFC 6<sup>4</sup>, the Full Court of the Federal Court found that the appellant was a director and officer of Chameleon Mining NL (“Chameleon”) within the extended definitions of those terms and that transactions involving an issue of shares by Chameleon and the diversion of funds to a third party to fund an acquisition of an interest in a mining tenement were in breach of duty. The Full Court held that a person may be a “director” if he or she does the work reasonably expected of the director of a particular company in its commercial context,

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<sup>3</sup> For commentary, see A Hargovan, “Corporate Boards and ASIC on Notice: James Hardie Penalty Decision” [2012] *BCLB* [1048].

<sup>4</sup> For commentary, see R Baxt, “The definition of a ‘de facto’ director! Some further observations from the Full Federal Court” (2012) 40 *ABLR* 209.

determined as a matter of substance; and a person may be an “officer” without having ultimate control, if he or she has the requisite capacity to significantly affect a part of the company's business or participates in the making of decisions that affect a substantial part of the company's business. The Full Court held that the appellant was both a director and officer where he had the power to negotiate acquisitions of mining interests, a close involvement in capital raisings and, with other persons, directed the use of the funds raised.

Chameleon sought proprietary relief and compensation against the appellant and against two corporate entities involved in the transaction. The Court held both corporate entities had sufficient knowledge to establish accessorial liability. The Court also observed (at [243]) that a third party which is the corporate creature or alter ego of a fiduciary who acted in breach of duty can be held to be knowingly involved in that breach without the need to separately establish dishonesty on its part. The Court granted relief against the appellant by way of an account of profits or compensation, rather than imposing a proprietary trust over shares acquired in breach of duty. However, the Court declined to grant proprietary relief against two corporate entities involved in the transaction, given subsequent events including substantial capital raisings and contributions by subsequent shareholders and new management to the value of the business, and held that the proper remedy was an account of profits obtained from the use of the misappropriated funds.

### *Bell Group appeal*

The Court of Appeal of the Supreme Court of Western Australia has also delivered an important, and complex, judgment addressing several aspects of general law (as distinct from statutory) duties of directors in *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 89 ACSR 1; [2012] WASCA 157.<sup>5</sup> The court there considered a restructuring and extension of Bell Group's facilities, by which security over key assets was taken by the lenders to Bell Group, extending to assets of companies which had not previously given security including security over Bell Group's publishing assets, and all intra-group debt was subordinated. The liquidator of Bell Group alleged that directors of the relevant companies had not given consideration to the interests of the particular companies and that their decision to enter into the transaction was made for a collateral or improper purpose.

### *Nature of directors' equitable duties*

At first instance in *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1; 225 FLR 1; 70 ACSR 1; [2008] WASC 239, Owen J had held that the Australian directors of the Bell Group of companies had breached their duties by, inter alia, failing to consider the interests of the individual companies and causing companies which did not have a pre-existing obligation to give security over their assets in the interest of other Bell Group companies that were insolvent, nearly insolvent or of doubtful solvency. On appeal, the majority upheld the finding of breach of fiduciary duty by the directors in authorising the grant of the securities (per

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<sup>5</sup> For commentary, see S Grillo & A Evans, “The Bell Group litigation: the banks appeal the orders in favour of the liquidators” [2012] *BCLB* [832]; R Baxt, “The Conundrum thrown up by the Bell Group decision in the Western Australian Court of Appeal: To whom do directors owe their duties?” (2012) 30 *C&SLJ* 532.

Lee AJA at [1007], per Drummond AJA at [2084]; Carr AJA dissenting). The appellant banks submitted that duties owed by company directors to act in good faith in the company's best interests and to exercise their powers for a proper purpose were not fiduciary duties since they were positive rather than proscriptive in character. The majority held those duties were fiduciary in character (per Lee AJA at [918]-[933], per Drummond AJA at [1956]-[1978]). Carr AJA also observed that he was not prepared to hold, on the present state of authority, that duties to act in the company's interests and to exercise powers for proper purposes were not fiduciary duties: per Carr AJA at [2733]. While there are a number of statements in the cases that director's duty to exercise reasonable care is equitable, as well as legal in nature, but is not a fiduciary obligation<sup>6</sup>, Lee AJA doubted the proposition that a director's duty of care and diligence was not a fiduciary duty (at [840]) and held that a director's breach of an obligation of care and diligence involving a breach of a fundamental aspect of the fiduciary relationship should give rise to equitable compensation (at [874]).

At first instance, Owen J had held that directors' obligations to act in good faith in the company's best interests and for proper purposes at general law were to be assessed by subjective tests. On appeal, the Court unanimously held that the duty to act *in good faith* in the company's best interests was subjective and would be complied with if directors honestly believed they acted in the company's best interests (per Lee AJA at [1923], per Drummond AJA at [1988], [2027], per Carr AJA at [2772], [2795]). However, the majority held that whether a director acts for an *improper purpose* is determined objectively involving an assessment by the Court of what was reasonable in the circumstances (per Lee AJA at [933], per Drummond AJA at [1988], [2027], [2073]). By contrast, Carr AJA held that the test whether directors had acted for an improper purpose was primarily subjective, although a decision would be voidable if directors acted in good faith for a purpose that was beyond their powers or for a collateral purpose (at [2903]).

#### *Duty to take into account creditors' interests*

The majority took an expansive view of the duty to take into account the interests of creditors, in holding that directors had breached their duties to act in the companies' best interests and for proper purposes in authorising transactions that granted security to the companies' banks to the disadvantage of other creditors. Lee AJA held that dealings that prejudiced the interests of creditors other than the banks involved a breach of fiduciary duty, even if directors advanced a claim of honest belief that the entry into those transactions was or could be in the interests of the corporation and its creditors (at [1092]-[1093]). Drummond AJA observed that the relevant duties would usually be breached, even where directors had considered creditors' interests, if they proceeded with a transaction that will significantly prejudice the creditors (at [2042]) and that, when the Bell Group's financial position was distressed and the value of its assets was uncertain, a decision to carry on business could only properly be made in preference to liquidation if the interests of creditors were protected or with their consent (at [2095]). Carr AJA, dissenting,

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<sup>6</sup> *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187 at 238; 14 ACSR 109; 12 ACLC 674 per Ipp J, with whom Malcolm CJ and Seaman J agreed; approved in *O'Halloran v RT Thomas & Family Pty Ltd* (1998) 45 NSWLR 262 at 274; 29 ACSR 148; 12 ACLC 1705 per Spigelman CJ, with whom Priestley and Meagher JJA agreed.

noted (at [2819]) that any suggestion that directors were required to protect, as distinct from consider, creditors interests, was contrary to authority<sup>7</sup> and that:

“... a transaction designed to deprive the company of funds that would otherwise be available to creditors would be a breach of the duty to act for a proper purpose. However, if the directors bona fide believe that a transaction is in the best interests of the company and will in fact improve its financial position and that is in fact their purpose, there will be no breach of fiduciary duty merely because the transaction will not enable all creditors to be dealt with *pari passu* or because there is a prospect of the directors being wrong and creditors suffering as a result”.

### *Duties within corporate groups*

At general law, the directors of a company within a corporate group are obliged to act in the best interests of the company of which they are directors, and to consider separately the interests of that company in relation to any decision, although they may take into account any effect of a particular decision on the holding company, which indirectly affects the subsidiary.<sup>8</sup> The English courts have held that, provided that an intelligent and honest person in the director's position would have considered a transaction to be for the benefit of a subsidiary, the entry into the transaction would not involve a breach of directors' duties, even if the directors of the subsidiary had considered the interests of the group rather than those of that subsidiary.<sup>9</sup> On appeal, the majority held that the trial judge had been correct in not applying that approach. Lee AJA observed (at [1009]-[1012]) that a failure to consider the separate interests of the company involved a breach of a duty to act in its best interests and there was then no requirement to consider what an intelligent and honest person would have done; see also per Drummond AJA at [2079]. Carr AJA dissented as to this point, holding that the directors' decisions were not such that no intelligent and honest directors could have made them (at [2867]-[2902]).

### *Knowing receipt and knowing assistance*

At first instance, Owen J held that the banks that had taken assets as security from Bell Group knowingly received those assets as a result of a breach of the directors' fiduciary duty (being a failure to act in the best interests of the particular companies and to exercise powers for proper purposes) and that the banks had sufficient knowledge of the breach to give rise to liability for knowing receipt on the relevant facts. The majority upheld that finding on appeal.

At first instance, Owen J also held that the plaintiff could not establish liability for knowing assistance where it had not sought to establish that the breach of fiduciary duty by the directors involved a higher degree of wrongdoing than a simple breach of trust or fiduciary duty. On appeal, the majority held that it was sufficient to establish liability for knowing assistance if the fiduciary's conduct was dishonest or fraudulent

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<sup>7</sup> His Honour referred to *Spies v The Queen* (2000) 201 CLR 603; 173 ALR 529; 35 ACSR 500; [2000] HCA 43 and *Re New World Alliance Pty Ltd (rec and mgr apptd)* (1994) 51 FCR 425; 13 ACSR 766; 122 ALR 531.

<sup>8</sup> *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62; see also *Reid Murray Holdings Ltd (in liq) v David Murray Holdings Pty Ltd* (1972) 5 SASR 386; *Walker v Wimborne* (1976) 137 CLR 1 at 6-7 per Mason J; *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] 1 Ch 246; *ANZ Executors and Trustee Co Ltd v Qintex Australia Ltd (receivers and managers appointed)* (1990) 2 ACSR 676, 8 ACLC 980.

<sup>9</sup> *Charterbridge Corporation Ltd v Lloyds Bank* [1970] Ch 62.

under equitable principles and that the relevant breaches were sufficiently serious to satisfy that requirement (per Drummond AJA at [2012], [2432]); Carr AJA dissenting, holding that the directors' conduct had not been dishonest (at [3063]). Drummond AJA accepted that a finding of breach of fiduciary duty will not, without more, be sufficient to show a fraudulent design on the fiduciary's part, but held that it was not necessary to show conscious awareness of the fiduciary that what was done was wrong, and the additional element necessary for knowing assistance liability would be found if the breach of duty was more than trivial and too serious to be excusable on the basis that the fiduciary had acted honestly, reasonably and ought fairly to be excused (at [2112]) and that it would be sufficient if the relevant conduct was "morally reprehensible" (at [2117]). The majority also held that knowledge of facts which would indicate the breach to an honest and reasonable person was sufficient to give rise to liability for knowing assistance and that the knowledge of the banks and their agents could be aggregated for that purpose (per Drummond AJA at [2112], [2197], [2430]-[2432]).

### *Voidable settlements*

The Court of Appeal also held the transactions were void by reason of s 565 of the *Corporations Act* as it then stood (voidable settlements of property and dispositions with intent to defraud) and that a contravention of that section can be established by an intent to hinder, delay or defeat creditors not involving conscious dishonesty (per Lee AJA at [541]; per Carr AJA at [3120]), and that the requisite dishonesty may also be established by an intention to delay, hinder or defraud one group of creditors by preferring the interests of other creditors (at [3188] per Carr AJA).

### *Downer EDI Ltd v Gillies*

In *Downer EDI Ltd v Gillies* [2012] NSWCA 333, a chief executive officer conduct had accepted advances against his bonus entitlements under an oral agreement with the chief financial officer that had not been disclosed to the board. The chief executive officer had paid back those advances within a relatively short time and the trial judge had found that he had acted honestly although the conduct had potentially given rise to taxation and regulatory issues for the company. The Court of Appeal held that the company's board could properly have found that conduct was incompatible with the chief executive's due and faithful discharge of his duties and could have treated the conduct as involving a breach of s 180 (duty of care and diligence) and s 181 (duty to act in good faith) and arguably s 182 (use of position) of the *Corporations Act*, and to summarily dismiss the chief executive officer on that basis.

### **Continuous disclosure**

Listing Rule 3.1 of the ASX Listing Rules requires a listed entity immediately to notify ASX of any information concerning the entity of which it becomes aware, which a reasonable person would expect to have a material effect on the price or value of the entity's securities. Section 674 of the *Corporations Act* imposes liability on a listed entity if it fails to comply with rule 3.1. The elements of a contravention of that section are that a listed entity has information that rule 3.1 requires it to notify to ASX; that information is not generally available; a reasonable person would expect that information, if it were generally available, to have a material effect on the price

or value of securities of the listed entity, and the entity does not notify ASX of that information in accordance with rule 3.1: s 674(2).

ASX issued a proposed revised Guidance Note to Listing Rule 3.1 in October 2012. The draft Guidance Note contains a helpful flow chart which analyses questions to be addressed in determining whether information is required to be disclosed under rule 3.1 and identifies two questions which may assist in deciding whether information is required to be disclosed under that rule, namely whether that information would influence a decision to buy or sell the securities at the current market price, and whether a company officer who traded in the securities, knowing the information had not been disclosed to the market, would feel exposed to an action for insider trading. ASX also points out that the requirement for “immediate” disclosure in rule 3.1 requires disclosure promptly and without delay, rather than instantaneously; notes several matters relevant to the time within which such an announcement must be made, including any forewarning the entity had of the information, its complexity, and any need to verify its accuracy and bona fides; and emphasises that a company may place its securities in trading halt so as to manage continuous disclosure issues pending an announcement.

The High Court also considered issues as to continuous disclosure in *Forrest v Australian Securities and Investments Commission* (2012) 291 ALR 399; [2012] HCA 39, dealing with misleading and deceptive conduct, continuous disclosure and directors’ duties. Fortescue Metals Group Limited (“FMG”) had made an announcement to Australian Stock Exchange Limited that it entered into binding contracts with three Chinese enterprises in respect of the development of mining infrastructure. ASIC had alleged that FMG did not have a genuine or reasonable basis for that announcement and other associated statements, and alleged that FMG had contravened the continuous disclosure provision under s 674 of the *Corporations Act* and the misleading and deceptive conduct prohibition under, inter alia, s 1041H of the *Corporations Act*. ASIC had also alleged that FMG’s chief executive officer had, inter alia, contravened the duty of care and diligence under s 180 of the *Corporations Act*.

In *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 190 FCR 364; 81 ACSR 563; [2011] FCAFC 19, the Full Court of the Federal Court had held that the substance of the announcements made by FMG was that the parties had agreed upon the terms summarised in the announcements and that the Chinese enterprises had assumed legally enforceable obligations to build the infrastructure of the project on terms including deferred payment by FMG (at [117]) and that the announcements contravened the misleading and deceptive conduct provisions since the agreements were not binding agreements to build, finance and transfer the infrastructure for the project to FMG (at [177]). The Full Court held that ASIC’s case for breach of the continuous disclosure provisions also succeeded, because that section would require FMG to correct the misleading statements it had made and it had not done so (at [182]). The Full Court also held that FMG’s chief executive was involved in the contraventions of the continuous disclosure and misleading and deceptive conduct provisions, because he knew the terms of the framework agreements and could reasonably be inferred to have known of the disparity between the terms of those agreements and FMG’s representations about



them (at [191]) and these matters also gave rise to a contravention of the duty of care and diligence under s 180 of the *Corporations Act*.

On appeal in *Forrest v Australian Securities and Investments Commission* above, the plurality in the High Court questioned the utility of distinguishing between statements of fact and statements of opinion in determining whether a statement is misleading, and emphasised the importance of examining what the relevant statements conveyed to the persons to whom they were made. The plurality held that the intended audience of the ASX announcements and media releases made by FMG, being investors and the wider commercial business community, would have understood the reference to a “binding contract” in those documents as a description of the agreements which the parties understood themselves to have entered and not as conveying a representation as to the enforceability of those agreements; and that the relevant statements were not misleading or deceptive or likely to mislead or deceive because they accurately recorded the parties’ understanding that they had entered into binding contracts. The plurality held there was therefore no contravention of s 674 of the *Corporations Act*, and rejected an alternative argument that that section required publication of the complete agreements; and no breach of directors’ duties was established in consequence.

Heydon J reached the same result on the basis that the relevant agreements were calculated to ensure the projects were financed and built, by requiring negotiations for further detailed agreements to do so; were binding contracts, at least in respect of further negotiations and necessary further agreements; and any representation that they were “binding contracts” was one of opinion and ASIC had not established that FMG did not hold it or did not have reasonable grounds for it. His Honour also pointed to the fact that the target audience of the announcement was “tough, shrewd and skeptical”, and pointed to the audience’s knowledge of the difficulties and expense of creating infrastructure for mining projects and its consciousness of the difficulties in “forcing” another party to build and finance such a project. The emphasis in the judgments on the sophistication of the audience for the disclosure in the plurality’s judgment is quite different from the approach typically adopted in framing class actions in respect of continuous disclosure, although those actions have to date not generally gone to judgment.

## **Personal Property Securities legislation**

The *Personal Property Securities Act 2009* (Cth) (“*PPS Act*”) provides for the registration of security interests in personal property. The *Personal Property Securities (Corporations and Other Amendments) Act 2010* (Cth) in turn commenced on 30 January 2012 and introduced a new Pt 1.2 Div 6A into the *Corporations Act* dealing with security interests, which defines several important new terms including “security interest”<sup>10</sup>, “PPSA security interest”<sup>11</sup>, “circulating security interest”<sup>12</sup>;

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<sup>10</sup> The term “security interest” is defined in s 51A as meaning a PPSA security interest (as defined in s 51) or a charge (as defined in s 9), lien or pledge.

<sup>11</sup> The term “PPSA security interest” is defined in s 51 as a security interest within the meaning of the PPS Act and to which that Act applies other than a transitional security interest within the meaning of that Act. A “security interest” is in turn defined in PPS Act s 12 as “an interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property)” and includes interests that are not charges at general law, such as finance leases and

“possessory security interest” and “PPSA retention of title property”.

The *Personal Property Securities (Corporations and Other Amendments) Act 2010* also repealed Ch 2K of the *Corporations Act* (dealing with registration of charges) with effect from 30 January 2012. Charges previously registered by ASIC were migrated to the PPS register and registrable charges are registered on the PPS register from that date.<sup>13</sup> A failure to register a circulating security interest within 20 business days will expose it to the risk of avoidance by a liquidator if the company is wound up within 12 months: s 588FL. Even if a circulating security interest is registered within the 20 business day period, the relevant security interest will vest in the company if it is liquidated before that charge is perfected for the purposes of the PPS regime: *PPS Act* s 267. The steps by which a security is perfected, within the meaning of the *PPS Act*, are broadly by registration, possession, control or temporary perfection as applicable.<sup>14</sup>

The amendments also make changes to many provisions, particularly in *Corporations Act* Chapter 5, to reflect the new concepts introduced by the PPS regime. For example:

- Employee entitlements continue to have priority in receivership over the holders of a circulating security interest under s 433 and in liquidation under s 561. A particular complexity with these provisions was considered in *Re Great Southern Ltd (in liq); Ex parte Thackray* (2012) 260 FLR 362; [2012] WASC 59 which noted that, where there is both a receivership and winding up, s 433 operates as at the date of the appointment of the receiver and s 561 applies once a resolution is passed to wind up the company, so that a receiver appointed after an administrator needs to anticipate the possibility that the company may later be wound up and s 561 will then apply, for example by holding monies necessary to discharge employee entitlements in trust.
- Section 436C is amended so that an administrator may be appointed by a secured party with an enforceable security interest over the whole or substantially the whole of the company's property; however, that right will be available in respect of a PPSA security interest (as defined in s 51) only if that security interest is perfected within the meaning of the *PPS Act*.<sup>15</sup>
- An amended s 440B dealing with restrictions on exercise of third party property rights was introduced, and former s 440C was repealed.

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retention of title arrangements. The concept of “security interest” also includes specified deemed security interests: *PPS Act* s 12(3).

<sup>12</sup> The term “circulating security interest” is used in place of previous references to floating charges in the *Corporations Act*. That term is defined in s 51C as a security interest over circulating assets, and includes a PPSA security interest which is attached and where the grantor has title to the asset and a floating charge that is not a PPSA security interest as defined in s 51, such as a floating charge falling within the transitional provisions.

<sup>13</sup> Part 10.13 of the *Corporations Act* sets out transitional provisions in relation to the repeal of Ch 2K which does not affect registrable charges created before the commencement of the *PPS Act* for a seven-year period, with the exceptions specified in ss 1503–1506.

<sup>14</sup> *PPS Act* ss 19–22.

<sup>15</sup> This provision is qualified by s 1501 where a security interest within the transitional provisions is involved.

- The presumption of insolvency under s 459C will now arise where a person is appointed to enforce a “security interest” by taking possession or assuming control of the company's property.
- The voidable transaction provisions in Pt 5.7B are also extended, by an amendment to the definition of “transaction” in s 9, to apply to the grant of a security interest in property, including PPSA retention of title property (as defined in s 51F).
- Part 5.7B Div 2A provides for vesting of PPSA security interests (as defined in s 51) if collateral is not registered within time.

An extension of time for the registration of a security interest can be allowed by the Court under s 588FM, on grounds broadly corresponding to the former s 266. The operation of the new section was considered in *Re Barclays Bank plc* [2012] NSWSC 1095<sup>16</sup> and again in *Re Cardinia Nominees Pty Limited* [2013] NSWSC 32.

## Insolvency

### *Winding up of companies by ASIC*

Part 5.4C dealing with winding up by ASIC was introduced by the *Corporations Amendment (Phoenixing and Other Measures) Act 2012* (Cth), with effect from 1 July 2012.<sup>17</sup> ASIC may order a company's winding up in specified circumstances under s 489EA. The effect of an order made by ASIC that a company be wound up is, broadly, that the company is taken to have passed a special resolution under s 491 that it be wound up voluntarily, at the time when ASIC made the relevant order and without a solvency declaration having been made and lodged under s 494. On making an order under s 489EA for the winding up of a company, ASIC may appoint a liquidator for the purpose of winding up its affairs and distributing its property and determine the remuneration to be paid to the liquidator. These provisions are intended to facilitate payment of employee entitlements where a company has been abandoned: see ASIC CP 180 *ASIC's power to wind up abandoned companies*, July 2012.

### *Proposed reforms to the regulation of insolvency practitioners*

The Report of the Senate Economics References Committee, *The Regulation, Registration and Remuneration of Insolvency Practitioners in Australia: The case for a new framework* (September 2010) (“Senate Inquiry Report”) raised concerns as to the registration and disciplinary frameworks, insurance obligations and remuneration of registered liquidators and as to the effectiveness of regulatory oversight of liquidators. The government subsequently issued an options paper, *Modernisation and Harmonisation of the Regulatory Framework applying to Insolvency Practitioners in Australia*, in June 2011. The proposed *Insolvency Law Reform Bill 2012* would substantially amend both the *Bankruptcy Act 1966* (Cth) and the *Corporations Act* to

<sup>16</sup> For commentary, see D Brown, “Court cuts slack for late registrations in early days of PPSA” (2012) 13(5) *INSLB* 111.

<sup>17</sup> For ASIC's policy, see ASIC Regulatory Guide 242, *ASIC's power to wind up insolvent companies*, November 2012; and, for commentary, see H Anderson, “Comment on Consultation Paper 180: ASIC's power to wind up abandoned companies” (2012) 30 *C&SLJ* 528.

introduce common rules in relation to the registration, regulation, discipline and the registration of corporate and personal insolvency practitioners.

The proposed amendments would provide, inter alia, for amended registration and insurance obligations of insolvency practitioners; annual trustee returns to be lodged by such practitioners; notification requirements to regulators in respect of prescribed events; and amended provisions for discipline of insolvency practitioners.<sup>18</sup> It is possible here only to highlight some of the more significant aspects of the proposed amendments:

- A new registration process for practitioners in corporate insolvency will be based on the registration process under the *Bankruptcy Act* and the category of “official liquidators” will be removed so that registered liquidators will be able to perform all functions currently performed by official liquidators.<sup>19</sup>
- An insolvency practitioner would be required to maintain adequate and appropriate professional indemnity and fidelity insurance.<sup>20</sup>
- An insolvency practitioner would be required to notify ASIC or Insolvency Trustee Service Australia (“ITSA”), as applicable, of specified events, which would be wider than those presently required under *Corporations Act* s 1287.<sup>21</sup>
- ASIC and ITSA, as applicable, could require an insolvency practitioner to lodge, or correct any inaccurate, practitioner or administration statement and could suspend the practitioner's ability to accept new appointments unless the practitioner complied with that direction within two weeks.<sup>22</sup>
- ASIC and ITSA, as applicable, could deregister or suspend an insolvency practitioner on specified grounds. The registration of an insolvency practitioner who becomes an insolvent under administration or entered a debt agreement or died would be cancelled.<sup>23</sup> ASIC and ITSA, as applicable, could also suspend or cancel the registration of an insolvency practitioner where that practitioner is disqualified from managing companies, ceases to have adequate and appropriate professional indemnity or fidelity insurance, has their registration under the other insolvency framework cancelled or suspended or is convicted of an offence involving fraud or dishonesty.<sup>24</sup>
- The jurisdiction over disciplinary proceedings over liquidators will be removed from the Companies Auditors and Liquidators Disciplinary Board. ASIC and ITSA, as applicable, would be able to issue a show cause notice and refer a

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<sup>18</sup> Consultation Explanatory Document to the Exposure Draft: Insolvency Law Reform Bill 2013 (Primary Amendments) (“Consultation Explanatory Document” [1.1].

<sup>19</sup> Proposed Sch 2 Pt 2 Div 8B, replacing *Corporations Act* ss 1282–1283 and corresponding to *Bankruptcy Act* ss 154A, 155–155C.

<sup>20</sup> Proposed Sch 2 Pt 3 Div 10, replacing *Corporations Act* s 1284 and *Bankruptcy Act* s 155A, *Bankruptcy Reg* 8.04

<sup>21</sup> Proposed Sch 2 Pt 3 Div 14; see also *Bankruptcy Act* s 161A.

<sup>22</sup> Proposed Sch 2 Pt 3 Div 16.B.

<sup>23</sup> Proposed Sch 2 Pt 3 Div 16.C, replacing *Corporations Act* s 1290A and *Bankruptcy Act* s 182.

<sup>24</sup> Proposed Sch 2 Pt 3, Div 16.D, replacing *Corporations Act* s 1290A.

practitioner to a committee in specified circumstances, including breach of the practitioner's duties or failing to meet ongoing requirements to maintain registration. A committee would comprise a representative of the relevant regulator, a practitioner appointed by the Insolvency Practitioner's Association and a person appointed by the Minister and would be able to impose sanctions including deregistration, suspension of registration, suspension of the practitioner's ability to accept new appointments, imposition of conditions on a practitioner's registration, a public admonishment or reprimand or preventing the practitioner acting as an employee, agent or consultant of another insolvency practitioner for up to 10 years.<sup>25</sup> New provisions for reference of matters by professional and industry bodies to the regulator would be introduced.<sup>26</sup>

- ASIC would be required to appoint a replacement liquidator to an existing administration on suspension or cancellation of the current liquidator's registration.<sup>27</sup>
- The court would have a continued role in oversight of insolvency practitioners.<sup>28</sup>

The Insolvency Law Reform Bill would also introduce common rules regarding remuneration and other benefits received by insolvency practitioners; handling of administration funds; provision of information by insolvency practitioners during an external administration; meetings of creditors during an external administration; the committee of inspection and external review of the administration of an insolvency.<sup>29</sup> The proposed amendments seek to address concerns identified by the Senate Inquiry, particularly in the area of communication between practitioners and stakeholders, removal and replacement of practitioners from particular administrations and approval of insolvency practitioners' remuneration. In particular:

- *Remuneration* - An insolvency practitioner would be able to claim remuneration specified in a "remuneration determination" or, where it is the first practitioner appointed, a minimum fee of \$5500 indexed to CPI. The creditors, a committee of inspection or the court may make a remuneration determination. The court may review remuneration determination.<sup>30</sup> Insolvency practitioners would be prevented, without creditors' prior approval, from directly or indirectly arriving a profit or advantage from a transaction, sale or purchase for or on account of the estate, or conferring a profit or advantage from such a transaction, sale or purchase on a related entity.<sup>31</sup>

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<sup>25</sup> Proposed Sch 2 Pt 3 Div 16.E, replacing *Corporations Act* s 1292, *Bankruptcy Act* ss 155H, 155I.

<sup>26</sup> Proposed Sch 2 Pt 3 Div 16.F.

<sup>27</sup> Proposed Sch 2 Pt 3 Div 16.G

<sup>28</sup> Proposed Sch 2 Pt 3 Div 17, replacing *Corporations Act* ss 447A, 447E, 479, 482, 511 and *Bankruptcy Act* ss 176 and 179.

<sup>29</sup> Consultation Explanatory Document [1.17].

<sup>30</sup> Proposed Sch 2 Pt 3 Div 22.B, replacing *Corporations Act* ss 473, 449E, *Bankruptcy Act* ss 161B, 162)

<sup>31</sup> Consultation Explanatory Document [1.27]; proposed Sch 2 Pt 3 Div 22.E, dealing with matters which were the subject of officers' duties under *Corporations Act* ss 180 – 184 and *Bankruptcy Act* ss 165 – 166.

- *Requests for information by creditors* - A new provision would be introduced permitting creditors to request an insolvency practitioner to provide information, by resolution or on an ad hoc basis, and requiring the practitioner to comply with a reasonable request. A request would not be reasonable where there were insufficient funds to cover costs of completing it unless the requestor paid the costs of providing the information. ASIC and ITSA, as applicable, and the court may direct an insolvency practitioner to provide such information where the request was reasonable.<sup>32</sup>
- *Meetings of creditors* – An insolvency practitioner would be required to convene a meeting of creditors if a committee of inspection so directs; creditors so resolved; 25% of creditors by value so direct in writing; or 10% of creditors by value so direct and security is provided for the cost of the meeting, or ASIC and ITSA, as applicable, requires it to do so. A liquidator must also convene such a meeting where 5% of creditors unrelated to the company direct to do so and the direction given in the first two weeks of the winding up.<sup>33</sup>
- *Removal of insolvency practitioners* - Section 503 of the *Corporations Act* permits the removal of a liquidator in specified circumstances.<sup>34</sup> However, the Consultation Explanatory Document notes that the need for an application to the court for such a removal is a significant cost barrier to that course. The amendments would allow creditors to remove an insolvency practitioner by resolution and resolve to appoint a replacement. The court may reinstate the appointment of a practitioner but only where it is satisfied the removal was an improper use of the power.<sup>35</sup>
- *Reports as to affairs* - The penalties for breach of directors' obligations to provide a report as to affairs or the company's books to an insolvency practitioner would be strengthened, and the *Corporations Act* would be amended to provide for automatic disqualification of directors who have failed to provide a report as to affairs or the company's books with a liquidator until they comply with those obligations. The court would have power to set aside is such a disqualification if it is satisfied that the person had a reasonable excuse for failing to comply with the requirement.<sup>36</sup>

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<sup>32</sup> The Commonwealth department or agency responsible for the General Employee Entitlements and Redundancy Scheme would have a corresponding right to request such information: proposed Sch 2, Pt 3 Div 26.E, 26.F.

<sup>33</sup> Proposed Sch 2 Pt 3 Div 28, cf *Corporations Act* s 479, *Bankruptcy Act* s 12, 64, 64ZBA).

<sup>34</sup> See, for example, *SingTel Optus Pty Ltd v Weston* [2012] NSWSC 674; (2012) 90 ACSR 225, where Bergin CJ in Eq made orders for the removal of a special purpose liquidator who had been appointed to deal with the conduct of litigation where a loss of confidence by the creditors, on reasonable grounds, was established; and *Haulotte Australia Pty Ltd v All Area Rentals Pty Ltd (in liq)* (2012) 90 ACSR 177; [2012] FCA 615, where Jessup J held that a liquidator should be removed where that course would be advantageous to the liquidation and those interested in the company's assets, without needing to establish personal unfitness, impropriety or breach of duty on the part of the liquidator.

<sup>35</sup> Proposed Sch 2, Pt 3, Div 32.D, replacing *Corporations Act* ss 436E, 444A, 446A, 473, 496 and 499.

<sup>36</sup> Proposed *Corporations Act* s 206BB.

## Financial services and market regulation

### *Claims arising from sale of complex financial products*

There have now been two significant decisions in respect of claims brought in respect of the issue of complex financial products to wholesale investors. Each of these decisions depends upon detailed findings of fact and may not ultimately raise novel issues of legal principle.

In *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* [2012] FCA 1028, a group of municipal councils brought representative proceedings against the defendant (formerly known as Grange Securities Limited (“Grange”)) in respect of the sale of synthetic collateralised debt obligations (“SCDOs”). The SCDOs had credit ratings of AAA or AA-, equivalent to the credit ratings of major Australian banks. However, some of those products had lost some or all of their value following that the global financial crisis and the repayment of capital in other of the products would potentially be delayed by several years. The councils claimed that Grange acted in breach of contract, negligently and engaged in misleading or deceptive conduct and acted in breach of fiduciary duty in recommending, and advising on (or, in the case of Wingecarribee Shire Council (“Wingecarribee”) and Swan Council (“Swan”), using the power under Individually Managed Portfolio Agreements (“IMPAs”) to make) investments in the SCDOs. In broad summary, the councils alleged the Grange had represented to them that the SCDOs were suitable investments within a conservative investment strategy, were prudent and capital-protected and complied with requirements by statute and under the councils’ investment policies and were easily tradeable on an established secondary market.

Rares J recognized (at [719]) that the central feature of the relationships between each Council and Grange was a contract, either to buy or sell a particular financial product or, in the case of the two IMPAs with Wingecarribee and Swan, authorising Grange to undertake such sales and purchases on their behalf. However, Rares J held that the contracts contained additional terms, for example, in the contracts between Swan and Grange prior to the IMPAs, that the product had a high level of security for protection of the invested capital, was easily tradeable on an established secondary market, was readily able to be liquidated for cash at short notice, was suitable and an appropriate investment for a risk-averse local government council, had a secure income stream, and that Grange would exercise reasonable skill and care in making an investment recommendation and giving investment advice. His Honour held that the SCDOs did not have those characteristics. His Honour also held that Grange breached its obligations under the IMPAs with Wingecarribee and Swan by using its powers under the IMPAs to invest in SCDOs; breached the IMPA with Swan because the SCDOs did not provide ready access to the councils’ funds because of their lack of liquidity; and also breached the IMPA with Wingecarribee because the SCDOs had no active secondary market and were derivatives.

His Honour also found (at [785]) that a duty of care arose<sup>37</sup> and noted (at [789]) that, even in the absence of an advisory relationship, Grange could be held liable if it

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<sup>37</sup> His Honour applied the principles identified by Gleeson CJ, Gummow and Hayne JJ in *Tepeco Pty Ltd v Water Board* (2001) 206 CLR 1 at [16]–[18] as to when a duty of care will attach to the making of statements providing information or advice.

offered advice that was inaccurate.<sup>38</sup> His Honour held that Grange had breached that duty of care owed to the councils in advising them to make the relevant investments. The councils also brought claims of misleading and deceptive conduct in contravention of s 1041H of the *Corporations Act*, s 12DA of the *Australian Securities & Investments Commission Act* and s 52 of the *Trade Practices Act 1974* (Cth). Rares J held that the promotion of the SCDOs as suitable investments had contravened the prohibitions on misleading and deceptive conduct.

The councils also claimed that Grange acted in breach of fiduciary duty as an investment adviser or portfolio manager. Rares J rejected (at [226]) an argument that Grange could not be a financial adviser to the councils where it was not the only source of financial advice or their sole means of investing funds. His Honour does not specifically distinguish between the fiduciary duty applicable in a traditional fiduciary relationship, such as agency, and the ad hoc fiduciary duty which may arise in non-traditional arrangements, typically involving an undertaking to act in the interests of the other.<sup>39</sup> Rares J held that Grange breached fiduciary duties owed as a financial adviser and owed under the IMPAs to Swan and Wingacarribee in making investments as their agent. His Honour found a breach of the prohibition on conflicts of interest by reason of a conflict between Grange's duty to give sound financial advice to, or make investment decisions on behalf of, the councils and an undisclosed interest in earning large fees or profits in sales of SCDOs.

In *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, Jagot J dealt with a very complex series of claims and cross claims arising from the sale of complex structured financial products titled "Constant Proportion Debt Obligations" ("CPDOs"). The defendants were Local Government Financial Services Pty Ltd ("LGFS"), an Australian financial services licensee that had acquired the CPDOs and onsold them to local councils; ABN Amro, an investment bank that had designed and distributed the products; and Standard & Poors ("S&P"), a credit rating agency that had been retained by ABN Amro to rate the products. A CPDO was, broadly, a credit derivative involving a notional 10 year product credit default swap referencing two credit swap indices. Jagot J noted that the CPDO was ultimately "an extraordinarily complicated bet on the future performance of two [credit default swap] indices over a period of up to 10 years" (at [9]). The products were rated "AAA" by S&P and marketed with S&P's consent on that basis.

S&P had used a model provided by ABN Amro as the basis for its modelling of the CPDOs and also used information provided by ABN Amro as to the average volatility of an index that was critical to the assumptions adopted in modelling the product's financial performance, which substantially understated the volatility of that index. Jagot J also found that other assumptions made by S&P as to the long-term average spread had no reasonable basis and there were also other difficulties with the model prepared by ABN Amro and adopted by S&P. Jagot J held that the product would not have been rated "AAA" but for those errors. By the time a third series of the product was issued, S&P had become aware of the error with the volatility of the index but did not undertake further modelling and maintained the earlier rating of the

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<sup>38</sup> His Honour here applied *Commonwealth Bank of Australia v Mehta* (1991) 23 NSWLR 84 at 92.

<sup>39</sup> *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at 96–97; *John Alexander's Clubs Pty Ltd v White City Tennis Club* (2010) 241 CLR 1 at 34–35 [87].



product.

### *Claims against LGFS*

LGFS in turn caused a workers compensation insurer to purchase \$10 million of the second series of the CPDOs. LGFS was at that time also seeking a structured financial product with a high rating in order to compete with intermediaries that were selling collateralised debt products to councils, a development that had placed the viability of LGFS's previous business model under threat. LGFS purchased a third series of CPDOs with a face value of \$45 million for on-sale to councils, sold CPDOs with a face value of \$17 million to the 13 councils party to the proceedings and was left holding the remaining CPDOs itself. The CPDOs cashed out in October 2008 in accordance with their terms, when their net asset value fell below 10%, with the councils receiving back less than 10% of the principal they had invested.

The councils brought claims against LGFS for misleading and deceptive conduct and negligence<sup>40</sup> and those councils that had entered contracts with LGFS also brought claims for breach of contract. The councils succeeded in the claim for misleading and deceptive conduct against LGFS, by reason, inter alia, that it had not disclosed that it was under financial pressure to enter the market for structured products in order to compete with other products and restore the success of its business. Jagot J found that LGFS made other misrepresentations to the councils about their notes and their suitability as an investment, including failing to disclose their potential volatility or adequately explain the limits of a buyback mechanism for the notes.

The councils also contended that LGFS was in an informal advisory relationship with the councils (other than two with which it had a formal advisory relationship) and owed a duty of care to the councils care by reason of the recommendation to acquire the products. Jagot J referred to the multifactorial analysis required by the case law in assessing whether a duty of care exists in novel circumstances and held that LGFS owed a duty of care to the councils to which it proposed the product, that included a duty properly to analyse any investment being considered on behalf of a client, identify the risks associated with it and only recommend investments that were suitable for the client and properly provide the client with all material information about the investment that might reasonably be considered as bearing upon the investment decision. Two of the councils had contracts with LGFS by which it agreed to provide them with financial advice and the others had dealings with LGFS over the years which, Jagot J held, led to a belief that LGFS would act in their best interests and not prefer its own interests to those of the councils.

The councils also brought claims for breach of fiduciary duty against LGFS, relying on familiar case law in order to establish a fiduciary relationship between a financial adviser and its client.<sup>41</sup> Jagot J held that a fiduciary relationship existed and a LGFS breached the prohibition on conflict of interest by reason of the undisclosed commercial pressures upon it to distribute the products in order restore the success of its business. That finding should, in my view, be treated as confined to an interests in the sale of the products which is out of the ordinary course, here because

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<sup>40</sup> The councils' claim for negligence was governed by the *Civil Liability Act 2002* (NSW).

<sup>41</sup> The Councils referred to *Daly v Sydney Stock Exchange* (1986) 160 CLR 371 and *Aequitas Ltd v Sparad 100 Ltd* (2001) 19 ACLC 1006; [2001] NSWSC 14.

of the extent of the then pressures on LGFS's business.

Jagot J also held that the CPDOs were derivatives, rather than securities, for the purposes of Chapter 7 of the Corporations Act, and LGFS was not authorised to deal in those products under the terms of its Australian Financial Services Licence. However, the councils were not successful in their claim for an order for rescission of their purchase of the CPDOs, whether they had not given notice of rescission within a reasonable time after becoming aware of the relevant facts, for the purposes of s 925A of the *Corporations Act*.

### *Claims against S&P*

The councils brought claims against S&P for misleading and deceptive conduct and negligence. S&P argued that the fact that the councils were "wholesale" investors for the purpose of s 761G of the *Corporations Act* indicated that they should be treated as sophisticated investors who would take reasonable care for their own interests. (It might be noted that a similar argument might be advanced in respect of individuals with, for example, substantial superannuation entitlements who also satisfy the criteria for wholesale investors under s 761G of the *Corporations Act*). Jagot J held the fact that an entity qualified as a wholesale investor for the purposes of that section did not necessarily indicate that it would have the capacity to understand very complex financial products. The councils characterised the misleading and deceptive conduct of S&P as an alleged representation, by rating the products "AAA", that their expert opinion was that the products had an extremely strong capacity to pay the scheduled interest and repay the principal at maturity and that opinion was based on reasonable grounds and reflected the exercise of reasonable skill and care.

Jagot J held that, in exercising reasonable care, S&P should itself have calculated the volatility of the index, and had breached a duty of care in failing to do so and instead accepting the volatility calculations in respect of the relevant index provided by ABN Amro. Her Honour also held that S&P was liable for misleading and deceptive conduct because its rating of the relevant products was not based on reasonable grounds and had not exercised reasonable care. Her Honour also found that disclaimers contained in the ratings were not effective where S&P had authorised ABN Amro to publish the ratings and the disclaimers were not sufficiently prominent to displace the representations made by the ratings.

### *Claims against ABN Amro*

The councils also brought claims against ABN Amro for misleading and deceptive conduct, knowing involvement in S&P's alleged misleading and deceptive conduct and for negligence. Jagot J held that ABN Amro had engaged in misleading and deceptive conduct by disseminating and promoting the "AAA" credit rating of the products to LGFS, which had in turn acquired the products, recommended them to the councils and communicated S&P's rating of them to the councils. Jagot J found that ABN Amro knew that LGFS would communicate that rating to the councils and knew that rating was unjustified, by reason of the incorrect information as to the volatility of the index that it had provided to S&P. Jagot J also held that ABN Amro was knowingly involved in S&P's misleading and deceptive conduct, because it had actual knowledge that the "AAA" credit rating given by S&P to the products was

incorrect. Importantly, her Honour held that a suspicion of that matter would not have been sufficient to establish liability for knowing involvement.

### *Outcome*

In the result, the councils established an entitlement to damages against S&P, ABN Amro and LGFS, which Jagot J found were each proportionately liable as to one third each. The councils also established an entitlement to equitable compensation for breach of fiduciary duty against LGFS, in the same amount as their entitlement to damages against S&P, ABN and LGFS. LGFS in turn brought claims against S&P for misleading and deceptive conduct and negligence and against ABN Amro for misleading and deceptive conduct, negligence and breach of contract. LGFS in turn established an entitlement to damages against S&P and ABN Amro. Jagot J did not accept LGFS's, S&P's and ABN Amro's claims there was contributory negligence by the councils and also rejected arguments raised by S&P and ABN Amro that there had been contributory negligence by LGFS in acquiring the third series of the product that it did not onsell to the councils.

### *Regulation of litigation funding schemes*

On appeal in *International Litigation Partners Pte Ltd v Chameleon Mining NL (reca and mgs apptd)* (2012) 86 ALJR 1289; [2012] HCA 45, the plurality of the High Court, and Heydon J in a separate judgment, held that a litigation funding agreement in issue in that case was a "credit facility" (as defined in reg 7.6.01 of the Corporations Regulations 2001 (Cth)) and therefore excluded from the definition of financial product under s 765A(1)(b)(i) of the *Corporations Act* and, in reaching that result, pointed, without apparent enthusiasm, to the breadth of the legislative scheme introduced by the *Financial Services Reform Act 2001* (Cth).

ASIC has provided class order relief, most recently in CO 13/19 for lawyers and funders in respect of funded representative proceedings and the funding of lodgement of claims with liquidators. Amendments to the Corporations Regulations 2001 (Cth) introduced by the Corporations Amendment Regulation 2012 (No 6) (Cth), effective from 12 July 2013, will exclude litigation funding arrangements from the definition of managed investment schemes; funders of such schemes will be exempt from the licensing, conduct and disclosure requirements relating to financial products in Ch 7; and funders will be required to maintain adequate arrangements for managing conflicts of interest, including written procedures for identifying and managing such conflicts and addressing any conflict arising if one law firm acts for both the funder and the class members.<sup>42</sup>

### *Future of financial advice reforms*

Part 7.7A Div 2 was introduced by the *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) following the Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia* (November 2009).<sup>43</sup> That Division requires

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<sup>42</sup> See ASIC CP 185, *Management of Conflicts of Interest in Litigation and Proof of Debt Schemes*

<sup>43</sup> ASIC CP 182 *Future of Financial Advice: Best interests duty and related obligations—Update to RG 175* (August 2012); CP 189, *Future of Financial Advice: Conflicted Remuneration*; K Lindgren,

financial advisers to take reasonable steps to act in the best interests of their retail clients and to place the clients' interests ahead of their own when providing advice to retail clients.

A provider of personal advice to a retail client must act in the best interests of the client when giving the advice.<sup>44</sup> In the ordinary course, a financial adviser may owe a fiduciary duty to its client in equity, unless that duty is excluded by contract.<sup>45</sup> To the extent that the "best interests" duty is read as at least including the traditional fiduciary duty to avoid a conflict of interest, then that rule will not be excludable by contract. That is probably a desirable outcome in the retail sector, because the exclusion of general law fiduciary duties by contract as between the parties takes no account of whether such duties ought to be imposed by reason of public interest considerations.<sup>46</sup> Other statutory provisions that require a person to have regard to the "best interests" of another will provide some assistance as to the content of the "best interests" duty. For example, *Corporations Act* s 601FC(1)(c) requires a responsible entity, in exercising its powers and carrying out its duties, to "act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests". A broadly comparable covenant is implied in the rules of superannuation entities under *Superannuation Industry (Supervision) Act* 1993 (Cth) s 52(2)(c) which requires that entity to ensure that its duties and powers are "performed and exercised in the best interests of the beneficiaries": see *Manglicmot v Commonwealth Bank Officers Superannuation Corp Pty Ltd* (2011) 282 ALR 167; [2011] NSWCA 204. Section 961B(2) specifies steps that a provider may take to demonstrate that it has acted in the client's best interests.

Part 7.7A Div 3 (ss 962-962S)<sup>47</sup> deals with ongoing fee arrangements and is intended to prevent clients being locked into fixed term, ongoing fee arrangements.<sup>48</sup> Part 7.7A Div 4 (ss 963-963L) and Div 5 (ss 964-964H)<sup>49</sup> deal with conflicted and other banned remuneration. Broadly, these sections apply where personal advice is provided to a retail client and prohibit initial or upfront commissions (such as an advice fee charged as a percentage of the initial investment built into the price of the product by arrangement between the product provider and adviser), trail commissions (such as a commission charged as a percentage of the investment and built into the price of the product) and payments based on volume or sales targets (such as a volume bonus or fee rebates and volume-based payments). Fees calculated as a percentage of investments or by reference to assets under

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'Fiduciary Duty and the Ripoll Report' (2010) 28 C&SLJ 435; A Dahdal and E Kamerakis, "The future of financial advice (FOFA) reforms at a glance" (2012) BCLB [517]; G Craddock "The Ripoll Committee recommendation for a fiduciary duty in the broader regulatory context" (2012) 30 C&SLJ 216; AJ Serpell, "The future of financial advice reforms" (2012) 30 C&SLJ 240.

<sup>44</sup> *Corporations Act* s 961B(1)

<sup>45</sup> *Daly v Sydney Stock Exchange* (1986) 160 CLR 371; *Aequitas Ltd v AEFC Leasing Pty Ltd* (2001) 19 ACLC 1006 at [307]; *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35 at [282]-[285]

<sup>46</sup> P Hanrahan, "Fiduciary Duty and the Market: Private Law and the Public Good", paper presented at Obligations IV, Singapore, 23 July 2008

<sup>47</sup> Introduced by the *Corporations Amendment (Future of Financial Advice) Act* 2012 (Cth).

<sup>48</sup> Explanatory Memorandum to *Corporations Amendment (Future of Financial Advice Measures) Bill* 2011 at [1.50]

<sup>49</sup> Introduced by the *Corporations Amendment (Further Future of Financial Advice Measures) Act* 2012 (Cth).

management are permitted for ungeared (but not geared) products with a retail client's agreement. The focus on gearing reflects a concern that clients can be inappropriately advised to adopt highly geared financial strategies in order to increase commissions paid to advisers.

These reforms reflect a loss of confidence in disclosure as a mechanism for managing conflicts of interest, particularly those arising from commissions. That loss of confidence may well be justified. There is a clear basis for concern that financial incentives of advisers may have led at least some advisers to recommend investments for retail investors that have had inappropriately high levels of risk. A direct prohibition on commission structures that create incentives for inappropriate advice is likely to be an effective means of addressing that concern.

### **Market misconduct**

Earlier case law held that a contravention of the prohibition on creating an artificial price in s 1041A of the *Corporations Act* could be established where a price was created other than in implementing a genuine transaction and for a purpose outside the interplay of genuine market prices, for example with a sole or primary purpose of setting the price as distinct from the sole or primary purpose of a genuine purchase of the shares.<sup>50</sup> That section was given a significantly narrower reading by the Court of Appeal of the Supreme Court of Victoria in *Director of Public Prosecutions (Cth) v JM* (2012) 90 ACSR 96; [2012] VSCA 21. The majority (Nettle and Hansen JJA) held that the concept of "artificial price" in the section signified market manipulation by conduct of the kind typified by the American concepts "cornering" and "squeezing" a market (at [324]–[325], [335]). Their Honours recognised (at [334]) but did not accept the possibility that the term "artificial price" in s 1041A might have included not only market manipulation of the kind typified by cornering and squeezing but also by other kinds of false trading, market rigging and artificial setting and maintaining of prices that were the province of corresponding provisions in the Securities Industry Code. The majority emphasised the continuing operation of the formulation of "artificial or managed manipulation" in *North v Marra Developments Ltd* (1981) 148 CLR 42; 37 ALR 341; [1981] HCA 68 in respect of s 1041B and 1041C.

Warren CJ (at [6]) would have given the concept of "artificial price" a wider reading, as directed to a price created or maintained for the sole or dominant purpose of creating or maintaining that particular price, provided that genuine buyers and sellers had altered the price at which they were willing to trade the shares, as against the price at which they would have been willing to trade but for the impugned transaction. Her Honour observed (at [273]) that the fault elements of the offence would therefore be an intention to take part in or carry out the impugned transaction(s) and recklessness as to whether the transaction(s) will have the effect, or are likely to have the effect, of creating an artificial price or maintaining the price at an artificial level. Her Honour also noted that s 1041B applies where there is a false or misleading appearance as to price, for example the lodging of lower bids which suggests a genuine market for buying or selling shares at the price when the only instigator is willing to buy or sell at that price for non-genuine purposes. An

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<sup>50</sup> *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21; 77 ACSR 98; [2010] FCA 68 at [89]–[93], [95]–[98]; *Australian Securities and Investments Commission v Administrative Appeals Tribunal* (2010) 187 FCR 334; 271 ALR 593; [2010] FCA 807.

application for leave to appeal to the High Court has been referred to an expanded bench and it appears the application for leave to appeal and the appeal will be heard at the same time.

There have also been significant appellate decisions in respect of insider trading. In *Mansfield v R* (2012) 293 ALR 1; [2012] HCA 49, the High Court considered the position where a listed company's chief executive was alleged to have been communicated information concerning an increase in its expected profit and turnover and the fact that a prominent investor had acquired an interest in it. Messrs Mansfield and Kizon had traded on that information when it was not generally available. Mr Mansfield was indicted for an offence of insider trading and Messrs Mansfield and Kizon were indicted for conspiracy to commit that offence. The appellants argued that the information conveyed by the managing director was false and false statements cannot constitute "information" for the purposes of the insider trading prohibition. That prohibition applies where, inter alia, a person possesses "material" information that is not generally available and knows, or ought reasonably to know, that the information is not generally available and, if it were generally available, a reasonable person would expect it to have a material effect on the price or value of the relevant financial product.

The trial judge held that information that was false could not be inside information, and the Court of Appeal of the Supreme Court of Western Australia set aside that decision and ordered a new trial. The High Court dismissed an appeal from that decision. The plurality held that the ordinary use of the term "information" is not limited to information that is either true or believed to be true. Their Honours noted that the definition of "information" expressly includes "matters of supposition", and a reading of the prohibition as extending to information which was of doubtful accuracy or false was consistent with the purpose of the provision in ensuring the free and fair operation of the securities market. Heydon J, in a concurring judgment, observed that both true and false information may affect the market or value of securities and also pointed to the practical difficulties in treating the truth of information is a matter that the prosecution is required to establish in insider trading prosecutions

In *Joffe v R; Stromer v R* [2012] NSWCCA 277, the appellants were charged with insider trading in respect of dealings in contracts for differences.<sup>51</sup> They contended that the insider trading prohibitions did not apply, because the contracts for differences were excluded from the definition of "financial product" as credit facilities<sup>52</sup> or excluded as contracts for the future provision of services<sup>53</sup>, and were therefore not "Division 3 financial products" within s 1042A of the *Corporations Act* and not subject to the prohibition on insider trading. The Court of Appeal of the Supreme Court of New South Wales held that the definition of "financial product" in s 765A of the *Corporations Act* and the exclusions from it did apply for that purpose, so that a product was not within the scope of the insider trading prohibition if it was excluded from the definition of "financial product" but in no exception was

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<sup>51</sup> Mr Joffe was charged with an offence of procuring and Mr Stromer with the offence of acquiring the relevant products.

<sup>52</sup> Credit facilities were excluded by s 765A(1)(h) and, at the relevant time, reg 7.1.06 of the Corporations Regulations. These provisions were also in issue in *International Litigation Partners Pte Ltd v Chameleon Mining NL* (above).

<sup>53</sup> Contracts for the future provision of services were excluded from the definition of derivative by s 761D(3)(b).

established in the particular case. The result is consistent with the statutory structure and should not, in my view, involve any narrowing of the insider trading prohibition that would prevent its application in circumstances in which it should apply.

## **Conclusion**

It will be apparent from the above that 2012 has been, and 2013 is likely to be, a year of further development in corporate law. There has been significant regulatory and civil litigation in respect of directors' duties, although it would be difficult to say that the decision in *Bell Group* had clarified the applicable legal principles. Continuous disclosure remains a key focus of regulatory activity and class actions.

The amendments proposed by the *Insolvency Law Reform Bill 2012* will make significant changes to the regulation of insolvency practitioners and the conduct of insolvency administrations. In the area of financial services, the decisions in *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* and *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* and the Future of Financial Advice Reforms may each be seen as a working out of the implications of the global financial crisis, particularly for dealings in sophisticated financial products. In the area of market misconduct, the decision in *Director of Public Prosecutions (Cth) v JM* presently narrows the scope for application of s 1041A of the *Corporations Act*, subject to the result in the High Court, while appellate courts have continued to read the insider trading prohibitions in a manner that allows them wider operation.